Foreign Exchange Outlook

Global economic deceleration, risk aversion, commodity price adjustments, emerging-market correction, ongoing central bank intervention and Europe-centered heightened financial market volatility are the major drivers of investor sentiment and capital flows in foreign exchange markets.

The USD and the JPY are the major beneficiaries of a re-activated phase of financial market stress, despite their weakened sovereign debt and fiscal profile. Disappointing US economic data and commodity price declines temporarily affected the value of the CAD and MXN, yet a rebound of the NAFTA currencies is in store for the second half of the year. Sharp BRL losses will not be fully recovered in the near term.

European events (Greek elections, distressed Spanish banking sector and deeper recession) triggered a depreciating tone of the EUR. However, investors are differentiating within Europe and increasing demand for German and UK assets. Still the GBP has been punished, while the RUB adopted a defensive tone affected by declining energy prices.

Investor demand for the JPY will be short-lived due to its weakening sovereign debt profile – which triggered a rating downgrade – and official intervention risk. The CNY and the INR adopted a weakening bias which spilled over to the rest of the Asian floating-currency group. The AUD is reacting negatively to commodity price shifts, a dampened global growth outlook and additional monetary easing.

Index

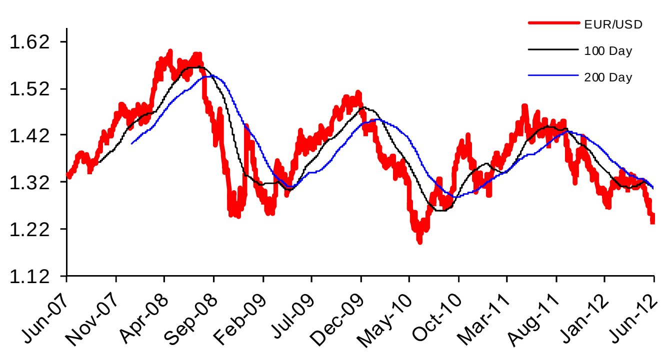
Foreign Exchange Outlook **is available on: www.scotiabank.com and Bloomberg at SCOE**

Global Foreign Exchange Outlook

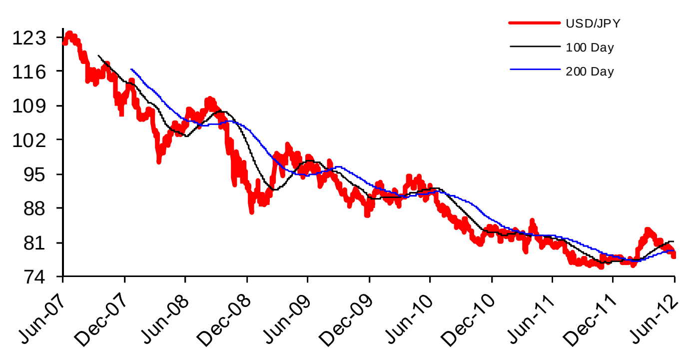
June 5, 2012		Actual	Q4a 11	Q1a 12	Q2 12	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13
Euro	EURUSD	1.24	1.30	1.33	1.22	1.23	1.23	1.22	1.22	1.21
	Consensus*				1.30	1.29	1.29	1.29	1.29	1.29
Yen	USDJPY	78.8	77	83	79	81	83	84	85	86
	Consensus*				81	81	82	82	83	84
Sterling	GBPUSD	1.54	1.55	1.60	1.56	1.59	1.60	1.62	1.63	1.64
	Consensus*				1.59	1.58	1.58	1.58	1.59	1.59
Canadian Dollar	USDCAD	1.04	1.02	1.00	1.05	1.02	0.99	0.98	0.97	0.97
	Consensus*				0.99	1.00	1.00	1.00	1.00	1.00
Australian Dollar	AUDUSD	0.97	1.02	1.03	0.96	0.99	1.02	1.04	1.04	1.05
	Consensus*				1.02	1.02	1.02	1.02	1.01	1.00
Mexican Peso	USDMXN	14.22	13.94	12.81	13.80	13.27	13.11	13.20	13.06	13.13
	Consensus*				12.99	12.72	12.59	12.46	12.41	12.54

Spot Price vs. 100 Day Moving Average vs. 200 Day Moving Average - (5yr Trend)

