Global Markets Research

Foreign Exchange: Strategy - Weekly Currency View

25 March 2013

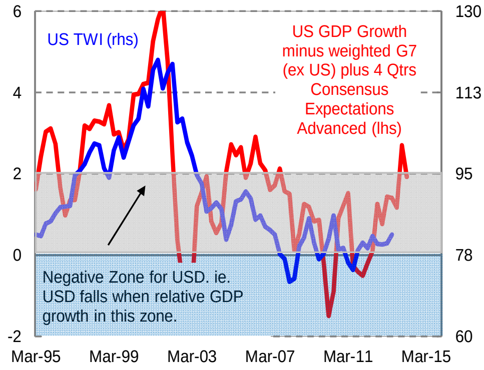
Short-term views on exchange rate direction

- **Uncertainty about the Cyprus sovereign bailout remains. At the timing of writing, a new bailout agreement has yet to be formally announced. However there appear to be tentative signs of progress being reported by media outlets. While the outcome around Cyprus appears binomial (positive or negative), the risks around the situation are somewhat asymmetric. A successful resolution should see the EUR undertake a relief rally, while failure to reach an agreement will raise concerns about a Cypriot banking collapse and possible Eurozone bank contagion. We would expect EUR to spike lower. Increased concerns Cyprus could leave the Eurozone would also support traditional safe-haven currencies such as the USD and JPY, as the EUR depreciates.**
- **The economic data flow is particularly light this week across the globe. This will intensify market focus on Cypriot developments. Consequently, the outcome in Cyprus is expected to set the tone for broader asset markets.**

Majors	One Week Bias
USD	**Neutral**

Market focus continues to be on Cyprus, and given the information at hand, the risks remain broadly balanced. If a deal is unable to be agreed in time, we would expect the USD to be supported on increased risk aversion. By contrast, a successful resolution may see the USD give back some of its recent gains. There is little in the way of economic developments in the US this week. However, there are some FOMC voters speaking (Bernanke Tuesday AEDT, Dudley Tuesday AEDT and Rosengren Thursday AEDT). Based on the FOMC's recent commentary we expect these members to reiterate the Fed's easing bias. This may soften the USD in and around the various speeches. Over the medium-term, we continue to think the mix of the US's current account deficit (3% of US GDP), sustained Fed policy stimulus resulting in negative US real interest rates should weigh on the USD. However, continued relative economic outperformance by the US over the remaining G7 will limit any substantial USD declines.

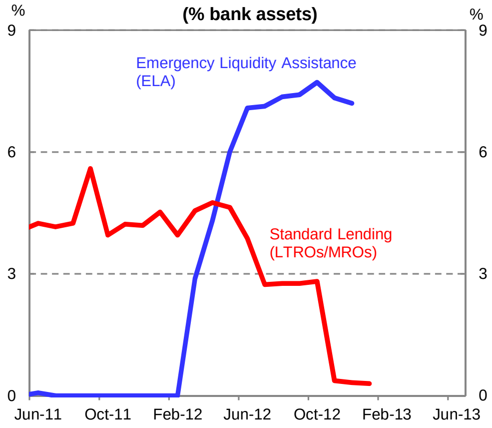
RELATIVE US-G7 GDP GROWTH & USD



EUR/USD	**Neutral**

Developments in Cyprus continue to unfold and remain the key focus. As it stands, the various stakeholders are negotiating the latest Cyprus sovereign bailout, which if successful will see the ECB continue to fund the Cypriot banks. The ECB has already lent Cypriot banks some €9bn, which is equivalent to 50% of Cyprus GDP. The ECB remains reluctant to lend to Cypriot banks under the ELA until the sovereign terms have been finalised. While the outcome around Cyprus appears binomial (positive or negative), the risks around the situation are somewhat asymmetric. A successful resolution should see the EUR undertake a relief rally, while failure to reach an agreement will raise concerns about a Cypriot banking collapse and possible Eurozone bank contagion. Heightened concerns would weigh on the EUR. Irrespective, our core view is that the EUR will grind up over the course of 2013 but the risk is we see EUR trade at the November 2012 low (1.2662) first. The policy framework now in place should limit broad based tail risks, and the Eurozone's current account surplus (1% of Eurozone GDP) continues to provide a degree of support and a major reason why we are not more bearish EUR. However, the prolonged Eurozone recession, depressed core Eurozone government bond yields and risk of further ECB policy stimulus should limit any accelerated EUR appreciation.

