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Emerging market currencies continue to look attractive

Major commodity currencies may pull back before appreciating further

Next week's FOMC meeting will be important for the US dollar

FX Weekly

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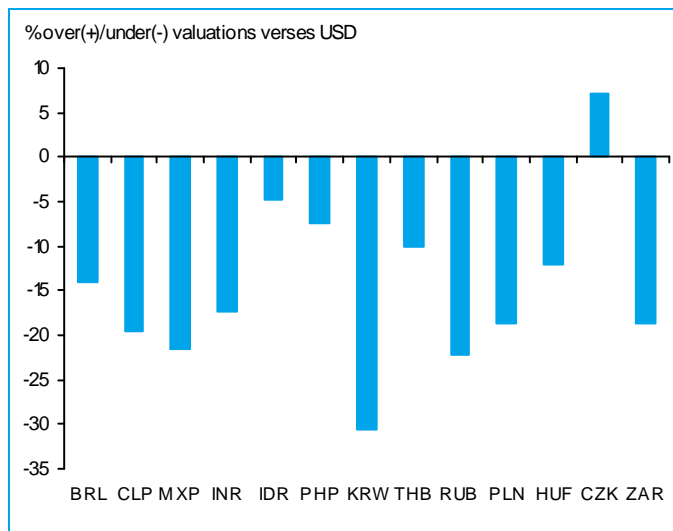
- The rally in risky currencies has reversed slightly in recent weeks, but we think that positions in emerging market currencies remain very attractive.
- The announcement at next week's FOMC meeting of whether purchases of US Treasuries will be increased is likely to have implications for the US dollar.

In line with the modest reversal of risk appetite in recent weeks, 'risky' currencies such as emerging market currencies and, to a lesser extent, major commodity currencies, have been under pressure following their strong rally since March. While some of the reversal is likely to be due to profit taking, one must ask whether the recent rally of risky currencies has become overstretched. We do not think that this is the case for emerging market currencies and investors should view the recent weakness as an opportunity to get long. Our long-run fair values of emerging market currencies¹ (Figure 1), which are estimated as the exchange rates which correspond with long-run growth and inflation rates, show that many emerging market currencies remain substantially undervalued. Hence, whilst the appreciation of emerging market currencies is likely to be volatile, a long position remains attractive on a long-term horizon. To reiterate, our preferred emerging market currencies are the Brazilian Real, Indian Rupee, Indonesian Rupiah, Korean Won, Polish Zloty and South African Rand. Meanwhile, we think that major commodity currencies do not offer such good value and, although are likely to appreciate further in the long run, may weaken in the short term.

The major currencies continued to trade in tight ranges this week, particularly against the US dollar. We expect next week's Fed meeting to be an important one for the US dollar given the recent sell-off in US Treasuries (Figure 2). The Fed has not signalled that it plans to increase its purchase of Treasuries, possibly due to increased confidence in the growth outlook and inflation concerns. We expect the dollar to be supported if the Fed confirms this at their meeting on Wednesday as it will ease concerns about the US authorities monetising debt, although a further sell-off in the Treasury market could be a threat if it is seen to be undermining foreign investors' appetite for US assets. Meanwhile, an increase in purchases of US Treasuries is likely to be a negative for the dollar next week.

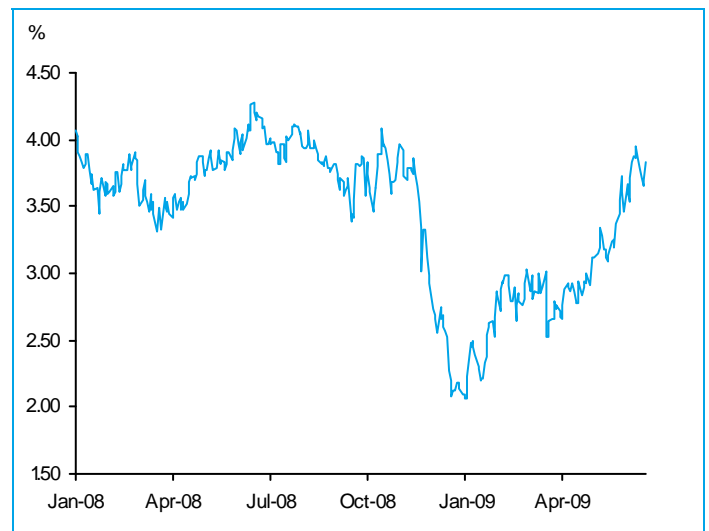
¹ Published in 'FX: A global framework for FX valuations' in April's edition of *Signpost*.

