Global Markets Research

Foreign Exchange: Strategy - Weekly Currency View

2 April 2013

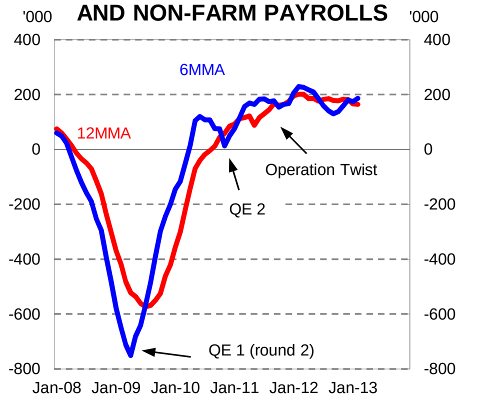
Short-term views on exchange rate direction

- **There are 4 major central bank meetings this week (the RBA, ECB, BoE and BoJ). We think the BoJ will be the only central bank to alter its policy stance. This is the long-awaited and first meeting of new BoJ Governor Kuroda. However, given the high level of expectations there is a risk participants are left disappointed by the BoJ. Failure to meet or exceed the markets perceived threshold is likely to trigger a bout of JPY strength. Nevertheless, we continue to expect the JPY to deprecate over 2013. In our view, the depreciating moves in the JPY are structural, driven by the collapse in Japan's current account surplus, and not based on BoJ actions.**
- **Eurozone uncertainties persist. Italy remains without a government, while the situation in Cyprus continues to play out. Added to this the Eurozone economy continues to struggle, and core Eurozone bond yields remain under downward pressure. These factors should continue to keep the EUR heavy. Dovish commentary by the ECB this Thursday will add to the EUR headwinds.**
- **March US non-farm payrolls are released this Friday. Various leading indicators point to monthly payrolls growth of around 200,000, despite some recent softening in the US economic data. Such an outcome would continue to illustrate the US economic outperformance relative to the other major G6 economies. Over recent months the USD has been positively correlated with US economic data, particularly against the other G4 currencies (EUR, GBP and JPY). We think another solid US payrolls print will be USD supportive.**

Majors	One Week Bias
USD	**Mildly Bullish**

In addition to being supported by ongoing uncertainty in the Eurozone, over recent months the USD has tended to have a positive correlation with US economic data. Hence, the USD has been supported by the US' relative economic outperformance, particularly against the other G4 currencies (EUR, GBP, and JPY). Key focus this week will be on the March non-farm payrolls print (Friday). Various leading indicators point to a monthly rise in non-farm payrolls of around 200,000 in March. While the USD should continue to be supported against currencies linked to weaker economies in the near-term by positive US data, a substantial lift in the USD is unlikely. The mix of the US' large current account deficit (3% of US GDP), sustained Fed policy stimulus and negative US real interest rates continue to act as USD headwinds.

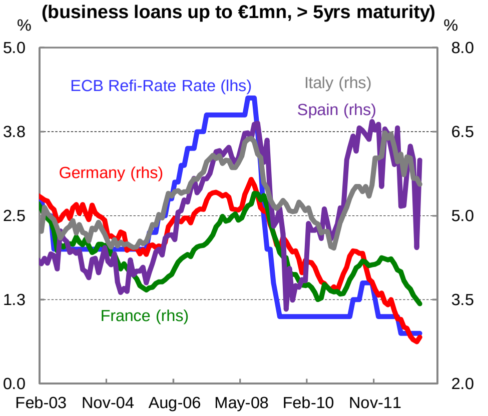
US QUANTITATIVE EASING AND NON-FARM PAYROLLS



EUR/USD	**Mildly Bearish**

Italy remains without a government, while the decisions made regarding Cyprus continue to play out. These uncertainties should continue to keep the EUR heavy. In addition to the political developments, the April ECB meeting will be a key EUR focus this week (Thursday). No change to policy is expected. However, given the dip in the Eurozone PMIs in March, the tone of the accompanying press conference should remain dovish. A rate cut had been discussed by the ECB in March, and it would not be surprising if the discussion was repeated in April. Increased discussion on how to repair the monetary policy transmission mechanism across the periphery may also intensify. Given the ongoing concerns in the Eurozone periphery, weak Eurozone economic outlook and likely dovish ECB, the German-US two-year yield differential should continue to remain negative (currently –26bpts). The risk is EUR/USD tests its November 2012 low (1.2662) before a recovery takes place. Nonetheless, a substantial EUR decline below this level appears unlikely. The Eurozone current account surplus (1.1% of Eurozone GDP) continues to provide a fundamental level of EUR support.

