ABN·AMRO

Marketing Communication

FX Convictions

Group Economics
Macro & Financial Markets

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Monetary policy divergence back in play?

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- **Risk-on environment and additional monetary stimulus push EM FX higher**
- **The USD recovered after the Fed… and dovish ECB weighs on euro**
- **We closed our USD longs versus euro and SGD on 15 October…**
- **…while we keep our USD longs versus Japanese yen, Australian and New Zealand dollar in place**

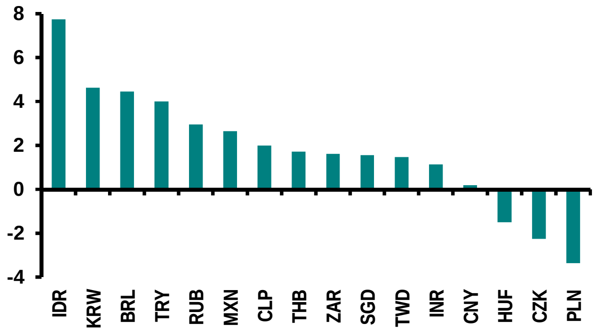
Risk-on environment and additional monetary stimulus push EM FX higher…
Over the past month, most emerging market currencies showed strong performances. The pricing out of a possible Fed rate hike this year supported investor sentiment and resulted in more risk taking. Emerging market currencies with the strongest performance were the ones that have been sold off the most this year such as the Indonesian rupiah, Brazilian real, Turkish lira and the Russian ruble. Additional monetary easing by the ECB and the PBoC further supported investor sentiment. However, the FOMC meeting put a halt on this sentiment because it signalled that it has left the door open for a rate hike in December.

…exception to the rule was CEEMA FX
CEEMA FX did not profit from the positive investor sentiment in currency markets. This was for a large part the result of expectations that central banks in the region need to further ease monetary policy because of low inflationary pressures. In addition, the recent outcome of the Polish election also weighed on sentiment towards the Polish Zloty

New Zealand dollar rebounds sharply….
After a sharp fall from May to September, the New Zealand dollar (NZD) rebounded as economic data and global dairy prices recovered. As a result, speculators' positioning reversed from net short to long NZD. Investor sentiment towards the NZD was also supported as financial markets priced in a slower pace of rate cuts in New Zealand.

Performance of our EM FX coverage 28 Sep – 29 Oct

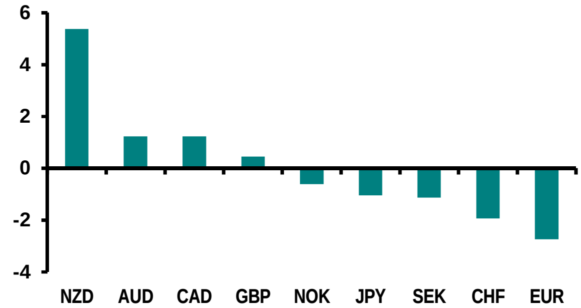
In % with USD as basis



Source: Bloomberg

Performance major FX 28 Sep – 29 Oct

In % with USD as basis



Source: Bloomberg

…and the dollar was saved by a more hawkish Fed

The US dollar (USD) gained across the board as the FOMC was more hawkish than expected. The FOMC appears to be less concerned about global developments. Our base scenario is that the Fed will wait until next year before raising interest rates, but the statement raises the probability of a December move. US economic data have softened recently. Meanwhile, it remains to be seen whether the pricing in of earlier Fed rate hikes negatively impacts sentiment, which could lead to a renewed tightening of financial conditions.

…while the dovish ECB pushed euro lower

The euro has weakened noticeably over the past few days. The ECB's signal that it will step up its monetary stimulus program in December has pressured the euro. Indeed we now expect the ECB to lower the deposit rate by 10bp to -0.3% later this year in December. In addition, it seems likely that the ECB will leave the door wide open to do more if necessary. This will depend on the strength on the euro. We also expect a 5bp cut in the refi rate, taking it to zero. We already expected the ECB to increase the size of its asset purchase program from EUR 60b a month to EUR 80b. The deadline of the QE program is also likely to be extended beyond September 2016. We have lowered our euro forecasts versus the US dollar and sterling to reflect our changes in the ECB call as we now also expect a deposit rate cut. Our new forecast for the end of this year for EUR/USD is 1.10. Our forecast for the end of 2016 remains unchanged at 1.00.

Since our latest report on 28 September, we have closed our long US dollar views versus the euro and the Singapore dollar (communicated on 15 October 2015) while we have kept in place our long US dollar views versus the Japanese yen the Australian and New Zealand dollar.

