HSBC Global Research

Currency

OUTLOOK

Macro
Currency Strategy
October 2013

The new FX paradigm

We no longer have a single unified model of FX behaviour. Instead, the global currency market is made up of three broad groupings: A) carry candidates, B) diminished safe havens and C) balance of payments club. We explain the mechanics of each of these groupings, and then use them to derive our currency forecasts.

Sterling rally on shaky foundations

The main reason for GBP's strength has been the recovery in the housing market. However, the reality of negative real income growth is likely to bite and we should see an unwinding of recent GBP strength.

Change in forecasts

In light of the ongoing US fiscal standoff, the USD has been weaker than we anticipated. By year end we now expect GBP-USD at 1.53 and EUR-USD at 1.30. In 2014 we still look for further USD strength.

Summary

No single paradigm can explain the behaviour of the overall FX market currently. We believe there are three broad groupings of FX behaviour: the carry candidates, the diminished safe havens and the balance of payments club. We explain the mechanics of each of these groupings, and then use them to derive our currency forecasts.

Can UK relative out-performance and GBP strength continue? This seems unlikely. While the improved housing market has supported UK consumer sentiment and spending, the reality of negative real income growth is likely to see a return of softer UK data and an unwinding of much of sterling's recent strength.

In light of uncertainty over the US fiscal outlook, we have modified our profile for EUR-USD, GBP-USD and USD-CAD, but maintain our bullish USD view going forward.

Attention remains squarely on the US fiscal backdrop with market participants expecting a resolution on the debt ceiling. But what if there is no resolution? We examine what would happen to FX in the extreme and hypothetical scenario of a US default.

Gold prices, so far, have been relatively unresponsive to the US government shutdown. The potential for a sharp short-covering rally in gold exists if the market proves to be too complacent. In a worst case scenario – a default by the Treasury on some of its obligations – gold is likely to move considerably higher.

CAD too calm for comfort: USD weakness looks to remain a key input for USD-CAD movements. Modest variations in economic data trends and the probability of subpar growth going forward suggest that the CAD should be stronger and, in light of that, we are adjusting our USD-CAD forecasts.

AUD-NZD: this cross is in play: In New Zealand rising inflation pressures are working against the RBNZ's forecasts and we now expect them to raise rates as soon as around year end. Meanwhile, the RBA is expected to remain on hold for the foreseeable future. This should bring some downward pressure on AUD-NZD.

Key events

Date	Event
11-13 October	World Bank and International Monetary Fund annual meeting
16 October	Fed releases Beige Book
23 October	BoC rate announcement
23 October	BoE MPC minutes
24 October	Riksbank rate announcement
24 October	Norges bank rate announcement
30 October	FOMC rate announcement
31 October	RBNZ rate announcement
05 November	RBA rate announcement
07 November	BoE rate announcement
07 November	ECB rate announcement

Source: HSBC

Central Bank policy rate forecasts

	Last	Q4 2013(f)	Q2 2014(f)
USD 0-0.	25	0-0.25	0-0.25
EUR 0.	50	0.25	0.25
JPY 0-0.	10	0-0.10	0-0.10
GBP 0.	50	0.50	0.50

Source: HSBC forecasts for Fed funds, Refi rate, Overnight Call rate and Base rate

Consensus forecasts for key currencies vs USD

	3 months	12 months
EUR 1.	286	1.265
JPY 102.	2	105.5
GBP 1.	507	1.497
CAD 1.	045	1.053
AUD 0.	887	0.867
NZD 0.	780	0.765

Source: Consensus Economics Foreign Exchange Forecasts September 2013

The new FX paradigm

The bucket list

There is no longer a single paradigm that explains the behaviour of all FX. From 2000-07, the carry model provided a "one size fits all" mechanism for understanding currencies, but was undone by the global financial crisis. It was quickly replaced by another universal model, that of "risk on-risk off", which provided the FX framework until earlier this year when its grip on currencies began to wane. Since then, markets have looked for, but failed to find, RORO's FX successor.

The mistake has been to look for a single model that can be applied across the board. It simply does not exist anymore. Instead, the global currency market is made of three broad groupings, somewhat interlinked, but with distinct behaviours and drivers.

A. The carry candidates: predominantly G10 currencies, the key consideration here is the outlook for the economy and associated implication for relative interest rates. Here your FX strategist is basically your economist.

B. The diminished safe havens: the CHF and the JPY are no longer exclusively driven by the global consideration of RORO. The JPY, in particular, is trading more as a local than a global currency.

C. The balance of payments club: largely but not exclusively emerging market FX, where the current account balance and the outlook for capital account financing are the key FX drivers. This is back to old school FX analysis.

1. The three buckets

Source: HSBC, iStockphoto

Different strokes for different folks

Far from complicating matters, the realisation that multiple models are in play actually makes life easier. The earlier confusion was driven by the misplaced hunt for a single model, which made for apparent contradictions, inconsistencies and potentially poor strategy. Instead, when one accepts that there are different models for different currencies, it is simply a question of deciding which "bucket" a particular currency belongs in and analysing its prospects accordingly.

Bucket A: The carry candidates

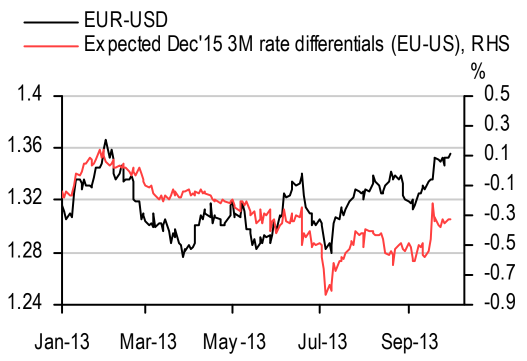
The grip of RORO on the FX market was most potent when we were moving from one crisis to another, and interpreting the resultant policy response or solution. Over the last year, the economic situation in developed market economies has begun to normalise. In the US, the Federal Reserve is debating when its QE programme should be tapered. In Europe and the UK, economic data has generally been coming in better than expected. Recession and deflation are no longer the main talking points. The conversation has moved on to recovery prospects and what this means for monetary policy and, by extension, for the currency. In this way, the currency comes at the end of the economic discussion. It is not driving the economic debate, it is the residual.

The growing influence of cyclical considerations means carry is evident in the major traded currencies and RORO has lost its grip on the markets. Chart 2 shows EUR-USD spot plotted against expectations for where the differential between Eurozone and US 3M rates will be at the end of 2015. We choose such a distant point because the ECB, BoE and Fed argue that rates will be on hold for some time to come. It shows that the exchange rate has begun to track the interest differential increasingly as the year has progressed. In fact, the 3M correlation between daily changes in the two series has risen to 0.57 from a mere 0.06 at the start of 2013 (see chart 3), when RORO was still the chief analytical paradigm.

The relationship is also evident in GBP (see chart 4). In addition, carry considerations are not confined to these G10 currencies' behaviour against the USD. For example, chart 5 shows AUD-NZD against their expected interest rate differential at the end of 2015.

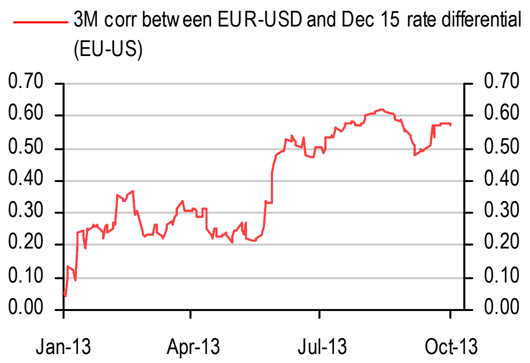
In short, the power of RORO as an all encompassing paradigm has all but disappeared. In the RORO paradigm for example, a stronger piece of US data was seen as USD negative, in

2. EUR-USD vs Dec 15 3M expected rate differential



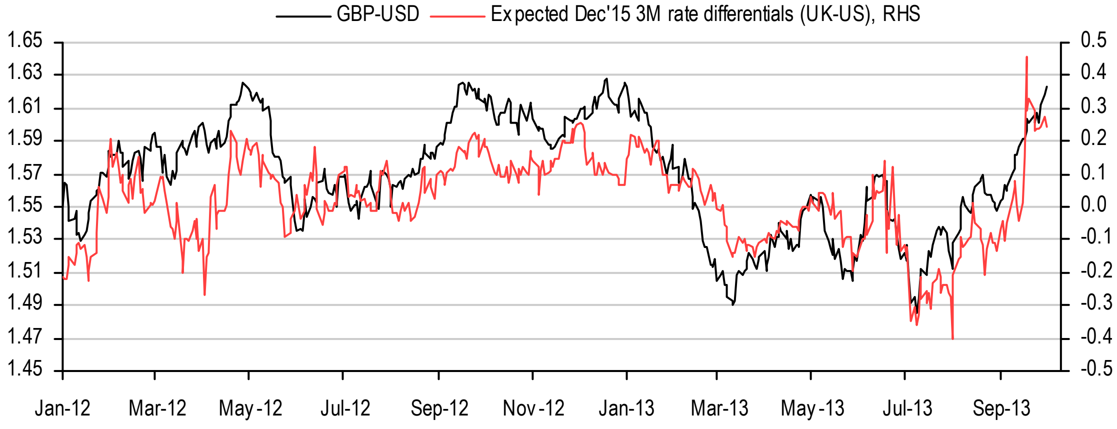
Source: Bloomberg, HSBC

3. EUR is becoming more correlated to rate expectations



Source: Bloomberg, HSBC

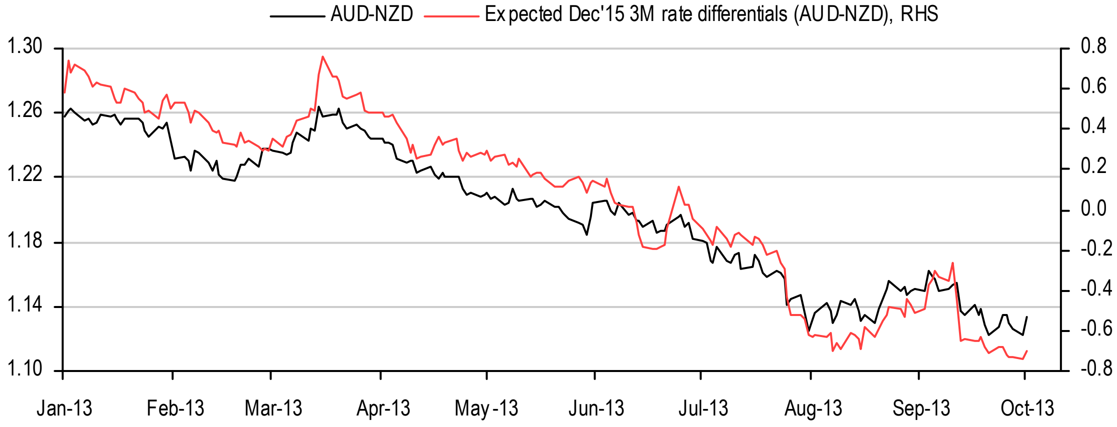
4. GBP-USD is also tracking expected interest rate differentials closely



Source: Bloomberg, HSBC

this bucket it's the opposite. In RORO paradigm positive US surprises were "risk on" and the higher beta returns of the EM world would outstrip returns in the US, so EM was bought and the USD sold. However, we are now back to the world when strong data drives rate expectations and that propels the currency higher. However, this same line of thinking does not work for all currencies.

5. The carry plays are not just against the USD



Source: Bloomberg, HSBC

Bucket B. Diminished safe havens

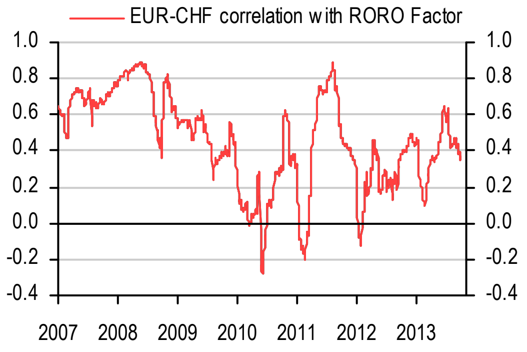
In the old world of RORO, the spectrum of choice was clear. The "risk on" AUD and NZD lay at one end, and the "risk off" safe havens of the CHF and JPY lay at the other. The safe havens did not trade on local fundamentals. They looked globally. Apart from occasional intervention threats, what happened in Japan mattered little for the performance of the JPY. Similarly, the CHF was not a function of the Swiss economy, but of global mood swings.

Unprecedented local change

The ability of the CHF and JPY to act as true safe havens has been increasingly undermined by local shifts in policy. In Switzerland, the introduction of the EUR-CHF floor in September 2011 means the CHF is no longer a clean safe haven. Chart 6 shows the correlation of the EUR-CHF to the RORO factor. The higher the red line, the more the CHF is behaving as a safe haven. Since the introduction of the EUR-CHF floor, whenever the exchange rate has traded close to 1.20, the safe haven characteristics fade. Equally, when EUR-CHF moves away from 1.20, it begins to regain its safe haven characteristics. Overall, this means it is no longer the perfect "risk off" play.

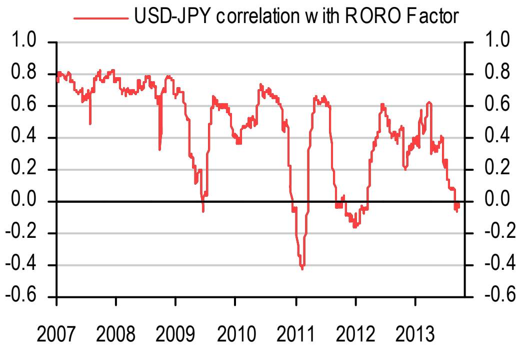
The picture is even more dramatic for the JPY. Since the shift to "Abenomics" in Q3 2012, and the associated rapid monetary expansion, the JPY has traded on the basis of this local factor rather than global considerations. The USD-JPY correlation has moved to zero, meaning it is neutral to the RORO phenomenon (see chart 7). Nor is this a case of a safe haven USD and safe haven JPY offsetting each other. The trade-weighted JPY also has a zero correlation with the RORO factor currently.

6. EUR-CHF has a mixed performance as a safe haven



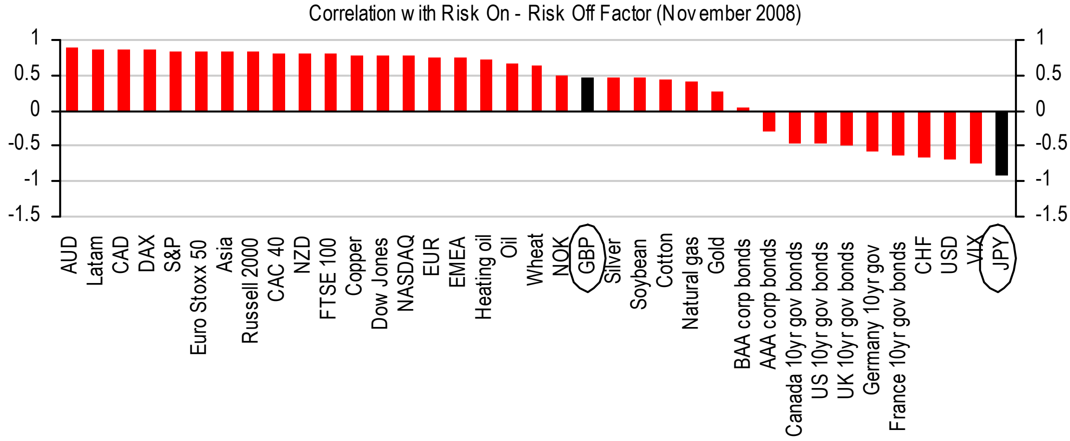
Source: Bloomberg, HSBC

7. USD-JPY is no longer a safe haven



Source: Bloomberg, HSBC

8. GBP used to be "risk on" and JPY the safe haven

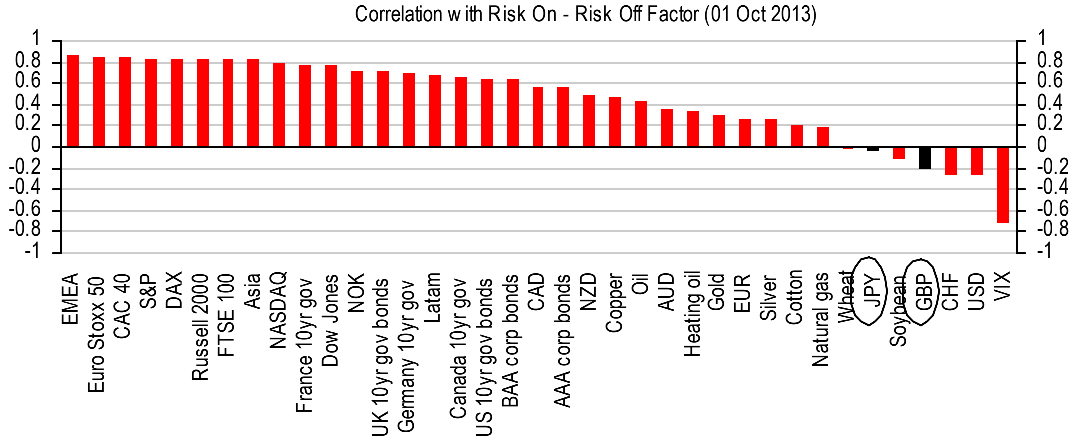


Source: Bloomberg, HSBC

This has had an impact back on some other currencies. For example GBP is now a more risk off currency than the JPY. This is illustrated in charts 8 and 9, which show the correlations of different asset classes against the RORO factor. Chart 8 shows the levels in 2008 when the JPY was the clear "safe haven" whereas GBP had more "risk on" characteristics. Chart 9 shows the most recent readings, and GBP is now behaving more like a safe haven than the JPY.