ECB & COMMERCIAL LENDING RATES (business loans up to €1mn, > 5yrs maturity)

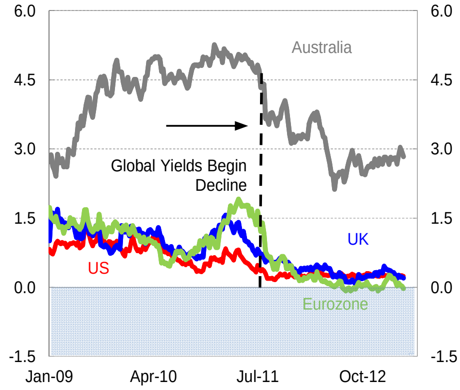


Peter Dragicevich Currency Strategist T. +612 9118 1107 E. peter.dragicevich@cba.com.au
Andy Ji Asian Currency Strategist T. +65 6349 7056 E. andy.ji@cba.com.au
Chris Tennent-Brown FX Economist T. +612 9117 1378 E. chris.tennent-brown@cba.com.au
Richard Grace Chief Currency Strategist & Head of International Economics T. +612 9117 0080 E. richard.grace@cba.com.au

AUD/USD — Neutral

The AUD continues to trade near the middle of the range it has occupied since October 2012. In the short term we cannot make a case for the AUD to move substantially from its recent range. No change is expected from the RBA this week (Tuesday), while the underlying tone should remain in line with recent months. We expect the RBA to remain cognisant of the dampening impact of the AUD, and as such we expect the RBA to retain its easing bias. However should the RBA dilute its easing bias, we would expect the AUD to lift. On the data front, we expect the trade deficit to widen because of weather induced restrictions on port activity (Wednesday) and for retail sales growth to have eased in February following the sharp rise in January (Thursday). The low vol. environment continues to support the AUD given Australia's relative economic outperformance and attractive yields. Demand for AUD denominated assets remains robust, while Asia's economy continues to show a trend improvement.

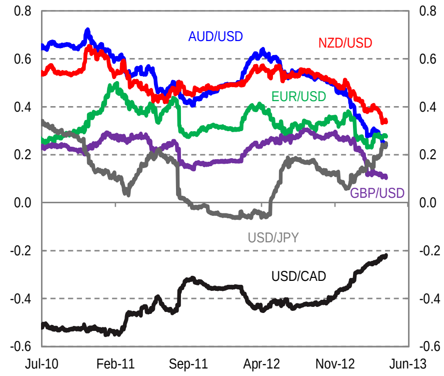
TWO-YEAR BOND YIELDS



NZD/USD — Neutral

There is no New Zealand economic data released this week. Consequently, offshore events should be the key influence on the NZD. Eurozone uncertainty and the prospect of a firmer USD driven by the relative US economic outperformance should weigh mildly on the NZD. Nonetheless, do not expect any declines in the NZD to be substantial. NZD/USD should respect its recent range. Ongoing reinsurance inflows into New Zealand, firm foreign demand for NZ$ government bonds, rising dairy prices, New Zealand's attractive yields, and the improving Asian economic outlook remain NZD supportive.

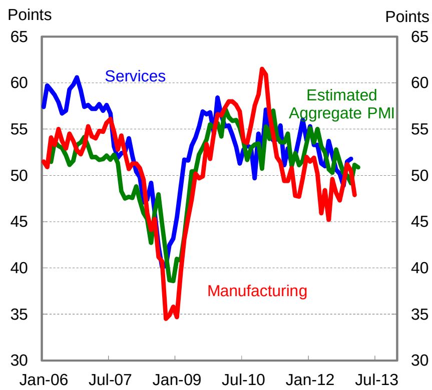
FX SENSITIVITY TO US EQUITIES
(rolling 6 month regression of FX majors & S&P500 daily changes)



GBP/USD — Mildly Bearish

Following the bounce of its lows, GBP/USD has tracked sideways. In our view, the bias remains for GBP to track lower over coming months. The fundamental economic backdrop in the UK remains weak. This week the March readings of the UK manufacturing (Tuesday) and services (Thursday) PMIs are released. The manufacturing measure should remain in contractionary territory while there are risks of a pullback in the services PMI. Both outcomes would highlight the precarious position of the UK economy. Despite this we do not expect the BoE to announce any further policy measures this week (Thursday). However in our view, it is still a matter of when and not if the BoE announces more stimulus. The ongoing risk of more BoE policy stimulus, prolonged economic underperformance, elevated UK inflation, the increasingly negative US-UK two-year yield differential, negative real UK yields and a large UK current account deficit (3.7% of UK GDP) should continue to act as GBP headwinds over coming months.