ECB LENDING TO CYPRUS BANKS
(% bank assets)



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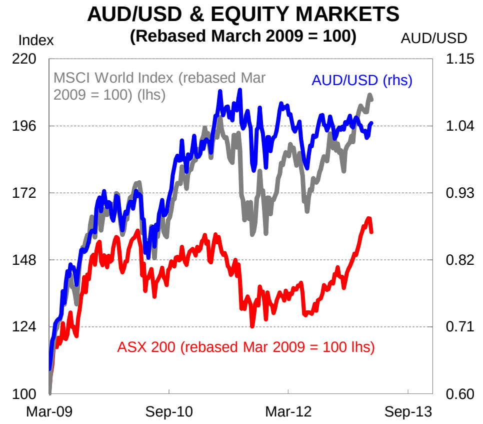
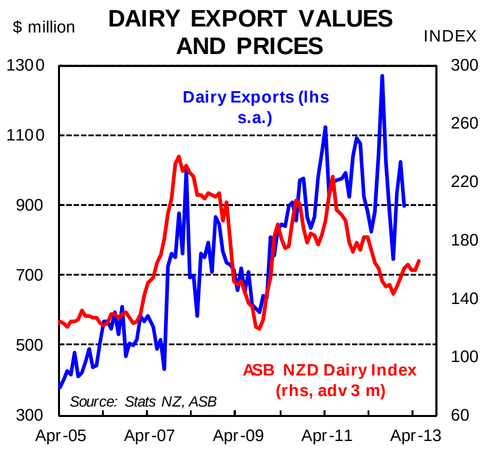
AUD/USD — Neutral

No major Australian or Chinese economic data is released this week. Hence, offshore developments, particularly those in Cyprus, should guide the AUD. Positive sentiment stemming from a successful resolution should provide a boost to the AUD, while increased concerns about a Cypriot bank collapse and/or contagion across the Eurozone should weigh on risk assets, and the AUD. However, without a sustained spike in market volatility, we do not think any falls in the AUD stemming from Cyprus uncertainty will be substantial or long lasting. Australia's relative economic health remains strong; while the risk adjusted return on AUD denominated assets remains attractive.



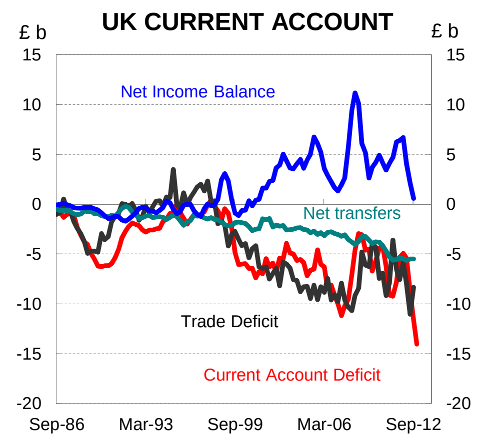
NZD/USD — Neutral

February international trade data (Tuesday) is the main New Zealand data released this week. Historically the trade data has not been a substantial market mover. Consequently, offshore events should have greater bearing on the NZD in the near-term. The fluid situation in Cyprus implies that the risks remain broadly balanced. A positive outcome should see risk assets spike higher, while a negative outcome would have the opposite effect. Given the NZD continues to have the greatest sensitivity (beta) to global equity markets among the G10 currencies; theoretically the NZD could have the largest relative movement. Nonetheless, we would expect any declines in the NZD to remain well supported. This level of support comes from the ongoing reinsurance inflows into New Zealand, firm foreign demand for New Zealand government bonds, and elevated dairy prices. One risk to our NZD outlook is the current drought and the associated negative economic implications.



