ABN·AMRO

G10 FX Weekly

Group Economics
Macro & Financial Markets Research

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FOMC and oil prices in focus

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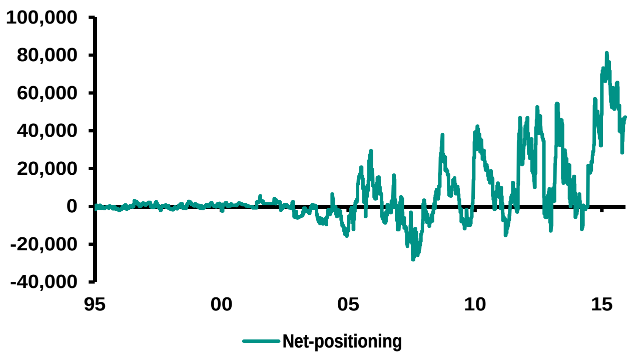
- **The US dollar has not profited from stronger data…**
- **…because of cautious approach towards the Fed and position closing**
- **The break lower in oil prices drags down currencies of oil exporting countries**
- **Stronger domestic data neutralize rate cut and weak commodity prices for AUD and NZD**

Why has the US dollar not profited from stronger data?

We would have expected that the US dollar would have rallied strongly after the strong US employment report last Friday. In fact this was not the case. To begin with investors appear to have taken a more cautious stance towards central bank events after the ECB under-delivered compared to market expectations. As a result, the US dollar has not been able to fully profit from the strong US employment report last Friday. Other currencies and precious metal prices profited, however, temporary from this. The probability of a Fed rate hike has barely increased after the strong US employment report. We would have expected that this this probability would have increased further. Next week, we expect the FOMC to raise the Fed funds rate by 25bp on 16 December. The probability of a rate hike at this meeting is close to 78%, so it is not fully priced in and this decision will likely support the US dollar with EUR/USD moving towards 1.05. But there is a risk of a profit-taking wave following the decision.

Net non-commercial positions US dollar

In contracts



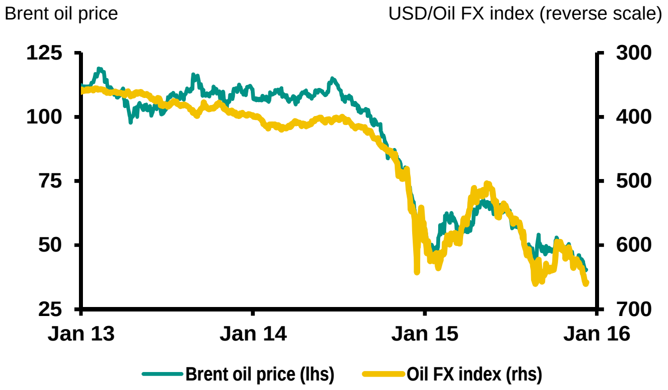
Source: Bloomberg, ABN AMRO Group Economics

Second, it is likely that investors have started to close main positions this year. In general, investors have been short euro, long US dollar, short emerging market currencies, short metals and short oil. The perception that we may have seen the move for the year could have triggered the closing of some of these positions in currency and commodity markets. However, the drop in oil prices below the previous lows appears to have halted or even reversed this process at least until the Fed meeting. When the Fed meeting is out of the way, there is a possibility that investors close the books for the year resulting in a recovery of the heavily battered assets this year. This would put the US dollar temporary under pressure, but in our view this would be an opportunity to position for dollar strength ahead. For 2016, monetary policy divergence will remain a dominant topic in our view. Therefore, we expect a higher US dollar especially versus the euro, yen, sterling and Australian and New Zealand dollars.

New low in oil prices trigger sell-off in oil FX

Brent oil prices dropped below USD 40/bbl, which is the lowest level in more than six years. Brent prices fell under pressure as the negative sentiment surrounding the oversupply in the market deteriorated, with speculators and investors being positioned for more price declines. Last Friday, the Organisation of Petroleum Exporting Countries (OPEC) decided not to cut oil production as some had hoped, but to raise the production ceiling instead. The actual OPEC production output was already significantly higher than the official targets. By raising the production ceiling to 31.5 million barrels per day (mb/d) from 30 mb/d, basically the OPEC now confirmed its existing strategy to regain market share at the expense of other oil (high cost) producers.

Oil price and Oil FX



Source: Bloomberg, ABN AMRO Group Economics

As a result of the drop in oil prices, currencies of oil exporting countries (read oil FX) fell around 1.5 % versus the US dollar. In general, weak oil prices have increased the likelihood of larger fiscal deficits in these countries. In addition, financial markets have priced in a larger probability that the Bank of Canada may resume its monetary easing cycle in the second quarter of 2016 given the impact of lower oil prices on growth and inflation. In the case of Norway, the risk of another rate cut this year to support the economy has also increased despite inflation running just above its target. The Norges Bank will decide on interest rates next week (17 December).

Stronger domestic data neutralize rate cut and weak commodity prices

Weak iron ore prices weighed on the Australian dollar (AUD) earlier in the week. Losses were retraced after surprisingly strong employment gains for the second consecutive month in November. Given inconsistencies with other PMI employment indices we doubt that the strong job gains will be sustained. In addition, we expect RBA to lower the Official Cash Rate in early 2016 (not fully priced in) and to increase their net AUD sales. Therefore, we remain bearish on the AUD. Separately, the New Zealand dollar (NZD) recovered after economic data imply that the economy will expand at a faster pace in the third quarter. It is likely that the RBNZ will cut rates by 25bp rate cut in the second quarter of 2016 because of lower inflation pressures. This and RBNZ intervention in the currency will likely move the NZD lower towards 0.60 by the middle of next year.

ABN AMRO major currency forecasts

Changes in bold/red

	10-Dec	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
EUR/USD	1.0972	1.05	1.00	0.95	0.95	0.95	1.00	1.00	1.05	1.10
USD/JPY	121.79	125	127	130	133	135	130	130	125	120
EUR/JPY	133.64	131	127	124	126	128	130	130	131	132
GBP/USD	1.5161	1.50	1.41	1.28	1.25	1.27	1.35	1.37	1.46	1.57
EUR/GBP	0.7237	0.70	0.71	0.74	0.76	0.75	0.74	0.73	0.72	0.70
USD/CHF	0.9857	1.05	1.10	1.18	1.20	1.21	1.15	1.15	1.14	1.09
EUR/CHF	1.0815	1.10	1.10	1.12	1.14	1.15	1.15	1.15	1.20	1.20
AUD/USD	0.7292	0.70	0.68	0.66	0.64	0.62	0.64	0.68	0.70	0.72
NZD/USD	0.6738	0.64	0.62	0.60	0.58	0.58	0.60	0.62	0.64	0.66
USD/CAD	1.3558	1.33	1.35	1.37	1.39	1.41	1.40	1.35	1.30	1.25
EUR/SEK	9.2689	9.50	9.50	9.50	9.50	9.50	9.25	9.00	8.75	8.50
EUR/NOK	9.5075	9.50	9.25	9.25	9.00	9.00	8.75	8.50	8.25	8.00
EUR/DKK	7.4610	7.46	7.46	7.46	7.46	7.46	7.46	7.46	7.46	7.46

Source: ABN AMRO Group Economics

Find out more about Group Economics at: **https://insights.abnamro.nl/en/**

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