International Personal Bank

May 28th 2012

FX Market Headlines

United States

Euro zone

Australia

Japan

United Kingdom

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FX Forecasts

		Forecasts			
		spot	0-3 mos	6-12 mos	long term
G10					
Euro	EURUSD	1.2533	1.23	1.25	1.30
Japanese yen	USDJPY	79.4800	80.00	80.00	85.00
British Pound	GBPUSD	1.5684	1.57	1.58	1.65
Swiss Franc	USDCHF	0.9589	0.98	0.97	0.96
Australian Dollar	AUDUSD	0.9838	0.93	0.95	0.90
New Zealand Dollar	NZDUSD	0.7599	0.72	0.73	0.63
Canadian Dollar	USDCAD	1.0254	1.03	1.00	0.97
Dollar Index	DXY	82.22	83.41	82.13	80.17
G10 crosses					
Japanese yen	EURJPY	99.6100	98.00	100.00	111.00
Swiss Franc	EURCHF	1.2019	1.20	1.21	1.25
British Pound	EURGBP	0.7991	0.78	0.79	0.79
Swedish Krona	EURSEK	8.9684	9.20	8.75	8.65
Norwegian Krone	EURNOK	7.5317	7.70	7.50	7.50
Norwegian Krone	NOKSEK	1.1907	1.19	1.17	1.17
Australian Dollar	AUDNZD	1.2946	1.29	1.30	1.43
Australian Dollar	AUDJPY	78.1910	74.00	76.00	77.00
Asia					
Chinese Renminbi	USDCNY	6.3331	6.33	6.21	6.11
Hong Kong Dollar	USDHKD	7.7627	7.75	7.76	7.75
Indonesian Rupiah	USDIDR	9482	9300	9400	9300
India Rupee	USDINR	55.38	54.00	55.00	51.00
Korean Won	USDKRW	1179	1176	1135	985
Malaysian Ringgit	USDMYR	3.1430	3.14	3.01	2.95
Philippine Peso	USDPHP	43.6	43.0	42.0	51.5
Singapore Dollar	USDSGD	1.2779	1.27	1.23	1.19
Thai Baht	USDTHB	31.63	32.00	30.20	30.00
Taiwan Dollar	USDTWD	29.63	30.30	28.80	28.20
EMEA					
Czech Koruna	EURCZK	25.3620	25.60	25.00	24.00
Hungarian Forint	EURHUF	299.3300	295.00	285.00	290.00
Polish Zloty	EURPLN	4.3474	4.55	4.25	3.90
Israeli Shekel	USDILS	3.8523	3.90	3.95	3.90
Russian Rouble	USDRUB	32.0931	31.30	32.10	32.20
Russian Rouble Basket	RUBBASK	35.7426	34.50	35.80	36.50
Turkish Lira	USDTRY	1.8386	1.86	1.90	1.85
South African Rand	USDZAR	8.3493	8.45	8.50	8.75
LATAM					
Brazilian Real	USDBRL	1.9800	2.04	1.91	1.85
Chilean Peso	USDCLP	509.4500	516.00	492.00	490.00
Mexican Peso	USDMXN	13.9520	14.10	13.40	12.20
Colombian Peso	USDCOP	1828.4900	1,815.00	1,811.00	1,850.00

Spot rates end of day 28th May 2012, FX Forecasts as of 18th May 2012

US: Despite favorable undercurrents in highly cyclical areas like autos and housing, the U.S. economic recovery confronts a major downside threat from a sharp planned deficit reduction in 2013. The convergence of sweeping tax increases and spending restraints totaling 5% of GDP (calendar-year basis) would likely halt economic growth, while avoiding this fiscal cliff altogether would leave in place longer-term risks to growth from crowding out. Of the two extreme policy options, Citi Analysts worry more about allowing the full brunt of current law that could unleash severe second round effects difficult to anticipate in standard model simulations. Monetary policy cannot effectively buffer a large-scale fiscal shock, and an already serious long-term unemployment problem could morph into a more significant structural challenge. Officials also need to weigh the uncertain feedback effects of another U.S. recession on a vulnerable global financial system. Importantly, prospective changes do not entail any structural reform to retirement and health care programs at the heart of rising public debt projections. Extended and emergency unemployment benefits are phasing out early. As a result, Citi Analysts can expect some modest fiscal drag in the second half of the year. Also, since many of the people losing benefits will either find jobs or leave the workforce, the unemployment rate is likely to tick down.

