FX Weekly

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Highlights of the Week

Risk aversion drives safe haven currencies higher

Possibility of QE in the UK leads to sterling weakness

'Operation Twist' unveiled in the US

Markets react negatively to macro policy announcements

Potential Greek default & ECB rate cut weigh on euro

EM central banks draw down their euro reserves

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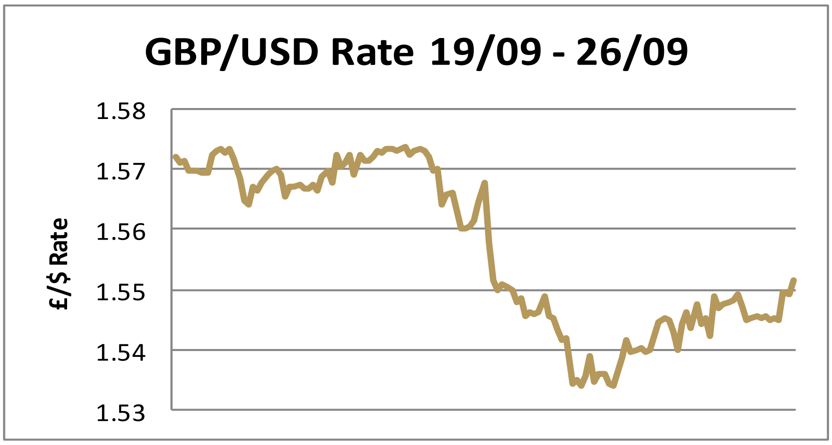
Risk aversion drives safe haven currencies higher

Heightened risk aversion drove safe haven gains last week following the Federal Reserve's warning about US growth, stating that there were "significant downside risks to the economic outlook". The US dollar and Japanese yen rallied while risk currencies sold off, as investors sought refuge. GBP weakened following speculation that another round of Quantitative Easing was likely in the UK, while the euro suffered due to the never-ending sovereign debt issues.

Possibility of QE in the UK leads to sterling weakness



Operation Twist unveiled in the US

The two day Federal Open Market Committee (FOMC) meeting delivered the anticipated 'Operation Twist'. This initiative involves selling $400billion of short dated government bonds and purchasing longer dated bonds with the proceeds. The goal is to flatten the yield curve, driving longer dated interest rates lower. Lower long-term interest rates are tied to business expansion and mortgage rates and so a reduction could lead to job creation and higher disposable income.

Markets react negatively to macro policy announcements

This announcement and Thursday's EU plan to more quickly recapitalise distressed Eurozone banks did little to jettison a 'risk-off' mood in the market. In the absence of a more meaningful policy response from the Fed and ECB – or global growth turnaround – there is unlikely to be a change in sentiment anytime soon. Stock markets and commodities sold-off sharply and reacted negatively to macro policy responses on both sides of the Atlantic in addition to weak Purchase Managers Index (PMI) readings in China and bank credit downgrades in the US and Italy.

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China also played down recent speculation that it would act as a buyer of last resort for Eurozone debt. The head of China Investment Corp, Gao Xiqing, said he would consider buying Eurozone bonds if they were issued, but only if they fit in with CIC's risk profile. The Eurozone saga is sure to remain front and center this week. We might hear more on Germany's plans for Greece Tuesday, when Greek PM Papandreou is due to visit Merkel in Berlin.

Potential Greek default & ECB rate cut weigh on euro

The markets now appear to be bringing the prospect for a Greek default to year end amid reports that Germany is pushing for a new Greek debt restructuring plan that would include up to a 50% loss for bondholders. There is no doubt that European policy makers are scared and are looking to 'do something'. But that has been the case for a while, and has so far achieved very little. Hence it seems too early to read too much into specific news reports and the only thing the markets are tagging themselves to right now is the possibility of a Greek default earlier than has been expected.

Also weighing on EUR are shifting market expectations for a rate cut from the ECB in October (this follows comments from some ECB council members last week) and emerging market central banks turning net sellers of EUR. Central banks appear to have flipped from being monthly buyers of EURUSD to the tune USD25bn worth, to in September being on track to be selling about USD10bn of EURUSD (a swing of USD35bn).

