

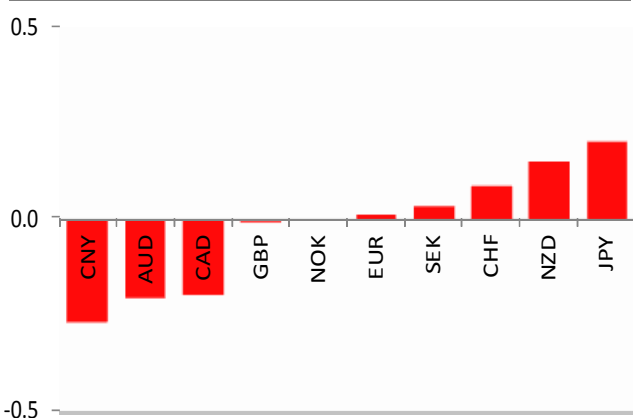
# DAILY FX UPDATE

Monday, June 16, 2014

## RISK AVERSION AND FED DRIVING A BOUT OF USD STRENGTH

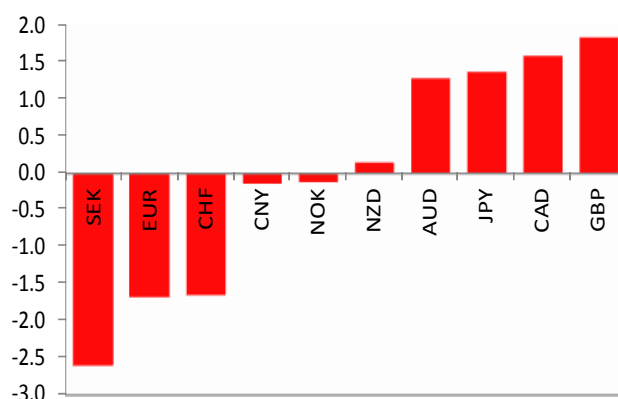
- USD is strong as risk aversion rises supporting the safe havens of USD, gold, JPY & CHF. Expect near-term strength.
- USD risk this week is strength as carry trades are vulnerable to a further spike in risk aversion as tensions mount in Iraq.
- USD—this week's focus is geopolitical risks and the Fed (Wed); 3 new members, a press conference & updated forecasts.
- CAD—is soft—the negative impact of rising risk aversion & the FED offset the positive impact of rising oil prices.
- USDCAD expected to drift closer to 1.10 this week; and remain in a range either side of 1.10 over next few months.
- EUR is flat—the flash CPI was confirmed today; EUR in tight 1.3512 to 1.3579 4-day range; expect downside break.
- GBP rallied to fresh 1.7011 high before collapsing lower; BoE turns increasingly hawkish is offsetting geopolitical risks and warns of building GBP upside risk.
- JPY rallies on building risk aversion; but USDJPY still within comfortable range.
- AUD is weak as carry trade is exposed; while NZD clings to last week's gains; a hawkish RBNZ is supporting it.
- USDCNY rises back into recent range; limited data from China this week.

### ONE DAY FX RETURNS AGAINST USD



Source: Scotiabank FX Strategy & Bloomberg

### QTD FX RETURNS AGAINST USD



Source: Scotiabank FX Strategy & Bloomberg

### THIS WEEK'S BIAS AND EXPECTED RANGE

- **USDCAD:** Upside bias—Expect range to fall within 1.0814 to 1.1000 (the May 8th low to the psychologically important 1.10) - The combination of the Fed meeting and rising risk aversion is likely to see USDCAD upside pressure build.
- **EURUSD:** Downside bias—Expect range to fall within 1.3477 and 1.3602 (the February 3rd low to last Monday's high) - the risk is a downside break which would open up 1.3374 the 50% Fibo of the July to May rally. Rising risk aversion, Fed policy versus ECB policy, sentiment and technicals all warn of downside EUR risk.
- **GBPUSD:** Upside bias—Expect range to fall within 1.6825 and 1.7100 (historical congestion to resistance) - risk aversion could weigh on GBP temporarily but the BoE minutes are likely to reveal a hawkish shift which should support GBP.
- **USDJPY:** Downside bias—Expect range to fall within 100.84 and 102.57 (the May 21st low to last week's high) - a light data week leaves risk aversion as the key driver for USDJPY.
- **AUDUSD:** Downside bias—Expect range to fall within 0.9300 to 0.9438 (support to last week's high) - AUD is biased for downside this week as rising risk aversion and oil prices weigh on both the carry trade and growth sensitive currencies.

### CORE THEMES

**Carry trades are at risk**—The current environment of low volatility and high liquidity has supported carry trades all year; however with building geopolitical risk, including Russian/Ukraine and unrest in Iraq, driving oil prices (WTI is above \$107 and Brent is above \$112) there are several building risks: 1) a spike in risk aversion; and 2) rising oil prices will slow the outlook for growth. These developments have different impacts on the USD, which is confusing, but the market's reaction is likely to be delivered in different ways depending on timing. The near-term risk shifts to a strong USD on risk aversion; but potentially a lower USD later

this year as a result of a dampening in the economic outlook. Currencies who are at risk of near-term weakness include: AUD, NZD, CAD, EUR, NOK and SEK (as well as the EM).

