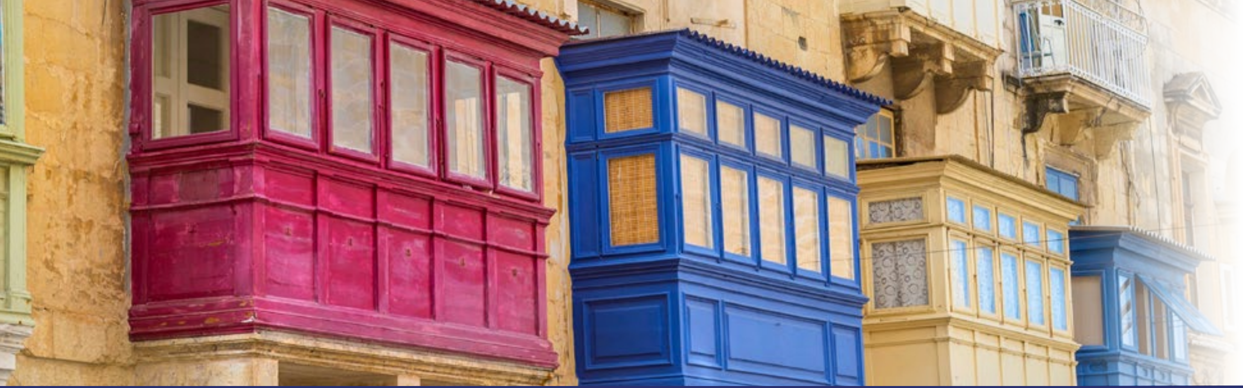

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FCM Bank Currency Outlook

MONTH OF DECEMBER

OVERVIEW

Politics and news have been key themes driving currencies more than usual in November. Brexit, the Italian Debt Crisis and U.S. - China trade relations have all played key roles in recent currency trends. With risk aversion creeping in against a backdrop of rising US interest rates and a turndown in commodities and US equities, safe haven currencies like the Japanese Yen, the Swiss Franc and the USD have strengthened. The GBP in particular has suffered on the back of rising political uncertainty. Volatility has picked up in a number of currency pairs as Fed policy and Brexit outcomes become increasingly hard to predict.

WHAT TO WATCH OUT FOR IN DECEMBER

- → December 11 vote on the Brexit Deal in the UK House of Commons
- → December 19 Federal Reserve Meeting, particularly commentary around 2019 rate hikes
- → Changes in trade policy after the G20 meeting between Trump and Xi
- → Italian budget revisions and dialogue between Rome and Brussels

USD – INTEREST RATES

In December markets will keep a keen eye on the Federal Reserve. At the previous meeting Fed officials predicted three rate hikes in 2019 but recent commentary has been more dovish. The market is currently expecting only one hike next year. We expect to see particular volatility around the December 19 Interest Rate Decision which will show how far the Fed has downgraded forecasts. If they still predict at least two hikes next year this will see the dollar strengthen.

GBP – BREXIT

Brexit uncertainty continues to weigh on the pound and the euro. Theresa May's proposed deal has faced harsh criticism in the UK and is not expected to pass the House of Commons vote on December 12. News announcements continue to create volatility as markets try to price in the alternatives to Theresa May's deal. If the deal is defeated by a large margin we would expect further weakness in the GBP which will flow over in to a weaker EUR. Any positive signals will see the GBP higher with the EUR making smaller gains.

EUR – ITALIAN DEBT

In Europe, the Euro is facing pressure on new Sovereign Debt concerns. The Italian government's projected 2.4% deficit has infuriated lawmakers in Brussels who seek further austerity in Europe's second largest debtor. While Italian officials have made grumblings about compromises, nothing concrete has been confirmed. Any further conflict between Brussels and Rome will put further pressure on the EUR while progress on a revised budget should help the common currency higher.

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FCM Bank Currency Outlook

MONTH OF DECEMBER

GBP VOLATILITY EXPECTED TO CONTINUE

Uncertainty around Brexit outcomes continues to weigh heavily on the pound. GBP volatility is being driven by a regular news flow, with strong opposition to Theresa May's proposed Brexit deal dragging on the GBP, currently trading at 0.8902 against the Euro.

All eyes now look ahead to the December 11 UK House of Commons vote on the proposed deal. Markets have largely priced in a failure to pass the vote on December 11, but defeat by a large margin could see the pound plummet as a "Hard Brexit" becomes more likely.

Failure to pass the deal by a slim margin could actually be bullish for the GBP in the short term as an eventual deal remains likely. Expect volatility to continue on political news announcements in the coming weeks as markets attempt to price in extreme alternatives to the deal: A No Deal Brexit (GBP lower) or no Brexit at all (GBP higher).

Over the longer term fundamentals currently look more favourable for the Sterling. Inflation has remained stubbornly above the Bank of England's 2 percent target and current BOE forecasts see it remaining above the target for the next 2 years. BOE chief Mark Carney has taken a cautious tone recently on concerns over a "disorderly Brexit" warning that the worst case scenario could see inflation hit 6.5% and the GBP down 25%. Catastrophes aside, increasing inflationary pressure due to the weaker currency, low unemployment and increasing wage growth could eventually force his hand on interest rates.