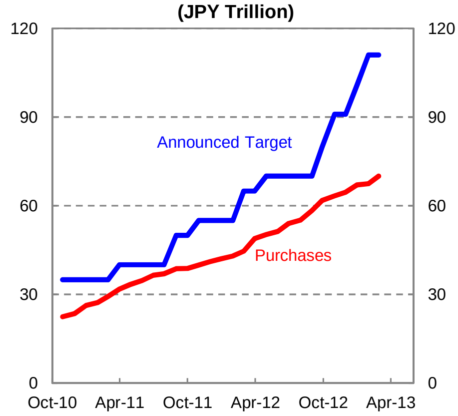
UK PURCHASING MANAGERS' INDEX



USD/JPY — Mildly Bearish

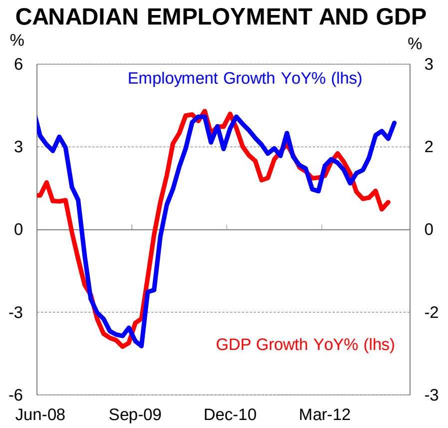
New Governor Kuroda chairs his first BoJ policy meeting this week (Wednesday-Thursday). We think the BoJ may announce a number of policy measures including: (a) immediately starting its open-ended asset purchase program; (b) increasing the amount of asset purchases from ¥3 trillion per month to ¥5 trillion per month; and (c) extending the maturities of its JGB purchases. We also see an outside risk the BoJ announces a greater emphasis on buying "risk" assets. However, our sense is that participant expectations for this week's BoJ meeting are extremely high. The extreme level of expectations suggests that participants may be left disappointed and the JPY strengthens in a knee-jerk "*buy the rumour sell the fact*" scenario. This reaction would obviously be amplified if Governor Kuroda chooses to merely outline his "framework" for defeating deflation and delays announcing further stimulus until the BoJ's 26 April meeting. Nonetheless, we still anticipate the JPY to weaken over the medium-term. In our view the JPY depreciation is structural, driven by the decline in Japan's current account surplus. The next Japan current account reading is due on 8 April. There is a high probability Japan recorded its second seasonally adjusted monthly current account deficit in 30 years in February.

BOJ ASSET PURCHASE PROGRAM
(JPY Trillion)



USD/CAD — Mildly Bullish

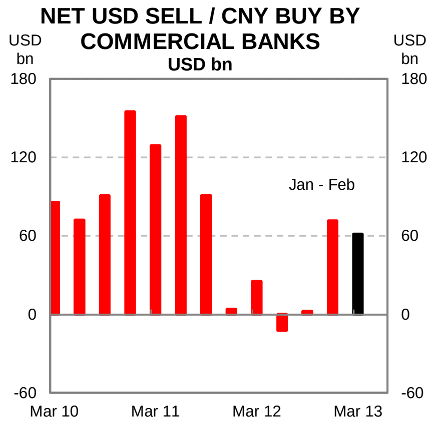
Some USD strength and changed market perceptions about how long the Bank of Canada (BoC) will keep rates on hold weighed on the CAD over most of Q1. However, USD/CAD has eased off its recent highs. The recent soft patch in the Canadian economic data has reaffirmed the BoC's watered down tightening bias. The combination of the outsized increase in Canadian jobs growth in February and the H2 2012 Canadian economic slowdown suggest a weak March Canadian employment report (Friday). When combined with our firmer near-term USD outlook, we think USD/CAD can drift modestly higher this week. Nonetheless, over the medium-term we still anticipate USD/CAD to ease lower. We don't think the Canadian economy is as weak as the recent data flow suggests, while demand for CAD denominated assets remains firm.