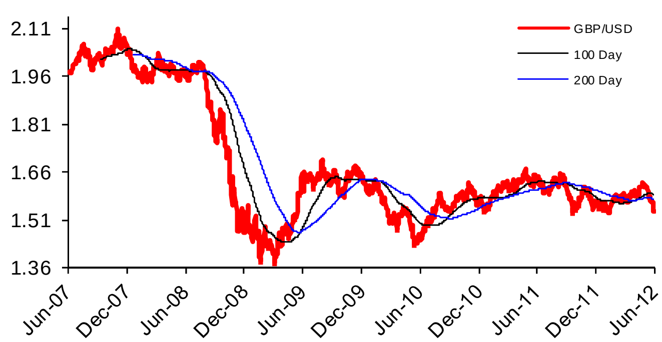
EURUSD



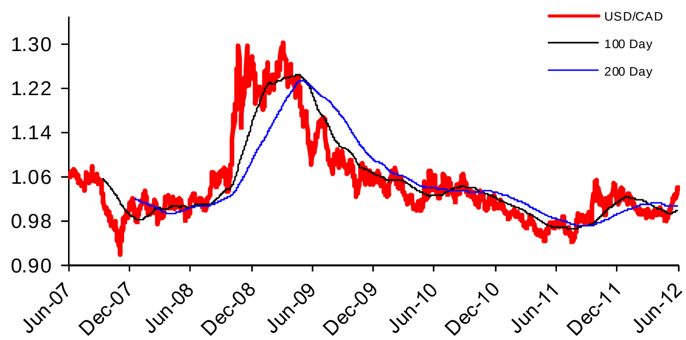
USDJPY



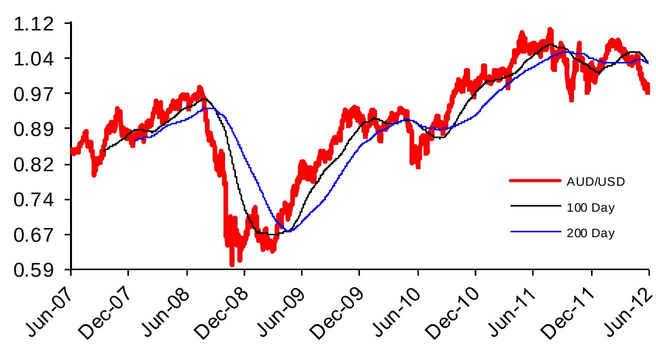
GBPUSD



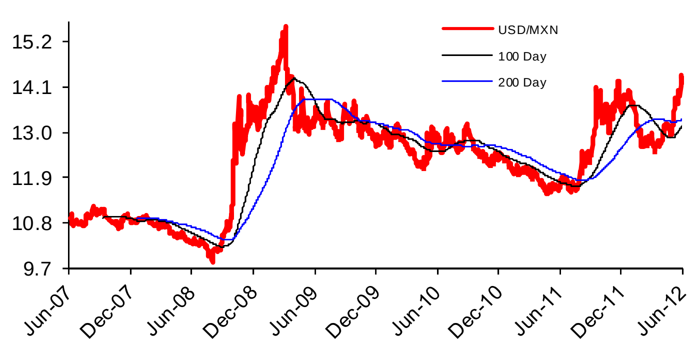
USDCAD



AUDUSD



USDMXN



(*) Source: Consensus Economics Inc. May 2012

Market Tone & Fundamental Focus

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Intensifying European financial stress, renewed evidence of a global economic deceleration, sharp commodity price adjustments, flight-to-liquidity, emerging-market asset price deflation, upcoming market-sensitive European events (Greek and French elections and EU summit) and a generalized investor sentiment of risk aversion are the primary drivers of flows and heightened volatility in foreign exchange markets.

The US dollar (USD) is again, in high demand during a new period of heightened financial market stress. Still perceived as the pre-eminent world reserve currency, the trade-weighted DXY index shows that global investors prefer to hold USD-denominated sovereign debt assets when volatility hits all asset classes in tandem. The 10-year US treasury (UST) bond yield continued its declining trend last month, reaching a low of 1.4% in early June. Despite this synchronized move in favour of highly liquid "safe" currencies, the US economy has underperformed in recent months on the hiring front, and must deal with intensify fiscal concerns by year-end. The USD's path will likely be more mixed into year-end.

The other NAFTA zone currencies have weakened on the back of a sharp correction in energy and metal prices, together with disappointing economic data in the US. Notwithstanding recent moves, the Canadian dollar (CAD) should regain an appreciating tone on the back of Canada's fundamental strengths: economic diversification, relative financial sector health, interest rate differentials and triple-A-rated credit status. The Mexican peso (MXN), has weakened considerably alongside the extreme global risk aversion and the sharp correction in crude oil prices. It is immersed in a fragile trading environment (12% depreciation in three months), which catapulted the USDMXN to 14.6 in early June. We expect a gradual recovery of the MXN once this phase of renewed market stress subsides. Elsewhere in the Americas, the Brazilian real (BRL) experienced the most significant negative adjustment, accumulating a 19% loss versus the USD over the past three months. Looking ahead, we are of the view that Latin American currencies will stabilize, without fully recovering the value lost in the recent high-volatility phase.

The euro (EUR) regained a bearish trading pattern and depreciated against major currencies. The combined effect of political-related uncertainties in Greece, investors' scrutiny of the systemic health of Spain's financial sector, and a deeper economic contraction in euro zone countries have led the EUR to abandon its relatively stable trend and weaken further. We now expect EURUSD to close the year at 1.23. At the same time, there is clear evidence of intra-regional credit/risk differentiation: both Germany and the United Kingdom are perceived as relatively safe-haven assets in times of financial market stress. Indeed, the yield of 10-year German and British bonds traded as low as 1.17% and 1.52%, respectively, in early June. The British pound (GBP) benefitted from investor demand and regained an appreciating bias versus the EUR and, to a lesser degree, the USD due to its triple-A status, credible fiscal plan and monetary policy bias. However, fundamentals in the UK have also deteriorated, punishing GBP and fuelling expectations that the Bank of England will increase its asset purchase program. We expect GBPUSD to close the year at 1.60. As for the Swiss franc (CHF), the SNB appears determined to maintain, if not increase, the EURCHF floor later this year. The Danish central bank's decision to cut interest rates twice in May, attempting to ease the burden of maintaining the EURDKK peg, is a reminder of how difficult fixed exchange rate regimes can be. The Swedish krone (SEK) has suffered as the country faces a downturn in the economic data complicated by a spike in risk aversion. The SEK's high beta nature should see it retrace some of its recent losses, particularly against the EUR.