EM central banks draw down their euro reserves

If EM central banks continue to draw down on reserves, there could potentially be a more permanent deterioration in the EURUSD flow picture, which is likely to have important implications for EURUSD trading dynamics in coming months.

In the US, we have several Fed speakers due up, headed by Chairman Ben Bernanke (Wednesday). The three members who dissented on Operation Twist also make public appearances: Kocherlakota (Monday), Fisher (Tuesday) and Plosser (Thursday). Other key speakers for the week include the SNB's Jordan (Wednesday). Important data releases are concentrated in the latter half of the week bringing US GDP (Thursday), Chinese Manufacturing PMI (Friday), Germany retail sales (Friday) and European CPI (Friday). Germany is scheduled to vote on proposed EFSF changes Thursday.

Citi FX Forecasts—September 2011

			Forecasts		
		spot	0-3 mos	6-12 mos	long-term
G10					
Euro	EURUSD	1.35	1.29	1.25	1.30
Japanese yen	USDJPY	76	75	76	78
British Pound	GBPUSD	1.55	1.52	1.51	1.65
Swiss Franc	USDCHF	0.90	0.95	0.95	1.04
Australian Dollar	AUDUSD	0.98	0.95	1.02	0.95
New Zealand Dollar	NZDUSD	0.78	0.76	0.83	0.63
Canadian Dollar	USDCAD	1.03	1.06	1.00	0.95
Dollar Index*	DXY	78.10	80.84	82.08	79.36
G10 Crosses					
Japanese yen	EURJPY	103	97	95	101
Swiss Franc	EURCHF	1.22	1.23	1.19	1.35
British Pound	EURGBP	0.87	0.85	0.83	0.79
Swedish Krona	EURSEK	9.30	9.35	9.00	8.80
Norwegian Krone	EURNOK	7.88	7.90	7.75	7.70
Norwegian Krone	NOKSEK	1.18	1.18	1.16	1.14
Australian Dollar	AUDNZD	1.26	1.25	1.23	1.51
Australian Dollar	AUDJPY	75	71	78	74
Asia					
Chinese Renminbi	USDCNY	6.39	6.30	6.12	5.87
Hong Kong Dollar	USDHKD	7.80	7.78	7.76	7.75
Indonesian Rupiah	USDIDR	8941	9300	8900	8650
Indian Rupee	USDINR	49.4	49.5	47.5	46.0
Korean Won	USDKRW	1167	1200	1140	1050
Malaysian Ringgit	USDMYR	3.17	3.20	3.06	2.89
Philippine Peso	USDPHP	43.6	43.7	42.8	41.5
Singapore Dollar	USDSGD	1.30	1.30	1.24	1.17
Thai Baht	USDTHB	30.9	30.7	30.0	29.5
Taiwan Dollar	USDTWD	30.4	30.8	29.5	28.2
EMEA					
Czech Koruna	EURCZK	24.7	25.3	24.8	23.8
Hungarian Forint	EURHUF	291	335	330	300
Polish Zloty	EURPLN	4.41	4.65	4.30	3.90
Israeli Shekel	USDILS	3.70	3.80	3.60	3.40
Russian Ruble	USDRUB	32.0	32.9	34.2	31.3
Russian Ruble Basket		37.1	37.2	38.0	35.5
Turkish Lira	USDTRY	1.84	1.86	1.88	1.79
South African Rand	USDZAR	8.29	8.00	8.50	8.75
LATAM					
Brazilian Real	USDBRL	1.86	1.82	1.80	1.70
Chilean Peso	USDCLP	518	520	530	490
Mexican Peso	USDMXN	13.8	13.2	13.0	12.2
Colombian Peso	USDCOP	1901	1850	1850	1850

Spot rates end of day 23rd September 2011, FX Forecasts as of 23rd September 2011

G10 Data Releases

USD:

Sep. 26, Federal Reserve Board Governor Raskin to speak on "Monetary Policy and Job Creation" in Washington.

Sep. 26, St. Louis Fed President Bullard in a panel discussion of policy after the crisis, in New York.