So whilst the US government is shutting down and Italy was on the cusp of a political crisis the go-to safe havens are no longer the JPY or the CHF. This then propels GBP higher as it wins the ugly contest. By looking at the CHF and JPY in a new and different light, it helps to explain outsized movements in other currencies.

9. Now GBP behaves more like a safe haven than the JPY



Source: Bloomberg, HSBC

Bucket C. The balance of payments club

The balance of payments has always been a component of FX analysis, but in recent years it has been crowded out by the RORO effect. Now it has once again become more prominent, principally for EM.

The beauty of the balance of payments is it always balances. The point is how this occurs. For many years the market was not bothered about the funding of the ever growing current account balances of the EM world, particularly as the Fed had the liquidity taps on full blast. So there were ample capital flows to finance ever increasing current account deficits.

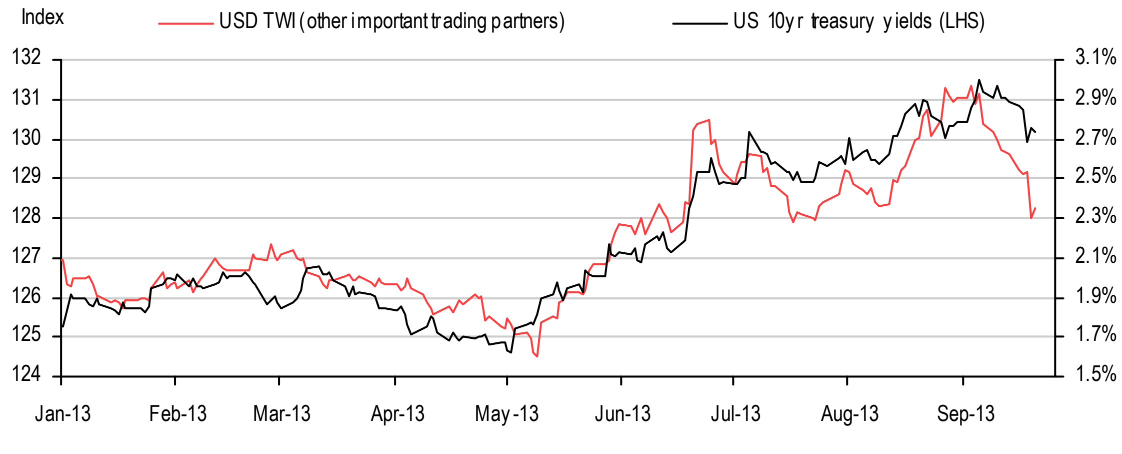
However, on 22 May Ben Bernanke hinted at the beginning of the end to QE. We suddenly got two different shocks. The price of money rose aggressively as depicted by the 10 year bond yield. More important was the impact on global capital flows as money began to withdraw from some EM, partly in fear that future capital flows would dry up. This saw a complete change of heart and suddenly and dramatically current account deficits were seen as unsustainable.

The flow of money shock and the BoP adjustment

The preoccupation with capital flows was evident in the relative performance of EM FX during the initial stages of tapering fears. For the most part, the demarcation between winners and losers was simply along the lines of who had a current account deficit and who had a current account surplus. Chart 11 shows the performance of EM FX between May and September 2013, when EM FX fears were at their height. It plots their performance against their current account deficits, with the worst performers generally being those with the wider deficits.

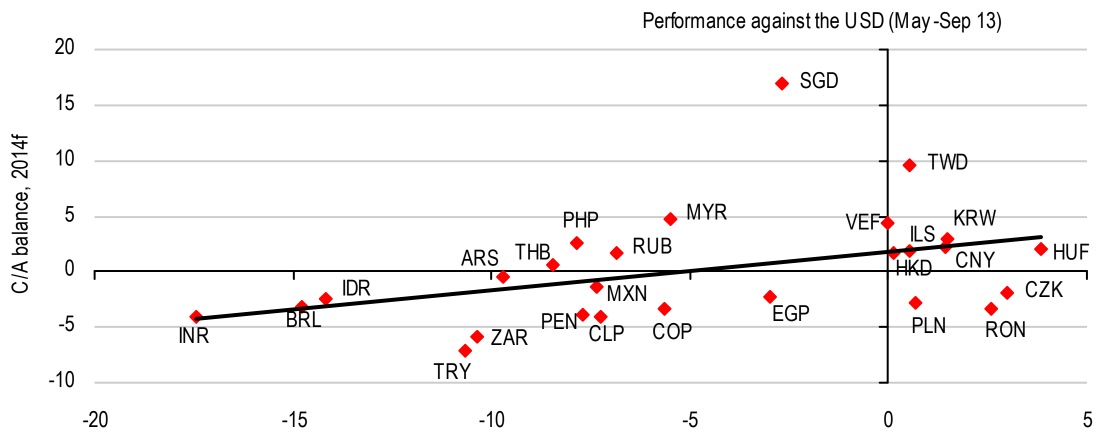
Understanding that current account balances are important for these currencies provides some basis for deciding where they may head next. Our EM FX forecasts still continue to broadly favour those currencies which are not reliant on external financing, thus reducing their sensitivity to the vagaries of the reduction in the quantity of money being provided by the US Federal Reserve. For this reason, we still favour currencies in CE4 (PLN, HUF, CZK and RON), and the likes of KRW and TWD in Asia.

10. The rise in the price of money has hit EM hard



Source: Bloomberg, HSBC

11. Current account balances helped explain the performance of EM FX (1 May – 1 Sep)



Source: Bloomberg, HSBC

The BoP mechanism in action

For those currencies already in the limelight because of their current account deficits, the policy prescription chosen to deal with the imbalance is central to the FX outlook. In effect, you have two routes to resolution:

1 **Reduce your current account deficit** through lower imports and/or higher exports

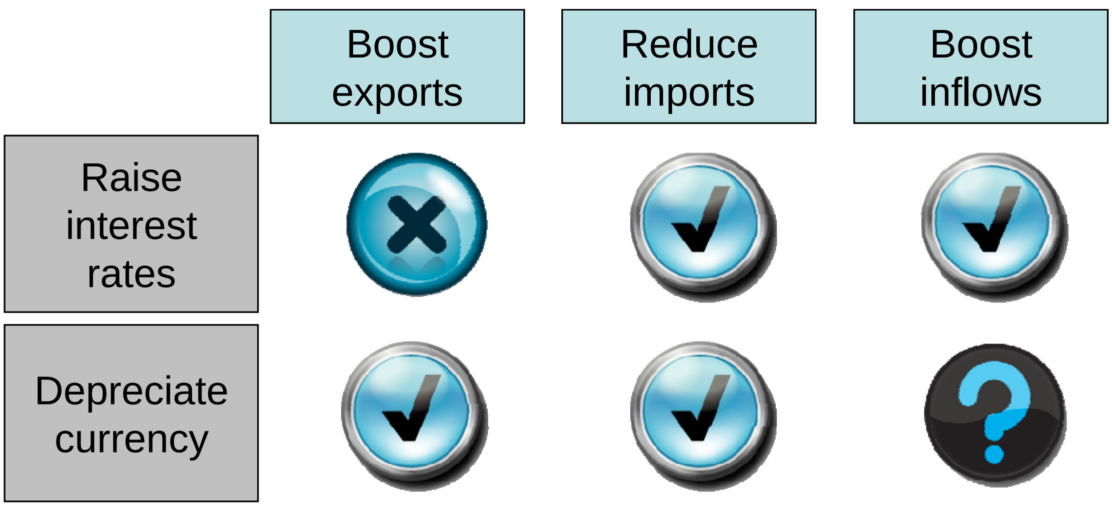
2 **Attract more capital**/liquidity to ensure the deficit is comfortably financed.

In turn, there are two main policy channels through which these aims can be achieved:

1 **Raise interest rates:** This will reduce domestic demand and therefore reduce imports. In addition, the higher interest rate may attract more capital inflows.

2 **Currency depreciation:** In most instances, this should reduce imports and boost exports, albeit with a lag. However, the impact on capital flows is uncertain. Currency weakness could initially deter capital inflows until such time as the adjustment is viewed as complete,

12. Re-establishing external stability can take different routes with very different FX implications



Source: HSBC, Clipart

and domestic assets then offer "value" to the foreign investor.

We have illustrated the simple matrix of choices in chart 12.

The outlook on these parameters is what will shape the relative performance of the currencies within this "bucket C". In a previous report, we noted that earlier depreciation was not a sufficient reason to buy EM FX (see *EM FX: Beyond Cheap*, 13 September), but that other local factors would need to be taken into consideration. But their prospects can still be defined within the simple framework in Chart 12.

A working example of the bucket framework – Turkey vs the UK

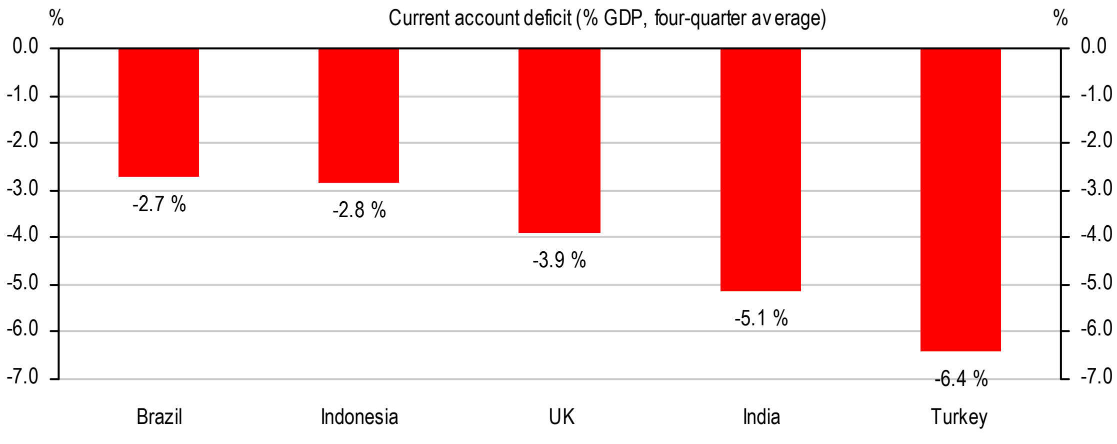
It may not seem like it but Turkey and the UK are in very similar positions yet have very different FX outcomes. In both countries the market is anticipating rate hikes sooner than either central bank has signalled. However, in analysing GBP we need to take a cyclical approach (Bucket A) whereas for the TRY we need to take a balance of payments approach (Bucket C). One approach leads to a stronger currency and the other to a weaker one!

In both Turkey and the UK markets desire higher short rates. In both countries the respective central banks are resisting the desires of the market. Now both countries also have current account deficits. So why is it that the TRY is falling and GBP is rising?

Here we put GBP into bucket A – we look at the UK through cyclical eyes and we do not analyse the UK through a BoP adjustment (bucket C). In bucket A the market ignores the current account deficit and argues that if the central bank does not want to raise rates, then the market will do the tightening for them. Also this is a carry bucket where higher prospective rates propel the currency higher. Taking this thinking a step further eventually the central bank will raise rates and the currency will stabilise; it could even fall back as the market now assumes that the FX does not have to do all the tightening for the central bank.

Turkey, on the other hand, is analysed through our bucket C; that is we view the situation though the eyes of a BoP adjustment. So if the capital flow to Turkey partially dries up in anticipation of Fed tapering, one needs the current account to shrink. Here, if the central bank does not want to raise rates to slow the economy and also attract capital

13. UK Current account deficit is large but does anyone cares?

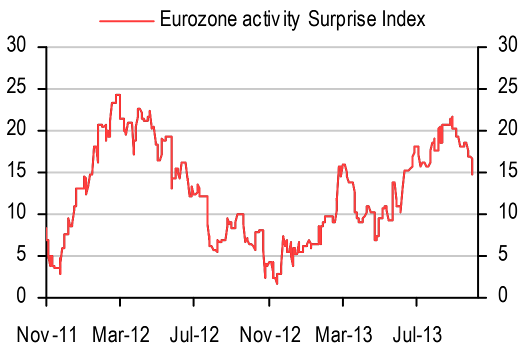


Source: Bloomberg, HSBC

flows then the currency needs to do all the work. The weaker currency will make imports more expensive and exports more competitive and thereby work to cause the BoP to balance. Let’s also take this a step further as per our UK example and assume the central bank eventually capitulates and raises rates. Here the currency will rally as the currency does not have to do all the work as higher short rates both attract capital and slow down domestic demand, thereby slowing imports.

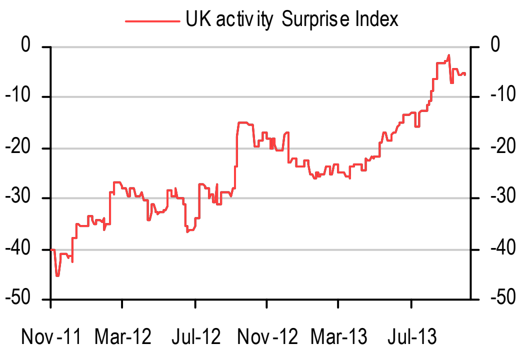
What we are demonstrating here is that we have two economies, both with current account deficits, with the market demanding higher rates. In the case of the UK this propels the currency higher through the paradigm of carry (bucket A) but in the case of Turkey it drives the currency lower through a perceived BoP adjustment. Indeed when both central banks actually raise rates this will propel the TRY higher, but in the case of the UK, the currency reaction to a rate rise is unclear.

14. Eurozone Economic Surprise index



Source: Bloomberg, HSBC

15. UK Economic surprise index



Source: Bloomberg, HSBC

The ABC Method

In the end, therefore, the decision process on FX requires choosing the appropriate bucket. Thereafter, it becomes a case of A-B-C.

Bucket A: make a macro decision about relative economic performance.

Bucket B: gauge the interplay between global and local drivers.

Bucket C: determine the inter-related forces at work between the currency, interest rates, the current account balance and capital flows – these lead to very different FX conclusions.

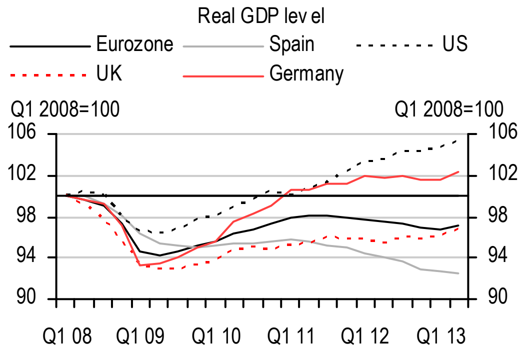
In the following section, we will examine what each of these approaches implies for our FX strategy.

From the Theory to the views

Bucket A: Buy the USD, sell the EUR and GBP

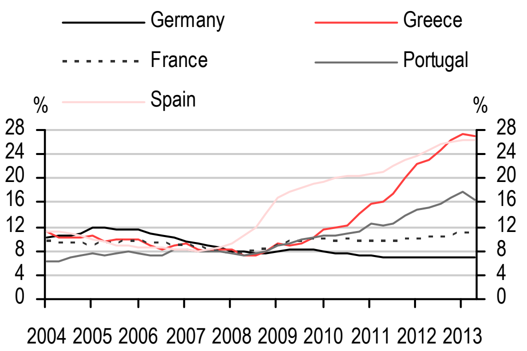
As noted above, the performance of the USD, EUR and GBP are being determined by shifts in interest rate differentials, determined by relative economic fortunes. We believe the current optimism on the UK and Eurozone economic revivals is overdone, and that the associated expectations for interest rate hikes will be pared back over the coming months. By contrast, although US tapering has been delayed by some patchy US data, the Federal Reserve is still heading towards the exit from ultra-accommodative monetary policy more swiftly than its peers. It is this reality that means current USD weakness will not persist.

16. Eurozone recovery is uneven and unimpressive



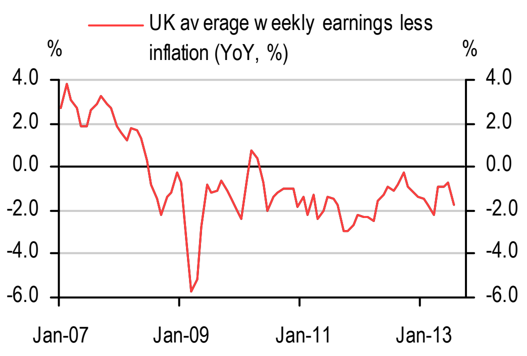
Source: Bloomberg, HSBC

17. Eurozone unemployment to fall only slowly



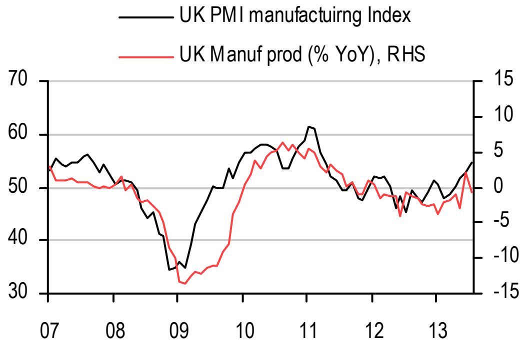
Source: Bloomberg, HSBC

18. UK real incomes growth remains negative



Source: Bloomberg, HSBC

19. PMI is expanding, output growth is flat



Source: Bloomberg, HSBC

Eurozone and UK growth: Better does not mean good enough

Economic statistics in the Eurozone and UK have come in better than expected most of the time since February 2013. We illustrate this in charts 14 and 15, which show our economic surprise indices for these two economies.

On the face of it, therefore, it looks entirely reasonable that interest rate expectations have moved higher and the EUR and GBP too. However, two things are worth remembering:

a) Better than expected economic data should not be confused with good economic data.