**Central banks**—Last week several central banks took a notably hawkish turn, including both the RBNZ (who maintained its profile of rate hiking) and the BoE (where Governor Carney bluntly stated that the first interest rate hike could be sooner than markets were pricing). This week's Fed meeting is critical. We (like consensus) expect a \$10bn taper with the interesting piece coming from the statement, press conference and forecasts, not to mention three new members: Fischer, Brainard and Mester who could sway the tone. Markets have already priced in a relatively hawkish tone, as the US 2-year yield has jumped to 0.47% (see chart) and Fed funds futures are pricing in a full rate hike by July 2015. Moderate but rising inflation combined with falling unemployment are likely to support an increasingly hawkish Fed, which warns of a USD rally, particularly against currencies like JPY and EUR.

**NEAR-TERM AND MEDIUM TERM SENTIMENT:**

Consensus forecasts for all majors suggest that the USD is expected to rise; while GBP, AUD, CAD, EUR and JPY are all expected to weaken into year-end (see chart below where the red bars detail the expected % change from spot to consensus forecasts for year-end). However near-term sentiment (judged by the CFTC positioning data—see grey bars in chart below) suggest that near-term there is a bullish outlook for GBP and AUD. In this environment we think it supports GBP but leaves AUD vulnerable to an unwind if risk aversion spikes higher. In addition there has been a significant build in the EUR short position, adding to our bearish outlook.

**EUR & JPY:** vulnerable to downside as both near and medium term sentiment have turned against the currencies.

**AUD & CAD:** vulnerable to downside as AUD longs are exposed to being unwound if risk aversion rises further; while stubborn CAD shorts suggest that overall sentiment remains eager to see CAD weaken.

**GBP:** GBP has the largest net long position and the least bearish medium term consensus view—the combination of which is supporting GBP.

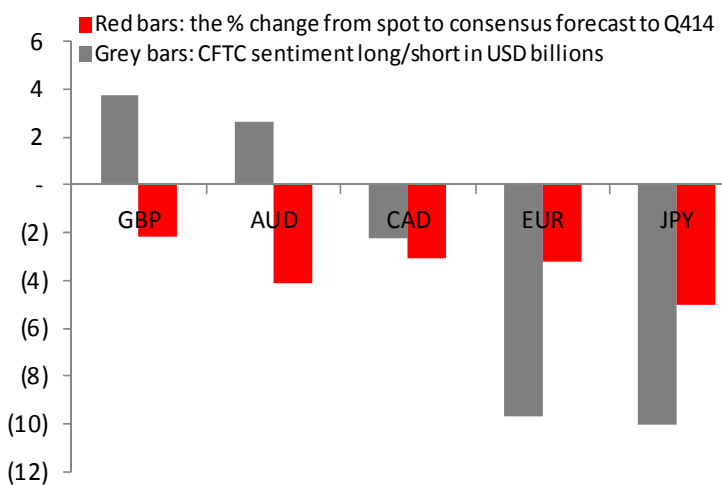
**WHAT IS OF INTEREST THIS WEEK:**

**U.S.:** The Fed meeting on Wednesday which will include updated projections and Chair Yellen's press conference will be the market's core focus. Tuesday's CPI, expected to rise 0.2% m/m on headline and core, bringing headline to 2.0% y/y and core to 1.9% y/y and housing data (housing starts, permits and NAHB) will all providing context for the outlook for Fed policy.

**Canada:** The highlight for Canada comes on Friday with the release of CPI, expected to remain at 2.0% y/y on headline with core climbing to 1.5% y/y. Any surprise here will feed directly into the BoC expectations and by default CAD. Beyond that, today's international securities transactions, existing home sales, Wednesday's wholesale trade sales and Friday's retail sales are all important.

**Europe:** Data is limited from the Eurozone this week, with consumer confidence on Friday likely to prove the highlight. At the country level, German ZEW and PPI are important.

**SENTIMENT—NEAR VS MEDIUM TERM OUTLOOKS**



Source: CFTC, Scotiabank FX Strategy & Bloomberg

**US 2-YEAR YIELD—TRENDING HIGHER ON RATE OUTLOOK**



Source: Scotiabank FX Strategy & Bloomberg

**U.K.:** The BoE minutes, likely to confirm the hawkish shift by Governor Carney last week, will be the highlight; but there is also a slew of important data, including CPI and home prices on Tuesday and retail sales on Thursday.

**Japan:** A quiet week for data with Tuesday's trade balance followed by second tier data the rest of the week. The release of the BoJ minutes (Tuesday) combined with a speech by Kuroda (Friday) are likely only to confirm that from the central bank's perspective it is moving towards its 2% inflation goal.

