International Personal Bank

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July 2nd 2012

FX WEEKLY

FX Market Headlines

United States

Euro zone

Asia – focus on China

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FX Forecasts

		Forecasts			
		spot	0-3 mos	6-12 mos	long term
G10					
Euro	EURUSD	1.2602	1.24	1.15	1.30
Japanese yen	USDJPY	79.77	80.00	82.00	84.00
British Pound	GBPUSD	1.5671	1.55	1.46	1.65
Swiss Franc	USDCHF	0.9534	0.97	1.04	0.92
Australian Dollar	AUDUSD	1.0252	1.00	0.96	0.90
New Zealand Dollar	NZDUSD	0.8031	0.80	0.73	0.63
Canadian Dollar	USDCAD	1.017	1.03	1.00	0.97
Dollar Index	DXY	81.808	83.06	87.82	79.86
G10 crosses					
Japanese yen	EURJPY	100.52	99.00	94.00	109.00
Swiss Franc	EURCHF	1.20147	1.20	1.20	1.20
British Pound	EURGBP	0.8041	0.80	0.79	0.79
Swedish Krona	EURSEK	8.7521	9.00	8.65	8.50
Norwegian Krone	EURNOK	7.5337	7.50	7.45	7.35
Norwegian Krone	NOKSEK	1.1618	1.20	1.16	1.16
Australian Dollar	AUDNZD	1.2767	1.26	1.32	1.43
Australian Dollar	AUDJPY	81.775	80.00	79.00	76.00
Asia					
Chinese Renminbi	USDCNY	6.3497	6.33	6.35	6.15
Hong Kong Dollar	USDHKD	7.7564	7.75	7.76	7.75
Indonesian Rupiah	USDIDR	9384	9400	9650	9650
India Rupee	USDINR	55.485	54.00	55.50	52.30
Korean Won	USDKRW	1144	1140	1165	1080
Malaysian Ringgit	USDMYR	3.1612	3.10	3.14	2.95
Philippine Peso	USDPHP	41.83	42.1	42.5	40.8
Singapore Dollar	USDSGD	1.2671	1.25	1.28	1.21
Thai Baht	USDTHB	31.59	30.70	31.90	30.00
Taiwan Dollar	USDTWD	29.878	30.30	28.80	28.50
EMEA					
Czech Koruna	EURCZK	25.51	25.90	26.30	24.70
Hungarian Forint	EURHUF	285.83	275.00	290.00	290.00
Polish Zloty	EURPLN	4.2184	4.21	4.55	3.90
Israeli Shekel	USDILS	3.9061	3.95	4.00	4.00
Russian Rouble	USDRUB	32.6346	33.40	35.60	33.00
Russian Rouble Basket	RUBBASK	36.4554	37.00	38.00	37.50
Turkish Lira	USDTRY	1.8078	1.78	1.88	1.85
South African Rand	USDZAR	8.1489	8.40	8.85	8.85
LATAM					
Brazilian Real	USDBRL	2.0094	2.01	1.95	1.85
Chilean Peso	USDCLP	500.75	493.00	508.00	490.00
Mexican Peso	USDMXN	13.326	13.40	13.70	12.20
Colombian Peso	USDCOP	1781.87	1,763.00	1,820.00	1,800.00

Spot rates 02 July 2012, FX Forecasts as of 25th June 2012

United States: Commonly accepted wisdom based on a combination of models and experience is that an international investment position (IIP) bigger than +30% of GDP or smaller than -30% is a problem. On the IIP surplus side, having too big of a net creditor position leads to a perennially strengthening currency that chokes out industry and stokes deflation. On the IIP deficit side, having too big of a net debtor position leads to a debt spiral. High debt leads to reluctant external creditors charging ever higher interest rates, which leads to economic stagnation and ultimately crisis. This blueprint has played out a number of times in emerging market economies.

Data released last week show a new record debtor balance for the US of 27% of GDP. The US dollar is not an emerging market currency, of course. It is not like any other G10 currency, either. As the global numeraire, it has been able to remain the undisputed principal reserve currency despite the US being a net debtor nation since 1985. With that in mind, it seems likely that the International Investment Position (IIP) deficit threshold that would put the US in a debt spiral is higher than for other countries. At present, with the US bond market still able to attract foreign investors at 10Y yields below 2%, a crisis appears a long ways away. The US may not be able run another dozen years of 3-6% current account deficits without starting to look like a ponzi scheme, but it can probably run another few years without problems, particularly if there is no other reasonable alternative as a reserve currency. At this stage, EUR is not credible and CNY is not ready in terms of FX liquidity or capital market depth and transparency. If/when the US finally gets close to the critical IIP threshold that makes foreign investors nervous, two things should happen. First, the USD should cease to appreciate during bouts of global risk aversion and begin to depreciate. Perhaps at an early phase the 'beta' of the USD relative to global equities will start to evolve from distinctly negative towards positive. There are no signs of this happening. The second thing that should happen as the US approaches an external debt spiral is that US rates should rise rather than decline during risk aversion episodes. At this stage, there is no evidence of even a moderation in the 'beta' of US bond yields relative to global yields.