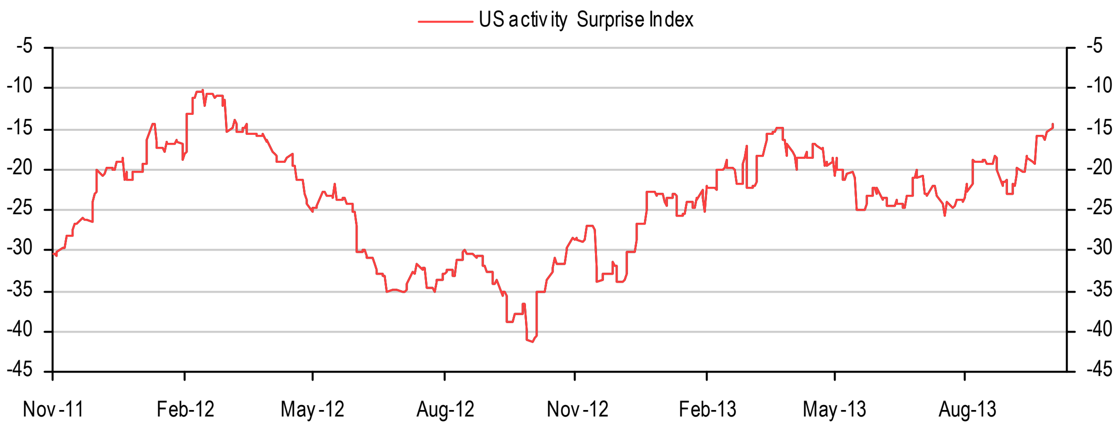
b) Good news has pushed up expectations, which are now proving harder to exceed.

In the Eurozone, the outlook for activity remains subdued. The breadth of the recovery is narrow, confined largely to improvements in Germany and, to a lesser extent, in France. Elsewhere, it is more a case of things getting worse less quickly than before. This is grounds for optimism and relief, but not necessarily a prompt for higher interest rates. Our European economists are projecting Eurozone GDP of just 0.8% in 2014, which will still not be enough to make much of a dent in the unemployment rate or lead to a substantial cyclical improvement in fiscal balances. Indeed, far from arguing for a sequence of interest rate hikes, we think the most likely next step in Eurozone policy will be for a further easing of policy, most likely through an LTRO before the end of this year and possibly an interest rate cut in 2014.

Similarly in the UK, we have our doubts about the current extent of hawkishness priced into the market. The recent revival in activity appears confined to a housing-related boost to spending and confidence that is unsustainable. Real incomes continue to decline, suggesting no lasting support for consumption growth. Labour hoarding through the downturn may mean little employment growth even if the economy gains some genuine upward traction. The government remains in austerity mode, a commitment reiterated at the ruling Conservative Party's recent conference. Net exports are not offering any boost to growth either, and the combination of moribund growth in the Eurozone and a relatively lofty GBP currently, suggests this is not about to change.

Without a more meaningful acceleration in GDP, the BoE is likely to assume the output gap will remain negative and allow the bank rate to be kept

20. US economic activity surprises are once again on the rise



Source: Bloomberg, HSBC

on hold for longer than the market is currently pricing. In addition, much of the recent improvement has been on the sentiment data rather than the hard data. Although the gap is small, it will be interesting to see if spending matches the upbeat mood. In the end, we think a shift lower in interest rate expectations will be matched by a push lower in GBP (for more detail on our GBP view please refer to *GBP rally on shaky foundations*, 24 September).

USD will lead the way

By contrast, in the US, we believe the market mood has moved too far in a dovish direction. There has been an excessive fixation on the exact timing of the likely start of the QE3 tapering, but the simple reality is that tapering will begin at some point. The ECB is expected to ease. The BoE may have to do more QE if it sees UK numbers fall back. In the US, however, the data remains consistent with tapering, and the need for emergency liquidity injections is on the wane. The Fed is heading to the exit, and it will lead the way. Through the summer the data on the US did become more erratic, but the economic surprise index has shown renewed upward momentum of late (see chart 20).

Bucket B: Steady times ahead of JPY and CHF

This bucket offers less excitement than the market would like to suggest. The consensus resolutely sticks to its view that the JPY must weaken against the USD. Similarly for CHF, the market expects future weakness, with 1.30 the consensus view for the end of 2014 on EUR-CHF and 1.03 the expectation for USD-CHF.

CHF will not weaken until foreign opportunities enthrall

For the CHF, the market bearishness has been driven by the assumption that the lack of a EUR break-up story now means the CHF must weaken given it acted as the safe haven during the depths of the Eurozone crisis. But the grip of RORO on the CHF has waned, as it has done across FX. As a result, while the lack of a crisis may mean EUR-CHF can trade away from the 1.20 floor, this is very different from supporting a sustained rise in the exchange rate towards the levels suggested by the consensus. What is needed is more attractive investment opportunities abroad to spur Swiss households and corporates to keep income from their existing overseas investments abroad. Our cautious view on the Eurozone economy, in particular, does not make this a very likely immediate prospect. Instead, advances beyond 1.26 on EUR-CHF will likely remain a challenge until there is a more meaningful pick-up in global growth prospects.

JPY bears looking jaded

Perhaps they are contemplating hibernation ahead of winter, but JPY bears are looking increasingly tired. We have long argued that the bearish view of the market on the Yen was overdone.

This remains the case, and our view is based on three factors:

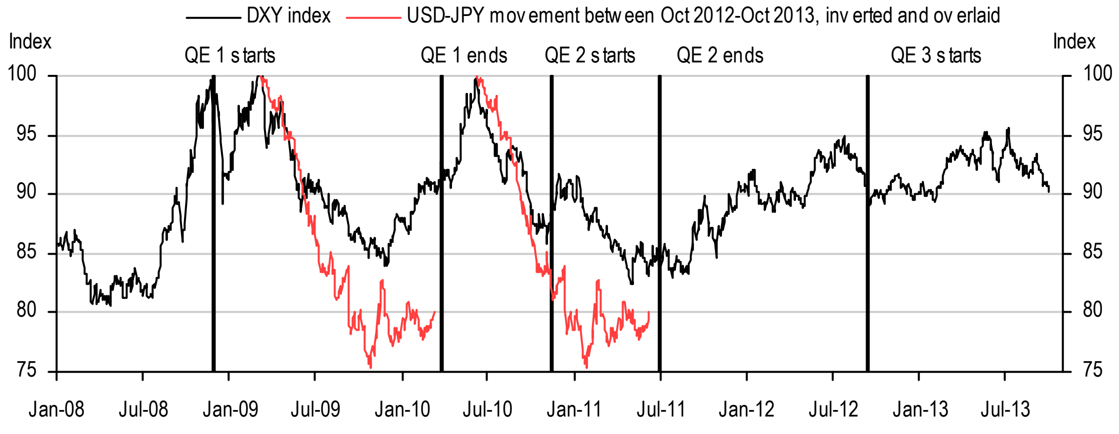
1 A lot is already in the price

2 Capital outflows have failed to materialise

3 The third arrow of structural reform has been underwhelming

The move higher in USD-JPY has already been sizeable. Chart 21 compares the USD index during the various phases of QE in the US with the experience of the JPY since Abenomics came into vogue in September 2012. The moves in the JPY are greater than seen during any phase of QE3. The JPY is now among the more undervalued among the currencies we cover. In addition, while the big announcement of the BoJ in April 2013 grabbed the market’s attention, it has precluded additional steps thereafter. We do

21. A lot is already in the price of the JPY



Source: Bloomberg, HSBC

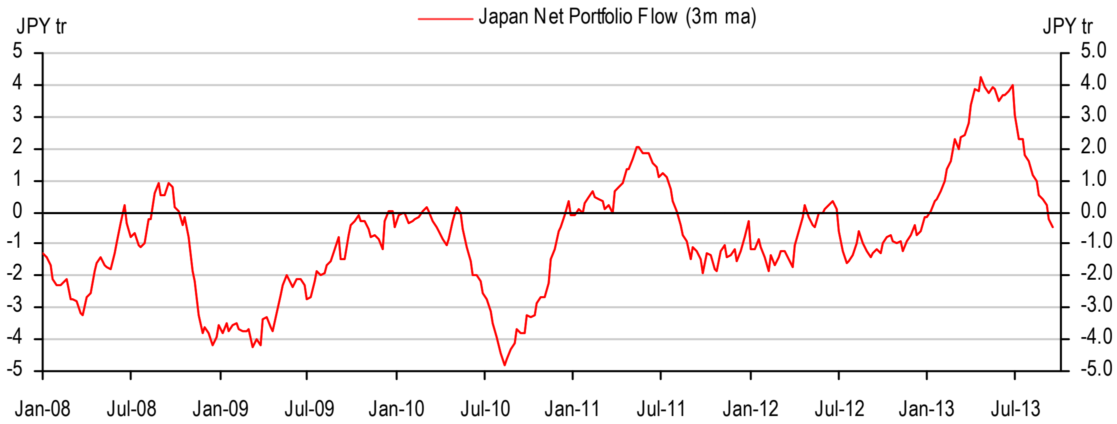
not anticipate the next move in monetary policy to come until 2014. The JPY bears are no longer being fed by monetary policy. They had a feast, fattened up and now need to hibernate.

Expectations that the Japanese would become avid investors abroad during Abenomics have so far failed to materialise (see chart 22). The BoJ's printing press may be running at full speed, but the money is not leaving Japan. This is, of course, relevant not only for the JPY but for those currencies in "bucket C" which might have hoped that Japanese QE could compensate for the expected reduction in US QE. This could yet prove to be the case, but so far it is not evident.

Finally, hopes that structural reform might provide a boost to the Japanese equity market and drag USD-JPY higher up alongside it have not been matched by reality. The consumption tax was introduced as expected, but the market reaction to the overall fiscal stimulus package was rather underwhelming. Challenging the vested interests within Japan remains a difficult task, even under the zealous Abenomics strategy.

Without a fresh spur from monetary policy, with capital not fleeing the country, and with structural reforms not yet a game changer, the more likely path for the JPY remains one of stability, punctuated by an occasional safe haven bid, but in a less potent way than in the past.

22. Japanese liquidity is not yet flowing abroad



Source: Bloomberg, HSBC

Bucket C: time to be selective

The starting point for demarcation within this bucket still largely hinges on the current account balance. Those with a surplus, such as South Korea and Taiwan in Asia, are in the best shape. But a surplus is not an absolute requirement for currency stability. For example, the likes of **PLN, CZK** and **RON** have a small deficit (**HUF** has a small surplus), but because they enjoy stable financing through EU official funding, they are not exposed from a balance of payments perspective.

But for those still struggling with the tribulations of a large deficit and uncertain financing, we must return to the mechanism under this model (chart 12). In other words, FX forecasts for this fraternity will hinge on whether the management of the deficit will come through higher interest rates, or a weaker exchange rate, or some effort to control/encourage capital flows.

For some, such as the **ZAR**, contrary to the consensus, we believe the adjustment already seen in the currency will be sufficient to foster an improvement in the terms of trade, and ease the pressure on the exchange rate as a result. If the data on net trade can improve, then the balance of payments situation can stabilise without recourse to higher interest rates or a further lurch lower in the currency. We are not expecting any rise in South African interest rates until 2015.

For others, the currency may still have to bear the brunt of adjustment. In **India**, it is still too early to say if the current account has stabilised, not least because a weaker currency inflates the oil import bill. Capital flows are also vulnerable to any flight out of equity market investments, to which India is far more exposed than bonds.

If currency weakness is not palatable, then higher interest rates will likely be favoured. For example, we expect **Turkey** to raise interest rates by 175bp before year end, a key element of our stable TRY forecast. The higher rate may tempt in additional capital, or at least raise the cost of shorting the currency, but it will also temper domestic demand and thereby trim imports. Indonesia perhaps falls in the middle in terms of the interest rate/FX rate trade-off, having already tightened policy in an effort to stabilise the currency, but where further FX weakness still seems likely. Interest rates are a damage limitation exercise, not a catalyst for reversal.

Others will look to affect the capital flow channel, either through direct intervention (which acts as the equivalent of an artificial capital inflow) or through regulatory changes. Brazil has been the most activist on this part, and its well-received intervention programme has allowed the currency to stabilise and help contain the pass-through to inflation which is the policy preoccupation. In fact, the authorities may be enjoying too much of a good thing given the BRL’s recent outperformance. But Brazil’s experience underlines that credible policy initiatives can be an important part of balance of payments management for the currencies in this bucket.

Linking buckets

We have spent much of this report drawing the distinctions between the behaviour of currencies in the different buckets. But clearly the buckets are linked.

For example, a more upbeat view of the US economy in Bucket A would imply a swifter tapering of QE with adverse implications for those currencies in Bucket C reliant on capital flows. But there could be some offset to this adverse effect if stronger US demand helped alleviate some of the pressure on EM current account deficits through higher export growth.

Alternatively, while the leakages abroad from Japan’s aggressive monetary easing have not materialised, this could change, altering the complexion of what might be a “sustainable” deficit for currencies within Bucket C.

Nor is membership of one bucket cast in stone. There have been times, for example, when the NOK or AUD have behaved more like an EM FX, whipped about by the whims of capital flows in illiquid markets. As noted above, GBP has increasingly adopted the price behaviour of the safe havens in Bucket B, because the CHF and JPY are no longer the “go to” risk off currencies. So whilst EM is undergoing a BoP adjustment and the US and the Eurozone have political issues, GBP becomes the go-to currency.

Conclusion

Understanding which bucket a currency generally belongs in makes gauging their likely path much easier. The common mistake is trying to identify a single “one size fits all” explanation for the behaviour of all currencies. This may have worked when the carry model was enjoying its universal hey-day in the 2000s, or during the global dominance of RORO following the 2007/08 crisis, but it is not a luxury the FX market is enjoying at the moment. How you visualise the different models may differ from our own, but in the end we believe our bucket approach will help make understanding FX as easy as A-B-C.

Sterling rally on shaky foundations

Sterling has performed strongly over the past two months, reversing most of the weakness seen in the first three months of this year (chart 1). On a trade weighted basis, sterling has risen about 5% since mid-July and is now back at levels last seen in early January.

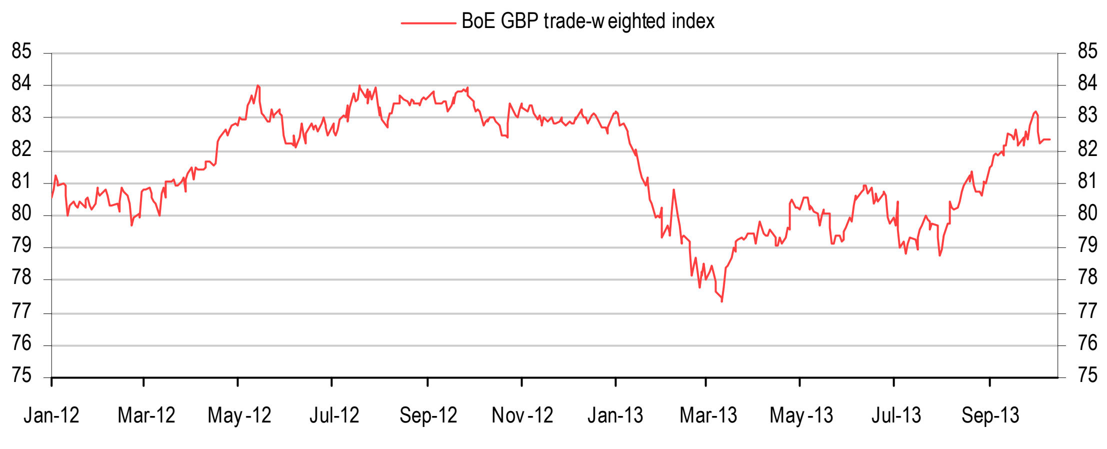
The rise against the dollar (about 7.5%, chart 2) has been even larger, and has come at a time when continued weakness seemed more likely.

The move higher in cable has come at a time when US and UK monetary policy seem to be moving in opposite directions. We had thought we would see the Fed taper with the BoE saying "the market rise in interest rates is unwarranted". In fact, we have seen the opposite. We have seen the Fed postpone tapering whilst the BoE removed the reference that the rise in market rates was unwarranted from its minutes. This turnaround in sentiment, driven partially by the data, is largely responsible for the boost in GBP against the USD. However, we would question how long this perceived US dovishness coupled with UK hawkishness will last. If, as we believe, this perception will once again be turned on its head then GBP will head straight back down again.

The UK data jump

The main reason for sterling's strength has been the string of surprisingly strong UK economic activity data seen recently. Almost all economic activity data for the UK has come in stronger than market expectations over the past two months. Chart 3 shows the HSBC economic activity surprise indices for the UK, US and Eurozone rebased to 0 at the beginning of this year. UK activity data have shown greater positive surprises than either of the other two, especially since July. No allowance has been made in this chart for the smaller number of monthly releases in the UK (average 10 per month) compared with the US

1. GBP TWI has rallied strongly since mid-July



Source: Bloomberg, HSBC

2. Cable at 7-month high

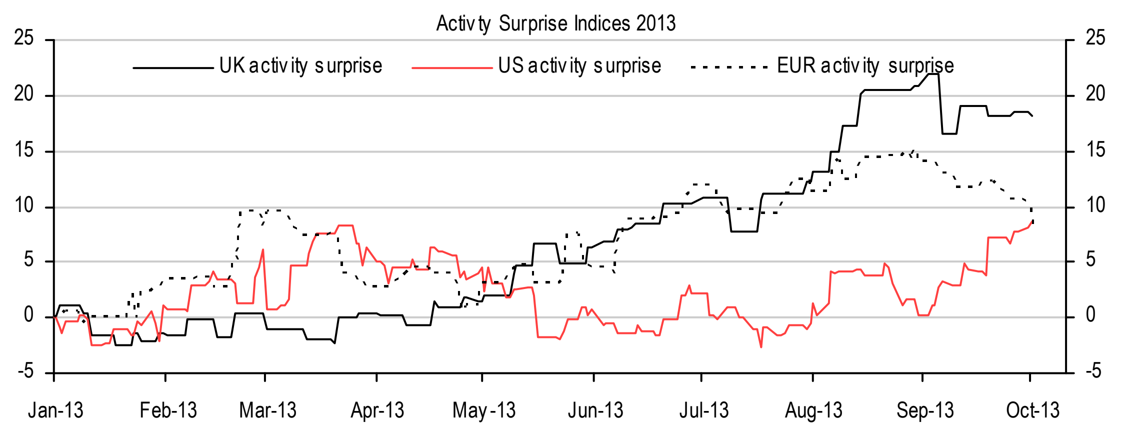
Source: Bloomberg, HSBC

(average 22) and Eurozone (average 17). This makes the UK out-performance more striking as the index has moved further from its starting point on fewer releases.