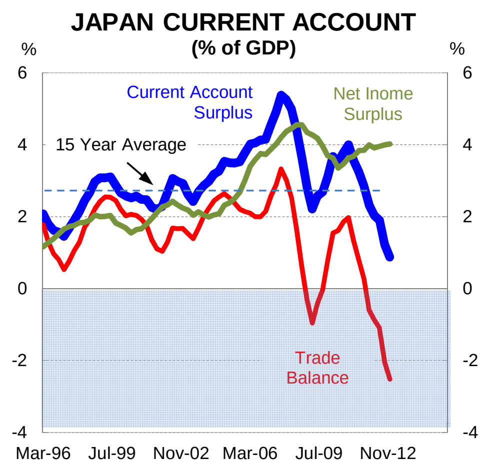
GBP/USD — Neutral

GBP has squeezed up off its recent lows. Following the 9.5% peak to trough decline in 2013, this is not surprising. But we doubt it is the start of a new sustained GBP uptrend. The fundamental backdrop in the UK remains weak. This was further highlighted late last week, with Fitch putting its UK AAA sovereign rating on "*watch negative*". This implies there is a high probability Fitch soon joins Moody's in cutting the UK's AAA sovereign rating in the next few months. In the near-term, the GBP centric focal points are a speech by BoE Governor King (Tuesday AEDT) and Chancellor Osborne's testimony to a Treasury panel on the recent UK budget (Wednesday AEDT). Specifically, given Governor King continues to vote for more BoE asset purchases, his commentary is likely to retain its dovish tones. This may apply some downward pressure on GBP. Given the various headwinds faced by the UK economy we continue to forecast GBP/USD to ease down to 1.48 by end-June.



USD/JPY — Neutral

February Japanese industrial production and CPI data released this week (Friday) should show that economic activity remains weak, while deflation remains entrenched. New BoJ Governor Kuroda has commenced his tenure and his first scheduled BoJ policy meeting takes place on 3-4 April. In the interim, market participants are likely to remain fixated on what possible policy measures the BoJ could implement. Regardless, we think the European developments should have a greater impact on market sentiment and JPY for most of this week. In that regard, increased uncertainty regarding Cyprus should support the JPY, while a positive outcome could weigh on the JPY. Nevertheless, our medium-term JPY outlook remains unchanged. Over coming months we think the structural depreciation in the JPY driver by the collapse in Japan's current account surplus will continue to push USD/JPY higher. Our end-September USD/JPY forecast is 100.00.



USD/CAD — Neutral

USD/CAD has pushed up over 3% since the start of the year. Over coming months, we still think USD/CAD can reverse its recent gains. In our view, the Canadian economy is not as soft as the recent data flow suggests. Improvement in the economic data, mixed with ongoing demand for CAD denominated assets should prove to be CAD supportive over the medium-term. In addition to the situation in Cyprus, there are some Canadian domestic factors that could influence the CAD. This week CAD should garner some support from a return to positive monthly Canadian GDP growth (January data due Thursday). However, preceding that the February CPI data (Wednesday) should show inflation pressures in Canada are very low. This could weigh on Canadian interest rates as expectations around the timing of any BoC policy tightening continue to be pushed back.

Asian Currencies — One Week Bias

USD/CNY — Neutral

The People's Bank of China (PBoC) continues to set the morning USD/CNY fixing just a tad above 6.27. Accordingly USD/CNY spot continues to grind lower towards 6.21, as it continues to trade at 1% below its midpoint on persistent onshore demand. Last week, the flash estimate of the HSBC manufacturing PMI rose to 51.7 in March, pointing to the continued expansion in the Chinese manufacturing sector. However, if the USD firms on heightened financial market uncertainties in the Eurozone, USD/CNY is likely to remain range-bound in the near-term.