The Asian region offers a mixed outlook. While the Japanese yen (JPY) has resumed its appreciating bias, the regional BRIC currencies, the Chinese renminbi (CNY) and the Indian rupee (INR), adopted a defensive bias in this heightened financial market environment. The JPY regained its status as a perceived safe-haven currency and extended its appreciating tone since mid-March. However, we are of the view that deteriorating sovereign creditworthiness and fiscal conditions (which prompted a double-notch credit rating downgrade by Fitch in late May) will weigh on Japan's mid-term outlook. We have adjusted our short-term view, but still believe that USDJPY will edge higher by the close of the year adopting a rising trend. In line with recent policy and market moves, we have adjusted our USDCNY view to reflect a slower pace of nominal exchange rate gains in China: CNY's weakness resurfaced driven by EUR weakness, clear signs of economic deceleration and eroding export competitiveness. The INR remains one of the most severely hit Asian currencies on the back of a widening twin deficit position, sharp economic slowdown and persistent inflation pressures.

Finally, the Australian dollar (AUD) was another casualty in the regional softness trend, adversely affected by declines in commodity prices and narrowing interest rate differentials (the Reserve Bank of Australia reduced its policy-setting cash rate by 25 basis points to 3½% on June 5th). The second-tier Asian floating currencies – South Korean won (KRW), the Taiwanese dollar (TWD) and the Thai baht (THB) – have also been subject to synchronized regional adjustments, although we expect relatively stronger fundamentals to drive these currencies higher over the coming months.

CANADA

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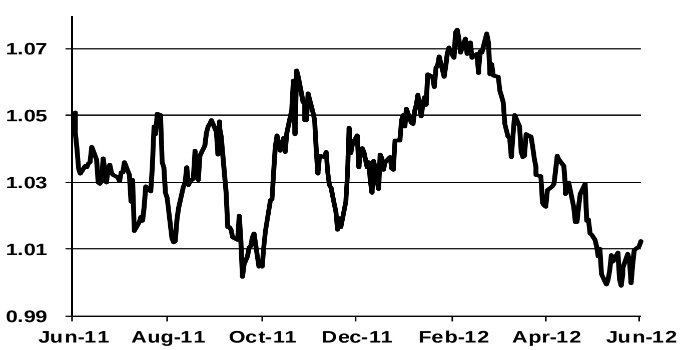
The escalation of the European crisis and the deterioration in the outlook for global growth has proven a difficult combination for financial markets. The month of May was marked by a significant jump in risk aversion and safe haven bond prices; while most other assets suffered significant losses. The Canadian dollar (CAD) lost 4.5% against the USD; however it performed relatively well against most of the other currencies, gaining 1% against GBP, 2% against AUD and EUR and 5% against MXN. Spikes in risk aversion are typically violent but temporary; however the retracement is renowned for being slow. The broader Scotiabank macro-forecast has been revised to include a downward adjustment to both China's and India's growth outlook, as well as an ongoing deterioration in the situation in Europe. Accordingly, the near-term outlook for CAD has also been revised lower, expecting it to weaken into quarter-end, potentially falling to 0.95, but in the medium-term CAD should prove a favoured currency and rally into year-end. Once risk aversion and the rapid flow into US dollar denominated assets subside, the outlook for CAD should brighten. The medium term interest rate outlook favours CAD as the Bank of Canada is likely to hike interest rates long before the Fed, the ECB or the BoJ, who all face more significant domestic headwinds. In addition, even though there has been some dampening in the expectation for Asian growth, it is still expected to generate historically strong demand for commodities, which prevents a collapse in most commodity markets. Nevertheless, the forecast for both WTI and Brent has been revised lower; but the spread (important due to the pricing of Canada's petrol exports versus imports) is expected to narrow in Canada's favour. In addition, lower oil prices will prove positive for global growth, particularly the US, somewhat offsetting the 'Europe effect'. The domestic real economy in Canada is likely to be pressured by Europe and Asia, however all indicators continue to favour the US economic outlook, which should bode well for the Canadian economy in the medium-term. Finally, Canada's triple-A status and developed bond market should keep global flows strong as investors use Canada as a diversification destination away from the more volatile Europe. To sum up, the outlook has deteriorated, particularly in the near-term; however the traditional drivers of CAD remain strong enough to generate a rally once risk aversion subsides, pushing CAD to close the year above parity to 1.01 (or USDCAD at 0.99).

