G10 FX Weekly

Group Economics
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Euro higher after the ECB

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- **ECB delivers but Draghi's comments push the euro higher**
- **The focus now turns to the Fed and BoJ meetings next week**
- **Stakes are high for the BoJ**
- **AUD and CAD rally; NZD slumps**

ECB delivers but Draghi's comments push the euro higher…

Today the ECB lowered the main refinancing to 0.0% from 0.05%. It also cut the deposit rate to -0.4% as widely expected. In addition, it increased the monthly asset purchases under the asset purchase programme by EUR 20 bn to 80bn and launched a series of four targeted longer-term refinancing operations each with a maturity of four years at a very favourable rate. The package was more aggressive than financial markets had expected. Therefore, the euro initially moved lower across the board. However, comments from ECB's Draghi during the press conference that he doesn't see any need to reduce rates further, resulted in a turnaround in sentiment pushing EUR/USD above 1.11 before it eased somewhat.

…shifting the focus to the Fed…

Since11 February expectations of a Fed rate hike increased. Surprisingly the US dollar has not profited from this. Last week, the US employment report has played an important role in a further improvement in investor sentiment. The US employment report came in strong but the US dollar failed to make significant gains despite higher US yields. The lower than expected hourly earnings may have been an important reason for this, however this would contradict the rise in yields. This strong US employment report has fueled optimism that the US economy may not be that weak as feared. As a result, currencies that are more cyclical such as commodity currencies and emerging market currencies outperformed the US dollar. Next week the Fed will decide on monetary policy. Market consensus is for no change in policy. However, if the Fed were to sound more hawkish than expected, the US dollar may recover some ground.

…and the bank of Japan

The Japanese yen has been under some pressure versus the US dollar as investor sentiment improved. Data from MoF shows that domestic investors continue to purchase overseas assets in search of higher returns in the first week of March. However, upside in USD/JPY has been limited. There have been reports that exporters have repatriated overseas earnings above the 114 level in USD/JPY.

Next week, the Bank of Japan (BoJ) is widely expected to not lower interest rates further into negative territory. We think that it still wants to assess the impact of January's easing measures. It is essential that the BoJ convinces financial markets that its tool-kit has not been exhausted. We do not rule out other monetary stimulus including enhancements of its qualitative and quantitative easing program on 15 March. Two of the BoJ members, who opposed negative interest rates on 29 January, are likely to be replaced by pro-Abenomics and deflation fighting candidates in the coming months. Our base case is that the BoJ will further lower interest rates by another 20bp in April. We maintain our stance that the MoF is likely to intervene in the currency market to weaken the yen if it strengthens further towards 111/110 versus the US dollar. Our year-end USD/JPY forecast is 120.

AUD and CAD rally; NZD slumps

Both the Australian dollar (AUD) and Canadian dollar (CAD) strengthened considerably versus the US dollar as both iron ore and oil prices rose. The Bank of Canada (BoC) left monetary policy unchanged. It judged that the overall balance of risks remains within the zone for which the current stance of monetary policy is appropriate. This was more constructive than was anticipated. Therefore, sentiment towards the Canadian dollar further improved. It is likely that the BoC will keep monetary policy rates unchanged this year. However, further gains in the Canadian dollar may result in a more dovish BoC's stance in the coming months. Carry trades have pushed the Australian dollar higher (it is a relative high-yielding currency) given that the Reserve Bank of Australia (RBA) has maintained its neutral policy bias and did not signal any discomfort on the recent strength in the currency. We maintain our bearish view in the Australian dollar as the RBA is likely to lower monetary policy rates further in May given subdued inflation outlook and soft labour market. We expect the unemployment rate to rise further in February which will be reflected in the next jobs report on 17 March. Our base and ferrous metals analyst judges that iron ore prices have risen too fast and could come under pressure.

Separately, the New Zealand dollar (NZD) slumped by about 2 cents after the Reserve Bank of New Zealand (RBNZ) unexpectedly lowered the Official Cash Rate (OCR) by 25bp on 10 March. We expect the RBNZ to further cut interest rates as soon as June. A weaker NZD/USD towards 0.61 is likely by the end of this year.

ABN AMRO major currency forecasts

Changes in red/bold

	10-Mar	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
EUR/USD	1.1067	1.10	1.05	1.05	1.05	1.05	1.05	1.05	1.05
USD/JPY	113.68	116	117	118	120	122	124	122	120
EUR/JPY	124.45	128	123	124	126	128	130	128	126
GBP/USD	1.4225	1.40	1.35	1.42	1.48	1.50	1.50	1.50	1.50
EUR/GBP	0.7722	0.79	0.78	0.74	0.71	0.70	0.70	0.70	0.70
USD/CHF	0.9966	1.00	1.05	1.05	1.05	1.06	1.07	1.08	1.09
EUR/CHF	1.0934	1.10	1.10	1.10	1.10	1.11	1.12	1.13	1.14
AUD/USD	0.7478	0.70	0.68	0.66	0.65	0.63	0.62	0.64	0.65
NZD/USD	0.6669	0.65	0.63	0.62	0.61	0.60	0.58	0.60	0.62
USD/CAD	1.3269	1.40	1.40	1.38	1.36	1.38	1.40	1.42	1.44
EUR/SEK	9.2783	9.50	9.50	9.50	9.50	9.25	9.00	8.75	8.50
EUR/NOK	9.4306	9.60	9.20	9.00	9.00	8.75	8.50	8.25	8.00
EUR/DKK	7.4592	7.46	7.46	7.46	7.46	7.46	7.46	7.46	7.46

Source: ABN AMRO Group Economics

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