With the UK economy seemingly doing better, the markets have become less convinced that monetary policy will remain so loose for so long, and the futures market is now discounting 3-month interest rates 75bp higher than current levels by the middle of 2015.

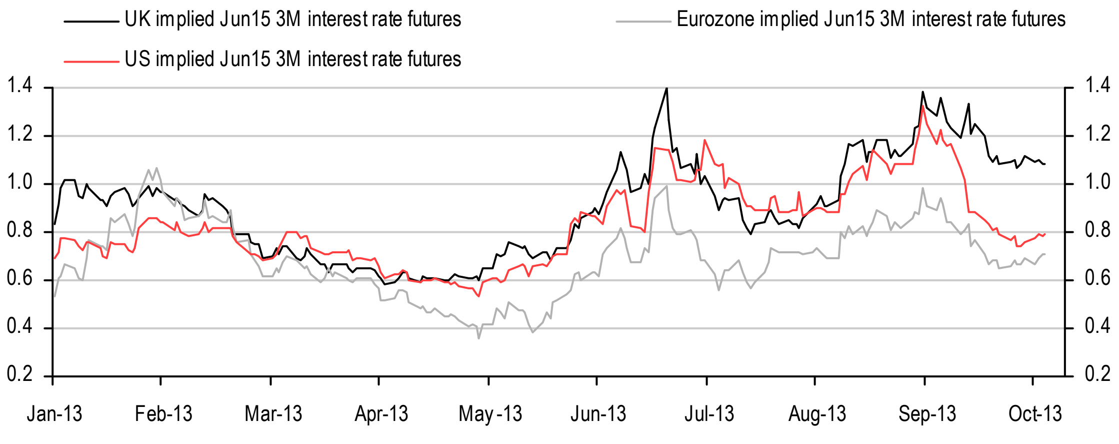
Chart 4 shows the implied interest rates on 3-month interest rate futures for June 2015 for the UK, US and Eurozone. The rise in implied rates in May and June came as bond yields moved up in anticipation of a change in Fed policy. The sharp decline in UK implied rates from mid-June to mid-July came in anticipation of a new monetary regime in the UK under the new Governor. The subsequent rise has reflected the stronger UK data. So while UK interest rate expectations continue to rise, those in the US have fallen quite dramatically. This differential shown in chart 5 explains much of GBP's rise against the USD. This change in interest sentiment could swing back against GBP just as easily.

3. UK, US and Eurozone surprise indices



Source: Bloomberg, HSBC

4. Market not convinced that UK rates can stay low for three more years



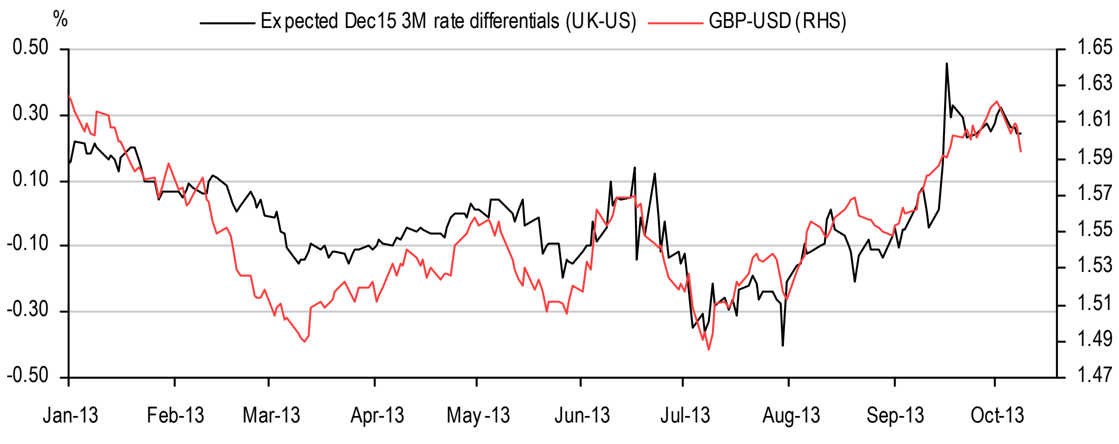
Source: Bloomberg, HSBC

The Fed has already tightened

The relative out-performance of the UK economy has come despite the fact that longer term bond yields have moved higher as global markets have begun to anticipate the change in Federal Reserve policy. Chart 6 shows 10-year government bond yields in the major economies. Since the beginning of May both US and UK bond yields have risen by well over 100bp, and German yields have risen by about 80bp. It would seem that the Fed was getting worried about this rise in yields and was one of the reasons it pulled back from tapering. The Fed turnaround provides further proof that Central Banks won't do anything that risks preventing a recovery. BoE will be no different, as soon as we see weaker UK data, sentiment could shift dramatically, taking rate expectations lower and causing GBP to fall. We need to remember the UK recovery is actually behind the US in the cycle.

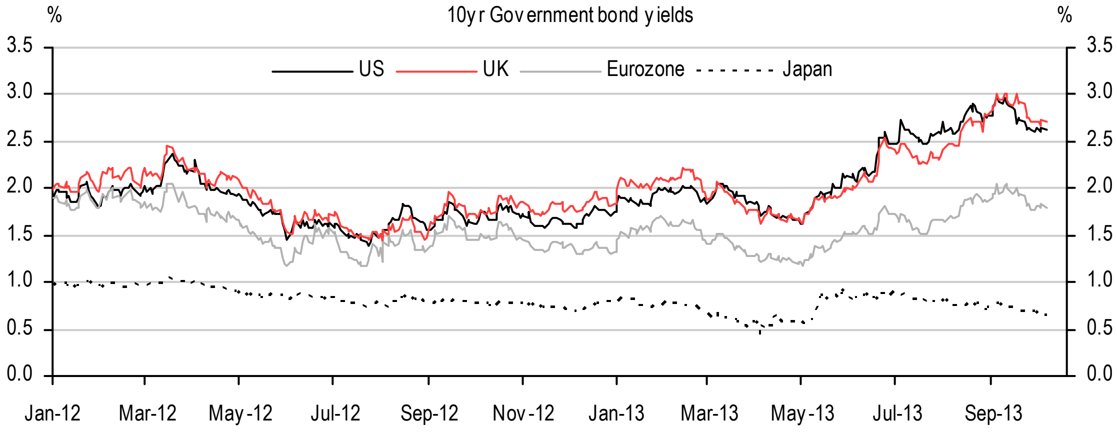
While the increase in bond yields seems to be having some impact on the US recovery, this does not seem to have been the case in the UK. Why is this?

5. Interest rate differential explains much of GBP-USD move



Source: Bloomberg, HSBC

6. UK and US bond yields up 120bp



Source: Bloomberg, HSBC

A tale of two housing markets

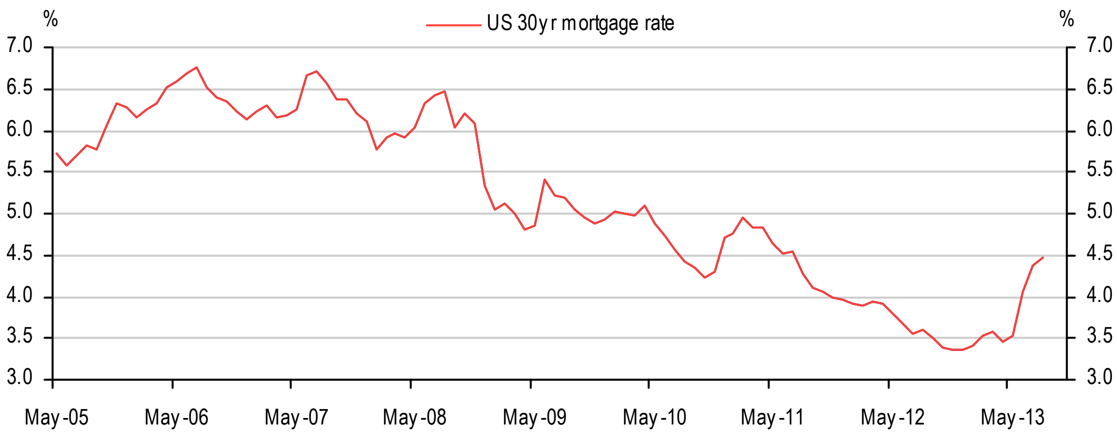
An important reason why a rise in long-term bond yields may have a greater short-term impact on the US economy than on the UK concerns the very different structure of the two housing markets. Chart 7 shows 30-year mortgage rates for the US. These reached record lows early this year, but have risen sharply with government bond yields in recent months.

This rise in mortgage rates seems to be having an impact on the economy with housing starts and building permits both softening. In addition there has been a big fall in mortgage applications as the refinancing demand has fallen away. According to the US Mortgage Bankers Association index, mortgage applications are down nearly 50% year-on-year. The inability to refinance mortgages will tend to have a dampening effect on consumer spending.

In the UK, by contrast, effective mortgage rates have continued to decline, despite the rise in bond yields (chart 8). This is possibly due to two main factors.

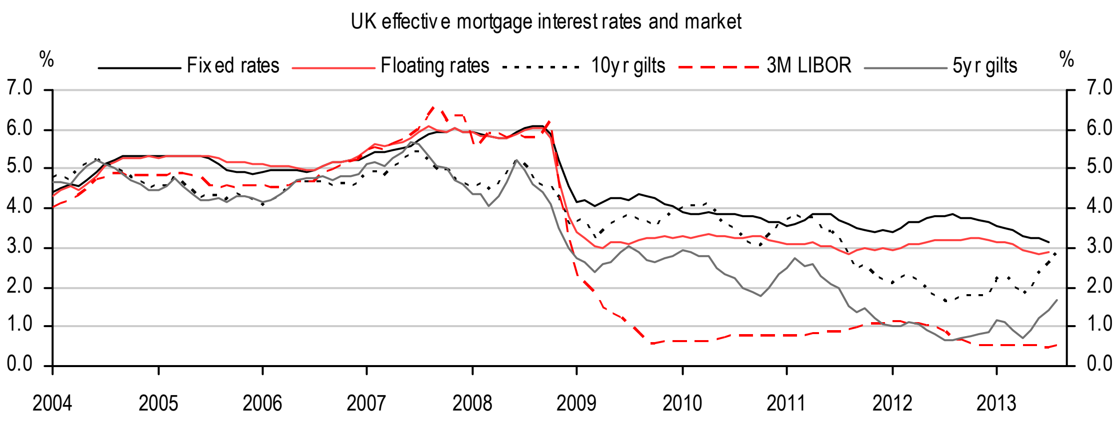
1 The vast majority of UK mortgages are based on short-term variable rates rather than long-

7. US mortgage rates up



Source: Bloomberg, HSBC

8. UK mortgage rates still low



Source: Bank of England, HSBC

term fixed rates.

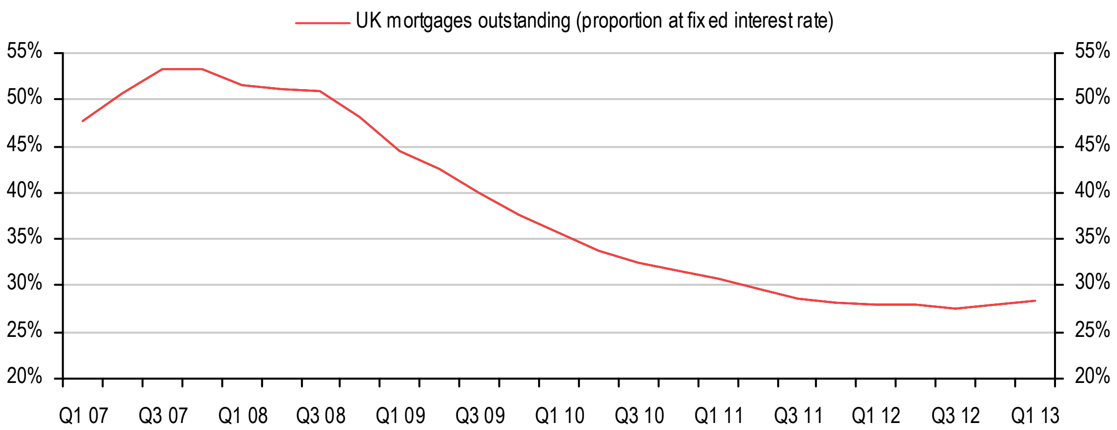
2 New government policies in place and proposed which have the effect of lowering mortgage costs.

1. Mortgages based on short term rates

Although bond yields have been rising, effective UK mortgage rates have continued to decline. An important reason behind this is shown in chart 9, this shows the proportion of the stock of UK mortgages that are based on fixed interest rates (mostly 2 to 5 years). Since 2008, when short-term rates were cut from 5% to 0.5%, this proportion has been falling as new mortgages have been taken out on a (cheaper) floating rate basis, and as older fixed rate arrangements have rolled off.

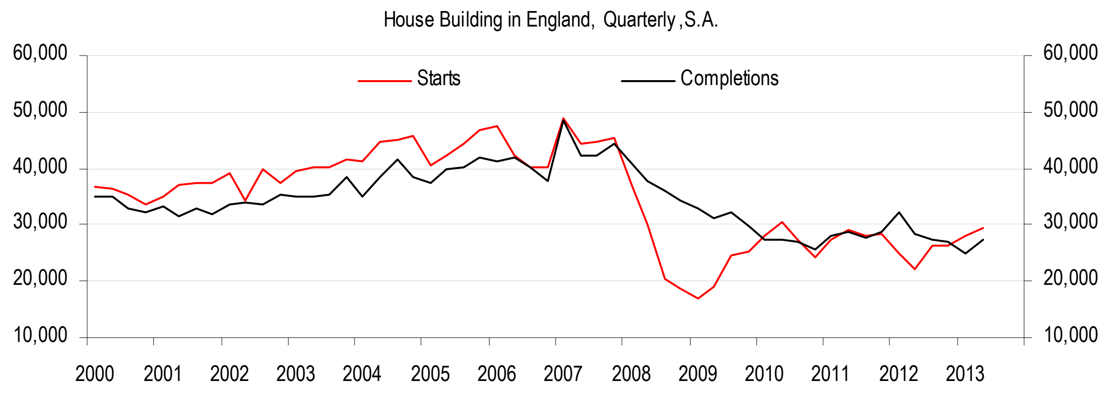
With the Bank of England giving forward guidance suggesting short-term rates will stay at record low levels for a further protracted period, there is a growing perception that the housing market improvement will continue (though this improvement seems to be heavily concentrated in London and the South East). With the BoE having made this promise to the interest-sensitive consumers, neither they nor the government will

9. The majority of UK mortgages are on a floating rate basis



Source: FSA, BoE, HSBC

10. Government aiming to boost house building



Source: FSA, BoE, HSBC

want to break this promise any time soon.

2. Policy aimed at boosting the market

In addition to continued low effective mortgage rates, the UK government has introduced policies aimed at supporting the housing market. There are two schemes under the government's "Help to Buy" policy.

- Equity Loan Scheme. This began in April this year and offers a 20% equity loan (free for the first 5 years) to first time buyers on new build homes for owner-occupation up to a home value of £600,000. The prospective home owner needs to put up a 5% deposit, but then can access a mortgage with a 75% loan to value (LTV) ratio, which will be cheaper than mortgage with a higher LTV ratio. This policy is specifically aimed at supporting house building which remains at low levels compared with the pre-crisis period (chart 10).
- Mortgage Guarantee Scheme. This is now planned to begin this month. It will apply to both new and existing homes, and to home movers as well as first time buyers. It will also apply to homes up to £600,000 in value. The mortgage guarantee will be given to the lender by the government on mortgages of up to 95% LTV ratio. Not all details of this scheme are yet available, but it will, if it goes ahead as planned, be a significant positive for the housing market.

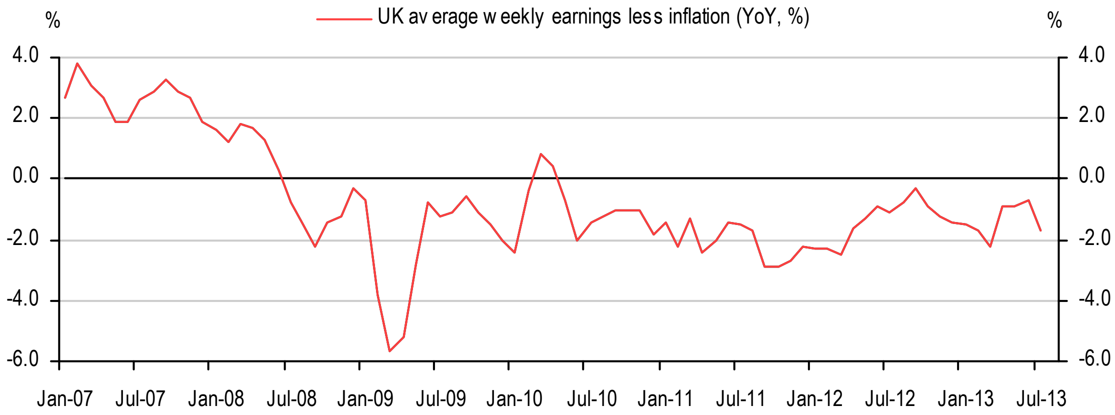
The improvement in the housing market may be encouraging UK consumers, but will it lead to a sustained improvement in UK activity?