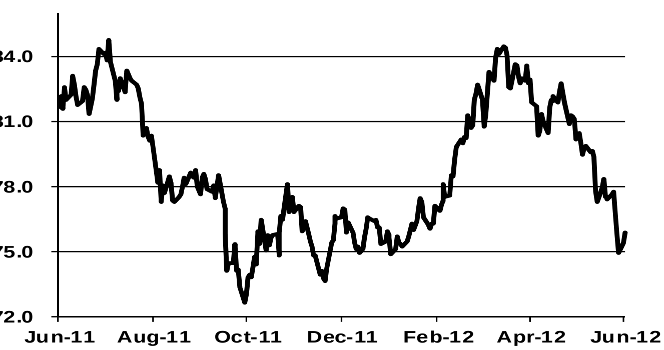
Currency Trends

FX Rate	Going Back 12 m	6 m	3 m	Spot 5-Jun	Outlook 3 m	6 m	12 m	FX Rate
AUDCAD	1.05	1.03	1.06	1.012	1.01	1.01	1.01	AUDCAD
CADJPY	81.66	76.96	81.30	75.85	82.73	82.32	82.41	CADJPY
EURCAD	1.43	1.35	1.31	1.293	1.26	1.23	1.19	EURCAD
USDCAD	0.98	1.01	1.00	1.038	1.03	1.00	0.97	USDCAD

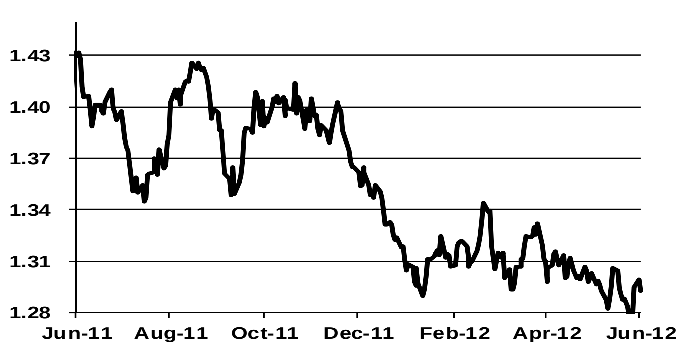
AUDCAD



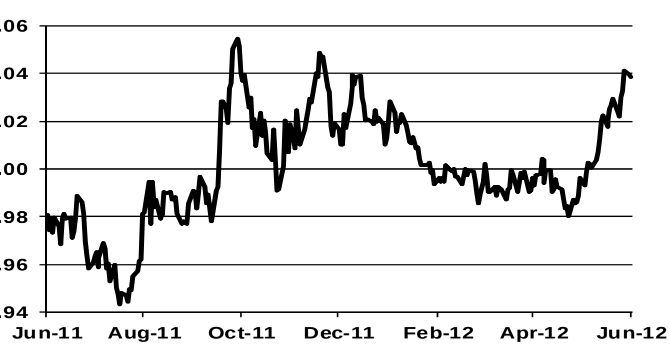
CADJPY



EURCAD



USDCAD



Canada and United States

Fundamental Commentary

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UNITED STATES - The US recovery has lost some momentum. Real GDP growth was revised lower to a 1.9% annualized rate in Q1, down from an initial 2.2% estimate and a 3.0% gain in the final quarter of last year. Consumers were a significant contributor to first-quarter growth, but several more recent indicators, including weaker-than-expected auto sales for May alongside lower sentiment readings for the month, suggest these gains may not be sustained. Softening employment conditions and weak income growth will likely weigh on discretionary spending in the latter half of the year, even as lower gasoline prices provide some support to household purchasing power. Job growth in April and May slowed to its weakest pace in almost a year, as renewed euro zone debt concerns and uncertainty over domestic fiscal policy tempered hiring plans. Business capital outlays have moderated in recent months, though this likely reflects some frontloading of purchases ahead of the scaling-back of the accelerated depreciation allowance at the end of last year. Manufacturing activity continues to expand, led by the automotive and high-technology sectors, though weak European and emerging market demand will hold back the pace of the US export recovery this year. Home sales are gradually edging up off historic lows, but demand remains restrained by high unemployment and continued tight lending conditions. Tightening rental markets have sparked a pickup in apartment construction, though overall residential investment remains weak. The timing and extent of federal fiscal consolidation, including the expiration of payroll tax cuts, the phasing out of extended unemployment benefits and the implementation of sequestration cuts, adds considerable uncertainty to the projected profile for US growth.

CANADA - Canadian GDP growth expanded at a moderate 1.9% annualized rate in Q1, unchanged from Q4 and matching the US advance in the quarter. Part of the late winter/early spring slowdown reflected temporary factors, including mine and maintenance shutdowns, but there are also signs of a more general loss in underlying economic momentum. Business investment remains the biggest contributor to growth, with outlays on machinery & equipment and non-residential construction supported by solid corporate balance sheets, favourable financing conditions and heightened competitive pressures. While business sentiment surveys remain upbeat and long-term investment prospects in the resource sector are positive, heightened global economic uncertainty, renewed financial market stress and the recent softening in commodity prices could slow or delay some potential expansion plans in the latter half of the year. Household spending indicators are mixed. Auto sales remained brisk through May, supported by enhanced incentives, attractive borrowing costs and still healthy job growth – the economy reported its strongest back-to-back job gains in 30 years in March and April. Home sales and construction also are quite buoyant. However, other discretionary consumer spending has softened in recent months alongside repeated warnings over high household debt levels and increasing public sector restraint. Combined with the potential for some softening in employment conditions in coming months, this suggests a relatively subdued outlook for retail sales and housing activity. Net trade remains a soft spot. In addition to the competitive challenges of a strong Canadian dollar, the sluggish pace of US growth and loss of momentum overseas will remain a hurdle to a faster export and manufacturing recovery. Overall, we expect growth to average about 2% in 2012.