USD/KRW — Neutral

USD/KRW remained range bound last week, despite the recent USD strength taking a breather. However, both onshore USD shortage and geopolitical risk persists. These factors should keep the cross well supported. Given the light economic data flow this week, we expect a slightly firmer USD to dominate at the margin if concerns in the Eurozone lift. On the other hand, Korea's elevated terms-of-trade should continue to provide some support to the KRW. Given the cross currents, we expect USD/KRW to stay broadly flat around current levels in the near-term.

USD/IDR — Mildly Bullish

Despite the improving outlook and subsiding capital outflows, USD/IDR spiked higher last week. The chronic onshore USD shortage continues to rattle investor confidence in the domestic currency, especially during bouts of USD strength. Given the light economic data flow this week, we expect USD/IDR to remain well supported with risks mainly on the upside.

USD/SGD — Neutral

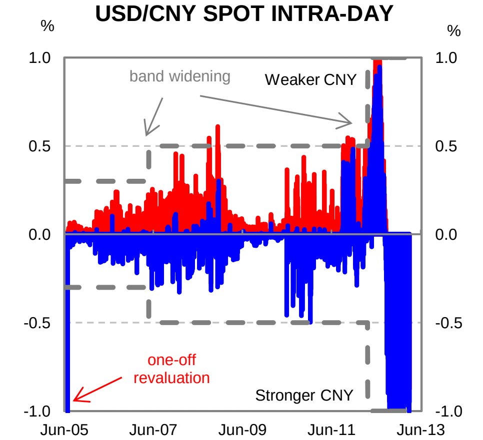
The SGD nominal effective exchange rate (NEER) remains little changed despite the weaker-than-expected non-oil domestic exports in February confirming the underperformance of the Singapore's trade sector relative to its Asian peers. However, with the semi-annual Monetary Authority of Singapore policy meeting scheduled to take place in three weeks, this week's February CPI (Monday) should garner investor interest. We expect Singapore's headline CPI to have edged higher in February. Against a neutral USD outlook, we expect USD/SGD to remain range bound. A positive resolution in Cyprus would weigh on USD/SGD.

AUD Crosses — One Week Bias

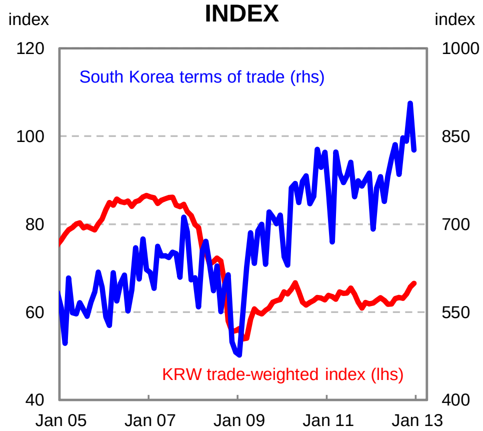
AUD/NZD — Neutral

AUD/NZD has ground back down towards 1.2500, with the NZD side of the pair helped by last week's stronger-than-expected Q4 NZ GDP data. With little in the way of top tier data due on either side of the Tasman, AUD/NZD is likely to consolidate around 1.2500 this week. We expect February trade data from New Zealand to show some weakening in dairy exports, as dry conditions result in lower production. The trade data typically doesn't have a lasting impact on NZD, or AUD/NZD, but we may