UK economic out-performance unlikely to last

Is it rational to believe the UK economy can power away whilst the US falters? The most likely case seems to be that the recent relative out-performance of the UK economy will fade away. First, by their very nature, positive surprises are very unlikely in the long term, simply because expectations adjust upwards. Second, and more importantly, it is difficult to see a sustained increase in UK consumer spending while real income growth continues to be negative.

Chart 11 shows yearly changes in UK weekly average earnings deflated by CPI. Real earnings growth has been negative almost continuously for 5 years. In addition, although employment levels have been rising recently, the level of employment and hours worked is roughly the same as it was in 2008, so aggregate real earnings have also fallen.

11. Real earnings have been falling since 2008



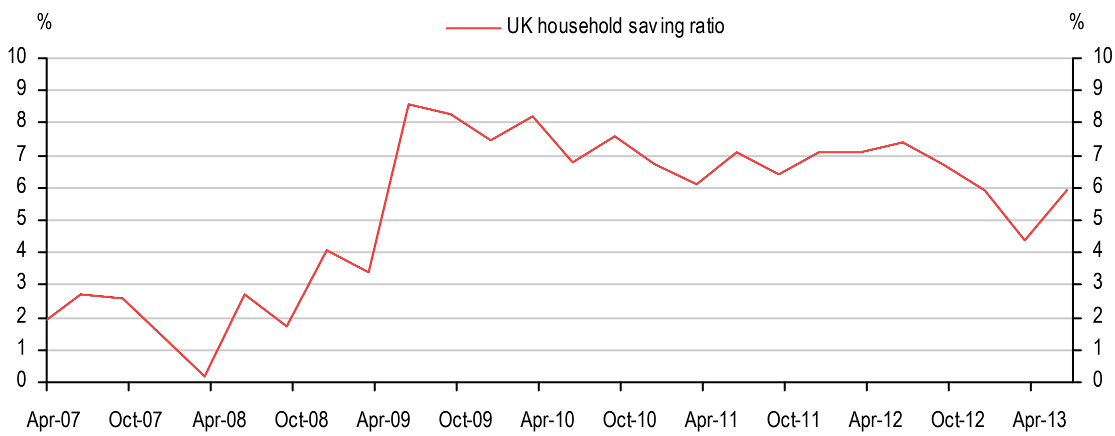
Source: FSA, BoE, HSBC

Higher levels of consumption spending can be maintained in the short term by dis-saving (chart 12), but this is clearly not sustainable. However, the Q1 drop in the savings ratio may have been exaggerated by the change in bonus payments – due to the change in the upper rate of tax. We are very unlikely to see a return of large scale mortgage equity withdrawal even if mortgage rates stay at very low levels, so eventually spending will have to reflect weak incomes.

Conclusion

It is tempting to believe that the strong UK economic data will continue as the housing market comes back to life and consumers continue to increase their spending. If this were the case, then the Bank of England would find it very difficult to keep rates at a record low for a further long period, and the recent rally in sterling could continue. However, the more likely case is the upside surprises in the UK turn into downside surprises as the reality of negative real income growth come back to bite. Meanwhile, in the US tapering is just a matter of when not if. In this case, we are likely to see sterling reverse much of its recent rise particularly against the USD.

12. Household saving ratio: relatively low



Source: Bloomberg, HSBC

Change in forecasts

Forecast revisions

The Fed cited uncertainty over the fiscal outlook as one reason for delaying the tapering, and this appears justified now in light of the ongoing fiscal standoff. As a result, the USD has been weaker than we anticipated, and the EUR and GBP have both benefited in this "ugly contest". In turn, this means the starting point for our anticipated sell-off in EUR-USD and GBP-USD is higher than we initially forecasted. We have modified our profile consequently (see table 1) but retain our view that both these exchange rates are set to fall in the medium term.

Further, with USD gains not panning out as quickly as we had anticipated, we are adjusting our USD-CAD forecasts modestly lower for later this year and 2014.

On the assumption that a solution will be hammered out in Congress, this will prove only a temporary headache for the USD, and one set to reverse swiftly once resolved. Beyond the issue of delayed tapering and the fiscal standoff lies a stronger USD.

21. Forecast revisions

		Q4 13f	Q1 14f	Q2 14f	Q3 14f	Q4 14f
EUR-USD	New	1.30	1.28	1.25	1.24	1.24
	Old	1.24	1.23	1.22	1.22	1.22
GBP-USD	New	1.53	1.51	1.48	1.46	1.46
	Old	1.45	1.44	1.44	1.44	1.44
EUR-GBP	New	0.85	0.85	0.85	0.85	0.85
	Old	0.86	0.85	0.85	0.85	0.85
USD-CAD	New	1.05	1.07	1.09	1.10	1.10
	Old	1.09	1.10	1.10	1.10	1.10

Source: HSBC

What if there is a default?

A theoretical debate

Attention remains squarely on the US fiscal backdrop. The Congressional stalemate on a spending resolution and the associated partial government shutdown continues to highlight the more troubling issue of reaching an agreement on the debt ceiling, which is due to be hit around October 17. Market participants expect a resolution on the debt ceiling, and while it is not clear what form that will take, the vast majority of the market expects the government to avoid a default on its debt obligations.

But what if...

All that said, we continue to field questions on what would happen to the USD in the extreme and hypothetical scenario of a US default. There are clearly a number of variables to consider, but our current thoughts on the matter are as follows:

In broad terms, we think a US default would severely weaken the USD and emerging market currencies. The traditional safe havens of the JPY and CHF would benefit somewhat, but could be restrained by local intervention. As a result, it is likely the EUR and GBP would also strengthen against the USD.

The US-centric nature of this potential crisis would most likely mean that the USD would be sold aggressively should the US default on its debt obligations. This would be very different from the fiscal standoff and US ratings downgrade in July-August 2011, as it could threaten the stability of the Treasury market and with it the functioning of the USD as a reserve currency and store of wealth. The anchor for the currency market would be loosened. We think it would be a mistake to assume that the USD could offer some sustained safe haven role under these circumstances given the likely attrition in both US bond and equity markets. Moreover, it is likely that the ramifications of a default would only emerge over time, which could create continuing headwinds to the USD well beyond the initial market fallout.

The JPY and CHF would initially capitalise on such a development, given their role as a safe haven in times of market stress.

However, the scale of the CHF rally would be constrained by the EUR-CHF floor at 1.20. It is also possible that the BoJ and Japanese MoF might feel tempted to intervene to limit the extent of JPY strength given currency weakness has been a key element of their current strategy to reflate the economy.

As a result, the EUR and GBP would likely benefit the most. GBP has already begun to exhibit safe haven characteristics around the US tapering debate, winning the "battle of the uglies" among G4 currencies. It is a contest that GBP would likely continue to dominate alongside the EUR in the event of a US default. There could be some push back from policymakers in the Eurozone and the UK to try and limit currency strength. But with interest rates already near zero and QE of questionable influence against sizeable capital inflows, it would likely only limit the damage rather than prevent it completely.

Finally, the "risk off" environment should also put EM currencies under pronounced weakening pressure, especially among those currencies already wobbling courtesy of their current account deficits. If the US default raises questions about the functioning of the global financial system, fears on whether sufficient funding would be available for these deficits would intensify. Those enjoying current account surpluses may enjoy some relative outperformance once again, but when global capital is fleeing for safe havens, EM currencies as a block would come under pressure.

Gold and chaos theory

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Gold is not glittering

Gold prices, so far, have been relatively unresponsive to the US government shutdown. There have been 17 previous government shutdowns between 1977 and 1996, lasting from 3 to 21 days. For most of these, gold's reaction was limited and difficult to separate from overall market trends.

Gold did react to a previous stand-off over the debt ceiling. The last time this occurred was in 2011, when a deal to extend the debt ceiling was reached on August 2, just days before it was estimated that the Treasury would be unable to meet debt payments. Gold prices accelerated sharply from the beginning of July 2011 (chart 1), moving from USD1,485/oz to nearly USD1,900/oz by late August 23. The resolution of the crisis slowed – but did not reverse – the gold rally. Prices peaked in nominal terms in September 2011, boosted by the European Union's sovereign risk crisis and expectations of another round of QE. Volatility and trading volumes in this period were high. The chart shows current volatility levels compared to August 2011.

All change

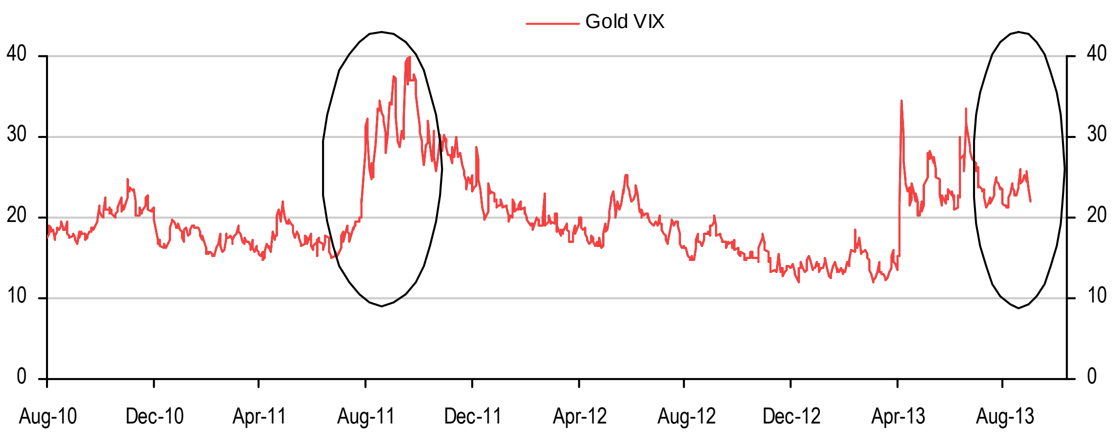
The gold market is behaving quite differently this time. Gold trading volumes and volatility are low and price ranges narrow. This inability of gold to rally may be due to broader based bearish sentiment towards the metal (see *'Gold Outlook: Getting physical'*, 12 September) than to indifference to events in Washington. If the stand-off does result in missed payments by the US Treasury, we do expect a gold reaction and a rally in gold.

Our fixed income strategists believe that US treasury yields would fall amidst a wider "risk-off" sentiment in the markets if a government debt

1. Gold reaction to 2011 stand-off over the debt ceiling and now

Source: Bloomberg, HSBC

2. Gold VIX



Source: Bloomberg, HSBC

payment is missed or delayed. In *'Debt-ceiling debate: Managing Treasury payment delays'* (7 October) HSBC's Global Head of Fixed Income Research, Steven Major, said that if Congress fails to raise the debt ceiling, a delay of payment by the US Treasury is more likely, and would not be the same as a bond default like that of Lehman Brothers in 2008. The disruption should be manageable by the government and treasury yields would likely fall given the weakening economy. However, there would be a longer-term impact on the credibility of the US financial system and the USD's reserve currency status. In such a scenario, bullion is likely to benefit due to it being mainly priced in USD terms, along with its historical status as a "safe haven" asset.

Chaos would suit gold

The potential for a sharp short-covering rally in gold exists if the market proves to be too complacent. At its worst, a failure to extend the debt ceiling could result in a default by the Treasury on some of its obligations. A default, or a delay, even for a few days, could potentially disrupt global financial markets by calling into question the value of the Treasury debt used as collateral or as a hedging vehicle in financial contracts around the world. If the situation were to get even more chaotic due to a lengthy delay in resolving the impasse then gold would be favoured. In this scenario gold is likely to move considerably higher, as investors scramble for bullion for its characteristics as a liquid and hard asset, which can be used for collateral.

Dollar Bloc

CAD too calm for comfort

USD-CAD briefly touched three-month lows in September, with the dip to 1.0200 stemming in part from the USD's swoon after the Federal Reserve's decision not to begin tapering its bond purchase program. USD weakness – and gyrations more broadly – look to remain a key input for USD-CAD movements in the coming months as well. The Canadian backdrop has been less dynamic than the one in the US, but modest variations in economic data trends and, from our perspective, the probability of subpar growth going forward suggest to us that the CAD should remain on the defensive, including against the USD. That said, we are adjusting our USD-CAD forecasts (see page 27) and now look for USD-CAD to end the year at 1.0500 and for gains to the 1.10 area by Q3 2014.

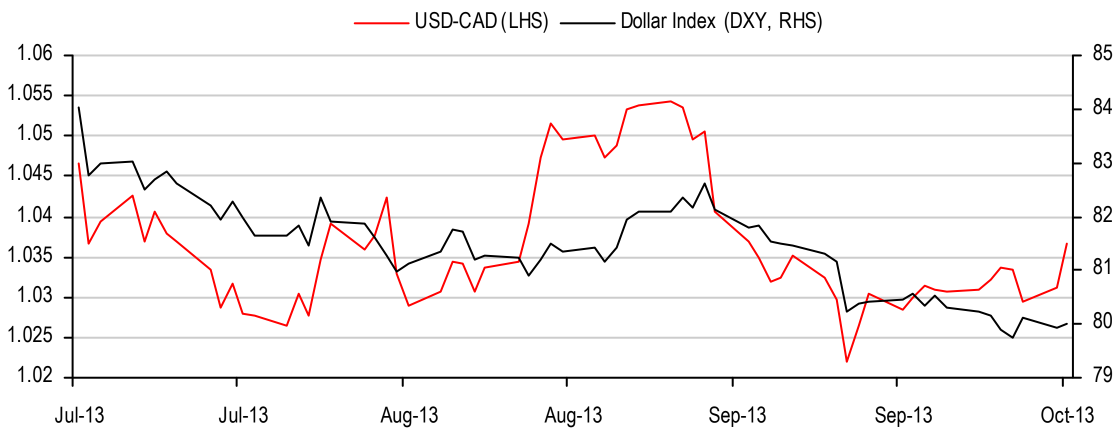
The USD as a driver

The Fed's decision not to begin scaling back its current bond buying program at the September 17-18 FOMC meeting was a key event, for all markets, and particularly the USD (chart 1).Our economists do not think the Fed will begin tapering before the December 17-18 FOMC meeting, suggesting the USD, including USD-CAD, will not derive much benefit from such speculation in the near-term. Moreover, the latest fiscal impasse in Washington throws further uncertainty into the Fed outlook, given the downside risks to growth and the delay of some economic data. That backdrop suggests recent USD weakness can persist a bit longer and if so, that will also create some headwinds for USD-CAD.

Canada data less eventful

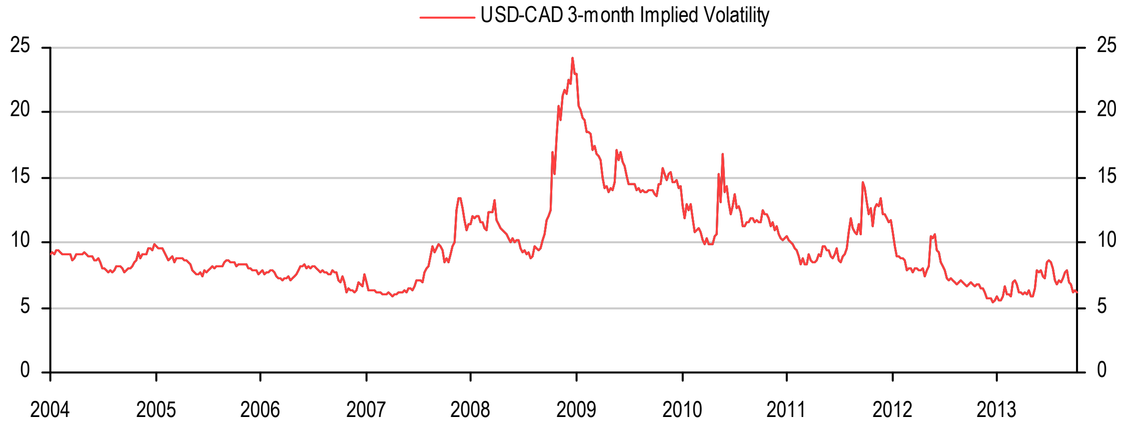
In Canada, the recent data flow has not led to material shifts in the outlook for the economy. Inflation remains benign, with August headline and core CPI coming in at 1.1% y/y and 1.3% y/y respectively. Retail sales rose 0.6% m/m in June, which essentially reversed the 0.6% decline in June. And in a similar pattern, GDP

1. Broad USD weakness plays some role in recent USD-CAD slippage



Source: Bloomberg, HSBC

2. USD-CAD volatility at exceptionally low levels



Source: Bloomberg, HSBC

rose a chunky 0.6% m/m in July, but that healthy increase reversed a sizeable 0.5% m/m decline in June GDP.

Bank of Canada gives some guidance

The next fixed rate announcement and Monetary Policy Report (MPR) by the Bank of Canada is due October 23 and, as has been the case for the past three years, no change in the 1% overnight target rate is expected. BoC Senior Deputy Governor Macklem provided some rare guidance about future forecast revisions at an October 1 speech, saying the Bank expects growth in Q3 and Q4 of this year between 2% and 2.5%, which runs contrary to the BoC's projection in the July MPR that Q3 growth would rebound to 3.8%. However, as our Canada economist points out, the change is more of a bookkeeping exercise. Essentially, the BoC previously expected Q2 growth to rise 1.0%, and for Q3 growth to rebound from that level (the 3.8% figure). However, Q2 growth came in better than expected at 1.7%, curtailing the opportunity for a bigger rebound in Q3, and accounting for the forecast change.

But importantly, Mr. Macklem noted that the anticipated rotation in Canada's economy from consumption towards exports and investment "has proven elusive". The slowdown in emerging market growth has created headwinds for commodity exporters such as Canada, and is a key reason why the CAD and other currencies such as the AUD, have declined this year. That might not put additional downward pressure on CAD at this stage, but it will certainly be a factor markets will continue to assess over time. More immediately, the upcoming BoC meeting and MPR will be monitored for detail on the Bank's thinking on these and other matters. But there should be no immediate policy implications from these developments and indeed, our economist looks for policy to remain on hold at least until the end of 2014.