Key data to watch is weighted towards the end of the month starting with the November CPI Inflation reading on the 19th. The next day the BOE rate decision will be closely followed as markets look for further guidance on the path of interest rates after the House of Commons' vote. Any hawkish comments will see sharp losses for the pound with markets currently pricing in only 2 rate hikes in the next 3 years. On the 21st UK GDP statistics round off what will be a massive 3 days for the British currency. Politics and news flow will likely be the main drivers of the pound this month.

KEY DATES FOR THE GBP IN DECEMBER

MONDAY 3RD
UK Manufacturing PMI

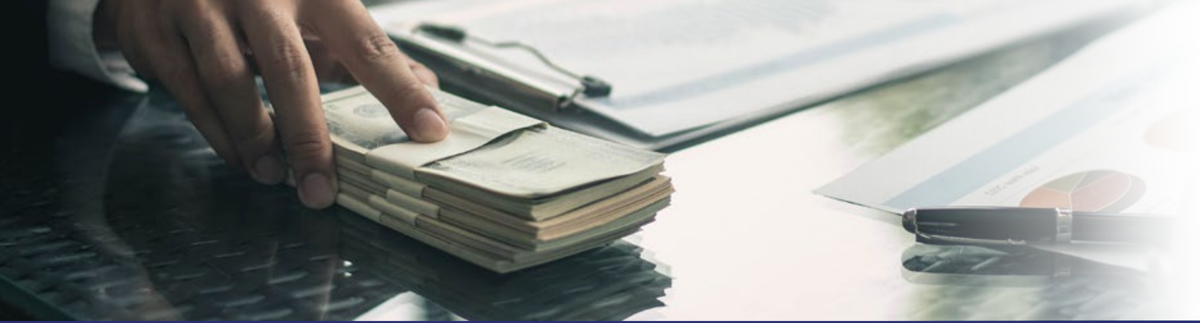
MONDAY 10TH
UK GDP (Monthly)

TUESDAY 11TH
House of Commons Brexit Vote

WEDNESDAY 19TH
UK CPI Inflation

THURSDAY 20TH
Bank of England Interest Rate Decision

FRIDAY 21ST
UK GDP (Quarterly and Yearly)



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FCM Bank Currency Outlook

MONTH OF DECEMBER

USD STRENGTH | FED AND TRADE RELATIONS RULE SENTIMENT

The USD has had a strong run in recent months currently trading at 1.1379 against the Euro. This has been largely driven by robust economic data. US unemployment sits at 3.7% the lowest level since 1969. Wage inflation has also picked up reaching the highest level since 2009, topping 3.1% in the year to October; and inflation in general remains at the top of the Federal Reserve's 1-3% target range. This has all put upward pressure on the dollar as markets look toward a data dependant Fed.

On the flip side the ongoing trade war between China and the US has been weighing on business confidence and corporate investment, tampering USD strength. All eyes move to the G20 meeting where Trump and Chinese Premier Xi Jinping are hoping to strike a trade deal. This coming at a time when President Trump has just confirmed an increase in tariffs to 25% on over 200 Billion US dollars' worth of Chinese trade goods at the start of January.

Markets aren't confident the Presidents will reach an agreement, so this wouldn't necessarily be catastrophic for the dollar, but expect to see volatility on political announcements and tweets from President Trump. Any tangible step toward the end of economic hostilities should help the dollar over the medium term. Further escalation of trade barriers could see the greenback lose ground.

The Federal Reserve will be the other main market mover this month with commentary by Fed officials being closely monitored as markets readjust expectations for rate hikes in 2019. The Federal Reserve's September forecast was to hike rates in December and a further 3 times in 2019. The market has priced in December but currently has only one hike priced in for 2019. Recent commentary from Fed officials has been more dovish but all eyes will be on the announcement December 19 to see how far they have downgraded their forecasts.

Key data to look out for this month starts with the Non-Farm Payrolls report December 7 which includes hourly wage inflation statistics closely watched by the Fed. Further price data comes the following week with Producer Prices Tuesday 11th and Consumer Prices on Wednesday 12th. This information will feed in to the Fed decision on the 19th which will be the biggest event on the economic calendar this month. GDP along with a raft of expenditure and consumption data will be released on the 21st. This will be closely watched as analysts assess the impact of the US China trade spat, setting the tone as we head into the New Year.

KEY DATES FOR THE USD IN DECEMBER

WEDNESDAY 5TH
ADP Jobs Report

FRIDAY 7TH
Nonfarm Payrolls and Wage Growth

TUESDAY 11TH
US Producer Price Index

WEDNESDAY 12TH
US CPI Inflation

WEDNESDAY 19TH
Federal Reserve Interest Rate Decision

FRIDAY 21ST
US GDP

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MONTH OF DECEMBER

ITALIAN DEBT AND BREXIT WEIGH ON THE EUR

The EUR continues to be hampered by ongoing sovereign debt concerns, currently focused around the Italian government's proposed 2.4% budget deficit. Lawmakers in Brussels and Italian political dialogue have been driving EUR volatility throughout November.