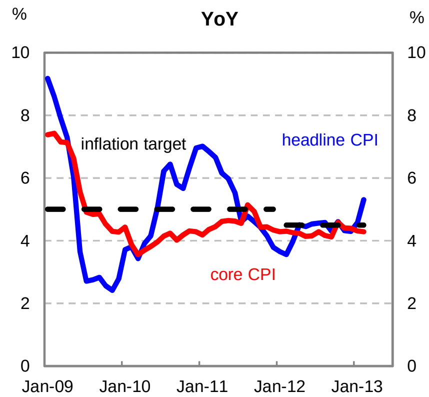
USD/CNY SPOT INTRA-DAY



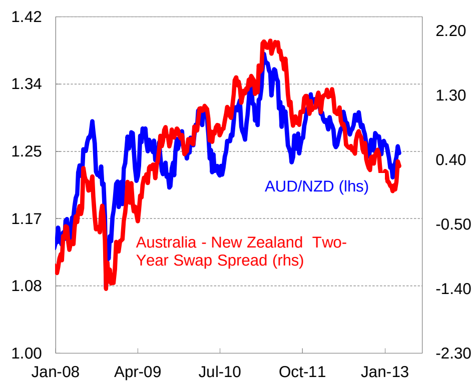
KRW TWI & TERMS OF TRADE INDEX



INDONESIA INFLATION



AUD/NZD TWO-YEAR SWAP SPREAD



see some short-term NZD softening if exports are weaker than expected.

AUD/EUR **Neutral**

AUD/EUR set a fresh 2013 high last week. But based on the broadly balanced risks in the Eurozone we think the near-term risks around AUD/EUR are also evenly balanced. Italian political concerns and/or a negative outcome in Cyprus risk weighing on EUR this week and support AUD/EUR. However, if the situation in Europe leads to a significant pickup in market volatility, and concerns that the crisis in Europe is re-intensifying, gains may be limited.

AUD/GBP **Neutral**

AUD/GBP has tracked sideways of recent sessions. Given the lack of significant market events in either the UK or Australia this week, movements in the cross should remain contingent on global developments. On balance, without a significant or sustained spike in volatility we expect AUD/GBP to respect its recent ranges in the near-term. However, over the medium-term, we continue to expect the UK's soft underlying economy to weigh on GBP. Given Asia's improving economic outlook and Australia's relative economic health, we think AUD/GBP can press higher over coming months.

AUD/JPY **Neutral**

AUD/JPY stopped just short of breaking through 100.00 last week (and the week prior), and has dipped as European concerns have led to a firmer JPY. We think AUD/JPY may edge lower this week, if Cyprus concerns increase. Alternatively, AUD/JPY could spike higher if there is a positive outcome. However, our medium- and long-term expectation of a structurally weaker JPY and higher AUD/JPY are unchanged.

AUD/CAD **Neutral**

AUD/CAD has pushed up over recent weeks, as question marks about the outlook for the Canadian economy have lifted. Over the short-term we think AUD/CAD is likely to consolidate these gains, without a further catalyst. The mix of Canadian economic data released this week should offset each other (see CAD section). Although the Eurozone concerns remain a market focus, both Australia and Canada have relatively low direct exposure to the problems in Europe (particularly Cyprus). However both currencies are sensitive to changing global growth expectations, risk sentiment and volatility.

European Crosses — One Week Bias

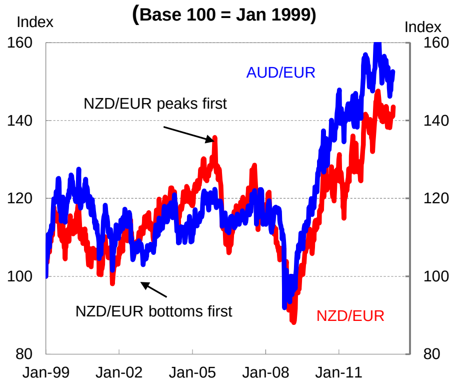
EUR/GBP **Neutral**

The developing situation in Cyprus should be the main influence on the EUR/GBP cross early this week. A positive outcome should push EUR/GBP higher, while a negative outcome would see the cross dip lower. While a negative resolution in Cyprus would weigh on EUR/GBP, from a fundamental standpoint we think the falls may not be substantial. Our core view continues to be that EUR/GBP will press higher over 2013. Fundamentally, the reduction in broader Eurozone tail risks, mixed with the UK's high inflation, large UK current account deficit (3.1% of UK GDP), probability of more BoE policy stimulus, and negative real UK yields are the main drivers of a higher EUR/GBP over 2013.