Our open and closed high conviction 2015 views

High conviction views

High conviction views	
Open	**Position base currency**
USD/JPY	Long since 20 November 2013
AUD/USD	Short since 3 July 2014
NZD/USD	Short since 30 March 2015
Closed	
AUD/USD	Closed short on 5 February 2014, re-opened on 3 July 2014
NZD/USD	Closed short on 6 January 2014
USD/CAD	Closed long on 5 February 2014
USD/CNY	Closed short on 6 February 2014 on opening
KRW/JPY	Closed long on 5 February 2014
EUR/GBP	Closed short on 16 June 2014
EUR/CHF	Closed long on 1 July 2014
EUR/SEK	Closed long on 3 July 2014
EUR/PLN	Closed short on 2 September 2014
USD/MXN	Closed short on 30 September 2014
USD/CHF	Closed long on 31 October 2014
CNH/JPY	Closed long on 10 November 2014
EUR/MXN	Closed short on 12 December 2014
GBP/USD	Closed short on 19 May 2015 at 14.30
EUR/USD	Closed on 15 Oct 2015 at 1.1440
USD/SGD	Closed on 15 Oct 2015 at 1.1780

Source: ABN AMRO Group Economics

On 15 October 2015 we closed our long US dollar conviction call versus the euro after almost 2 years with a total return of close to 16%

In the period of 20 November 2013 until 15 October 2015, we recommended to be short the euro versus the US dollar. This FX conviction was one of our best performing calls with a total return of close to 16%. Following our change in view that the Fed would delay its first rate hike to 2016 and the change in FX forecasts, we decided to take our short euro/long US dollar off our high conviction list. It is likely that EUR/USD in the near-term will move higher in wake of the pricing out of a possible Fed rate hike this year. Moreover, the recovery in the US dollar we expect for the coming months is relatively modest. Therefore, we close this high conviction call. The EUR/USD will probably only start to fall again more convincingly during the course of next year when Fed rate hikes approach. That might provide then a new opportunity.

We also closed our high conviction short in Singapore dollar versus the US dollar with a loss of 2%

Since the Monetary Authority of Singapore (MAS) monetary policy decision on 14 October, the Singapore dollar (SGD) is largely unchanged against the US dollar but has strengthened by about 1% against its trade weighted basket of currencies. The MAS reduced the slope of appreciation of S$NEER slightly as advance estimates show that the Singapore economy narrowly avoided a technical recession in the third quarter against market expectations of a

0.1% qoq contraction. Economic growth in the second quarter was also revised higher from -4% qoq to -2.5% qoq. This was less dovish than our forecast that the MAS will shift the S$NEER policy bias to neutral. We think that core inflation will edge higher due to favourable base year effects. Hence the MAS is unlikely to shift towards a more dovish bias next year, supported by the view that global growth should gradually improve in 2016. As a result, we have revised our 2015 and 2016 year end USD/SGD forecast to 1.40 (from 1.44) and 1.46 (from 1.50) respectively. As our SGD forecasts are less bearish than market consensus, we have also closed out our short SGD view from our high conviction FX list, realizing a loss of 2%.

JPY weakness – not if but when

In line with our view, the Bank of Japan (BoJ) kept their qualitative and quantitative easing (QQE) program unchanged on 30 October. However, the Japanese yen (JPY) was supported as about 40% of economists polled by Bloomberg had expected an increase in stimulus. The BoJ downgraded their GDP and inflation forecast for fiscal year (FY) 2015 and 2016. Its 2% inflation target is now expected to be achieved 6 months later in the second half of FY 16. We maintain our bearish view in the JPY as a result of the divergence in monetary policy. We see three reasons that will enforce this process. First, domestic investors are likely to position for overseas assets during periods of JPY strength. The table below shows that domestic life insurers have indicated their bias to increase overseas assets on an unhedged currency basis.

Investment plans

FY 15 H2 investment plans	Foreign bonds	Foreign stocks	Domestic stocks	JGBs
Nippon Life	Increase hedged and unhedged investments	Increase	Increase	Steady
Dai-Ichi Life	Steady hedged positions; unhedged positions depending on FX levels	Increase	Assessing	Steady
Meiji Yasuda Life	Increase unhedged positions	Increase	Steady	Increase
Sumitomo Life	Increase hedged and unhedged investments	Steady	Steady	Steady