EURO ZONE: Citi Analysts argue that the ESM ratification process is probably not sufficiently advanced to have the permanent rescue facility fully operational by 1 July 2012, as stipulated by the 17 euro area member states that signed the ESM treaty on 2 February 2012. Only three euro area countries have ratified the ESM to date and no contributions have been made so far towards paying the first €16bn capital tranche. Furthermore, the French presidential elections and the negotiations between the German government and the opposition, as well as the upcoming Irish referendum, have introduced some uncertainty about the timing of the Fiscal Compact Treaty (FCT) ratification. The FCT score currently stands at 4/25. Nevertheless, Citi Analysts believe that if “Grexit” occurred it would give rise to far-reaching policy responses, involving the ECB, the European Council, the EFSF/ESM and the European Commission, which should contain Grexit in the sense that no other country would be forced to exit EMU and that the European Banking system would continue to function. Citi Analysts list a range of measures, assess their likelihood and gauge their relevance from a financial market standpoint.

AUSTRALIA: The RBA policy outlook - Citi Analysts do not agree with the quantum of RBA rate cuts priced by the market. In this essay Citi Analysts point out why the market’s expectation for large cuts to the cash rate target is unlikely to be realised in the current policy cycle. Instead, Citi Analysts present evidence to support a more moderate pace of monetary policy easing. Citi Analysts core view is that the RBA will cut by 25 bps in Q3 and that a further cut in Q4 is a possibility. In policy Citi Analysts trust - The markets expected RBA policy path implies that the domestic economy will hit stall speed. Since the previous edition of this publication, market expectations for the RBA cash rate target have retreated further into the realm of highly accommodative policy. At the time of writing, the equivalent of almost six 25 bps rate cuts is priced-into the 30 day interbank curve over the next nine months. If the RBA were to deliver such an outcome, it would equate to a negative real cash rate using Citi Analysts forecast for the CPI. Such an outcome is generally associated with an economy that is close to stall speed or flat-lining. In reality, RBA pricing reflects the fear of what could occur in Europe following a potential “Grexit”. Explaining the market’s assessment of the RBA’s interest rate path comes back to factoring in the uncertainty wrought by Greece’s potential exit from the single currency union and the potential fallout from this event. This driver of RBA interest rate pricing is powerful and could remain for a considerable period of time, potentially pushing out current expectations for monetary policy well into the future. Citi Analysts doubt though, that rolling out current pricing into the future makes it more likely that the RBA will vindicate such pricing without evidence of a threat to domestic growth. While Citi Analysts have downgraded Australian growth forecasts, Citi Analysts do not see the sub-trend pace of growth continuing into 2013. Financial conditions support moderate Australian growth - Regular readers of our publications will know that Citi Analysts track financial conditions for Australia. Citi Analysts financial conditions index adjusts for changes in variables that influence household spending. It is particularly adroit at capturing turning points in aggregate economic activity and provides a useful risk indicator for Citi Analysts top-down GDP forecasts. Conditions remain in negative territory but improved slightly in April from -1.6 to -1.2 standard deviations below neutral, consistent with around 2.0% yearly GDP growth over the next quarter. This is below Citi Analysts top-down forecast and below the potential rate of growth, but is above what Citi Analysts could consider stall-speed. Explaining the current level of financial conditions is the decline in household wealth associated with weaker equities and sluggish credit growth. Citi Analysts view the RBA's May interest rate cut as an important condition to unwinding some of the tightness in financial conditions for households in coming months. Financial conditions support more easing, just not the quantum expected by the market. An important distinction between financial conditions now and those that predated the last time the RBA took official interest rates to a new low is that conditions are better now than at the time of the GFC. If financial conditions had retreated back to their historical low then Citi Analysts would consider the possibility of a highly accommodative cash rate as a central view, rather than as a tail risk. Citi Analysts expectation of 25 bps of policy easing in Q3 with the potential for an insurance cut in Q4 would further support financial conditions and therefore economic growth. The currency's cameo role - A weaker currency would potentially lessen Australia's economic divide… The decline in the Australian Trade Weighted Index (TWI) over the past three months has been more than 7.0%. Citi Analysts London based macro team expects the AUD to decline further over the course of 2012. Their forecasts imply the Australian TWI declining by a total of almost 12% by Q3 2012. In theory, such a decline in the exchange rate would be expected to create less of a two-speed economy by lifting the performance of export sectors that have found their competitive positions weakened against foreign alternatives (the substitution effect) while Australian consumers would experience less purchasing power for imports (the income effect). …but add to inflation concerns. The flipside of the potential boost to external competitiveness is that traceable inflation would also receive a boost. This is something that the RBA has mentioned as an upside risk to overall inflation. However, the RBA's inflation forecasts have been run on the assumption of the TWI at 76 points, not at Citi Analysts implicit medium-term TWI forecast of 71 points. The RBA is unlikely to consider the aggressive easing in policy expected by the market if they were to make downside changes to the exchange rate assumption when preparing future forecasts for inflation. Sustained currency depreciation could add to government revenue. A lower currency would probably provide a small amount of relief to the Federal Government's revenue estimates that have been subject to downward revision, most recently in the 2012-13 Federal Budget. A boost to offshore driven tax receipts when converted back into AUD would lift company sourced tax revenue, specifically from overseas operations of Australian listed mining companies. What could go wrong? If Europe's banks stutter, then the game changes. Despite o Citi Analysts best analysis, Citi Analysts do not pretend to be able to eliminate the downside risks completely. There is a huge amount of uncertainty about the extent of any post Grexit contagion and the policy responses that could be employed. Low probability downside events cannot be completely dismissed when their impact, if realized, would be large. In the event that the European banking system experiences problems, then Citi Analysts would expect that the market's expectation for the RBA's future policy path would not just be realized, but potentially exceeded. If China's slowdown is more severe, then policy will be lower than Citi Analysts expect. Policy makers are moving to shore up growth through the announcement of targeted fiscal policy. Citi Analysts expect more of this and further RRR cuts to boost growth in the second half of the year. But if further easing is delayed, then the slowdown could become more protracted, spilling over into other economies with a high export dependence on China's boom. This would obviously be a concern to the RBA. Timing - Citi Analysts don't believe that the RBA will cut rates at the June Board meeting. The surprise fall in the unemployment rate to 4.9% does not support a follow up cut after the May rate cut. Waiting until at least July will also provide a clean reading on consumer sentiment, which Citi Analysts suspect was muddied in May by the release of the Federal Budget. Holding back until July also allows the RBA to incorporate the outcome of the Greek election into the policy calculus. July then looms as the next likely candidate, but Citi Analysts are slightly more persuaded by the August meeting. This date follows the release of the Q2 CPI data and provides enough of a time lag to assess the impact of the May rate cut. Such a move would take the cash rate target to 3.50%, a level that is mildly expansionary and support acceleration in economic activity in 2013.