Sep. 26, Minneapolis Fed President Kocherlakota on a panel on sovereign debt in Chicago.

Sep. 27, Atlanta Fed President Lockhart to speak on "A Discussion of the U.S. Economy" in Florida.

Sep. 27, Dallas Fed President Fisher to speak on his dissent and why he voted against operation twist, in Dallas.

Sep. 28, Boston Fed President Rosengren to speak on the economic outlook in Sweden.

Sep. 28, Fed Chairman Bernanke to speak on "Lessons From Emerging Market Economies on Sources of Sustained Growth".

Sep. 29, Boston Fed President Rosengren to speak on "How Supervision Can Detect Failures Early" in Sweden.

Sep. 29, Philadelphia Fed President Plosser to speak on the economy to business leaders at Villanova University.

Sep. 29, Atlanta Fed President Lockhart gives opening remarks at employment and education conference.

Sep. 30, St. Louis Fed President Bullard to speak in San Diego.

Sep. 26, August New Home Sales (Thousands): Citi. 300, July 298, June 300, May 309, April 316, March 305 - *New home sales likely were little changed in August, remaining in the same well-worn rut as the past two months. Housing starts and pending home sales data, which would give advance notice of any upturn, have continued to signal weakness.* ***Note:*** *Sales for the year so far are on track to finish with barely more than 300,000 homes sold. The average selling rate is down 6% from 2010, which was already the weakest year in the nearly 50 year record. The current sales rate is more than 75% below the peak sales year of 2005.*

Sep. 27, September Consumer Confidence: Citi. 46.0, August 44.5, July 59.2, June 57.6, May 61.7 - *Incoming data have weakened recently and equity markets have fallen sharply, suggesting extremely soft consumer confidence. However, the confidence index already plummeted in August, as the political process dominated headlines and expectations. That move went further than the fundamental data suggested at that time. Normally, we would look for a significant bounce under these circumstances, but the current market and economic environment has deteriorated too much for that.* ***Note:*** *Handicapping the effects of changes in the political situation is nearly impossible, implying notable two-sided risk to the forecast.*

G10 Data Releases

USD:

Sep. 28, August Durable Goods (Percent Change): *New Orders –* ***Citi. 0.7 %, July 4.1 %, June -1.1 %, May 2.0 %; Excl. Transportation – Citi. -0.5, July 0.8, June 0.7, May 0.8 -*** *Durable goods orders likely edged up in August, which was an impressive result following the giant surge in orders in July. Once again, civilian aircraft orders appear set to substantially boost the total. Apart from aircraft, transportation was weaker on lower truck assemblies.* ***Note 1:*** *In July, nearly two-thirds of the increase in ex-transportation new orders was from a spike in primary metals. The reversal of this surge accounts for the bulk of our expected decline in August.* ***Note 2:*** *The two month run-up in civilian aircraft sets the stage for a dramatic decline in the months ahead.*

Sep. 29, Q2'11 (F) GDP Growth (Percent Change at Annual Rate Unless Noted): Citi. 1.4 %, Q2 (Prelim) 1.0 %, Q2 (Adv.) 1.3 %, Q1'11 0.4 %, Q4'10 2.3 % - *We look for an upward revision to second quarter real GDP. In this third pass, inventories and trade require the biggest adjustments, based on the monthly data releases. Domestic demand likely was marginally higher on greater investment spending. The faster pace of growth does not alter our perception that the economy was extremely weak in the first half.*

Sep. 30, August Personal Income and Consumption: Personal Income – Citi. -0.1 %, July 0.3 %, June 0.2 %, May 0.3 %; Personal Spending – Citi. 0.2, July 0.8, June -0.1, May 0.1; Core PCE (12-Month Percent Change) – Citi.1.7, July 1.6, June 1.4, May 1.3 - *Based on the dismal August employment report, which featured no payroll gains, a shorter average workweek and a decline in hourly earnings, we anticipate a small decline in wage and salary income. The surprising jump in energy prices ate into income even further, leaving the biggest decline in real disposable income since 2009. At the same time, stagnant core retail sales implies a slight decline in real consumer spending in August. The savings rate probably fell again.* ***Note:*** *Real disposable income is on track for a 0.4% decline in the third quarter, leaving little spark for consumer spending in the second half.*