**Australia:** A very quiet week for Australian release; today (9:30pm EST) RBA minutes are likely to be the highlight.

#### WHAT WE LEARNED LAST WEEK:

- GBP has upside risk with Governor Carney suggesting that markets were underpricing the risk of interest rate hikes; but then following up with when rate hikes do begin the pace is likely to be gradual and limited. This suggest that the BoE minutes (released June 18th) could deliver a more hawkish slant and confirm upside risk to the BoE's entry into its rate hiking cycle.
- USD, oil and safe havens could prove vulnerable to sudden geopolitical risk.
- NZD has upside risk as the RBNZ hiked rates to 3.25% as expected but maintained a stronger than expected path of future rate hikes.
- EUR positioning turns increasingly bearish and EUR has dropped dramatically on its crosses.
- CAD is quite happy to ignore provincial politics and rising oil prices on the back of supply concerns; with the real focus on Governor Poloz as he walks a fine line between recognizing that inflation has climbed back to target but reminded us that external downside risks have increased (the US, EM and Europe).

#### SUGGESTED READINGS

[Interest rate puzzle confronts Federal Reserve officials](#), J. Hilsenrath, **WSJ** (June 15, 2014) - When the Fed meets this week, the most challenging question won't be where to push interest rates in the next few days, weeks or even months. It will be where rates belong years from now.

[Federal Reserve won't roil the waters](#), S. Jakab, **WSJ** (June 15, 2014) - While it should be steady as she goes for Capt. Yellen and her crew this week, some are preparing for an early call to reduce steam.

[The need to focus a light on shadow banking is nigh](#), M. Carney, **FT** (June 15, 2014) - The goal is to replace a shadow banking system prone to excess and collapse with one that contributes to strong, sustainable balanced growth of the world economy.

[Time to take some chips off the table](#), M. ElErian, **FT** (June 15, 2014) - In their efforts to promote growth and jobs, central banks are trading the possibility of immediate economic gains for a growing risk of financial instability later.

#### TODAY'S RELEASES & SPEAKERS

Time (EST)	Country	Release	Period	Consensus	Last	Significance
08:30	CA	Int'l Securities Transactions	Apr	--	-1.23B	med
08:30	US	Empire Manufacturing	Jun	15.00	19.01	med
09:00	CA	Existing Home Sales MoM	May	--	2.70%	med
09:00	US	Net Long-term TIC Flows	Apr	\$30.0B	\$4.0B	med-high
09:15	US	Industrial Production MoM	May	0.50%	-0.60%	med-high
10:00	US	NAHB Housing Market Index	Jun	47.0	45.0	med
10:00	CA	Fin. Min. Oliver meets economists, speaks to reporters at 11:00am EST				med
21:30	AU	RBA Releases Minutes of June Policy Meeting				med-high
02:00	JN	Machine Tool Orders YoY	May F	--	24.1%	med
03:00	EC	ECB GC member Nowotny participates in panel				med
03:15	SZ	Producer & Import Prices MoM	May	-0.1%	-0.3%	med
04:30	UK	CPI MoM	May	0.2%	0.4%	<b>HIGH</b>
04:30	UK	RPI & PPI	May			med-high
04:30	UK	ONS House Price YoY	Apr	7.5%	8.0%	med
05:00		ZEW survey: euro area & Germany	Jun	35.0	33.1	med-high

**TECHNICALS: BUY/SELL SIGNALS AND PIVOT LEVELS** **Jun 16, 2014**

	30 Day Hist Vol	Spot	MACD	9 & 21- day MA	DMI	RSI	Pivot 1st Support	Pivot 1st Resist.
USDCAD	4.1	1.0867	sell	buy	sell	44	1.0846	1.0881
EURUSD	3.7	1.3530	sell	sell	sell	34	1.3502	1.3568
GBPUSD	4.6	1.6970	buy	buy	buy	65	1.6924	1.7013
USDCHF	4.2	0.9001	sell	buy	buy	62	0.8970	0.9023
USDJPY	3.9	101.88	sell	buy	sell	46	101.65	102.13
AUDUSD	5.8	0.9385	buy	buy	buy	59	0.9365	0.9416
USDMXN	4.9	13.05	buy	buy	buy	60	13.00	13.07
DXY (USD index)	3.3	80.64	sell	na	buy	58	80.48	80.75
EURCAD	5.2	1.4703	sell	sell	sell	33	1.4669	1.4740
GBPCAD	5.5	1.8442	buy	buy	buy	58	1.8386	1.8481
AUDCAD	4.6	1.0199	buy	buy	buy	56	1.0173	1.0230
CADMXN	5.6	12.00	buy	buy	buy	64	11.96	12.03
BoC Noon Rate		1.0868	Source: Scotiabank & Bloomberg					