# FX and Precious Metals Watch

## Impact of our new Fed call

Group Economics
Macro & Financial Markets Research

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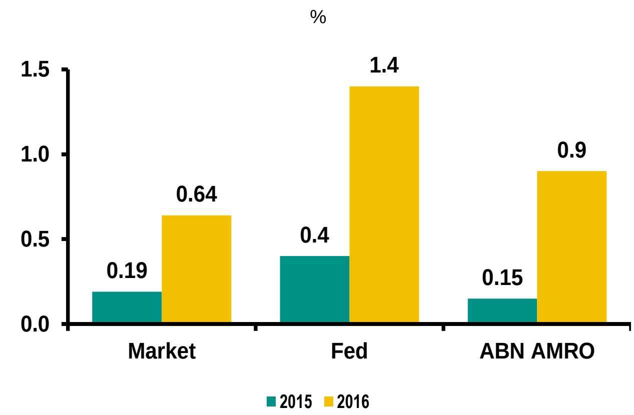
**8 October 2015**

- **We expect the Fed to delay its first rate hike to 2016, given EM risks and softer macro data**
- **We downgrade our US dollar versus the euro for 2015, but we still see parity at the end of 2016**
- **EM FX likely to remain volatile**
- **We remain bearish on AUD, NZD and CAD and Asia FX for 2016**
- **We are now less bearish on precious metal prices…**
- **…and expect substantial gold price weakness to come in 2016:**
- **New year-end forecasts for gold prices: USD 1,100 per ounce (2015), USD 900 per ounce (2016)**

**Adjusting our Fed rate hike view**

We now think that the Fed will further delay raising interest rates beyond December and into 2016. Uncertainty is high about the exact month, but our sense is that the first hike will not come until June 2016. We expect a rate hike every other meeting after that, which would leave the target for the Fed funds rate in a range of 0.75-1.00% in December 2016. A delay will give the Fed time to allow financial conditions to stabilise, external uncertainties to wane and data to improve again. We do not rule out a rate hike in March 2016 if this process turns out to run relatively quickly (see *Global Daily Insight 8 October 2015 – Fed hike now seen in 2016*).

**Federal Funds Rate forecasts**




Source: Bloomberg, ABN AMRO

**Fed's delay: a knock on effect to other central banks**

If the FOMC does put the rate hike on ice as we expect, it will lead to reactions from other central banks. Our base scenario was already for an increase in the ECB's monthly purchases by EUR 20bn.  This looks likely to come in December rather than this month give recent ECB commentary. We now think that the ECB will also extend the time horizon for QE through the end of 2016. The risks of yet more decisive action have increased. Meanwhile, the BoJ will likely step up QE early next year, but the chances of an earlier move are now also much bigger. Finally, we are also pushing back our forecast for the first BoE hike to Q3 of next year, from Q1 previously. What do these changes mean for our FX and precious metals forecasts?

**Downgrade our US dollar versus the euro for 2015…**

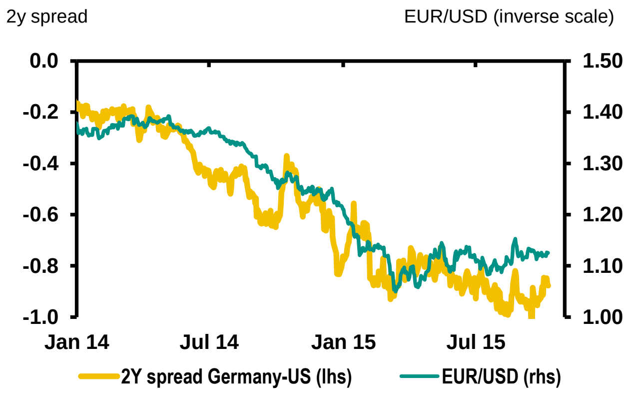
We expect that the first rate hike will not come until June 2016. This will have a neutral to modest negative impact on the US dollar versus the euro in 2015. Therefore, we expect EUR/USD to trade within the range 1.10-1.15. If the US dollar were to come under pressure on the pricing out of Fed rate hikes then the ECB will likely expand its QE programme. This is because the ECB is currently assuming a EUR/USD rate of 1.10. Further QE by the ECB will offset the impact of the Fed delay, keeping EUR/USD at around 1.12 this year.

There are many forces driving the US dollar outlook:  the state of the US economy, the prospect of Fed rate hikes, overall investor sentiment, the actions by other central banks and the state of emerging market economies. These can be opposing forces impacting the US dollar's path. A crucial variable is investor sentiment, because this will determine if the net impact is negative or positive for the US dollar. For the remainder of this year, we expect investor sentiment to often change from positive to negative and vice versa. As a result, a clear direction in the US dollar will likely be missing.