Asian Currencies — One Week Bias

USD/CNY — Mildly Bearish

On Monday, the People's Bank of China (PBoC) set the morning fixing in USD/CNY just 4pips above its historical low of 6.2670. As a result, USD/CNY spot traded at its weakest level of 6.2073, roughly 1% below its midpoint on persistent onshore demand. In Jan–Feb, net USD selling by onshore corporate and individuals was equal to US$61bn, compared to US$71bn in Q4 2012. The official China manufacturing PMI registered its sixth consecutive above-50 reading in March, pointing to a continued recovery in the manufacturing sector. As such, despite a firmer USD outlook this week, we expect the USD/CNY cross to remain heavy.



USD/KRW — Neutral

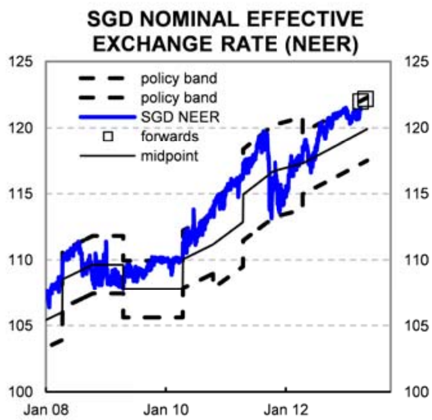
USD/KRW traded firmly above 1,100 last week, despite signs of stabilization. The uptick in rhetoric surrounding the current geopolitical tussle in the region continues to support the USD. At the same time, both consumer price inflation and exports growth in Korea were softer than expected in March. Therefore, despite continued valuation support from Korea's favourable terms-of-trade, we expect the USD/KRW to stay around current levels this week.

USD/IDR — Mildly Bullish

USD/IDR continued to struggle around 9,700 levels last week. The chronic onshore USD shortage continues to rattle investor confidence in the domestic currency. At the same time, both headline and core Indonesian CPI in March surprised on the upside, suggesting unabated inflationary pressure in the domestic economy. Therefore, we expect the USD/IDR to be well supported especially with the USD likely to remain firm this week.

USD/SGD — Mildly Bullish

The SGD nominal effective exchange rate (NEER) was little changed last week. Singapore headline consumer price inflation was significantly faster than market had expected in February. While this reflected higher costs of private transportation and accommodation, market participants expect the elevated headline inflation to warrant an unchanged policy stance from the Monetary Authority of Singapore at its upcoming semi-annual monetary policy meeting. Against a firmer USD, we expect the USD/SGD to lift this week.



AUD Crosses — One Week Bias

AUD/NZD — Neutral

There is no data due in New Zealand this week, so the RBA's April meeting (Tuesday) is the key event for the interest-rate sensitive AUD/NZD cross rate. No change is expected from the RBA, while the underlying tone should remain in line with recent months. Accordingly, we do not expect the RBA meeting to have a significant impact on the

AUD or the AUD/NZD over the week.

AUD/EUR **Mildly Bullish**

Assuming vol. remains subdued, Australia's relative economic outperformance, and attractive yields should continue to support the AUD against the EUR. Although the RBA is likely to reiterate its easing bias (Tuesday), we doubt the statement will deviate from recent commentary and market RBA interest rate expectations will remain largely unaffected. As it stands, the market is now pricing in 25bpts worth of RBA rate cuts over the coming year. This is down from 50bpts at the start of March. By contrast, the risk is the ECB sounds more dovish this week (Thursday) given the recent downturn in the Eurozone business surveys. A retest of 0.8200 in AUD/EUR looks increasingly possible in the near-term.

AUD/GBP **Mildly Bullish**

Momentum in the UK economy remains weak. The UK PMI data released this week (Tuesday/Thursday) should further highlight the UK's poor fundamental backdrop. While we do not expect the BoE to announce further policy stimulus on Thursday it should be announced in the coming months. Another set of poor UK PMI figures should raise market expectations of more BoE stimulus and weigh on GBP. By contrast, we expect the RBA to remain on hold for the foreseeable future. Although the RBA is expected to reiterate its easing bias (Tuesday), the overall statement should not be too dissimilar to recent months. In our view, the risks reside with the RBA diluting its easing bias. As such, the Australia-UK yield differential should remain firmly in Australia's favour. Australia's relative fundamental strength should continue to support the AUD versus GBP over the months ahead.

AUD/JPY **Mildly Bearish**

Although we expect the BoJ to announce further policy stimulus this week, the risk is the BoJ fails to meet the markets lofty expectations (Thursday). This may trigger a bout of JPY strength. AUD/JPY would not be immune and we would expect the cross to edge lower. Nonetheless, we don't foresee the declines in AUD/JPY to be overly large nor long lasting. In our view, the deprecation in the JPY is structural rather than BoJ driven. The decline in Japan's current account surplus has reduced the level of JPY support. By contrast, the Asian economic outlook remains firm and Australia's relative economic position is positive. This fundamental backdrop should continue to support the AUD. We continue to forecast AUD/JPY to rise to 104.00 by year-end.