USD-CAD volatility

There is relatively low volatility in USD-CAD and indeed, it continues to sport the lowest levels of implied volatility among the G10 currencies versus the USD. Recently, volatility has declined further still, with three-month implied volatility falling to near 6% after trading near 8% at the beginning of September. Price action in the spot is, of course, the driver in that regard, and USD-CAD remains in very familiar ranges. While we do expect USD-CAD to move higher, it looks to take more time to develop and if so, it is one condition that suggests volatility will remain at lower, rather than higher levels.

That said, the latest decline in volatility has put it in closer proximity to the May low of roughly 5.6% as well as the cycle low near 5.3% reached in December 2012 (the lowest level seen since the financial crisis erupted). Current levels of volatility are moving towards the lowest levels seen in the past decade-plus and on that measure alone; they are "cheap." The current uncertainty regarding the political atmosphere in the US and the implications of either a resolution or a missed Treasury payment could suddenly and dramatically see volatility surge. Those looking to hedge CAD exposure particularly through options should take advantage of the current low levels of volatility.

AUD-NZD: this cross is in play

AUD-NZD has been tracking the interest rate differentials in a broad brush fashion since 2009 (see chart 1) but not closely enough to be considered a prime driver. This year is different as the carry phenomenon has notably intensified (see chart 2). It is therefore worth looking at the relative economic performance of both countries and associated interest rate expectations.

In New Zealand rising inflation pressures are working against even the RBNZ's desire to only raise rates in mid-2014. The spillover from the rising housing market into general inflation as well as the momentum in the construction sector, particularly in Canterbury, are the key inflation risks the central bank is facing. The RBNZ have suggested they will raise rates in the first half of next year but we fear that building inflationary pressures in particular are pointing to another adjustment before then. In fact we expect a rate rise around year-end.

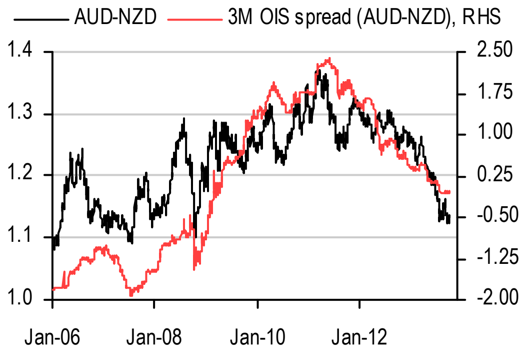
Meanwhile, over the Tasman Sea, the RBA is expected to remain on hold for the foreseeable future. This should bring some downward pressure for AUD-NZD.

So whilst the RBNZ is getting increasingly hawkish, the RBA seem to be comfortable with the current rate setting. Australian economic data has been coming in better than expected as well as sentiment has improved recently. The lift in sentiment in the past two months has been driven by the improvement in the housing market and the recent change of government. A housing boom is largely considered as a positive development, in fact, it is part of the RBA's plan to rebalance growth as the mining boom fades. This further supports the idea that they would be reluctant to hike rates any time soon.

Our central case is that the RBNZ could hike rates in Q4 this year, though the market is looking for a 25bp hike between the second and third quarters of 2014. This should see the NZD hold on to its outperformance of the AUD.

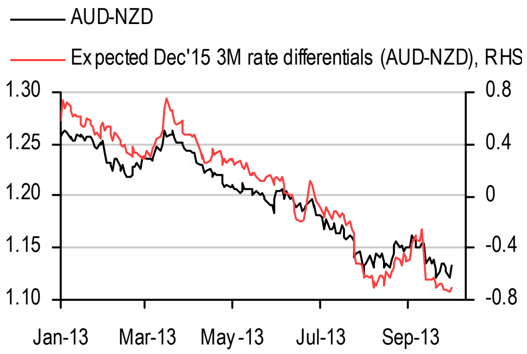
Importantly, as the progress on the US fiscal impasse remains elusive and there is little US data produced, the AUD-NZD becomes an attractive cross. The cross is understandable and is based on economic fundamentals as evidenced by chart 2. In short AUD-NZD is data dependant and shies away from the whole issue of the US political situation.

1. AUD-NZD tracks interest rate expectations closely



Source: Bloomberg, HSBC

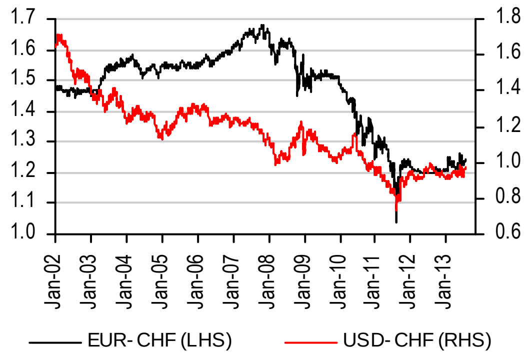
2. Carry has particularly intensified in 2013



Source: Bloomberg, HSBC

G10 at glance

CHF

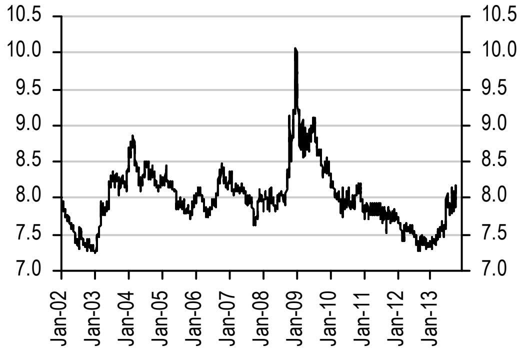


Source: Bloomberg

Switzerland: Diminished safe haven

- See 'The new FX paradigm', page 3

EUR-NOK

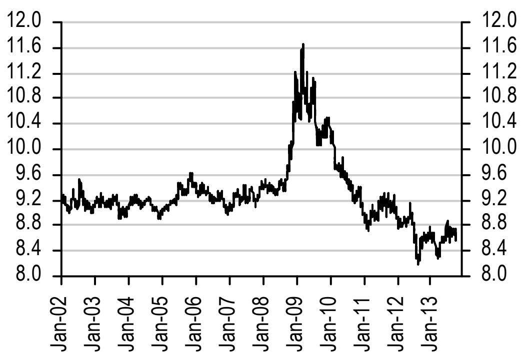


Source: Bloomberg

Norway: The battle between liquidity and fundamentals

- It seems NOK is fearing a repeat of 2008. In 2008 when we witnessed large position unwinds, the less liquid NOK got hit hard. It's the fear of a lack of global liquidity that seems to have overwhelmed the fundamentals.
- The local data has not helped either, with inflation, retail sales and the industrial production data all coming out weaker than expected. Added to this was a rise in the July unemployment rate from 3.3% to 3.6%. This has driven interest rate expectations down and taken the NOK down with it.
- For the NOK there is a battle between fundamentals and liquidity. In a world where we are worried about liquidity rather than fundamentals the currency loses out. This of course will not persist and the NOK medium-term appeal on the basis of its current account surplus, its fiscal surplus and the fact that it will still deliver one of the highest rates of growth within G10 should see the NOK snap back.

EUR-SEK



Source: Bloomberg

Sweden: Stuck in a global rut

- The USD has been particularly weak over the last month but SEK has been unable to fully capitalise on this. Scandies have been the worst performers in the G10 space against the USD. NOK has the issues of liquidity to deal with but the SEK has the issues of the equity market. The market loves to believe that the SEK is a partial play on equities. We have attempted to dispel this idea however, that's how the market likes to trade the SEK. The issue of the US government shut down has hit the equity market and thus has harmed the SEK.
- As far as the data is concerned we had one blockbuster upside surprise. The PMI manufacturing rose to 56.0 from 52.2. However, these elevated expectations were soon brought down to reality as the important PMI services report and the actual IP data disappointed.
- All in all the SEK is range bound and caught up in the prospects for equities which have been harmed by the US political stalemate.

Asia – regional overview

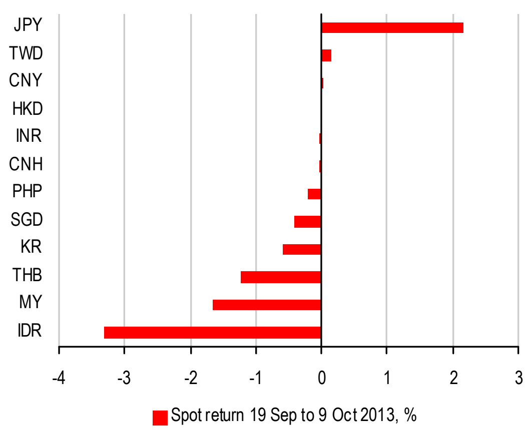
Although many Asian currencies staged a significant rally after the Fed's decision to delay its tapering, the follow through performance of have been disappointing. In fact most Asian currencies are weaker versus the USD at the time of writing (Chart 1). This implies that the structural challenges facing some of these currencies like the IDR and MYR continue to act as a drag.

So overall, this is still a 'pick and choose' market. There will likely be a continued divergence between North Asian currencies compared to their South East Asian peers.

In the longer run the outlook for the Fed's tapering will remain in focus for Asian currencies, particularly those with current account deficits or those with thinning current account surpluses. In this context we remain cautious towards the INR, IDR and MYR, albeit less so than previously.

This is because the fallout from the US shutdown is expected to moderate broad USD strength for now. And in turn, we have scaled back some of our expected USD strength versus some currencies, especially the INR and MYR.

1. Asian currencies struggled after the Fed delayed tapering



Source: HSBC, Bloomberg

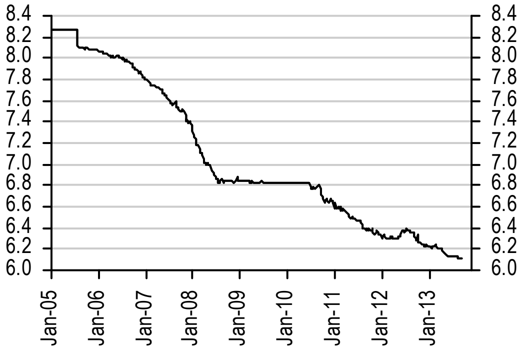
The calming of Asian FX volatility has provided a window of opportunity for some policy makers. For example, the RBI has started to roll back some of its emergency liquidity measures, installed in July 2013 to limit currency weakness. Since the FOMC meeting, the RBI has reduced the Marginal Standing Facility (MSF) rate by a total of 125bps, possibly reflecting the central bank's renewed focus on inflation given the recent stability in the INR.

Meanwhile in the medium term the likes of the KRW and the TWD will continue to outperform, buffeted by strong current account balances and portfolio inflows. In these countries we have seen policy makers increasingly showing a preference for currency stability, which suggests FX policy resistance against local currencies' strength, could intensify. Nevertheless, the KRW and TWD's stronger fundamentals and larger external balances should stand them in good stead.

We have also recently revised our year-end 2013 and 2014 USD-CNY forecasts to 6.12 and 6.10 from 6.16 and 6.16, respectively. We take into consideration recent improvements in data and better external sentiment. Medium-term RMB is also closer to equilibrium value. Moreover, we think that the RMB story is more about internationalizations and reforms, rather than outright appreciation. As we near China's Third Plenary session in November, there could be more announcements of FX liberalisation measures.

Asia at a glance

USD-CNY

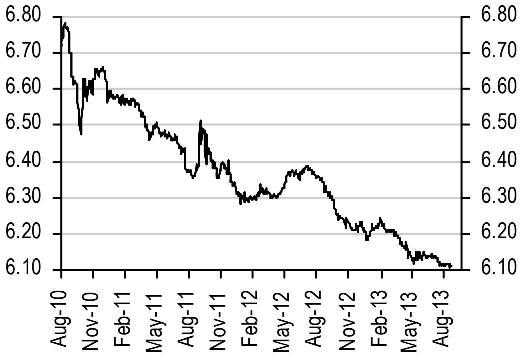


Source: Bloomberg

China (CNY): Resilience intact

- We lower our forecasts for USD-CNY for 2013 and 2014 to 6.12 and 6.10 respectively, in view of the recent improvement in China economic data and a delay in Fed QE tapering. These should have improved the capital account inflows, which along with resilient trade surplus would suggest improving FX inflows in the months ahead.
- Nevertheless, we still hold the view that the RMB is now closer to its equilibrium level and hence do not look for strong appreciation against the USD from current levels.
- We also expect a gradual convergence of short-end USD-CNY NDF and USD-CNH curves, taking into account the PBoC's intention to lower the USD-CNY mid-point fixing. A potential closing of the gap between onshore spot and the fix, together with China's third plenary session of the 18th CPC in November, may increase expectations of further FX liberalisation in Q4.

USD-CNH



Source: Bloomberg

China (CNH): Boosting reforms

- The launch of Shanghai's pilot Free Trade Zone (FTZ) on 29 September is another step forward in China's drive for RMB convertibility and internationalization.
- A wide range of financial and regulatory innovations planned in this special zone will prove helpful. Policy experiments with currency convertibility and interest rate liberalization mean we could see an offshore RMB market which more accurately reflects onshore RMB funding rates as well as offshore USD rates.
- The FTZ will also be an important test ground for FX regulations. A "negative list" means we are likely to see an evolution towards a more market-based FX regulatory system used in financial centres such as Hong Kong. For instance this may be evident in terms of requirements for net open positions, liquidity requirements and liquidity facilities.

USD-INR

Source: Bloomberg

India: Gradually stabilizing

- Sentiment towards the INR has improved visibly since late August, thanks to an improving external environment due to a delay in Fed tapering, rebound in China growth and better than expected balance of payment data.
- The new RBI governor Rajan's FX measures including FX windows for oil companies, FX swaps for FCNR deposits and banks' external borrowings have also helped to attract temporary FX inflows. Given the recent stabilization in USD-INR, the RBI governor has started to roll back some of the FX measures. After the September FOMC meeting, the repo rate was raised by 25bps while the MSF rate was lowered by 75bps. A further lowering of the MSF rate by another 50bps was announced on 7 Oct, coupled with extra liquidity measures.
- Despite this temporary stabilization, we are still cautious towards the currency due to some of its structural weakness from a large current account deficit. More reforms are needed to tackle India's structural challenges.

Asia at a glance continued

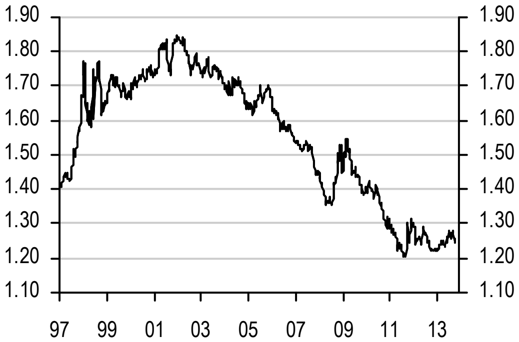
USD-IDR

Source: Bloomberg

Indonesia: Not yet out of the woods

- Recent rate hikes by Bank Indonesia (BI) and the delay in Fed tapering has helped to create some short-term stability for the IDR. This could mean that there is less pressure on BI to sell USDs in the coming months. In this case, it could help build more confidence in the currency, though we will need to see more evidence of this through deeper FX liquidity.
- Meanwhile domestic data in September are showing some signs of stabilization. Inflation was lower on the month and the trade balance recorded a small surplus on the back of decelerating import growth.
- Despite recent policy efforts and stabilization in the data, we remain cautious towards the IDR until FX liquidity and price discovery become more apparent and the trend in the current account deficit shows a meaningful improvement. Also the trend of estimated intervention by BI should provide some clues as to whether or not FX policy is relaxing.

USD-SGD



Source: Bloomberg

Singapore: MAS - happily hawkish

- The MAS policy decision will take place on 14 October. We expect the MAS to maintain the slope of the SGDNEER at 2% with the width of the band to be unchanged at +/-2% around its mid point, same approach as in the April 2013 meeting. Given the MAS's forward-looking nature and focus on core inflation, we expect it to maintain its current tightening stance.
- Singapore's high-beta economy has felt the pinch of the global economic slowdown. While inflation has eased, this has to a large extent been driven by an engineered drop in car prices. Looking ahead, global economic conditions should improve, lifting growth towards the end of 2013 and more so during the course of 2014. This should further squeeze existing capacity and again build up underlying inflation pressures.
- SGD continues to have the strongest current account surplus in Asia, and its core and basic balances remain sizeable. Thus, it stands out as a defensive currency if market jitters re-emerge.

USD-THB

Source: Bloomberg

Thailand: Better momentum

- While THB's external balances may have weakened due to rising external debt, we note this appears to have been driven by a combination of Japanese FDI and intra-company borrowing by Japanese subsidiaries in Thailand, which are less volatile and vulnerable to a retracement.
- Moreover, Thailand's current account seasonality tends to improve into Q4 with the majority of equity dividend outflows in Q2 and Q3. Meanwhile, from a bond perspective, our rates team is overweight Thailand given the favourable supply outlook, which could drive more bond inflows.
- On the FX policy front, estimated FX intervention activity in Thailand has been much more tilted towards selling USDs in recent months and hence we would not expect the same resistance to a stronger THB as we may see in other markets in Asia. Even though we see the divergence between North Asian and South East Asian FX to continue, we believe the THB may weaken to a lesser extent than some South East Asian peers.

Latam– regional overview

Uncertainties to keep volatility high

We turned more constructive on LatAm FX last month and, indeed pressures have subsided as have outflows, even though investors' conviction remains low. (See *'Latm FX Focus: After the storm, the rally'*, 18 September). However, uncertainties over the timing of Fed tapering and, more recently, the political impasse in the US over the budget, remain in place and are weighing on markets, including LatAm FX.

Assuming a resolution in the US budget negotiations and a less severe reaction to tapering when it is finally announced, we see tail risks reduced and room for some more gains in LatAm FX ahead. Concerns over current accounts in the region are somewhat mitigated, at least for now, by evidence that capital flows have remained strong as well as via terms of trade improvements. A resumption of corporate and sovereign bond issuances since the September FOMC decision should also help to attract fresh inflows into the region near-term, we believe. To be clear, our more constructive view is a tactical one.