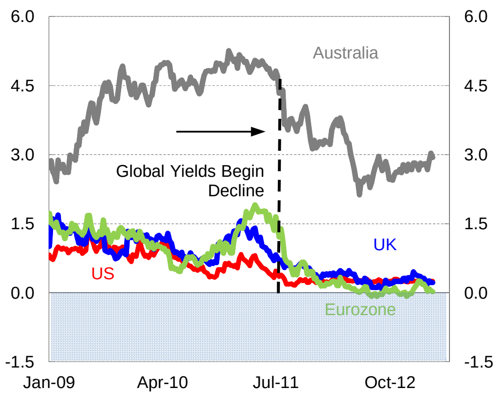
EUR/JPY **Neutral**

Eurozone concerns are likely to weigh on EUR/JPY, particularly early in the week. However, the evolving situation in Cyprus suggests that the risks around EUR remain balanced (see EUR section). On the JPY side of the equation, new BoJ Governor Kuroda's first slated policy meeting is not until 4 April. In the interim, market focus is likely to shift to what policy options he may unveil, particularly given Japan's weak fundamental backdrop (see JPY section). We retain our view that the JPY depreciation is being driven by the deterioration in Japan's current account surplus rather than BoJ machinations. This fundamental

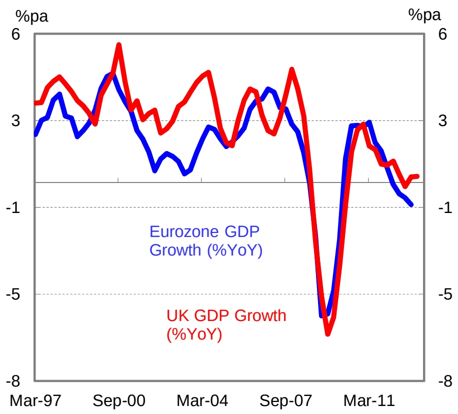
AUD/EUR & NZD/EUR
(Base 100 = Jan 1999)



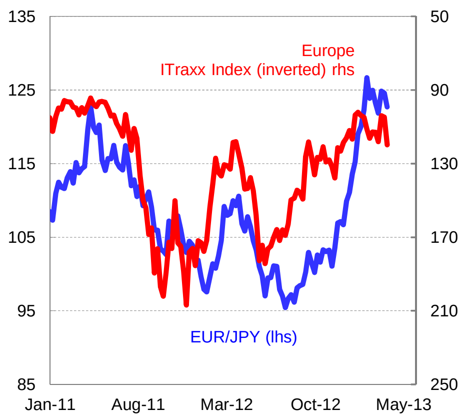
TWO-YEAR BOND YIELDS



UK & EUROZONE REAL GDP GROWTH



EUR/JPY AND EURO ITRAXX



change, overlayed with the reduction in broader Eurozone tail risks should see EUR/JPY lift to 138.00 by year-end.

EUR/CHF and USD/CHF **Neutral & Neutral**

Movements in EUR/CHF will be dictated by developments in Cyprus. A positive outcome would be EUR supportive, while a negative outcome would be EUR negative (CHF positive). Nonetheless, we expect the Swiss National Bank (SNB) to continue to successfully defend its EUR/CHF 1.2000 minimum exchange rate policy for the foreseeable future. Over the medium-term, we think a reversal in CHF safe-haven inflows will weigh on the CHF and help EUR/CHF grind higher. With respect to USD/CHF, the situation in Cyprus remains key for the near-term outlook. Given the SNB's FX reserve diversification, sustained CHF strength is somewhat limited. Furthermore, based on the SNB's exchange rate diversification, EUR/USD weakness often translates into USD/CHF strength. Hence, an increase in risk aversion and/or EUR weakness, stemming from a negative outcome in Cyprus should be USD/CHF supportive.