AUD/CAD **Neutral**

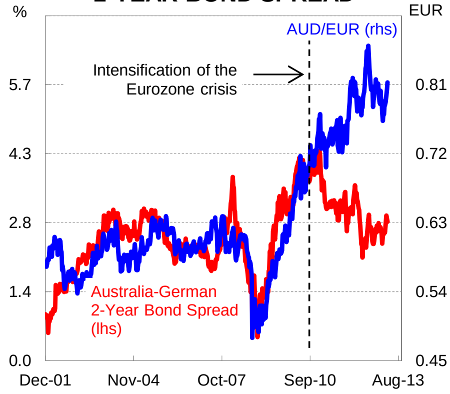
AUD/CAD has consolidated some of its 2013 gains over recent sessions. In our view, this period of consolidation is likely to continue in the near-term. The RBA is not expected to deviate too much from its recent script when it meets on Tuesday, while the Australian economic data released throughout the week should be slightly softer. The March Canadian employment data (Friday) is also likely to come in at the lower end of expectations. These factors should largely negate each other and keep AUD/CAD range bound in the near-term.

European Crosses — One Week Bias

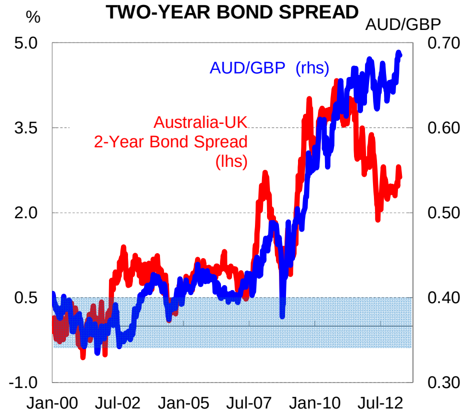
EUR/GBP **Mildly Bearish**

Various fundamental cross currents suggest that EUR/GBP should respect its recent range in the coming week. However, given the political uncertainty in the Eurozone periphery and the practice of the ECB to publish a policy statement following its board meeting (in contrast to the BoE) the bias is for EUR/GBP to ease modestly lower. A dovish tilt by the ECB would also continue to keep core Eurozone bond yields under pressure. Hence, the German-UK yield differential should remain in the UK's favour. EUR/GBP is unlikely to make substantial gains while German yields remain so depressed. Nonetheless, over the course of 2013 we still expect EUR/GBP to grind higher. The greater relative

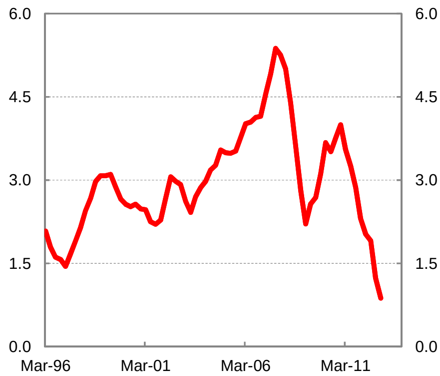
AUD/EUR VS AUS-GERMAN 2-YEAR BOND SPREAD



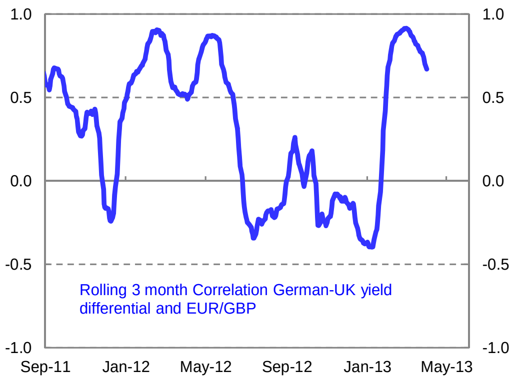
AUD/GBP TWO-YEAR BOND SPREAD



CURRENT ACCOUNT SURPLUS (% of GDP)



GERMAN-UK YIELD DIFFERENTIAL & EUR/GBP (rolling 3 mth correlation)



economic change should occur in the Eurozone, as it emerges from recession over 2013. This contrasts to the UK's and GBP's various fundamental impediments (see GBP section).