We also find conditions to be rather mixed across countries at present and thus reiterate our call for differentiation, with opportunities for relative value trades.

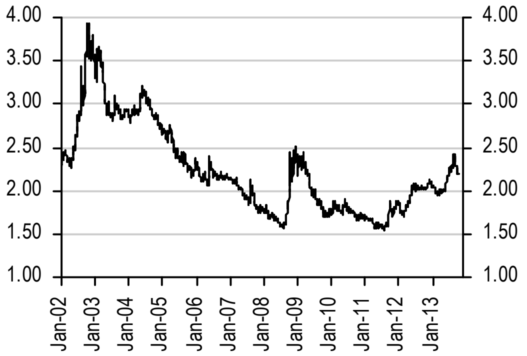
We continue to see positioning, FX policy, carry, and inflows momentum favouring BRL outperformance near-term. Foreign investors' long USD positions continue to run at near historic highs while the pipeline of USD inflows continues to grow. The key question in investors' minds is how comfortable the Brazilian authorities will be if the BRL continues to outperform, and whether they might consider suspending or reducing their automated dollar sales program. For now, the authorities are embracing the reduction of volatility in the currency and we see a number of potential inflows supporting a more stable BRL near-term.

We also see value in being long COP tactically on a heavy calendar of inflows and reduced dollar purchase program. The main source of USDs on the horizon is the likely repatriation of USDs by the national oil company Ecopetrol as it prepares to make dividend payments in 4Q. Meanwhile FDI inflows continue to show remarkable resilience, likely explained by still-high oil prices. We think these flows will smoothen out the usual negative seasonality for the COP in 3Q and 4Q and thus see room for the currency to re-test the 1860/USD level now that the central bank has cut back its reserve accumulation program.

In contrast, we see the MXN struggling to gain much ground with Banxico cutting rates amidst on-going downward revisions to growth. Given that the main support of FX inflows for the currency comes from short-term capital flows into the local bond and equity market, the MXN is likely to continue trading with general sentiment towards EM. We see value in being long the currency medium-term on the structural improvements that will follow the reforms, but near-term gains seem more limited, for now.

Latin America at a glance

USD-BRL

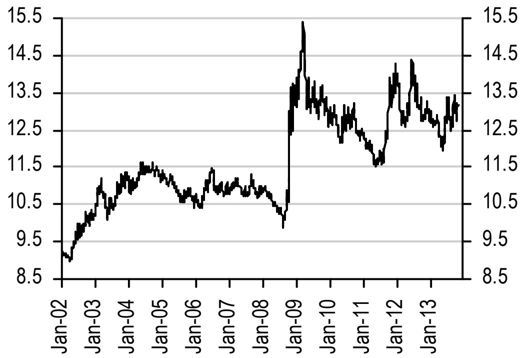


Source: Bloomberg

Brazil: Flows support stability near-term

- We turned more constructive on the BRL when the automated intervention program was introduced on 22 Aug. Since then the BRL has outperformed other LatAm FX and we see this trend continuing near-term. From a flows perspective, the BCB intervention will bring USD2bn in inflows per week. Other sources of FX inflows include the USD2.5bn in CVRD dividend payment in late October and another potential USD3bn from the auction of the Libra oil field. Data also show that foreigners have been buying bonds in the local market again since the removal of the IOF tax in May.
- We see the BRL well supported near-term to trade with increased stability. We also note that at current BRL levels, the current account deficit has already started to correct.
- Therefore, we see pressures on the currency contained for now. Looking into 2014, the main risks for the BRL is the presidential election and we see room for more weakness to 2.40/USD.

USD-MXN

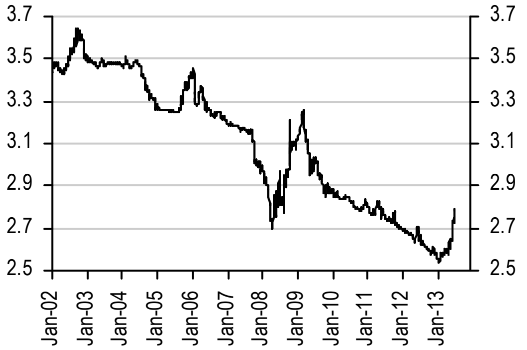


Source: Bloomberg

Mexico: Activity drops, awaiting reforms

- The recent drop in economic activity remains a concern and will likely result in a further rate cut when the central bank meets this month. Notably, the last two rate cuts have been followed by sharp bouts of MXN appreciation, so it's not a certainty that another cut will undermine the local currency, especially as it's priced into the curve.
- That said, we do think that a lower yield spread to the US reduces the longer term attractiveness of the MXN, especially when compared to rising Brazilian yields. Reforms are still a key domestic focus, with the fiscal reform expected to be passed in the next month, followed by the all-important energy reform before year-end. The former has the potential to disappoint investors, while the key focus of the energy reform will be on the details of the secondary laws on the style of oil contracts offered to foreign oil companies.
- We believe the MXN has room to recover to 12.70 by year-end.

USD-PEN



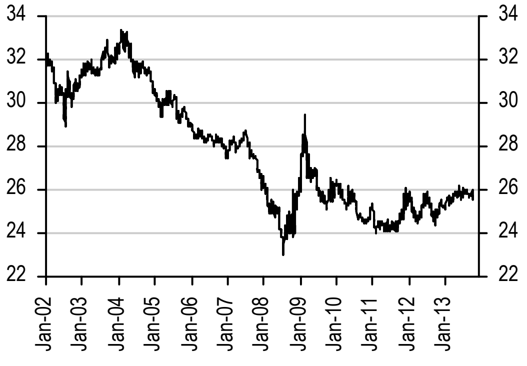
Source: Bloomberg

Peru: Central bank to maintain FX range

- There are good reasons for the central bank to want to keep the currency range-bound vs the USD, and further there are good reasons why they are likely to do so. PEN strength is undesirable from an export competitiveness standpoint, especially given the recent weakness in the currencies of main trading partners and competitors, while too much PEN weakness becomes a concern given the still-high degree of USD-denominated credit in the financial system – much of it unhedged. For these reasons we can expect the central bank to continue its sporadic intervention tactics on both sides of the market, and USD-PEN is likely to be kept in a 2.70-2.80 range over the medium term.
- For now the primary focus is on the top side of that range. There was no need for the central bank to sell USDs since early September, but any threat of a breach of the 2.80 level will likely induce them to do so.

EMEA at a glance

EUR-CZK

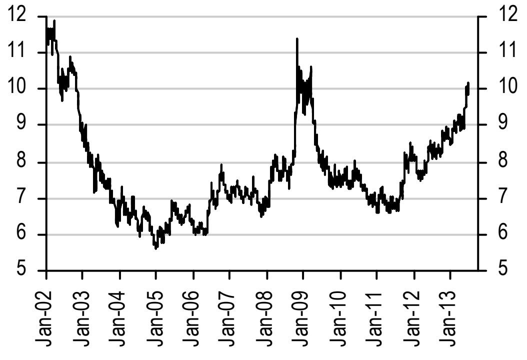


Source: Bloomberg

Czech Republic: The CNB passes again on FX intervention

- The Czech central bank voted again on FX intervention. The motion has not found a majority. The majority of MPC members continue to consider that there is no imminent deflation risk. Therefore, FX intervention to weaken the CZK is not needed, particularly with an economy has bottomed out.
- Yet inflation remains at a very low level. The so-called 'monetary policy relevant inflation' used by the CNB to determine the underlying trend of inflation has fallen in recent month. If the economic recovery is not sustained, the need to loosen monetary conditions further will re-emerge. With the policy rate at almost zero, FX intervention would be the only option.
- All in all, the risk of intervention is low but has not totally disappeared. For now, the CZK is unlikely to weaken significantly from the current levels as the balance of payments dynamics are supportive and the CZK is still seen as a 'safe haven'. However, we continue to see it underperforming its

USD-ZAR

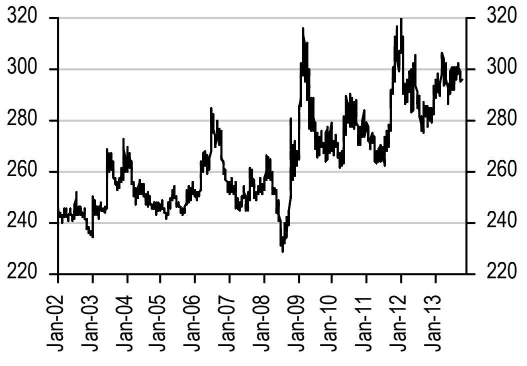


Source: Bloomberg

South Africa: rebalancing should eventually support FX

- The current account deficit widened in Q2 and August trade deficit came out wider than expected. Yet, there is a clear sign that export performances are improving. Export volumes are on the rise. However, imports continue to grow at a very strong pace offsetting the positive effects of better exports. The high level of oil price fuel imports is the main reason behind this although there are also some structural factors at play.
- We continue to believe that eventually the past sharp depreciation of the ZAR will correct imports, while the nascent signs of export revival will strengthen. Therefore, we stay rather bullish ZAR in the medium-term.
- In the short-term, the wide trade deficit and the uncertainties surrounding the fiscal situation may maintain some downward pressure on the currency. But we do not see a significant fall as the bulk of the FX adjustment is already done.

EUR-HUF



Source: Bloomberg

Hungary: The FX debt programme around the corner

- From a valuation perspective, we consider that the HUF is an attractive currency. We also believe it is able to show some resilience to Fed tapering thanks to its strong current account balance.
- Admittedly, there are still several factors of vulnerability. The most imminent risk is the forthcoming new plan for mortgages denominated in FX. The government aims at phasing them out. Banks have till 1 November to propose a plan or the parliament will vote a law. The reduction of the sensitivity to FX movements is not fundamentally negative for Hungary in the long-term. However, the market is concerned by the uncertainties surrounding the details of the plan and its potential implications on the banking sector and FX policy going forward.
- Therefore, we are neutral-HUF in the short-term as the outlook is government policy depend but see value in the medium-term.

HSBC

HSBC Volume-Weighted REERs

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For full details of the construction methodology of the HSBC REERs, please see *"HSBC's New Volume-Weighted REERs"* Currency Outlook April 2009.

The value of a currency

Since FX prices are always given as the amount of one currency that can be bought with another, the inherent value of a currency is not defined. For example, if EUR-USD goes up, this could be because the EUR has increased in value, the USD has decreased in value, or a combination of both. One possible method for getting some insight into changes in the value of a currency is to look at movements in the value of a basket of other currencies against the currency of interest. For example, if EUR-USD increased over some time period, one could see how EUR had performed against a range of other currencies to determine whether EUR has become generally more valuable or whether this was simply a USD-based move. An effective exchange rate is an attempt to do this and to represent the moves in index form.

There are two main approaches to building an effective exchange rate: Nominal Effective Exchange Rates (NEERs) and Real Effective Exchange Rates (REERs). NEERs simply track the weighted average returns of a basket of other currencies against the currency being investigated; REERs deflate the returns in an attempt to compensate for the differing rates of inflation in different countries. The reason for doing this is that, particularly over long time frames, inflation can have a large impact on the purchasing power of a currency.

How should we weight the basket?

If we are trying to create an index for the change in value of a currency against a basket of other currencies, we now need to decide on how to weight our basket. One possible solution would be to simply have an equally-weighted basket. The rationale for this would be that there is no *a priori* reason for choosing to put more emphasis on any one exchange rate. However, this could clearly lead to the situation where a large move in a relatively small currency can strongly influence the REERs and NEERs for all other currencies. To avoid this, the indices are generally weighted so that more "important" currencies get higher weighting. This, of course, begs the question of how "importance" is defined.

Trade Weights

Weighting the basket by bilateral trade-weights is the most common weighting procedure for creating an effective exchange rate index. This is because the indices are often used to measure the likely impact of exchange rate moves on a country's international trade performance.

Volume Weights

The daily volume traded in the FX market dwarves the global volume of physical trade. From this it is possible to make a convincing argument that the weighting which would be really important would be to weight the currency basket by financial market flows, rather than bilateral trade.

To do this properly would require us to have accurate FX volumes for all currency pairs considered in the index. However, these are not available. The BIS triennial survey of FX volumes only gives data for a small number of bilateral exchange rates. However, the volumes are split by currency for over 30 currencies. From these volumes we can estimate financial weightings for each currency. We believe that this gives another plausible definition for "importance", and one which may be more relevant for financial investors than trade weights. We call this procedure volume weighting and the indices produced through this procedure we call the HSBC volume-weighted REERs.

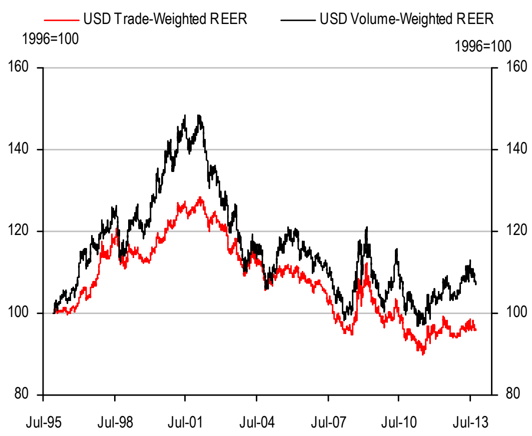
We would argue that if you are a financial market investor, the effective value of a currency you would be exposed to is more accurately represented by the HSBC volume-weighted index rather than the trade-weighted index.

Data Frequency

This is something which is rarely considered when constructing REERs – inflation data is generally released at monthly frequency at best so the usual procedure is to simply create monthly indices by default. However, some countries release their inflation data only quarterly. The usual procedure for these countries is to simply *pro-rata* the change over the period. Here there is an implicit assumption that the rate of inflation changes slowly. We take this assumption one step further and assume that it is valid to spread the inflation out equally over every day in the month.