JAPAN: More Bank of Japan (BoJ) easing under stable growth likely: The BoJ stands pat last week — The Bank of Japan policy board unanimously left monetary policy unchanged last week as widely expected. Apparently, policymakers want to remain in a monitoring mode after having expanded the asset purchase program twice this year. Over the near term, yen appreciation might push the BoJ to act further... — if upward pressure on the yen intensifies in the global context of risk aversion, the BoJ might increase the asset purchase program in June or July. ...Over the longer term — If as Citi Analysts anticipate, actual inflation shows compelling signs of undershooting the BoJ's official forecasts, the BoJ will have to introduce more easing measures even if the economy continues to grow stably, in line with our scenario. If the size of the asset purchase program is not expanded further, starting next January, the amount of JGBs purchased under the program would roughly halve from the current amount of ¥2.1trn per month.

UK: Heading for Extra Stimulus - The case for extra stimulus is rapidly coming together in the UK, reflecting weak economic data, slowing inflation and the escalating EMU crisis. Real GDP has fallen significantly for two consecutive quarters and nominal GDP growth is down to just 1.9% YoY — a woefully inadequate pace and far below the pre-crisis norm of 5-5½% YoY. Citi Analysts expect UK growth to be around zero this year. Moreover, in Citi Analysts view, the long period of inflation stickiness (caused chiefly by the huge overheating in the economy during the boom and the pound's plunge in 2007-09) is now coming to an end. YouGov report that inflation expectations have fallen back and, barring new external cost pressures, CPI inflation is likely to fall below target next year. Citi Analysts continue to expect a sizeable further expansion of QE, with the next instalment soon, perhaps even in June. The MPC should also cut Bank Rate, in Citi Analysts view, although Citi Analysts do not include a cut in central forecast. Other additional options for stimulus — credit easing and temporary fiscal stimulus — also are coming into play, especially if the EMU crisis escalates. The UK's economic position and prospects are sufficiently gloomy that action is more likely and less risky than inaction, in Citi Analysts view.