EUR/JPY — **Mildly Bearish**

The risk of disappointment by the BoJ (Thursday), and a dovish ECB (Thursday) should see EUR/JPY remain on the back foot. A decline back towards 118.00 looks likely in the near-term if we are right about the reactions to the respective central bank decisions. While the intentions/actions of the BoJ continue to garner market focus, we see the JPY deprecation as structural, a function of the sharp decline in Japan's current account surplus.

EUR/CHF and **USD/CHF** — **Mildly Bearish** & **Mildly Bullish**

There are no CHF-centric events this week. Hence, movements in EUR/CHF should remain contingent on EUR moves. Given the uncertainties in peripheral Eurozone and the risk of a dovish ECB, we expect the EUR to remain under mild downward pressure. Consequently, EUR/CHF should continue to trade heavy. Irrespective, we still expect the Swiss National Bank (SNB) to successfully defend its EUR/CHF 1.2000 minimum exchange rate policy. By contrast, we think USD/CHF can grind higher. Positive US employment data should continue to support the USD in the near-term. Although Eurozone concerns have re-appeared, market volatility has remained subdued. A low vol. environment should allow the US' relatively favourable economic fundamentals to continue to support the USD vis-à-vis the CHF.

NZD Crosses — One Week Bias

NZD/AUD — **Neutral**

There is no data due in New Zealand this week, so the RBA's April meeting (Tuesday) is the key event for the interest-rate sensitive NZD/AUD cross rate. No change is expected from the RBA, while the underlying tone should remain in line with recent months. Accordingly, we do not expect the meeting to have a significant impact on the AUD or the NZD/AUD over the week.

NZD/EUR — **Mildly Bullish**

Assuming vol. remains subdued, New Zealand's relative economic outperformance, and attractive yields should continue to support the NZD against the EUR over the week ahead. The risk is the ECB sounds more dovish this week (Thursday) given the recent downturn in the Eurozone business surveys. This, along with the other Eurozone uncertainties should keep the EUR heavy (see EUR section). The year's high of 0.6567 is likely to be retested in the near-term.

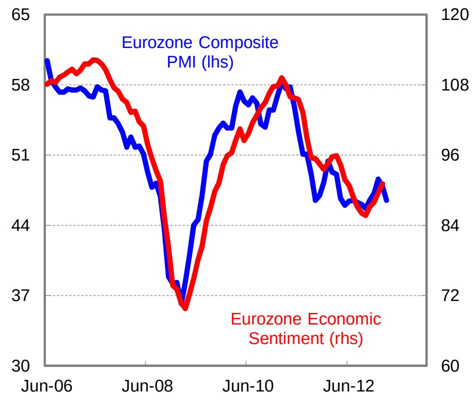
NZD/GBP — **Mildly Bullish**

Momentum in the UK economy remains weak. The UK PMI data released this week (Tuesday/Thursday) should further highlight the UK's poor economic fundamental backdrop. While we do not expect the BoE to announce further policy stimulus (Thursday) it should be announced in the coming months. Another set of poor UK PMI figures should raise market expectations of more BoE stimulus and weigh on GBP. In contrast, the New Zealand data calendar is bare, and market pricing for start of a gradual tightening cycle in New Zealand over the coming year is unlikely to change. As such, the New Zealand-UK yield differential should remain firmly in New Zealand's favour.

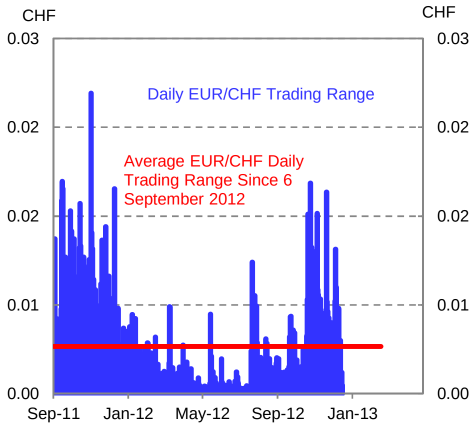
NZD/JPY — **Mildly Bearish**

Although we expect the BoJ to announce further policy stimulus this week, the risk is the BoJ fails to meet the markets lofty expectations (Thursday). This may trigger a bout of JPY strength. NZD/JPY would not be immune and we would expect the cross to edge lower. Nonetheless, we don't foresee the declines in NZD/JPY to be overly large nor long lasting. In our view, the deprecation in the JPY is structural