Sep. 30, September Chicago Purchasing Managers' Index: Citi. 53.5, August 56.5, July 58.8, June 61.1 - *We expect that the Chicago purchasing managers' index slipped again in September. We note that motor vehicle assemblies declined in the month and that may have had a dampening effect on Chicago area business. However, we continue to expect this index to signal growth.* ***Note:*** *Unlike the headline Philadelphia Fed index, which can be a subjective assessment of the general business climate, the Chicago and the national ISM indexes are weighted averages of their components. These components attempt to gauge changes in actual activity. We think this is why the Chicago PMI and the ISMs have been much tamer in recent months, relative to the extremely downbeat Philly survey.*

Sep. 30, September (Final) Reuters/Michigan Sentiment Consumer Index: Citi. 58.0, Sep. (Prelim) 57.8, August 55.7, July 63.7, June 71.5 - *Consumer sentiment was likely little changed at an extremely low level in the second pass at September. The wealth shock from equities continues to be digested by households.* ***Note:*** *The fall in equities at the end of the September survey, have limited ability to drag down the monthly average. However, if they persist, they set up the potential for a further step down of sentiment in October.*

G10 Data Releases

EUR:

***Sep. 26, German Ifo Business Climate, Sep Forecast: 104 Prior: 108.7 -** We expect a third consecutive fall in the ifo business climate. We expect a fall in business expectations from 100.1 in August to 95 in September, the lowest reading since June 2009. Furthermore, the assessment of the current business situation probably will drop from 118.1 in August to 114 in September, the lowest reading since August 2010. The decline in business confidence is probably widely spread among sectors.*

***Sep. 27, Euro Area M3, Aug Forecast: 1.4% YY, 1.8% 3-M YY Prior: 2.0% YY, 2.1% 3-M YY -** With adverse base effects, we expect M3 YY growth to drop in August. However, the monthly comparison probably will show a second consecutive modest increase: M3 is likely to edge up by around 0.1% MM in August. Loan growth to the private sector is also likely to be up by 0.1% MM after increasing by 0.2% MM in July.*

***Sep 29, Euro area Economic Confidence, Sep Forecast: 93 Prior: 98.3; Industrial Confidence, Sep Forecast: -8 Prior: -3; Consumer Confidence, Sep Forecast: -19 Prior: -17 - Av**ailable data from member countries and the flash estimate for consumer confidence suggest a further broad based decline in confidence in the euro area. The further escalation of the sovereign debt crisis and global financial market turbulence probably are the main factors behind the fall in sentiment. If our forecast is correct, sentiment will be lowest reading since November 2009.*

***Sep 30, Euro area HICP, Sep Preliminary Forecast 2.8% YY Prior: 2.5% YY -** The inflation rate is likely to increase back to the April high of 2.8% YY. In addition to higher energy prices (mainly reflecting the rebound in oil prices) the VAT increase in Italy is likely to push euro area inflation rates higher as well. Unless there is a large fall in oil prices, inflation is likely to stay around the elevated level up to the end of the year, as additional indirect tax increases, e.g. in France, are likely to come through.*

***Sep 30, Euro area Unemployment Rate, Aug Forecast: 10.0% Prior: 10.0% -** The unemployment rate is likely to remain unchanged in August. However, seasonally adjusted unemployment claims are likely to increase for a fourth consecutive month.*

AUD:

***30 Sep, Private Sector Credit, Aug Forecast: 0.0%, Previous: 0.2% -** A difficult month for markets that weakened business and household confidence levels is consistent with no growth in private sector credit. Mild growth in owner-occupier and investor housing credit is likely to be offset by a combination of negative personal consumer and business credit. The credit data has been more volatile in 2011 than over the history of the series. Based on the risks in August, this provides some downside risk to our flat forecast.*

NZD:

***30 Sep, Building Permits, Aug Forecast: -2.0%, Previous: 13% Forecast: na, P -** Permits for residential dwellings are likely to fall in August. Large gains in this series are usually followed by a decline. With little evidence of Canterbury related reconstruction and weaker migration, there is little to suggest otherwise.*