The Week Ahead

USD:

- ***May 30, Fed President Fisher to speak about Federal Reserve Operations and Economic Update in San Antonio.***
- ***May 30, Fed resident Dudley to give a press briefing on job polarization and rising inequality in the region.***
- ***May 30, Fed President Rosengren to speak at the 27th Annual meeting of the Worcester Regional Research Center.***
- ***May 31, Fed President Pianalto to speak to the National Association for Business Economics in Cleveland.***
- ***May 29, May Consumer Confidence: Citi. 70.5, April 69.2, March 69.5, Feb. 71.6, Jan. 61.5 -*** *Consumer confidence likely edged higher in May, following the bump up in the Michigan survey.* ***Note:*** *Confidence raised this high in early 2011 only to slump back to the low 40's in October. But May would mark the fourth month that the index held the current range. Also, the more stable present situation sub-index established a new recovery high in April. Taken together, these factors suggest that confidence is presently establishing a healthier footing to grow from.*
- ***May 31, Q1 Real GDP (Prelim.) Percent Change at Annual Rate Unless Noted: Citi. 1.8 %, Q1'12 (A) 2.2 %, Q4'11 3.0 %, Q3'11 1.8 %, Q2'11 1.3 % -*** *Based on the most recent economic data, the Commerce Department seems to have overestimated first quarter real GDP in the advance release. Most of the overstatement was in inventory accumulation. Domestic demand probably will not be revised much, as upward adjustments to business investment likely will be offset by downward revisions to state and local government spending.* ***Note:*** *The expected GDP revisions actually have repercussions for the near-term growth outlook. Formerly, it had appeared as if an overabundance of inventories in the first quarter would lead to a pullback in second quarter growth. But, the expected revisions indicate that there was no material overshoot in inventories at the start of the year. So, there won't be a correction that hampers overall growth.*

- ***May 31, May Chicago Purchasing Managers' Index: Citi. 59.0, April 56.2, March 62.2, Feb. 64.0 -*** *The Chicago purchasing managers' index probably rebounded in May, after a surprising six-point drop in April. The manufacturing sector continues to outperform the rest of the economy, and with the motor vehicle sector on the upswing, the Chicago area is likely to remain among the most robust regions.* ***Note:*** *There may be some downside risk to our forecast bounce-back, however. The Chicago business index has been incredibly strong and out of step with other manufacturing gauges. There is a chance that the April figure wasn't an odd print that will reverse, but was instead a normalization of this series.*
- ***Jun 1, May Employment Situation (Thousands Unless Indicated): Total Employment – Citi. 135, April 115, March 154, Feb. 259; Unemployment Rate (Percent) – Citi. 8.1, April 8.1, March 8.2, Feb. 8.3 –*** *Citi analysts think the payback for the boost from mild weather continued in May. So Citi analysts expect another soft reading on nonfarm payroll employment that could be accentuated by springtime seasonal factors. However, this may be the last of the payback. Citi analysts anticipate a pickup in job gains back to the 175,000 per month trend by summer.* ***Note:*** *Citi analysts look for no change in the unemployment rate, but there are risks on both sides. The latest two reports featured big declines in the labor force, which could rebound and at the same time boost the jobless rate. What keeps us from forecasting an increase is the fact that many workers' extended unemployment benefits are being eliminated because state unemployment trigger criteria are no longer being met. Upon losing their benefits, these people may leave the labor force or take new jobs. However, Citi analysts think this is more a June story.*
- ***Jun 1, April Personal Income and Consumption (Percent Change): Personal Income – Citi. 0.2 %, March 0.4 %, Feb. 0.3 %, Jan. 0.3 %; Personal Spending – Citi. 0.3, March 0.3, Feb. 0.9, Jan. 0.5; Core PCE (12-Month Percent Change) – Citi. 2.0, March 2.0, Feb. 1.9, Jan. 1.9 -*** *The April employment report, featuring a modest payroll gain and no change in hours or earnings, signaled a small increase in personal income. Meanwhile, solid core retail sales and a weather-related bounce-back in utilities usage suggested a bigger increase in spending. The net effect is a slight downtick in the savings rate.* ***Note:*** *Citi analysts are encouraged by the fact that consumer spending has held up even after motor vehicle sales have flattened out after huge gains around the turn of the year. Further, Citi analysts think that the recent drop in energy prices could give an added lift to spending in coming months.*
- ***Jun 1, May ISM Manufacturing Activity Index: Citi. 53.0, April 54.8, March 53.4, Feb. 52.4, Jan. 54.1, Dec. 53.1 -*** *The ISM manufacturing activity gauge has been in a fairly tight range for the past year and Citi analysts don't anticipate a break out in the May report. Citi analysts forecast is consistent with other regional survey results.* ***Note:*** *The April print moved to the high side of the recent range and the strength was in the new orders and production sub-indexes, which often lead the headline ISM figure. As a result, Citi analysts see upside risk to this release.*