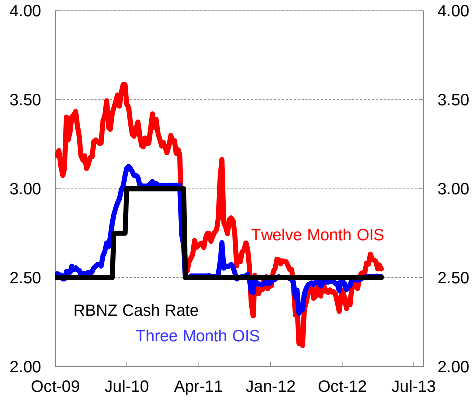
EUROZONE COMPOSITE PMI & SENTIMENT



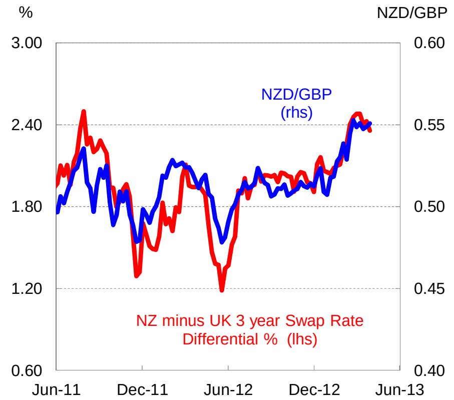
EUR/CHF TRADING RANGE



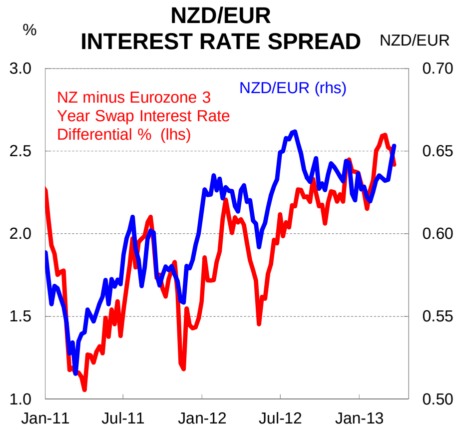
RBNZ OCR AND MARKET EXPECTATIONS



NZD/GBP INTEREST RATE SPREAD



rather than BoJ driven. The decline in Japan's current account surplus has reduced the level of JPY support. By contrast, the Asian economic outlook remains firm and New Zealand's relative economic position is positive. This fundamental backdrop should continue to support the NZD. We continue to forecast NZD/JPY to rise to 85.00 by year-end.



Foreign Exchange Forecasts

	End Period			
	Jun-13	Sep-13	Dec-13	Mar-14
Majors				
EUR/USD	1.3500	1.3700	1.3800	1.4000
USD/JPY	98.00	100.00	100.00	104.00
GBP/USD	1.4800	1.4600	1.4600	1.4700
AUD/USD	1.0400	1.0400	1.0400	1.0300
NZD/USD	0.8400	0.8500	0.8500	0.8600
USD/CAD	0.9900	0.9900	0.9800	0.9800
USD/CHF	0.9370	0.9343	0.9348	0.9286
USD/CNY	6.1600	6.1200	6.0000	5.9000
AUD cross rates				
AUD/EUR	0.7704	0.7591	0.7536	0.7357
AUD/GBP	0.7027	0.7123	0.7123	0.7007
AUD/JPY	101.92	104.00	104.00	107.12
AUD/NZD	1.2381	1.2235	1.2235	1.1977
AUD/CAD	1.0296	1.0296	1.0192	1.0094
AUD/CHF	0.9745	0.9717	0.9722	0.9564
AUD/CNY	6.4064	6.3648	6.2400	6.0770
AUD/SGD	1.2636	1.2480	1.2376	1.2051
NZD cross rates				
NZD/EUR	0.6222	0.6204	0.6159	0.6143
NZD/GBP	0.5676	0.5822	0.5822	0.5850
NZD/JPY	82.32	85.00	85.00	89.44
NZD/AUD	0.8077	0.8173	0.8173	0.8350
NZD/CAD	0.8316	0.8415	0.8330	0.8428
NZD/CHF	0.7871	0.7942	0.7946	0.7986
NZD/CNY	5.1744	5.2020	5.1000	5.0740