Monetary Policy Commentary

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UNITED STATES - Key US economic data deteriorated significantly during the final days of May. Q1 2012 US GDP was revised lower to 1.9% q/q SAAR from 2.2% q/q SAAR on the first pass. May non-farm payrolls came in at 69k and April payrolls were revised lower to 77k. That brought the average jobs gains to 164k/month during the first 5 months of 2012, in line with the average during 2011 (153k/month) but nowhere near the 200k+ numbers that were encouraging investors and the Fed at the start of this year. The unemployment rate ticked up to 8.2%. Both labor and output growth are now trending lower than the Fed's latest staff economic projections imply. In our view, these developments, combined with the significantly weaker global economic and moreover financial outlook, materially increase the likelihood that the Fed will engage in additional easing in H2 2012.

CANADA - The Bank of Canada (BoC) used its June 5 announcement to soften the hawkish tone that was in its April 17 statement. Since April 17, the global economic situation has deteriorated, Q1 2012 GDP showed that the economy grew at 1.9% SAAR with consumption growth slowing markedly, oil prices have fallen both in terms of WTI and various grades that Canada exports, CAD has weakened, Canadian equities have sold off, and Canada's housing sector has shown signs of cooling. Markets are now pricing very slight odds of BoC easing this summer, which we also think is rather unlikely barring a global liquidity and funding crisis – a risk but by no means our base case. We expect the BoC to revise its growth projections lower in the July MPR but to remain on hold at least until mid-2013.

Foreign Exchange Outlook

EUROPE
Currency Outlook

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EURO ZONE - The euro (EUR) lost almost 7% in the month of May and remains weak into the early part of June. According to the CFTC, traders hold a record short EUR position of US$32 billion, leaving an uneven balance and opening the risk of short covering. In early June rumours of a 'grand' European plan provided some stability, the question from here is whether politicians will have the ability to sell such a plan. EUR should avoid a collapse, supported by value in Germany, the looming US fiscal cliff and repatriation flows into EUR; however the currency is expected to trend lower, closing the year at 1.23.

UNITED KINGDOM - Sterling lost 5% in May on the back of a jump higher in risk aversion, deterioration in domestic data and rising expectations that the Bank of England's Monetary Policy Committee will entertain another round of asset purchases (QE). Once risk aversion subsides the outlook for GBP should brighten as it benefits from flows into its Triple-A rated bond market, the UK's credible fiscal plan and the likelihood that even a dovish BoE will prove more hawkish than the other G4 central banks. We expect GBPUSD to close the year at 1.60.

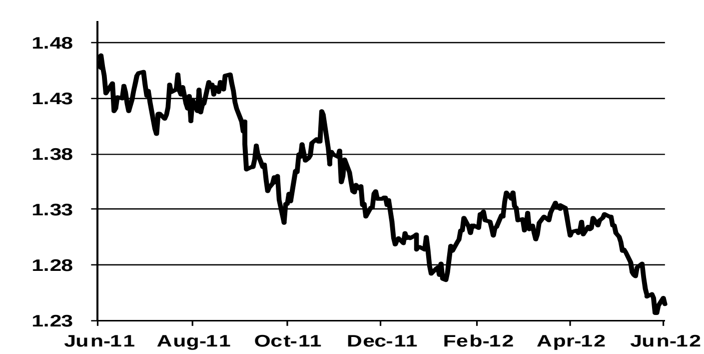
SWITZERLAND - The Swiss franc (CHF) lost almost 7% against the USD in May, as the weight of the 1.20 EURCHF floor limited its direction. The Swiss National Bank's policy is viewed as a credible one. Once risk aversion passes, there is likely to be renewed pressure to push the floor up to 1.25. Accordingly we hold a year-end target of 1.25 in EURCHF.

NORWAY - The Norwegian krone (NOK) weakened in tandem with EURUSD, losing almost 7% in the month of May. Correlation between asset classes is high as markets endure a period of risk aversion; however once this breaks, the outlook for NOK brightens on its significant oil reserves, relatively strong fundamentals and investor sentiment. We hold a USDNOK year-end forecast of 5.75.