EURO ZONE: EURUSD has lost some of its upward impetus most recently in a sign that last week's post-EU summit enthusiasm is already fading. The euro zone leaders indicated they are willing to take steps to alleviate further short-term selling pressure on Italian and Spanish bonds. They also took important steps towards a euro zone banking union with centralized supervisory body and bank restructuring mechanism relying on the ESM. Some questions remained unanswered, however. Among these is the issue with the pan-European bank deposit insurance guarantee. In addition, there was little new on the move towards closer fiscal integration considered by many the road to euro zone bonds and thus the only sustainable solution of the debt crisis. Citi Analysts suspect that the absence of more clarity on euro zone bonds and the still limited firepower of the euro zone bailout facilities (according to the current plans, the ESM will have only EUR32bn of paid-in capital or EUR200bn of firepower by end of 2012) will likely leave the pressure on the ECB to act very much in place. Ahead of the regular monetary policy meeting on July 5 market consensus is looking for a 25bp cut of the main refinancing rate. In addition, Citi economists also expect a 10bp cut of the deposit rate. Citi Analysts think that market participants will pay particular attention to the prospects for more unconventional ECB monetary policy measures. More and longer-term LTRO programs may be needed given the still weak euro zone lending data and the recognition that, in the absence of euro zone bonds, domestic demand will have to absorb the supply of sovereign paper going forward.

Citi Analysts think that more (conventional and unconventional) easing measures by the ECB later this week could add to the cyclical headwinds for the single currency across the board, turning it into even more attractive funding currency. In addition, like in case of the first two 3y LTROs, it may take time for any new unconventional measures to alleviate the selling pressure on the Spanish and Italian bonds. All this would

suggest that EURUSD could resume its slide before long. With the euro zone tail risks moving lower after the EU summit, we think that G10 smalls could remain resilient against the single currency in the very near term.

ASIA – focus on China: Citi Analysts expect a growth rebound in H2 with sustained policy easing – Growth appears to have stabilized, although at a low level. Q2 growth may be falling to 7.3% YoY in the absence of a strong lift from Jun. Meanwhile, inflation is likely to stay below 3% in the next few months, creating room for further policy easing. Citi Analysts expect the government to fully utilize the scope under the current policy mix, which would facilitate a growth rebound in Q3. Citi Analysts downgrade annual growth from 8.1% to 7.8% to reflect anaemic domestic activity in Q2 and further weakening of demand from the EU. More decisive policy easing, but no large-scale stimulus – Unless the debt problem in Europe escalates to a full-blown economic and financial crisis and results in a deep recession in the continent, Citi Analysts think the Chinese government does not have the appetite to introduce a 2008-09 type of stimulus, as the negative fallout of the last stimulus—such as LGFV debt and property bubble—still lingers. Instead, Citi Analysts expect two more rate cuts to boost demand, two more RRR cuts to bring money growth to 14%, expansionary fiscal policy within the limit of the budget, and targeted property policy easing to prevent an investment slump. Citi Analysts are constructive about new leaders' ability to deliver reform – The current government has surprised the market by introducing reforms, including steps toward exchange rate and interest rate liberalization, in the last year of its tenure. The need for reform appears to have been recognized by the hopefuls of the new leadership. In making forecasts for 2013 and beyond, Citi Analysts assume the new government would tolerate slower growth for better quality, introduce reforms to correct cost distortions, and deregulate investment to encourage private sector involvement. Growth may stay below potential, but structure may improve – Cost normalization may increase inflationary pressures. To contain inflation, the new government may accept lower-than-potential growth. As a result, China's economy may not grow at full capacity in the near future. Citi Analysts expect growth to rebound slightly in 2013 to 7.9%, benefiting from the spill over from policy easing in 2012, but medium-term growth may approach 7%. The correction of over-investment and government policies to support consumption will likely decelerate investment more than consumption, causing investment to GDP ratio to decline as early as in 2013-2014. An escalation of the European debt crisis may cause hard landing – In a simplistic scenario where a full-blown debt crisis deepens a euro area recession to -2%, weaker external demand—including spill over to China's other trading partners—may further cut China's growth by nearly 1ppt. This could cause a second-round effect on domestic demand due to higher unemployment in export-oriented industries, resulting in growth below 7% in the absence of additional policy support.

The Week Ahead

USD:

- ***July 2nd, a Francisco Fed President Williams to appear on a panel discussing "Federal Reserve Policy Since the Financial Crisis" at the Annual Conference of Western Economic Association International jointly with the International Banking, Economics and***
  Finance Association.