The third largest economy in the Eurozone currently holds a Government Debt to GDP ratio of 131.8% second only to Greece. Underlying Italian government bonds have had a wild ride this year with Italian 10 year yields trading as high as 3.62% in November up from less than 1.8% as recently as April. Italian bond yields are important as Italian banks hold €375 Billion in government debt. As yields rise the value of these bonds decreases tying up liquidity in Italian banks and increasing the risks of a credit crisis. The over 3% difference in yields between German and Italian bonds also hurts the ECBs ability to conduct monetary policy, further pressuring the EUR.

Recent commentary by Italian officials has offered a little respite, indicating signs of a potential reduction in the deficit to 2.2% or even 2% of GDP. Expect any belligerent comments or further discord between Italian officials and Brussels to weigh on the EUR.

The Brexit debate in the UK and surrounding news has also been impacting the euro. The UK has a higher trade dependence on the EU than the reverse so volatility is more pronounced in the pound. Changes in sentiment do however impact the EUR significantly against other currency pairs. Brexit news habitually sees the EUR gain ground against the GBP while losing ground against other currencies and vice versa. Expect this trend to continue as Brexit plays out.

From a central bank perspective, the ECB has reaffirmed it will halt its €2.6 trillion bond buying program at the end of December and continues to tentatively speak of a rate hike in late 2019. Inflation currently sits slightly above target at 2.2% but ECB president Mario Draghi has been warning of a possible slowdown as manufacturing data continues to weaken. Manufacturing PMIs being released on the 3rd will be closely followed as markets assess this risk.

Producer prices on the 4th followed by European GDP on the 7th will be the other key data to watch in the first week of the month. On the 13th of December while most of us will be enjoying Republic day the ECB announcement will be closely followed by markets looking for any clearer signals around a potential rate hike late next year. Inflation and trade data on the 17th followed by ECB Meeting Accounts released on the 22nd will be the main market movers in the run up towards Christmas.

KEY DATES FOR THE EUR IN DECEMBER

MONDAY 3RD

EU Manufacturing PMI

TUESDAY 4TH

EU Producer Price Index

FRIDAY 7TH

European GDP

THURSDAY 13TH

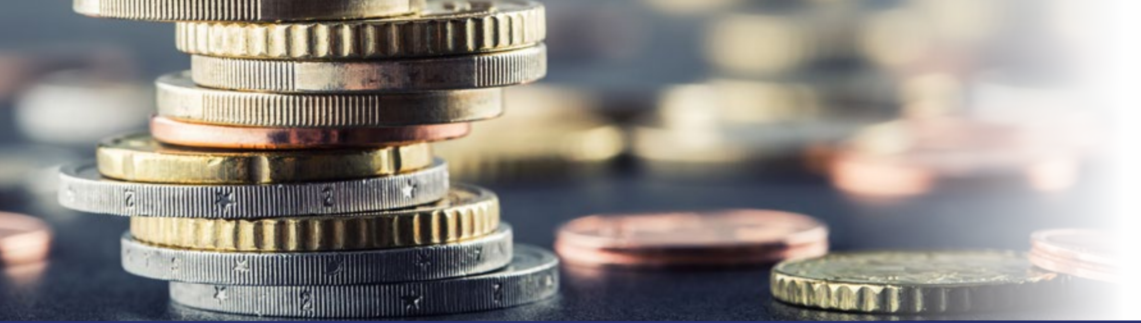
ECB Rate Decision

MONDAY 17TH

Europe CPI Inflation

SATURDAY 22ND

ECB Minutes December Meeting



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MONTH OF DECEMBER

RISK AVERSION AND THE COMMODITY DOWNTURN SKEW OTHER MARKETS

Risk and commodity prices have been key themes in other markets. Safe haven currencies led by the Japanese Yen and the Swiss Franc have strengthened as investors seek less risky assets, responding to lower outlooks for global growth and the pullback in US equities. The USD has also been helped higher on decreasing risk appetite while riskier currencies like the Australian and New Zealand dollars have been pulled lower. If we see this risk off move continue expect to see further gains in the CHF, JPY and USD. A turnaround in US equities would see these currencies lower.

Trade concerns also prop up the CHF and JPY while hurting commodity currencies like the CAD, AUD and NZD. The drop in commodity prices has further held back these three currencies that have otherwise had very encouraging signals as their central banks turn more hawkish. Expect strong upside in these currencies if commodity prices rebound or trade concerns diminish.

For further information on any of the topics discussed above please reach out to our Currency Specialists directly at dealing@fcmbank.com.mt.

Written by Jonty Blundell, Director of Dealing, FCM Bank Limited 28/11/2018.

KEY DATES FOR OTHER CURRENCIES IN DECEMBER

TUESDAY 4TH
(AUD) Reserve Bank of Australia Interest Rate Decision

WEDNESDAY 5TH
(CAD) Bank of Canada Interest Rate Decision

THURSDAY 13TH
(CHF) Swiss National Bank Monetary Policy Assessment

WEDNESDAY 19TH
(NZD) New Zealand GDP

THURSDAY 20TH
(JPY) Bank of Japan Interest Rate Decision