NZD Crosses — One Week Bias

NZD/AUD **Neutral**

NZD/AUD has ground back up towards 0.8000, with the NZD side of the pair helped by last week's stronger-than-expected Q4 NZ GDP data. With little in the way of data due on either side of the Tasman, NZD/AUD is likely to consolidate around 0.8000 this week. We expect February trade data from New Zealand to show some weakening in dairy exports, as dry conditions result in lower production. The trade data typically doesn't have a lasting impact on NZD, or NZD/AUD, but we may see some short-term NZD softening if exports are weaker than expected.

NZD/EUR **Neutral**

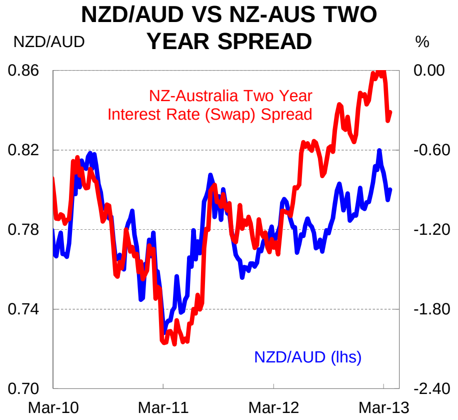
NZD/EUR set a fresh 2013 high last week. But based on the broadly balanced risks in the Eurozone we think the near-term risks around NZD/EUR are also evenly balanced. NZ trade data is unlikely to have a lasting impact on NZD. In contrast, the Italian political concerns and/or a negative outcome in Cyprus risk weighing on EUR this week. However, if the situation in Europe leads to a significant pickup in market volatility, and concerns that the crisis in Europe is re-intensifying, NZD/EUR gains may be limited.

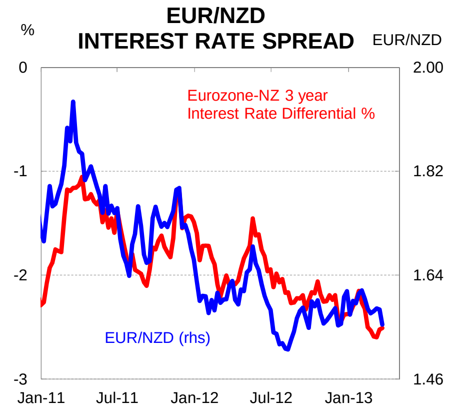
NZD/GBP **Neutral**

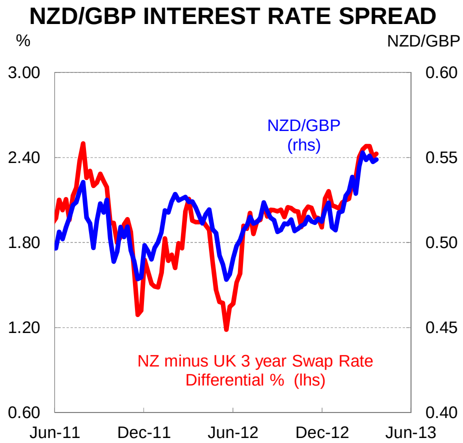
NZD/GBP has drifted sideways of recent sessions, around 1.5% below the highs set in late February and early March. Given the lack of significant market events in either the UK or New Zealand this week, movements in the cross should remain contingent on global developments. Without an unexpected spike in market volatility, NZD/GBP is likely to continue to trade within the recent range largely between 0.5420 and 0.5510 this week. However, over the medium-term, we continue to expect the UK's soft underlying economy to weigh on GBP. We think NZD/GBP can press higher over coming months, reflecting New Zealand's relative economic health, and its strong trade ties with strong growing economies in the Asian region. By contrast, the UK economy and in turn GBP should continue to struggle.