**…but we still see parity for the end of 2016…**

For 2016, we expect US economic growth to strengthen and emerging and commodity markets to stabilise. Once this plays out the Fed will likely hike interest rates in June 2016. But earlier stabilization could also trigger a rate hike in March. Our call for a June lift-off is more dovish than market expectations, while we also expect the ECB and the BoJ to ease further. As a result, this Fed lift-off in June 2016 will not be a serious headwind for the US dollar. The improvement of the US economy and positive investor sentiment will be positive for the US dollar versus the euro and the yen in 2016 in our view. Therefore, we expect EUR/USD to trend lower to parity. In short, we have delayed our call for parity in EUR/USD by a year because of uncertainty surrounding the global economy and financial markets and the response of central banks (Fed, ECB)

**EUR/USD and 2y interest rate spread**




Source: ABN AMRO Group Economics

**EM & commodity FX to remain volatile in 2015…**

Uncertainty about global growth, commodity prices, the state of the US and Chinese economies and the Fed lift-off could have a profound impact on investor sentiment in financial markets. As a result of swings in investor sentiment and domestic challenges (political and fundamental), emerging market currencies and currencies of commodity exporters will remain volatile for the remainder of this year in our view. New lows in the currencies versus the US dollar are very well possible.

**… and mixed EM FX in 2016…**

The sharp weakness in emerging market currencies will likely result in positive developments in the trade balances of these countries. In addition a stabilisation and slight upward momentum in commodity prices should take away some of the negative sentiment in currencies of commodity exporters. Moreover, the slowdown in China will likely be less severe than financial markets currently anticipate. Last but not least, we expect investor sentiment to be positive resulting in investors searching for global growth exposure and higher-yielding currencies. This is positive for currencies where central banks have stopped their easing cycle and the next step is to tighten. However, not all is positive for these currencies. Most of them remain vulnerable for higher interest rates in the US. The Fed may hike later, but the prospect of higher rates will remain a headwind. Other headwinds could be the domestic political situation, the economy and possible downgrades. If we take all these factors into account the overall picture is mixed. We see some recovery in Latin American currencies, Russian ruble, South African rand because of stabilisation of commodity prices and some improvement on the domestic front. We remain bearish on Asian currencies as a weaker Chinese yuan, euro and Japanese yen will remain headwinds for Asian exports and monetary policy easing in Asia weighs.

**…but we remain negative on commodity currencies**

We remain bearish on commodity currencies like the Australian, New Zealand and Canadian dollar, albeit a smaller magnitude than before for the following reasons. We expect the Reserve Bank of Australia to lower the Official Cash Rate by 25bp later this year in November due to a weaker inflation outlook and wider misalignment between the AUD and key commodity export prices. Though the recovery in dairy auction prices have supported the NZD and provided some flexibility for the Reserve Bank of New Zealand to keep monetary policy unchanged in October, the RBNZ is expected to remain dovish and reiterate that further easing is likely. We also expect the Bank of Canada to strike a dovish tone as the trade deficit has widened in August and core inflation is trending lower. The recent recovery in the CAD is also expected to be a headwind to recovery in non-energy exports.

**New forecasts**

Our new forecasts reflect the impact of delaying the Fed rate hike to June 2016, more QE by the ECB and the BoJ, vulnerable financial and emerging markets in 2015, but improvement in investor sentiment, and stabilization in emerging and commodity markets in time. We downgrade the US dollar versus G4 in 2015, but expect renewed strengthening in 2016.

**Our major FX forecasts**

Adjustments in bold/red

| | 08-Oct | Q4 2015 | Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---|---|---|---|---|---|---|
| EUR/USD | 1.1254 | **1.12** | **1.10** | **1.05** | **1.00** | **1.00** |
| USD/JPY | 119.78 | **122** | **126** | **130** | **133** | **135** |
| EUR/JPY | 134.80 | **137** | **139** | **137** | **133** | **135** |
| GBP/USD | 1.5314 | **1.56** | **1.55** | **1.50** | **1.45** | **1.47** |
| EUR/GBP | 0.7349 | **0.72** | **0.71** | **0.70** | **0.69** | **0.68** |
| USD/CHF | 0.9718 | **0.98** | **1.00** | **1.07** | **1.14** | **1.15** |
| EUR/CHF | 1.0937 | **1.10** | **1.10** | **1.12** | **1.14** | **1.15** |
| AUD/USD | 0.7174 | **0.70** | **0.68** | **0.66** | **0.64** | **0.62** |
| NZD/USD | 0.6594 | **0.64** | **0.62** | **0.6** | **0.58** | **0.58** |
| USD/CAD | 1.3067 | **1.33** | **1.35** | **1.37** | **1.39** | **1.41** |
| EUR/SEK | 9.2787 | 9.50 | 9.50 | 9.50 | 9.50 | 9.50 |
| EUR/NOK | 9.2460 | 9.50 | 9.25 | 9.00 | 8.75 | 8.50 |
| EUR/DKK | 7.4609 | 7.46 | 7.46 | 7.46 | 7.46 | 7.46 |