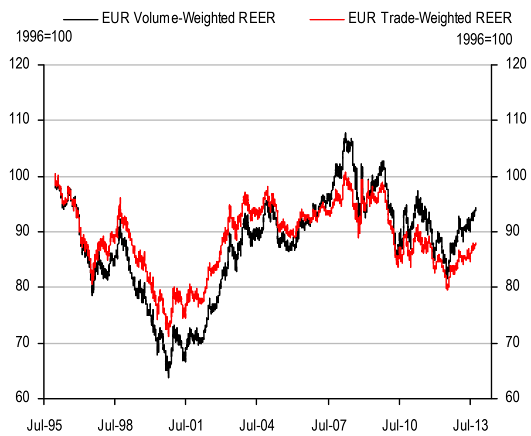
HSBC Volume – Weighted REERs

USD REER index



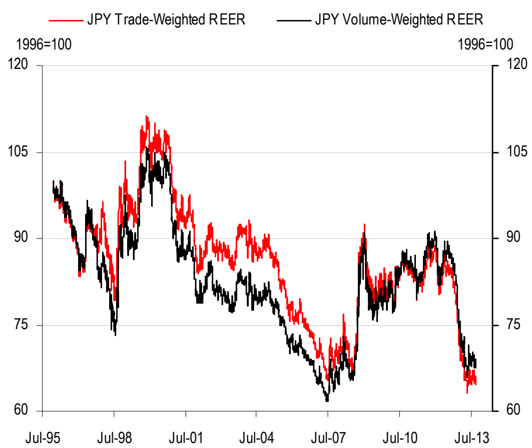
Source: HSBC

EUR REER index



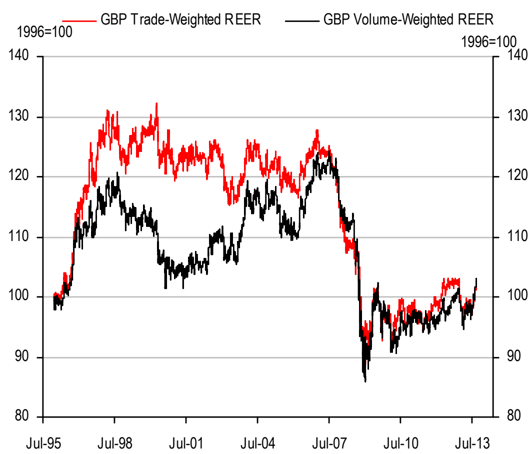
Source: HSBC

JPY REER index



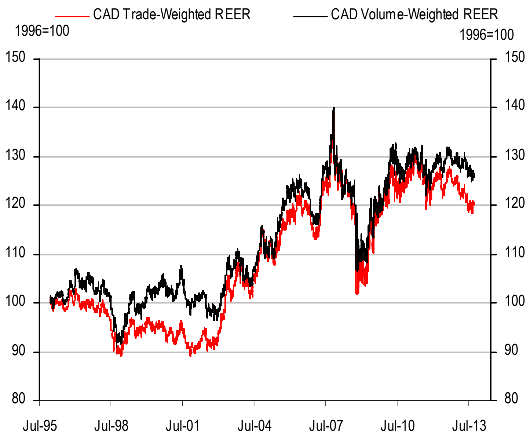
Source: HSBC

GBP REER index



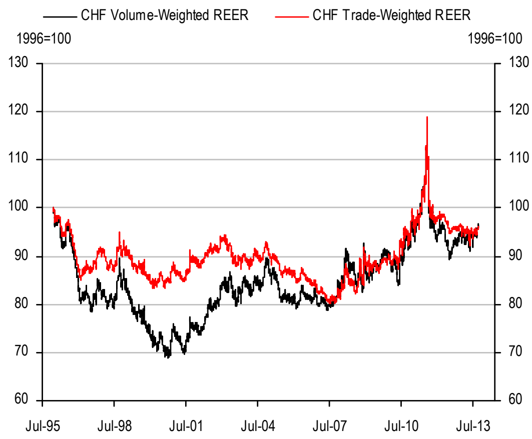
Source: HSBC

CAD REER index



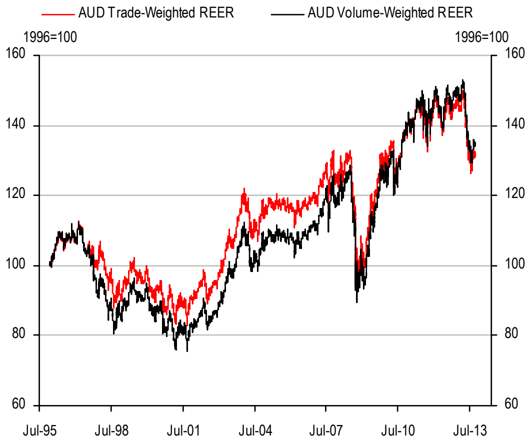
Source: HSBC

CHF REER index



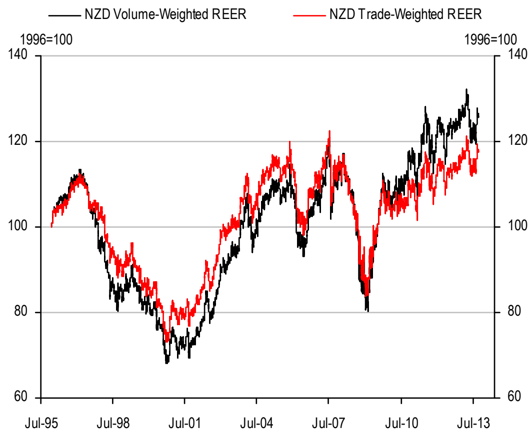
Source: HSBC

AUD REER index



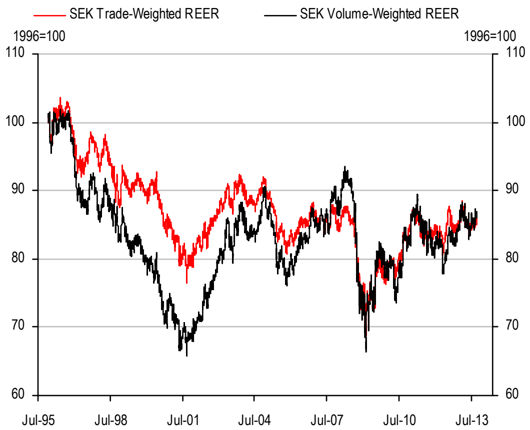
Source: HSBC

NZD REER index



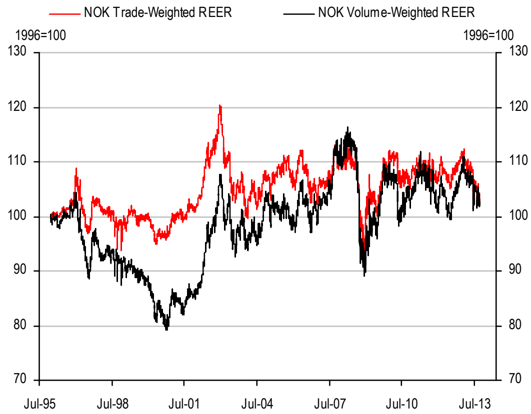
Source: HSBC

SEK REER index



Source: HSBC

NOK REER index



Source: HSBC

HSBC forecasts vs forwards

EUR-USD vs forwards

Source: Thomson Financial Datastream, Reuters, HSBC

EUR-CHF vs forwards

Source: Thomson Financial Datastream, Reuters, HSBC

GBP-USD vs forwards

Source: Thomson Financial Datastream, Reuters, HSBC

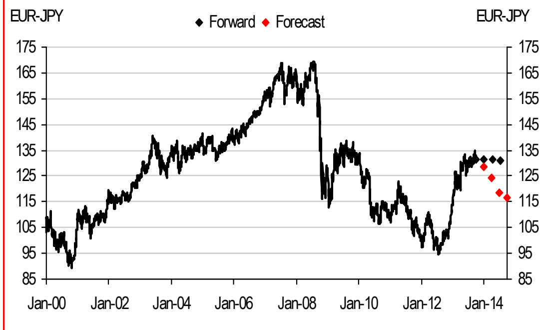
EUR-GBP vs forwards

Source: Thomson Financial Datastream, Reuters, HSBC

USD-JPY vs forwards

Source: Thomson Financial Datastream, Reuters, HSBC

EUR-JPY vs forwards



Source: Thomson Financial Datastream, Reuters, HSBC

Short rates

3 Month Money

end period		2009 Q4	2010 Q4	2011 Q4	2012 Q4	2013 Q1	Q2	Q3	Q4f	2014 Q1f	Q2f
North America											
	US (USD)	0.3	0.3	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3
	Canada (CAD)	0.5	1.2	1.4	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Latin America											
	Mexico (MXN)	5.5	4.6	4.4	4.2	4.1	4.1	3.8	3.5	3.5	3.5
	Brazil (BRL)	8.7	11.1	10.4	7.1	7.9	8.6	9.4	9.8	9.8	9.8
	Chile (CLP)	0.5	3.3	5.1	4.9	5.2	5.2	4.8	4.6	4.6	4.6
Western Europe											
Eurozone		0.7	0.9	1.3	0.1	0.1	0.1	0.2	0.1	0.1	0.1
Other Western Europe											
	UK (GBP)	0.6	0.8	1.1	0.5	0.5	0.5	0.5	0.5	0.6	0.6
	Norway (NOK)	2.2	2.6	2.9	1.9	1.9	1.8	1.8	1.8	2.0	2.2
	Sweden (SEK)	0.5	1.8	2.7	1.6	1.3	1.3	1.3	1.3	1.3	1.5
	Switzerland (CHF)	0.3	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EMEA											
	Hungary (HUF)	6.0	5.9	7.2	5.8	4.9	4.2	3.7	3.5	3.5	3.5
	Poland (PLN)	4.2	4.0	5.0	4.1	3.4	2.8	2.7	2.7	2.9	3.1
	Russia (RUB)*	6.6	4.1	6.4	7.5	7.1	7.1	6.6	6.4	6.0	6.3
	Turkey (TRY)	7.5	6.7	10.1	5.5	6.1	6.5	7.5	7.5	7.5	7.5
	Ukraine (UAH)	16.1	9.1	21.5	18.3	14.3	14.3	18.3	12.3	10.3	9.3
	South Africa (ZAR)	7.1	5.5	5.5	5.2	5.1	5.5	5.4	5.3	5.1	5.0
Asia/Pacific											
	Japan (JPY)	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
	Australia (AUD)	4.0	5.0	4.5	3.0	3.0	2.8	2.6	2.6	2.6	2.6
	New Zealand (NZD)	2.8	3.2	2.7	2.6	2.6	2.7	2.7	3.0	3.2	3.4
North Asia											
	China (CNY)	1.7	2.3	3.1	2.6	2.6	2.6	2.6	2.6	2.6	2.6
	Hong Kong (HKD)	0.5	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
	Taiwan (TWD)	0.5	0.7	0.9	0.9	0.9	0.9	0.9	0.9	0.9	1.0
	South Korea (KRW)	2.8	2.8	3.6	2.9	2.8	2.7	2.7	2.8	2.8	2.8
South Asia											
	India (INR)	4.6	9.0	9.8	8.2	8.2	8.5	11.0	9.4	8.0	8.0
	Indonesia (IDR)	7.1	6.6	5.3	5.0	4.9	5.3	7.0	7.2	7.2	7.2
	Malaysia (MYR)	2.2	3.0	3.2	3.2	3.2	3.2	3.2	3.3	3.3	3.5
	Philippines (PHP)	3.9	0.8	1.6	0.6	0.3	0.5	0.5	0.7	0.7	0.7
	Singapore (SGD)	0.7	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
	Thailand (THB)	1.4	2.2	3.2	2.9	2.9	2.6	2.6	2.7	2.8	2.9
Africa											
	South Africa (ZAR)	7.1	5.5	5.5	5.2	5.1	5.5	5.4	5.3	5.1	5.0

*Notes: * 1-month money. Source: HSBC*

Important note

This table represents three month money rates. Due to the dislocation in the three month money markets, these rates may not give a good indication of policy rates.

Emerging markets forecast table

	10-Oct-13	2012	2012	2013				2014			
	last	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
Latin America vs USD											
Argentina (ARS)	5.82	4.70	4.92	5.12	5.39	5.79	6.25	6.60	7.00	7.35	7.75
Brazil (BRL)	2.21	2.03	2.04	2.01	2.22	2.23	2.30	2.33	2.35	2.38	2.40
Chile (CLP)	501	475	479	472	508	505	500	505	510	510	510
Mexico (MXN)	13.11	12.86	12.87	12.33	12.98	13.17	12.70	12.60	12.50	12.40	12.40
Colombia (COP)	1891	1800	1825	1826	1827	1828	1950	1925	1900	1900	1900
Peru (PEN)	2.77	2.60	2.55	2.59	2.77	2.79	2.70	2.70	2.70	2.70	2.70
Venezuala (VEF)	6.28	4.30	4.30	6.29	6.29	6.29	6.30	7.80	7.80	7.80	7.80
Eastern Europe vs EUR											
Czech Republic (CZK)	25.52	25.20	25.10	25.76	25.97	25.74	26.00	26.00	26.00	25.80	25.50
Hungary (HUF)	296	285	291	304	295	297	300	295	295	290	285
Russia vs USD (RUB)	32.73	31.20	30.48	31.00	32.88	32.35	32.60	33.50	34.70	34.40	33.80
Romanian (RON)	4.46	4.40	4.50	4.50	4.40	4.40	4.40	4.40	4.35	4.30	4.30
Turkey vs USD (TRY)	1.98	1.80	1.78	1.81	1.93	2.02	2.00	1.95	1.95	1.95	1.90
Poland (PLN)	4.19	4.12	4.08	4.18	4.33	4.23	4.20	4.10	4.00	4.00	3.90
Middle East vs USD											
Egypt (EGP)	6.89	6.07	6.10	6.80	7.00	7.00	7.50	6.80	6.80	6.80	7.50
Israel (ILS)	3.56	3.90	3.85	3.64	3.70	3.55	3.60	3.60	3.55	3.55	3.50
Africa vs USD											
South Africa (ZAR)	9.92	8.25	8.48	9.17	9.93	10.06	9.80	9.80	9.50	9.30	9.20

Source: HSBC

Exchange rates vs USD

end period		2009	2010	2011	2012	2012	2013				2014			
		Q4	Q4	Q4	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
Americas														
	Canada (CAD)	1.05	0.99	1.02	0.98	1.00	1.02	1.05	1.03	1.05	1.07	1.09	1.10	1.10
	Mexico (MXN)	13.08	12.36	13.97	12.86	12.87	12.33	12.98	13.17	12.70	12.60	12.50	12.40	12.40
	Brazil (BRL)	1.74	1.67	1.88	2.03	2.04	2.01	2.22	2.23	2.30	2.33	2.35	2.38	2.40
	Argentina (ARS)	3.80	3.97	4.30	4.70	4.92	5.12	5.39	5.79	6.25	6.60	7.00	7.35	7.75
Western Europe														
	Eurozone (EUR*)	1.43	1.34	1.30	1.29	1.32	1.28	1.30	1.35	1.30	1.28	1.25	1.24	1.24
Other Western Europe														
	UK (GBP*)	1.61	1.57	1.55	1.61	1.63	1.52	1.52	1.62	1.53	1.51	1.48	1.46	1.46
	Sweden (SEK)	7.14	6.72	6.86	6.56	6.51	6.50	6.75	6.42	6.46	6.41	6.40	6.45	6.45
	Norway (NOK)	5.78	5.81	5.97	5.72	5.57	5.83	6.11	6.01	5.69	5.63	5.68	5.65	5.65
	Switzerland (CHF)	1.03	0.93	0.94	0.94	0.92	0.95	0.95	0.90	0.95	0.98	1.00	1.01	1.01
Emerging Europe														
	Russia (RUB)	30.2	30.5	32.0	31.2	30.5	31.0	32.9	32.3	32.6	33.5	34.7	34.4	33.8
	Poland (PLN)	2.86	2.95	3.43	3.20	3.09	3.25	3.33	3.12	3.23	3.20	3.20	3.23	3.15
	Hungary (HUF)	188	207	242	222	221	237	227	220	231	230	236	234	230
	Czech Republic (CZK)	18.4	18.7	19.6	19.6	19.0	20.1	20.0	19.0	20.0	20.3	20.8	20.8	20.6
Asia/Pacific														
	Japan (JPY)	93	81	77	78	86	94	99	98	99	97	95	94	94
	Australia (AUD*)	0.90	1.03	1.03	1.04	1.04	1.04	0.92	0.94	0.90	0.89	0.88	0.87	0.86
	New Zealand (NZD*)	0.73	0.78	0.78	0.83	0.83	0.84	0.77	0.83	0.78	0.77	0.76	0.75	0.75
North Asia														
	China (CNY)	6.83	6.59	6.29	6.28	6.23	6.21	6.14	6.12	6.12	6.11	6.11	6.10	6.10
	Hong Kong (HKD)	7.75	7.77	7.77	7.75	7.75	7.76	7.76	7.76	7.80	7.80	7.80	7.80	7.80
	Taiwan (TWD)	32.1	30.4	30.3	29.3	29.0	29.8	30.0	29.6	29.3	29.4	29.5	29.6	29.7
	South Korea (KRW)	1166	1121	1159	1114	1064	1111	1142	1075	1070	1075	1080	1090	1095
South Asia														
	India (INR)	46.4	44.7	53.0	52.9	55.0	54.3	59.5	62.6	62.0	63.0	64.0	65.0	66.0
	Indonesia (IDR)	9425	9010	9068	9570	9638	9718	9925	11580	11100	11200	11300	11400	11500
	Malaysia (MYR)	3.42	3.08	3.17	3.06	3.06	3.09	3.16	3.26	3.18	3.21	3.24	3.27	3.30
	Philippines (PHP)	46.5	43.6	43.8	41.7	41.1	40.9	43.1	43.5	43.0	43.2	43.4	43.6	43.8
	Singapore (SGD)	1.41	1.28	1.30	1.23	1.22	1.24	1.27	1.26	1.25	1.26	1.27	1.28	1.29
	Thailand (THB)	33.3	30.1	31.6	30.8	30.6	29.3	31.1	31.3	31.4	31.6	31.8	32.0	32.2
	Vietnam (VND)	18200	19498	21037	20853	20835	20930	21170	21119	21250	21500	21500	21500	21500
Africa														
	South Africa (ZAR)	7.36	6.62	8.07	8.25	8.48	9.17	9.93	10.06	9.80	9.80	9.50	9.30	9.20

Source HSBC

Exchange rates vs EUR & GBP

end period		2009	2010	2011	2012		2013				2014			
		Q4	Q4	Q4	Q3	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
Vs euro														
Americas														
	US (USD)	1.43	1.34	1.30	1.29	1.32	1.28	1.30	1.35	1.30	1.28	1.25	1.24	1.24
	Canada (CAD)	1.50	1.33	1.32	1.27	1.31	1.30	1.37	1.39	1.37	1.37	1.36	1.36	1.36
Europe														
	UK (GBP)	0.89	0.86	0.84	0.80	0.81	0.85	0.86	0.84	0.85	0.85	0.85	0.85	0.85
	Sweden (SEK)	10.24	9.02	8.90	8.44	8.58	8.35	8.77	8.69	8.40	8.20	8.00	8.00	8.00
	Norway (NOK)	8.29	7.80	7.75	7.37	7.34	7.49	7.94	8.14	7.40	7.20	7.10	7.00	7.00
	Switzerland (CHF)	1.48	1.25	1.21	1.21	1.21	1.22	1.23	1.22	1.24	1.25	1.25	1.25	1.25
	Russia (RUB)	43.4	40.9	41.6	40.1	40.2	39.8	42.7	43.8	42.4	42.9	43.4	42.7	41.9
	Poland (PLN)	4.11	3.96	4.46	4.12	4.08	4.18	4.33	4.23	4.20	4.10	4.00	4.00	3.90
	Hungary (HUF)	270	278	315	285	291	304	295	297	300	295	295	290	285
	Czech Republic (CZK)	26.4	25.1	25.5	25.2	25.1	25.8	26.0	25.7	26.0	26.0	26.0	25.8	25.5
Asia/Pacific														
	Japan (JPY)	134	109	100	100	114	121	129	133	129	124	119	117	117
	Australia (AUD)	1.60	1.31	1.27	1.24	1.27	1.23	1.42	1.45	1.44	1.44	1.42	1.43	1.44
	New Zealand (NZD)	1.97	1.72	1.66	1.55	1.60	1.53	1.68	1.63	1.67	1.66	1.64	1.65	1.65
Vs sterling														
Americas														
	US (USD)	1.61	1.57	1.55	1.61	1.63	1.52	1.52	1.62	1.53	1.51	1.48	1.46	1.46
	Canada (CAD)	1.69	1.56	1.58	1.59	1.62	1.54	1.60	1.66	1.61	1.61	1.61	1.61	1.61
Europe														
	Eurozone (EUR)	0.89	0.86	0.84	0.80	0.81	0.85	0.86	0.84	0.85	0.85	0.85	0.85	0.85
	Sweden (SEK)	11.53	10.53	10.65	10.59	10.57	9.87	10.24	10.40	9.88	9.64	9.45	9.45	9.45
	Norway (NOK)	9.33	9.10	9.27	9.24	9.05	8.86	9.26	9.74	8.70	8.47	8.39	8.27	8.27
	Switzerland (CHF)	1.67	1.46	1.45	1.52	1.49	1.44	1.44	1.46	1.46	1.47	1.48	1.48	1.48
Asia/Pacific														
	Japan (JPY)	150	127	120	126	141	143	151	159	151	146	140	138	138
	Australia (AUD)	1.80	1.53	1.52	1.55	1.57	1.46	1.66	1.73	1.70	1.69	1.68	1.68	1.70
	New Zealand (NZD)	2.22	2.00	1.99	1.94	1.97	1.81	1.96	1.94	1.96	1.95	1.94	1.95	1.95

Source: HSBC

Disclosure appendix

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