CAD:

- ***Jun 1, Real GDP (1Q): Citi Forecast 2.0%, Median 1.8%, Last 1.8%: Moderate Expansion in Tow*** *– The Canadian economy likely expanded by 2.0% annualized in the first quarter of this year after a subdued 1.8% annualized gain in the final quarter of last year. (Upward revisions to monthly external trade data hint at a possible upward revision to the 4Q 2011 GDP print.) The economy probably continued to operate just above its production potential and well short of the Bank of Canada's forecast 2.5% annualized pace, published in the April Monetary Policy Report. On balance, it appears that the economy is growing at a slower clip in the first half of 2012 than the central bank anticipated. Moreover, key uncertainties loom and the potential for intensification of certain downside risks is significant. These factors, along with near 2% inflation and roughly balanced risks, should keep the BoC on the sidelines through yearend.*

GBP:

- ***1 Jun, Manufacturing PMI (May) Forecast: 49.8, Prior: 50.5*** *- Citi analysts expect to see a further drop in this index as the EMU crisis hits euro area growth. A figure in line with our forecast would put this index below 50 for the first time since last November.*

EUR:

- ***May 30, Euro zone M3, Apr Forecast: 3.2% YY, 3.1% 3-M YY, Prior: 3.2% YY, 2.8% 3-M YY*** *- Following consecutive monthly increases Citi analysts expect a decline in April. However, the YY rate is likely to remain unchanged at 3.2% YY. Despite the December and February 3Y LTROs Citi analysts expect the weakness in loan growth to continue. Citi analysts expect a contraction of loans to households and companies of 0.2% MM.*
- ***May 30, Euro zone Economic Confidence, May Forecast: 91.0, Prior: 92.8; Industrial Confidence, May Forecast: -11, Prior: -9; Consumer Confidence, May Forecast: -19, Prior: -20*** *- Despite the small increase in the flash estimate of consumer sentiment, Citi analysts expect that a fall in sentiment among companies will contribute to a third consecutive fall in the Economic Sentiment reading. If our forecast is correct, it would be the lowest reading since October 2009, one standard deviation below the long-term average.*
- ***May 31, Euro zone HICP Flash Estimate, May Forecast: 2.5% YY, Prior: 2.6% YY*** *- After an unchanged reading for two consecutive months, a fall in oil and fuel prices probably contributed to a decline in the headline inflation rate in May. This would be the lowest reading since February 2011.*
- ***Jun 1, Euro zone Manufacturing PMI, May Final Forecast: 44.7, Prior: 45.9*** *- Citi analysts expect a downward revision of the flash estimate for the May manufacturing PMI, as confidence in the sector probably deteriorated further in the second half of the month.*
- ***Jun 1, Euro zone Unemployment Rate, Apr Forecast: 10.9%, Prior: 10.9%*** *- Citi analysts expect a further increase in seasonally adjusted unemployment in April, but the unemployment rate is likely to remain unchanged at the highest reading since the introduction of the euro in 1999.*

AUD:

- ***30 May, Retail Sales, Apr Forecast: 0.2%, Previous: 0.9% -*** *Retail sales growth should decelerate in April from the extremely strong unexpected increase in March. Consumer sentiment fell in April and petrol price gains eroded disposable incomes slightly. Citi analysts expect that the trading environment for large retailers was challenging and consider the risks to Citi analysts forecast as largely to the downside.*
- ***31 May, Private Sector Capex, Q1 Forecast: 0.1%, Previous: -0.3% -*** *The level of total capital expenditure look set to begin 2012 only marginally higher than where it finished 2011. The small overall increase probably reflects a stronger building and structures component that has to contend with a likely fall in equipment, plant and machinery investment. Citi analysts look for the second estimate of expected new capital expenditure for 2012-13 to print at $A175bn.*
- ***31 May, Building Approvals, Apr Forecast: 0.5%, Previous: 7.4% -*** *March's large increase in approvals was payback for the previous decline. For April, we expect a return to the softer underlying growth rate that reflects the effective increase in demand for private sector house approvals. The risks to the forecast are evenly weighted and come from the volatile apartment approvals component.*
- ***31 May, Private Sector Credit, Apr Forecast: 0.3%, Previous: 0.4% -*** *Moderate demand from the private sector for intermediated credit should keep the April increase mild and within the gains recorded in previous months. Business credit growth could weaken slightly but be offset with a mild increase in the other personal component.*

JPY:

- ***May 29, Nominal Household Spending, All Households (Apr) Forecast: 3.4% YoY; -0.5% SA MoM, Previous: 4.1% YoY; 0.0% SA MoM; Real Household Spending, All Households (Apr) Forecast: 2.9% YoY; -0.2% SA MoM, Previous: 3.5% YoY; -0.1% SA MoM -*** *Nominal spending of all households probably increased 3.4% YoY and declined 0.5% MoM in April (+4.1% YoY and no change in March) while real spending likely advanced 2.9% YoY and dropped 0.2% MoM (+3.5% YoY and -0.1% MoM). If we are on the mark, real household spending is estimated to have increased 0.3% from the first quarter average. Citi analysts expect consumer spending to remain relatively healthy in the second quarter.*
- ***May 29, Labor Data, Job Offers-to-Seekers Ratio (Apr) Forecast: 0.77, Previous: 0.76; Unemployment Rate (Apr) Forecast: 4.4% of Workforce, Previous: 4.5% of Workforce -*** *Citi analysts expect the April unemployment rate to have declined to 4.4% from 4.5% in March.*
- *May 29,* ***Retail Sales, Overall (Apr) Forecast: 6.4% YoY; 0.2% SA MoM, Previous: 10.3% YoY; -1.2% SA MoM -*** *Citi analysts estimate that retail sales increased 6.4% YoY and 0.2% MoM in April (+10.3% YoY and -1.2% MoM in March). YoY growth likely moderated in April from March, when sales increased sharply from the depressed level amid the March 2011 disaster. On a MoM basis, sales probably rose moderately in April. Based on Citi analysts projection, April retail sales remained flat from the first quarter average (-1.0% QoQ in 4Q11 and +4.0% QoQ in 1Q). It seems likely that consumer spending has been increasing steadily in the current quarter.*
- ***May 31, Industrial Production (Apr) Forecast: 0.2% MoM; 13.4% YoY, Previous: 1.3% MoM; 14.2% YoY -*** *Citi analysts expect industrial production to have increased 0.2% MoM in April after a 1.3% MoM gain in March. A slow export recovery probably limited industrial output growth. Citi analysts forecast suggest that output increased 0.5% in April from the first quarter average (+1.3% QoQ in 1Q). Citi analysts will also find out production projections for May and June next week. Citi analysts are paying close attention whether or not production is expected to rebound in June after a large 4.1% MoM decline in May projected last month.*
- ***May 31, Housing Starts (Apr) Forecast: 4.3%YoY; 0.845mn units SAAR, Previous: 5.0% YoY; 0.848mn Units SAAR -*** *Citi analysts expect April housing starts to stand at 845k (+4.3% YoY) on a seasonally adjusted annualized basis (848k, +5.0% YoY in March). On a MoM basis, we expect a 0.3% drop (-7.6% in March). Based on our projection, housing starts likely have decreased 2.0% in April from the first quarter average (+8.3% in 1Q). Yet, Citi analysts believe that the trend of housing starts is on the mend.*