Figure 1 – Long-run valuations of EM currencies



Source: Barclays Wealth Research

Figure 2 – US 10-year Treasury yields



Source: Barclays Wealth Research

Forecasts and market data

FX Forecasts (Majors)¹

	Spot	Forecasts				Forecasts vs Forward ²				
		1 month	3 month	6 month	12 month	1 month	3 month	6 month		12 month
EUR/USD	1.39	1.35	1.35	1.35	1.25	-2.9%	-2.9%	-2.9%	-10.2%	USD per EUR
USD/JPY	97	98	98	99	102	1.1%	1.1%	2.3%	6.0%	JPY per USD
GBP/USD	1.64	1.62	1.65	1.65	1.65	-1.3%	0.5%	0.5%	0.5%	USD per GBP
USD/CHF	1.09	1.14	1.17	1.15	1.18	5.0%	7.7%	5.9%	9.8%	CHF per USD
USD/CAD	1.13	1.13	1.10	1.10	1.10	0.1%	-2.5%	-2.4%	-2.2%	CAD per USD
AUD/USD	0.81	0.78	0.80	0.79	0.76	-2.9%	-0.2%	-1.3%	-3.6%	USD per AUD
NZD/USD	0.64	0.62	0.64	0.56	0.65	-3.0%	0.3%	-11.8%	3.4%	USD per NZD
EUR/JPY	135	132	132	134	128	-2.1%	-2.1%	-0.7%	-4.8%	JPY per EUR
EUR/GBP	0.85	0.83	0.82	0.82	0.75	-1.6%	-3.4%	-3.4%	-11.5%	GBP per EUR
EUR/CHF	1.51	1.54	1.57	1.55	1.48	1.9%	3.9%	2.8%	-1.4%	CHF per EUR
EUR/SEK	10.96	10.50	10.40	10.00	9.68	-4.2%	-5.1%	-8.7%	-11.6%	SEK per EUR
EUR/NOK	8.91	8.50	8.20	8.10	7.98	-4.6%	-8.1%	-9.3%	-11.0%	NOK per EUR
GBP/JPY	159	159	162	163	168	-0.3%	1.6%	2.8%	6.5%	JPY per GBP
GBP/AUD	2.04	2.08	2.06	2.10	2.18	1.6%	0.7%	1.8%	4.3%	AUD per GBP
GBP/NZD	2.56	2.61	2.58	2.95	2.54	1.7%	0.2%	13.9%	-2.8%	NZD per GBP
GBP/CAD	1.85	1.83	1.82	1.82	1.82	-1.2%	-2.0%	-1.9%	-1.7%	CAD per GBP
GBP/CHF	1.78	1.85	1.93	1.89	1.95	3.6%	8.3%	6.4%	10.3%	CHF per GBP

Notes: ¹ We utilise our colleagues at Barclays Capital for the 1 month and, generally, 3 month forecasts. The 6 month+ forecasts are Barclays Wealth forecasts in line with our economic and market outlook. ² The Forecast vs. Forward is the expected return on a cross-rate long position having accounted for the cost of carry.

Brief summary of views

US dollar

A continued improvement in risk appetite poses a threat to the USD in the near term. That said, a rebound in the US economy – which is likely to lead a wider global recovery – should benefit the currency.

Euro

The EUR is overvalued relative to its long-run fair value. Less aggressive policy stimulus suggests that euro area recovery is likely to be anaemic and lagging. This will be harmful to the euro and various political issues provide additional downside risks.

Sterling

We are bullish on GBP in the medium term, especially against the EUR. Sterling is significantly undervalued and will benefit from an improvement in risk appetite and increasing signs of a recovery in the UK economy.

Japanese yen

We expect the yen to weaken against the dollar in the longer term given the Japanese economy's dire state and if the yen returns as a popular funding currency for carry trades.

Swiss franc

CHF has benefited from its safe haven status and is likely to continue to do so in the short term. Meanwhile, long-run fundamentals suggest that the currency will remain strong against the euro but weaken against the dollar.

Canadian dollar

Whilst the currency looks expensive on our valuation models, improving risk appetite and strengthening commodity prices will remain supportive.

Australian dollar

Valuation models suggest the currency has further to fall, but it will benefit from any further rebound in base metals prices and risk appetite. Signs of resilience in the Australian economy will also prove supportive.

New Zealand dollar

As with the Australian dollar, the kiwi will benefit from any rebound in commodity prices and risk appetite. However, any further aggressive monetary easing would be negative.

Swedish krona

The SEK has benefitted from the recent improvement in risk appetite, but still remains well below its fair value.

Norwegian krone

The NOK has benefitted from the improvement in risk appetite and energy prices over recent months. Further energy price gains would be supportive.

Market data

Commodities	Level	w-o-w %chg	mtd %chg	ytd %chg	Interest rates LIBOR (%)	w-o-w pp chg	mtd pp chg	ytd pp chg
GSCI index	428.7	-2.6%	4.1%	10.1%	USD 3 month	0.61	-0.02	-0.05
Oil (US\$ per barrel, Brent)	69.3	-3.6%	6.3%	91.6%	GBP 3 month	1.25	0.00	-0.03
Gold (US\$/Ounce)	932.4	-2.3%	-4.8%	6.2%	EUR 3 month	1.23	-0.04	-0.03

Note: Prices at close of business, 18 June 2009

Source: FactSet

Policy rate forecasts

	History				Current	Forecasts			
	2008 Q2	2008 Q3	2008 Q4	2009 Q1		2009 Q2	2009 Q3	2009 Q4	2010 Q1
US (Fed funds)	2.00	2.00	0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25
UK (bank rate)	5.00	5.00	2.00	0.50	0.50	0.50	0.50	0.50	0.50
Euro area (Refi rate)	4.00	4.25	2.50	1.50	1.00	1.00	1.00	1.00	1.00
Japan (Call rate)	0.50	0.50	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Canada (Call rate)	3.00	3.00	1.50	0.50	0.25	0.25	0.25	0.25	0.25

Note: End of period data

Source: FactSet and Barclays Wealth Research

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