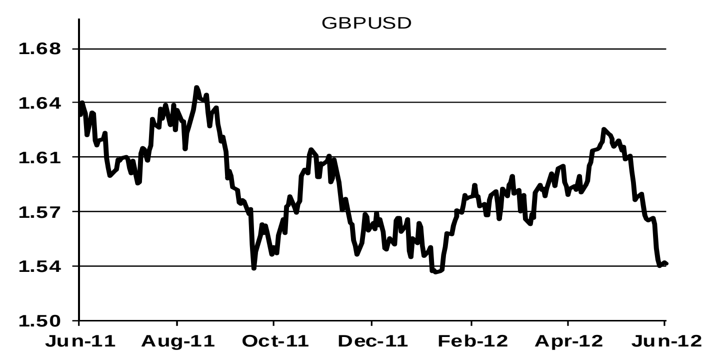
Currency Trends

FX Rate	Going Back			Spot	Outlook			FX Rate
	12 m	6 m	3 m	5-Jun	3 m	6 m	12 m	
EURUSD	1.46	1.34	1.31	1.24	1.23	1.23	1.22	EURUSD
GBPUSD	1.64	1.56	1.57	1.54	1.58	1.60	1.63	GBPUSD
EURCHF	1.22	1.24	1.21	1.20	1.23	1.25	1.25	EURCHF
USDNOK	5.38	5.76	5.65	6.11	5.97	5.80	5.53	USDNOK

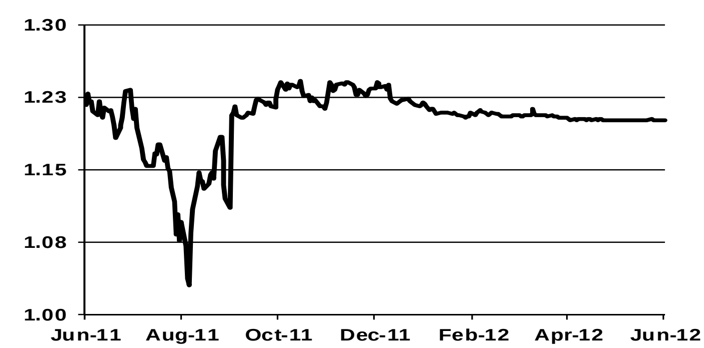
EURUSD



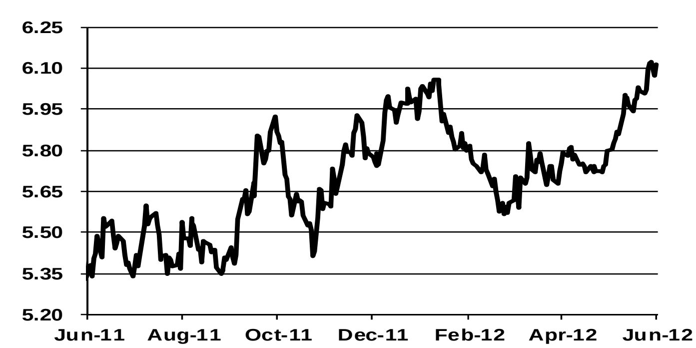
GBPUSD



EURCHF



USDNOK



EUROPE
Fundamental Commentary
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EURO ZONE - The euro crisis has again intensified, with several near-term uncertainties clouding the outlook for the currency union. The next month will be marked by significant event risk, with a key European Central Bank (ECB) meeting on June 6th, French and Greek elections on the 10th and 17th, respectively, and an EU summit at the end of the month (28th-29th). Financial markets have relapsed, evidenced by rising sovereign bond yields and widening credit spreads (Spanish 10-year yield at 6.5% in late May, approaching late-November highs), as well as falling equity and commodity prices and massive safe haven flows weighing on the euro. This volatility will likely persist in the months ahead with many unresolved issues pertaining to the debt crisis straining investor confidence, including the possibility of a Greek exit from the union, rising TARGET2 imbalances and their varied implications for different euro zone members, rising social and political tensions in the context of the growth versus austerity debate, and the enduring woes in the Spanish banking sector (with estimates of ultimate state recapitalization needs varying widely). Ongoing financial instability and deteriorating confidence will dampen growth, particularly in the periphery. Notwithstanding the surprising 0.1% q/q advance registered by the aggregate euro area economy in the first quarter, we have lowered our expectations for 2012-13. We now project a contraction of 0.6% this year to be followed by growth of just 0.7% next year. Further monetary easing by the ECB is still considered likely.

UNITED KINGDOM - The UK's weak fundamental outlook finally caught up with the currency as market sentiment collapsed in May. We have lowered our profile for the GBP through 2013, though the trajectory remains upward-sloping. The preliminary figure for first-quarter GDP (the second of three estimates) was revised lower, from -0.2% q/q to -0.3%, with the sectoral breakdown showing that weakness was concentrated in inventory investment and net exports. Available data for the second quarter point to continued fragility (though we do not foresee another negative print). The manufacturing PMI sunk nearly five points in May to 45.9, a three-year low. The services sector PMI most likely also dipped in May (from 53.3 in April), and key for monetary policy will whether it lands above or below the neutral 50-mark. We have adjusted lower our growth expectation for this year and next to 0.4% and 1.7%, respectively. The Bank of England (BoE) left policy conditions unchanged at the May meeting, putting the quantitative easing (QE) program on hold given concerns about the near-term inflation outlook (meanwhile, the bank's medium-term inflation projection was lowered). The annual inflation rate came down considerably in April, from 3.5% y/y to 3.0%, and we expect the rate to dip again in the third quarter before ending the year around 3%. With downside risks to both growth and inflation having materialized in the first half of the year, we see a sizeable probability of additional QE in the months ahead.