Source: Bloomberg

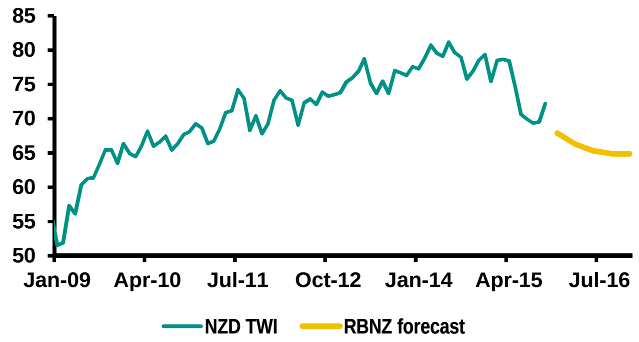
Second, firmer short term yields in the US next year as the Fed tightens monetary policy is expected to push the yen lower against the US dollar. Last but not least, we still think it is likely that the BoJ will enhance its QQE program in 2016 given downside risks to their forecasts. In the short term, the government may boost fiscal stimulus to support the economy if economic growth in the third quarter (to be released on 16 November) disappoints. Our 2015 and 2016 year end USD/JPY forecasts are 122 and 135.

RBNZ warns strong NZD will trigger more rate cuts

We maintain our bearish view on the New Zealand dollar (NZD) and year-end forecast of 0.64. We expect the Reserve Bank of New Zealand (RBNZ) to lower the Official Cash Rate (OCR) by 25bp to 2.50% later this year in December. This is not fully priced in by financial markets. The RBNZ has warned that the recent strength in the NZD if sustained would require more aggressive rate cuts in the future. As the current level in the NZD trade weighted index is more than 6% stronger than the RBNZ year-end forecast, intervention in the currency market to weaken the NZD is also a likely option for the central bank. Our 2016 forecast for the NZD/USD is 0.58.

NZD trade weighted index

Index Level



Source: RBNZ

Stay bearish in the AUD

A weaker than expected inflation print in the third quarter has reinforced our view that the Reserve Bank of Australia (RBA) will resume its easing cycle on 3 November. This is not fully priced in by financial markets. Hence a weaker Australian dollar (AUD) of around 0.70 by the end of this year is expected. Looking ahead, weaker house price inflation, subdued wages will continue to weigh on non-tradable inflation. A weaker Australian dollar (AUD) is also needed to boost tradable inflation. Indeed, the risk has increased that the RBA may need to further lower monetary policy next year due to sub trend economic growth and weak commodity prices. A slower economic growth in China next year to 6.5% will remain a headwind to the Australian economy. We expect the AUD to decline to 0.62 by the end of 2016.

ABN AMRO major currency forecasts

Changes in red/bold

	02-Nov	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
EUR/USD	1.1015	1.10	1.08	1.05	1.00	1.00
USD/JPY	120.63	122	126	130	133	135
EUR/JPY	132.87	134	136	137	133	135
GBP/USD	1.5467	1.57	1.54	1.50	1.45	1.47
EUR/GBP	0.7122	0.70	0.70	0.70	0.69	0.68
USD/CHF	0.9868	1.00	1.02	1.07	1.14	1.15
EUR/CHF	1.0870	1.10	1.10	1.12	1.14	1.15
AUD/USD	0.7140	0.70	0.68	0.66	0.64	0.62
NZD/USD	0.6754	0.64	0.62	0.6	0.58	0.58
USD/CAD	1.3105	1.33	1.35	1.37	1.39	1.41
EUR/SEK	9.3865	9.50	9.50	9.50	9.50	9.50
EUR/NOK	9.3236	9.50	9.25	9.00	8.75	8.50
EUR/DKK	7.4583	7.46	7.46	7.46	7.46	7.46

Source: ABN AMRO Group Economics

ABN AMRO emerging market currency forecasts

Changes in red/bold

	02-Nov	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
USD/CNY (onshore)	6.34	6.40	6.45	6.50	6.55	6.55
USD/CNH (offshore)	6.35	6.40	6.47	6.53	6.57	6.57
USD/INR	65.6	65	66	66	67	67
USD/KRW	1,137	1,190	1,200	1,220	1,230	1,240
USD/SGD	1.40	1.40	1.42	1.44	1.45	1.46
USD/THB	35.61	36.80	37.00	37.20	37.50	38.00
USD/TWD	32.58	33.00	33.50	33.70	33.80	34.00
USD/IDR	13,669	14,300	14,500	14,800	14,900	15,000
USD/RUB	64	60	60	55	55	55
USD/TRY	2.82	3.10	3.05	3.00	2.95	2.90
USD/ZAR	13.79	14.00	13.80	13.60	13.40	13.20
EUR/PLN	4.26	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	312	315	315	310	310	310
USD/BRL	3.86	4.00	3.90	3.85	3.80	3.75
USD/MXN	16.53	17.00	16.75	16.50	16.25	16.00
USD/CLP	691	700	690	680	670	660

Source: ABN AMRO Group Economics

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