**Forecasts were adjusted on 27 January 2013*

**JPY forecasts were originally lowered on 19 December 2012*

	End Period			
	Jun-13	Sep-13	Dec-13	Mar-14
European cross rates				
EUR/JPY	132.30	137.00	138.00	145.60
EUR/GBP	0.9122	0.9384	0.9452	0.9524
EUR/CHF	1.2650	1.2800	1.2900	1.3000
EUR/AUD	1.2981	1.3173	1.3269	1.3592
EUR/NZD	1.6071	1.6118	1.6235	1.6279
GBP/JPY	145.04	146.00	146.00	152.88
GBP/CHF	1.3868	1.3641	1.3648	1.3650
GBP/AUD	1.4231	1.4038	1.4038	1.4272
GBP/NZD	1.7619	1.7176	1.7176	1.7093
Non-Japan Asia				
USD/SGD	1.2150	1.2000	1.1900	1.1700
USD/HKD	7.7500	7.7500	7.7500	7.7500
USD/THB	29.40	29.20	28.90	29.00
USD/IDR	9500	9200	9000	9000
USD/TWD	28.50	28.25	28.00	27.75
USD/KRW	1025	1000	950	925
USD/MYR	3.00	2.90	2.85	2.80
USD/VND	22000	22000	22000	22000
USD/PHP	40.00	39.50	39.00	38.50
USD/INR	51.00	49.00	48.00	47.50

Unless otherwise noted, all data is sourced from Australian Bureau of Statistics material (www.abs.gov.au).

Research

Commodities		Telephone	Email Address
Luke Mathews	Agri Commodities	+612 9118 1098	luke.mathews@cba.com.au
Lachlan Shaw	Mining & Energy Commodities	+613 9675 8618	lachlan.shaw@cba.com.au
Vivek Dhar	Mining & Energy Commodities	+613 9675 6183	vivek.dhar@cba.com.au

Economics		Telephone	Email Address
Michael Blythe	Chief Economist	+612 9118 1101	michael.blythe@cba.com.au
Michael Workman	Senior Economist	+612 9118 1019	michael.workman@cba.com.au
John Peters	Senior Economist	+612 9117 0112	john.peters@cba.com.au
Gareth Aird	Economist	+612 9118 1100	gareth.aird@cba.com.au
Diana Mousina	Associate Economist	+612 9118 6394	diana.mousina@cba.com.au

Fixed Income		Telephone	Email Address
Adam Donaldson	Head of Debt Research	+612 9118 1095	adam.donaldson@cba.com.au
Philip Brown	Fixed Income Quantitative Strategist	+612 9118 1090	philip.brown@cba.com.au
Alex Stanley	Interest Rate Strategist	+612 9118 1125	alex.stanley@cba.com.au
Steve Shoobert	Chief Credit Strategist	+612 9118 1096	steve.shoobert@cba.com.au
Tariq Chotani	Credit Research Analyst	+612 9280 8058	tariq.chotani@cba.com.au
Tally Dewan	Credit Research Analyst	+612 9118 1105	tally.dewan@cba.com.au
Kevin Ward	Database Manager	+612 9118 1960	kevin.ward@cba.com.au

Foreign Exchange and International Economics		Telephone	Email Address
Richard Grace	Chief Currency Strategist & Head of International Economics	+612 9117 0080	richard.grace@cba.com.au
Joseph Capurso	Currency Strategist	+612 9118 1106	joseph.capurso@cba.com.au
Peter Dragicevich	Currency Strategist	+612 9118 1107	peter.dragicevich@cba.com.au
Andy Ji	Asian Currency Strategist	+65 6349 7056	andy.ji@cba.com.au
Chris Tennent-Brown	FX Economist	+612 9117 1378	chris.tennent.brown@cba.com.au
Martin McMahon	Economist Europe	+44 20 7710 3918	martin.mcmahon@cba.com.au

Delivery Channels & Publications		Telephone	Email Address
Monica Eley	Internet/Intranet	+612 9118 1097	monica.eley@cba.com.au
Ai-Quynh Mac	Information Services	+612 9118 1102	maca@cba.com.au

New Zealand		Telephone	Email Address
Nick Tuffley	ASB Chief Economist	+649 301 5659	nick.tuffley@asb.co.nz
Jane Turner	Economist	+649 301 5660	jane.turner@asb.co.nz
Christina Leung	Economist	+649 301 5661	christina.leung@asb.co.nz
Daniel Smith	Economist	+649 301 5853	daniel.smith@asb.co.nz

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NY	+1212 336 7749

Corporate	Telephone
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VIC	+613 9675 7737
SA/NT	+618 8463 9011
WA	+618 9215 8201
QLD	+617 3015 4525
NZ	+64 9375 5738
Metals Desk	+612 9117 0069
Agri Desk	+612 9117 0145