SWITZERLAND - With a credible exchange rate floor and an accommodative fiscal stance underpinning an improvement in confidence in the Swiss economy, macroeconomic conditions appear comparatively stable. Real GDP expanded by 0.7% q/q in the first quarter, driven by gains in private and public consumption and partially offset by contractions in investment and net exports. Looking to the quarters ahead, the picture remains unclear; the KOF Leading Indicator (a composite business survey) registered another gain in May, continuing its steady improvement since the turn of the year, while the manufacturing PMI dipped to 45.4, its lowest level since mid-2009. We anticipate modest growth of under ½% this year, picking up to 1½% in 2013. The consumer price index fell for a seventh straight month on a yearly basis, losing 1.0% y/y in April (the same pace as the prior month). Nevertheless, officials at the Swiss National Bank (SNB) maintain that the existing exchange rate floor of EURCHF 1.20 has diminished the deflationary risks threatening the nation's medium-term growth outlook. Moreover, the SNB has recently voiced concern about building imbalances in domestic credit and property markets in the context of a prolonged period of very low interest rates. Relative to the US dollar the franc weakened considerably in May, shedding 6.5% to reach .9713 (its lowest level in over a year), which may lessen some of the pressure on exporters. We now foresee the SNB raising the floor to EURCHF 1.25 in the third quarter.

NORWAY - Domestic economic conditions have proved fairly resilient in Norway in the context of weak external demand, financial market turmoil and krone strength (relative to the euro, the currency of several trading partners). Real GDP expanded by 1.4% in January-March over the prior quarter on the back of healthy activity in the petroleum sector as well as solid consumption and net exports. The manufacturing PMI recovered slightly in May after dropping more than five points in April, and remains in expansionary territory at 54.9. Although the trade surplus moderated from a record-high NOK 46.4 billion in March, it remained large at 38.4 billion. Some of this drive will cool over in the months ahead – particularly exports, given the stagnating growth conditions in the UK and euro area. We expect growth to average approximately 2¼% this year and 2½% in 2013. Inflationary pressures have been quite subdued over the last year (sitting below the Norges Bank's 2.5% target since late 2010), with a gain of just 0.3% y/y at the latest reading. The recent sharp depreciation of the krone versus the US dollar – roughly 6% alongside the dive in oil prices in May – should prevent inflation from falling much further, particularly with unemployment low and house prices continuing to rise. The central bank reiterated at its May 10th meeting that the policy rate (left unchanged at 1.50%) is expected to stay at its current level into next year; however, additional easing may materialize if global economic and financial conditions deteriorate further.

ASIA/OCEANIA
Currency Outlook

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JAPAN - Reacting to a rise in risk aversion, flows into yen have been strong, pushing the currency up 2% in the month of May. Traders cut their short positions and added to longs, reducing the net short position to just US$-1.7 billion. Technicals suggest ongoing downside risk; however a drop below 77 in USDJPY will aggravate intervention rhetoric. The near-term suggest a lower USDJPY; however Japanese fundamentals are weak, which should help USDJPY recover back up to 83.00 by year-end.

CHINA - The path of USDCNY has changed materially in the last month. The combination of a narrowing current account surplus, a broadly stronger USD and a deterioration in the global growth outlook have temporarily halted (and reversed) yuan appreciation. Forward markets are pricing in a 0.5% depreciation into year-end. On the back of these shifts we have amended our year-end USDCNY forecast to 6.25.

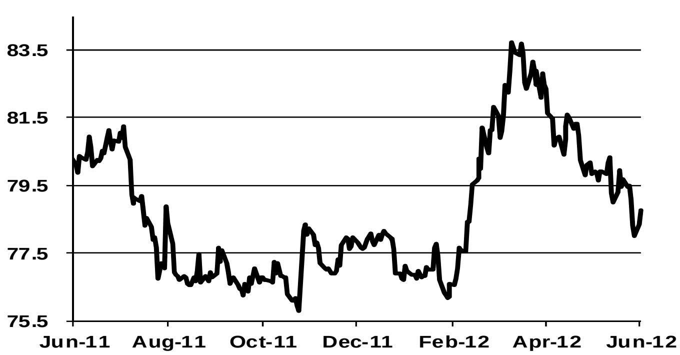
AUSTRALIA - The Australian dollar (AUD) suffered an almost 7% loss in May as risk aversion jumped higher, the outlook for global growth deteriorated and the central bank cut interest rates – a challenging combination for the high-beta, growth sensitive AUD. The CFTC reports a record net short position of US$3.5 billion, as sentiment has turned violently against AUD. However, based on a soft-landing in China and an important yield differential, AUD should outperform into year-end, closing at 1.02.

NEW ZEALAND - The worst performer of the primary currencies, the New Zealand dollar (NZD) lost 8% in May. The CFTC reports a net short NZD position of just US$-0.4 billion; however it is reflective of sentiment that has turned noticeably bearish. Technicals suggest early signs of stabilization into June. We hold a year-end target of 0.76.