G10 Data Releases

JPY:

Sep. 29, Retail Sales, Overall (Aug) Forecast: -0.7% Yr.-Yr.; 0.2% SA Mo.-Mo., Previous: 0.7% Yr.-Yr.; -0.3% SA Mo.-Mo. - *We expect retail sales to decline by 0.7% YoY, decreasing for the first time since May. The average level of July and August retail sales would be 2.5% higher than the second-quarter average, after +1.5% QoQ in the second quarter.*

Sep. 30, Nationwide Consumer Prices, Overall (Aug) Forecast: -0.1% Yr.-Yr.; -0.6% SA Mo.-Mo., Previous: 0.2% Yr.-Yr.; 0.3% SA Mo.-Mo.; Excluding Fresh Food (Aug) Forecast: 0.0% Yr.-Yr.; -0.3% SA Mo.-Mo., Previous: 0.1% Yr.-Yr.; 0.1% SA Mo.-Mo.; Excluding Food (Excl. Alcoholic Beverages) and Energy (Aug) Forecast: -0.7% Yr.-Yr.; -0.3% SA Mo.-Mo., Previous: -0.5% Yr.-Yr.; 0.0% SA Mo.-Mo.

Sep. 30, Nominal Household Spending, All Households (Aug) Forecast: -4.6% Yr.-Yr.; -2.2% SA Mo.-Mo., Previous: -1.8% Yr.-Yr.; 1.3% SA Mo.-Mo.; Real Household Spending, All Households (Aug) Forecast: -4.6% Yr.-Yr.; -1.3% SA Mo.-Mo., Previous: -2.1% Yr.-Yr.; 0.7% SA Mo.-Mo.

Sep. 30, Labor Data, Job Offers-to-Seekers Ratio (Aug) Forecast: 0.65, Previous: 0.64; Total Employment (Aug) Forecast: -0.1% Yr.-Yr., Previous: -0.3% Yr.-Yr.; Unemployment Rate (Aug) Forecast: 4.7% of Workforce, Previous: 4.7% of Workforce

Sep. 30, Industrial Production (Aug) Forecast: 1.3% Mo.-Mo.; 1.1% Yr.-Yr., Previous: 0.4% Mo.-Mo.; -3.0% Yr.-Yr.

Sep. 30, Housing Starts (Aug) Forecast: 2.9% Yr.-Yr.; 0.84 Million Units SAAR, Previous: 21.2% Yr.-Yr.; 0.96 Million Units SAAR - *August housing starts likely rose by 2.9% YoY after +21.2% YoY in July. Our forecast would place the average level of July and August housing starts 11.0% higher than the second-quarter average after -3.8% QoQ in the second quarter.*

Oct. 3, BoJ Quarterly Tankan Survey, Large Mfg. Business Conditions (Sep) Forecast: 1, Previous: -9; Large Nonmfg. Business Conditions (Sep) Forecast: 2, Previous: -5; Small Mfg. Business Conditions (Sep) Forecast: -14, Previous: -21; Small Nonmfg. Business Conditions (Sep) Forecast: -23, Previous: -26; Fiscal 2011 Capital Spending Plans, Large Firms (Sep) Forecast: 3.7, Previous: 4.2; Fiscal 2011 Capital Spending Plans, Small Firms (Sep) Forecast: -20.9, Previous: -24.9 - *Business confidence DI will likely improve as the economy normalizes after the disaster — In the Bank of Japan's September Tankan survey, the business confidence DI for large manufacturing is expected to rise to +1 from -9 in June. The DI will likely fall short of +2, the level the group forecasted in June, in our view. Business investment plans for fiscal 2011 will likely remain healthy. The latest business outlook survey (conducted in August) revealed that companies of all sizes in all industries intend to expand capex (including software and excluding land purchases) by 5.4% YoY in fiscal 2011, revised upward slightly from a 4.9% YoY increase in the previous May survey. Even though there are negative factors, including weaker overseas economies, a higher yen and large manufacturers' overseas transfer of their production facilities, we expect capital investment will remain cyclically solid partly due to restoration of production capacity damaged by the disaster*