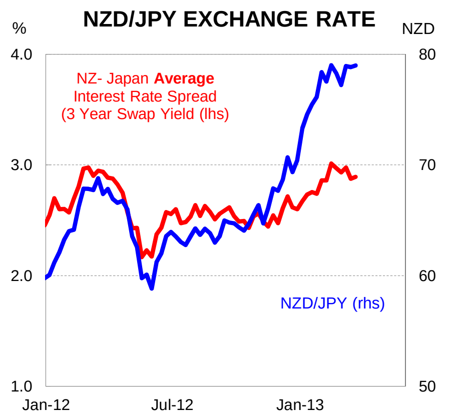
NZD/JPY **Neutral**

NZD/JPY has stopped short of breaking through 80.00 on three occasions in March, including last week. NZD/JPY dipped modestly on Friday as European concerns led to a firmer JPY. We think NZD/JPY may edge lower this week, if Cyprus uncertainty increases. However, our medium- and long-term expectation of a structurally weaker JPY and higher NZD/JPY are unchanged.









Foreign Exchange Forecasts

	End Period				
	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Majors					
EUR/USD	1.3200	1.3500	1.3700	1.3800	1.4000
USD/JPY	94.00	98.00	100.00	100.00	104.00
GBP/USD	1.5000	1.4800	1.4600	1.4600	1.4700
AUD/USD	1.0300	1.0400	1.0400	1.0400	1.0300
NZD/USD	0.8300	0.8400	0.8500	0.8500	0.8600
USD/CAD	1.0000	0.9900	0.9900	0.9800	0.9800
USD/CHF	0.9470	0.9370	0.9343	0.9348	0.9286
USD/CNY	6.2000	6.1600	6.1200	6.0000	5.9000
AUD cross rates					
AUD/EUR	0.7803	0.7704	0.7591	0.7536	0.7357
AUD/GBP	0.6867	0.7027	0.7123	0.7123	0.7007
AUD/JPY	96.82	101.92	104.00	104.00	107.12
AUD/NZD	1.2410	1.2381	1.2235	1.2235	1.1977
AUD/CAD	1.0300	1.0296	1.0296	1.0192	1.0094
AUD/CHF	0.9754	0.9745	0.9717	0.9722	0.9564
AUD/CNY	6.3860	6.4064	6.3648	6.2400	6.0770
AUD/SGD	1.2566	1.2636	1.2480	1.2376	1.2051
NZD cross rates					
NZD/EUR	0.6288	0.6222	0.6204	0.6159	0.6143
NZD/GBP	0.5533	0.5676	0.5822	0.5822	0.5850
NZD/JPY	78.02	82.32	85.00	85.00	89.44
NZD/AUD	0.8058	0.8077	0.8173	0.8173	0.8350
NZD/CAD	0.8300	0.8316	0.8415	0.8330	0.8428
NZD/CHF	0.7860	0.7871	0.7942	0.7946	0.7986
NZD/CNY	5.1460	5.1744	5.2020	5.1000	5.0740

	End Period				
	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
European cross rates					
EUR/JPY	124.08	132.30	137.00	138.00	145.60
EUR/GBP	0.8800	0.9122	0.9384	0.9452	0.9524
EUR/CHF	1.2500	1.2650	1.2800	1.2900	1.3000
EUR/AUD	1.2816	1.2981	1.3173	1.3269	1.3592
EUR/NZD	1.5904	1.6071	1.6118	1.6235	1.6279
GBP/JPY	141.00	145.04	146.00	146.00	152.88
GBP/CHF	1.4205	1.3868	1.3641	1.3648	1.3650
GBP/AUD	1.4563	1.4231	1.4038	1.4038	1.4272
GBP/NZD	1.8072	1.7619	1.7176	1.7176	1.7093
Non-Japan Asia					
USD/SGD	1.2200	1.2150	1.2000	1.1900	1.1700
USD/HKD	7.7500	7.7500	7.7500	7.7500	7.7500
USD/THB	29.80	29.40	29.20	28.90	29.00
USD/IDR	9700	9500	9200	9000	9000
USD/TWD	29.25	28.50	28.25	28.00	27.75
USD/KRW	1050	1025	1000	950	925
USD/MYR	3.07	3.00	2.90	2.85	2.80
USD/VND	22000	22000	22000	22000	22000
USD/PHP	40.50	40.00	39.50	39.00	38.50
USD/INR	53.50	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).

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