Source: ABN AMRO Group Economics

## Our EM FX forecasts

Adjustments in bold/red

| | 08-Oct | Q4 2015 | Q1 2016 | Q2 2016 | Q3 2016 | Q4 2016 |
|---|---|---|---|---|---|---|
| USD/CNY (onshore) | 6.35 | **6.40** | **6.45** | **6.50** | **6.55** | **6.55** |
| USD/CNH (offshore) | 6.36 | **6.40** | **6.47** | **6.53** | **6.57** | **6.57** |
| USD/INR | 65.2 | **65** | **66** | **66** | **67** | **67** |
| USD/KRW | 1,159 | **1,190** | **1,200** | **1,220** | **1,230** | **1,240** |
| USD/SGD | 1.40 | **1.44** | **1.46** | **1.48** | **1.50** | **1.50** |
| USD/THB | 35.90 | **36.80** | **37.00** | **37.20** | **37.50** | **38.00** |
| USD/TWD | 32.61 | **33.00** | **33.50** | **33.70** | **33.80** | **34.00** |
| USD/IDR | 13,887 | **14,300** | **14,500** | **14,800** | **14,900** | **15,000** |
| USD/RUB | 63 | 60 | 60 | 55 | 55 | 55 |
| USD/TRY | 2.95 | 3.10 | 3.05 | 3.00 | 2.95 | 2.90 |
| USD/ZAR | 13.49 | 14.00 | 13.80 | 13.60 | 13.40 | 13.20 |
| EUR/PLN | 4.24 | 4.15 | 4.10 | 4.05 | 4.00 | 4.00 |
| EUR/CZK | 27.50 | 27.50 | 27.40 | 27.25 | 27.00 | 26.75 |
| EUR/HUF | 313 | 315 | 315 | 310 | 310 | 310 |
| USD/BRL | 3.89 | 4.00 | 3.90 | 3.85 | 3.80 | 3.75 |
| USD/MXN | 16.68 | 17.00 | 16.75 | 16.50 | 16.25 | 16.00 |
| USD/CLP | 679 | 700 | 690 | 680 | 670 | 660 |

Source: ABN AMRO Group Economics

## Our Precious Metals forecasts

Adjustments in bold/red

| End period | 08-Oct | *Close 14* | *Mar-15* | *Jun-15* | Sep-15 | Dec-15 | Mar-16 | Jun-16 | Sep-16 | Dec-16 |
|---|---|---|---|---|---|---|---|---|---|---|
| Gold | 1,143 | *1,185* | *1,184* | *1,172* | *1,112* | **1,100** | **1,050** | **1,000** | **950** | **900** |
| Silver | 15.7 | *15.7* | *16.6* | *15.7* | *14.5* | **15.0** | **14.5** | **14.0** | **14.5** | **15.0** |
| Platinum | 938 | *1,216* | *1,141* | *1,081* | *910* | **900** | **875** | **850** | **900** | **1,000** |
| Palladium | 694 | *798* | *736* | *674* | *652* | **650** | **625** | **600** | **625** | **650** |

| Average | *Q1 15* | *Q2 15* | *Q3 15* | Q4 15 | 2015 | Q1 16 | Q2 16 | Q3 16 | Q4 16 | 2016 |
|---|---|---|---|---|---|---|---|---|---|---|
| Gold | *1,218* | *1,193* | *1,126* | 1,106 | **1,170** | **1,075** | **1,025** | **975** | **925** | **1,000** |
| Silver | *16.7* | *16.4* | *15.0* | 14.8 | **16.0** | **14.8** | **14.3** | **14.3** | **14.8** | **14.5** |
| Platinum | *1,194* | *1,129* | *993* | 905 | **1,075** | **888** | **863** | **875** | **950** | **894** |
| Palladium | *786* | *759* | *618* | 651 | **700** | **638** | **613** | **613** | **638** | **625** |

Source: ABN AMRO Group Economics

**Substantial weakness in gold prices to arrive in 2016…**

For long we have been very negative on gold prices. For a large part this was driven by our bullish view on the US dollar, our above-consensus view on Fed rate hikes and expectation about positive investor sentiment. A combination of these factors would trigger a substantial liquidation of investor positions. Our change in Fed call has implications for this view. Our more dovish view than market-consensus implies firstly that when financial markets price out a Fed rate hike, gold prices will be supported. Secondly, we have downgraded our US dollar forecasts for the remainder of 2015. Also this should be gold supportive. Therefore, we changed our year-end forecast from USD 1,000 to USD 1,100 per ounce. Periods of more constructive investor sentiment will likely push gold prices below USD 1,100 per ounce, while some deterioration combined with US dollar weakness prices above again.

This does not mean that we have seen the low in gold prices. We still expect the Fed to hike interest rates next year (total of 75bp) and the US dollar to rally in an environment of positive investor sentiment. This should push gold prices towards USD 900 per ounce in 2016 because of investor position liquidation. We remain optimistic on gold jewellery demand and this will likely reduce the downside somewhat.

**We are less negative on other precious metals**

The outlook for the other precious metals has also improved. Silver prices will likely continue to track gold prices while platinum and palladium will closely follow developments in the emission scandal. In the near-term, the upside in platinum and palladium looks limited. The latter mainly because the rally in palladium went too aggressive. For 2016, we expect an outperformance of the cyclical precious metals over gold.

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