- ***July 2nd, ISM Mfg. Activity Index (Jun): Citi. 51.0, May 53.5, April 54.8, March 53.4, Feb 52.4, Jan 54.1***
- ***July 2nd, Construction PIP (May): Citi. 0.0%,*** **April 0.3%, March 0.3%, Feb -0.4%, Jan -0.7%, Dec 1.1%**
- ***July 3rd,*** **Factory Orders (May): Citi. 0.1% , Apr -0.7 %, Mar -2.1 %, Feb 1.5 %**
- ***July 3rd,*** **Total Motor Vehicle Sales (Jun): Citi. 13.7M, May 13.7M, April 14.4M, Mar 14.3M, Feb 15.0M, Jan 14.1M, Dec 13.5M**
- ***July 5th,*** **Initial Jobless Claims (Jun 30): Citi. 390K, 23rd Jun 386, 16th Jun 392, 9th Jun 389, 2nd Jun 380, 26th May 389**
- ***July 5th, ISM Non Manufacturing Index (Jun): Citi. 52.5, May 53.7, April 53.5, March 56.0, Feb 57.3***
- ***July 6th,*** **Nonfarm Payrolls (Jun): Citi. 110K, May 69K, Apr 77K, Mar 143K**
- ***July 7th, Unemployment: Citi 8.2%, May 8.2%, Apr 8.1%, Mar 8.2%***
- ***July 7th, Average Hourly Earnings: Citi 0.2%, May 0.1%, Apr 0.1%, Mar 0.2%***
- ***July 7th, Private Workweek Data: Citi, 34.5H, May 34.4H, Apr 34.5H, Mar 34.5H***

GBP:

- ***Jun 26, Public Sector Net Borrowing (May) Forecast: £15.0 bn deficit, £1.5 billion surplus fiscal year to date (Figures Exclude Costs of Financial Intervention) Year Ago: £15.0 bn deficit, £24.0 billion deficit fiscal year to date –*** *Citi analysts expect the underlying fiscal deficit in May will be similar to a year ago, although the large surplus in April (helped by the assets from the state-owned postal service) will keep the year-to-date total much better than last year. Revenues have slowed sharply in recent months, and this weakness is likely to continue given the sharp slowdown in the economy.*
- ***July 2nd, Manufacturing PMI (Jun), Forecast: 45.0, Prior: 45.9***
- ***July 4th, Services PMI (Jun), Forecast: 52.0, Prior: 53.3***
- ***July 6th, Producer Input Prices (Jun), Forecast: -2.0% MoM, -2.0% YoY, Prior: -2.5% MoM, 0.1% YoY***
- ***July 6th, Producer Output Prices (Jun), Forecast: 0.1% MoM, 2.7% YoY, Prior: -0.2% MoM, 2.8% YoY***
- ***July 6th, Output Prices Ex Tax (Jun), Forecast: 0.0% MoM, 2.4% YoY, Prior: -0.2% MoM, 2.7% YoY***
- ***July 6th, Output Prices Excluding Food, Drink, Tobacco, Energy (Jun), Forecast: 0.0% MoM, 2.0% YoY, Prior: 0.0% MoM, 2.1% YoY***
- ***July 10th, Industrial Production (May), Forecast: 0.1% MoM, -1.7% YoY, Prior: 0.0% MoM, -1.0% YoY***
- ***July 10th, Manufacturing Output (May), Forecast: 0.5% MoM, -1.3% YoY, Prior: -0.7% MoM, -0.3% YoY***

EUR:

- ***July 2nd, Manufacturing PMI, Jun Final, Forecast: 44.7, Prior: 45.1***
- ***July 2nd, Unemployment Rate, May, Forecast: 11.1%, Prior: 11.0%***
- ***July 3rd, Industrial Producer Prices, May, Forecast: -0.4% MM, 2.4% YY, Prior: Unch MM, 2.6% YY***
- ***July 4th, Services PMI, Jun Final, Forecast: 46.7, Prior: 46.8***
- ***July 4th, Composite PMI, Jun Final, Forecast: 45.9, Prior: 46.0***
- ***July 4th, Retail Sales, May, Forecast: 0.3% MM, Prior: -1.2% MM***
- ***July 4th, GDP, 1Q Final, Forecast: Unch% QQ, Prior: -0.3% QQ***

AUD:

- ***July 3rd, Building Approvals, May, Forecast: 2.0%, Previous: -8.7%***
- ***July 3rd, RBA Board Meeting, Forecast: no change, Previous: -25bps***
- ***July 4th, Retail Sales, May, Forecast: -0.2%, Previous: -0.2%***
- ***July 5th, Trade Balance, May, Forecast: -$A900mn, Previous: -$A203mn***

JPY:

- ***July 2nd, BoJ Quarterly Tankan Survey, Large Mfg. Business Conditions (Jun),*** **Forecast: -5, Previous: -4**
- ***July 2nd, Large Nonmfg. Business Conditions (Jun),*** **Forecast: 5, Previous: 5**
- ***July 2nd, Small Mfg. Business Conditions (Jun),*** **Forecast: -12, Previous: -10**
- ***July 2nd, Small Nonmfg. Business Conditions (Jun),*** **Forecast: -11, Previous: -11**

- ***July 2nd, Fiscal 2012 Capital Spending Plans, Large Firms (Jun),*** **Forecast: 4.5, Previous: 0.0**
- ***July 2nd, Fiscal 2012 Capital Spending Plans, Small Firms (Jun),*** **Forecast: -11.5, Previous: -12.9**