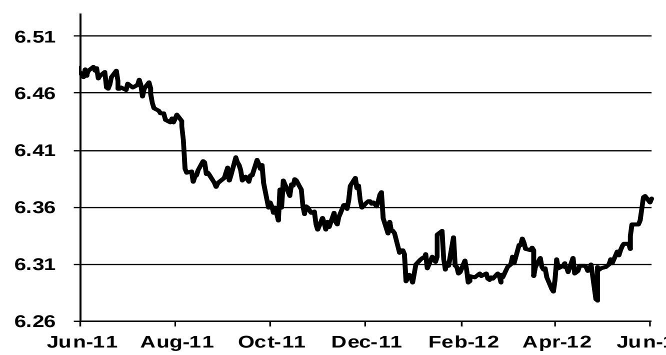
Currency Trends

FX Rate	Going Back			Spot	Outlook			FX Rate
	12 m	6 m	3 m	5-Jun	3 m	6 m	12 m	
USDJPY	80.10	77.73	81.09	78.8	80.33	82.33	84.67	USDJPY
USDCNY	6.47	6.36	6.31	6.37	6.32	6.27	6.22	USDCNY
AUDUSD	1.07	1.02	1.06	0.97	0.98	1.01	1.04	AUDUSD
NZDUSD	0.81	0.78	0.82	0.76	0.75	0.76	0.78	NZDUSD

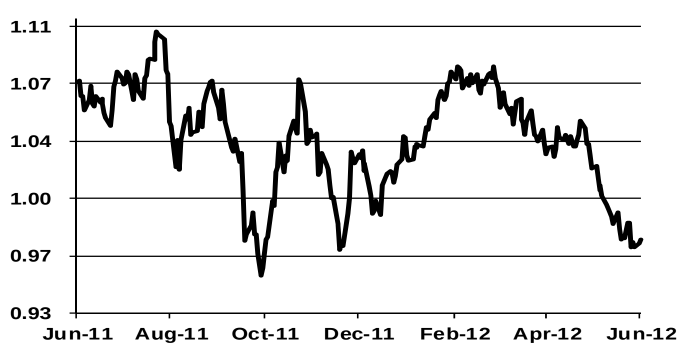
USDJPY



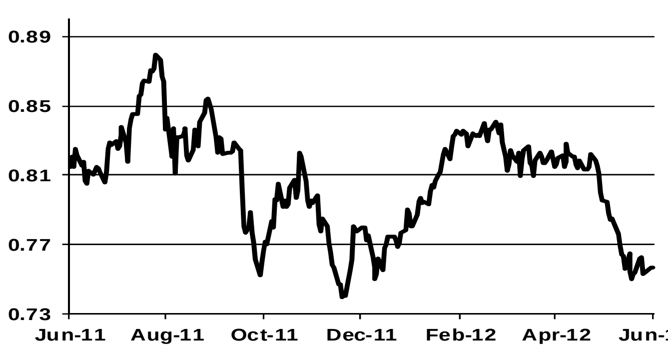
USDCNY



AUDUSD



NZDUSD



ASIA/OCEANIA

Fundamental Commentary

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JAPAN - The Japanese yen (JPY) continues to be perceived as a safe-haven currency in times of synchronized global financial stress. Since mid-March the yen has been appreciating against both the USD and the EUR in the context of deepening tensions in Europe caused by uncertainties regarding currency union sustainability and systemic erosion in the Spanish financial sector. We do foresee that the perceived safety premium will remain in place over the next quarter, yet the risk of decisive outright intervention by the Japanese authorities will escalate later in the year. Therefore, we are adjusting our quarterly view on USD/JPY values to reflect such a global preference in the near term. The Japanese economy, after expanding at a 4.1% y/y rate in the first quarter of the year, will moderate in the coming quarters to close the year at around 2% on the back of reduced exports to both China and the US, withdrawal of post-disaster consumption incentives and lower fiscal stimulus. At the same time, the 1% inflation target may also lead to higher price pressures throughout the year. Japan continues to suffer from a significant fiscal imbalance, which led Fitch to downgrade the country's long-term foreign-currency credit rating by two notches to "A+" on May 22nd. Nevertheless, market participants shrugged off the rating action as Japan's net external creditor status and a healthy financial sector continue to support the JPY.

CHINA - A marked slowdown in manufacturing activity, trade, output production and retail sales has led to a downward revision in our GDP growth projection: the Chinese economy will accelerate at an annualized rate of 8.0% and 8.5% in 2012 and 2013, respectively. On a quarterly basis, we estimate that the economic deceleration will bottom out during the second quarter of the year. The authorities are gearing decisively towards a pro-growth policy mix in the context of relatively well contained price pressures; indeed, consumer price inflation declined to 3.4% y/y in April 2012, down from 6.5% y/y in July 2011. We do anticipate coordinated monetary and fiscal stimuli to be put in place in the coming months. The Chinese central bank will lower reserve requirements to stimulate credit-intensive activity during the process of rebalancing from investment to consumption. In the fiscal arena, tax cuts and a boost to basic infrastructure investment projects will become primary growth drivers. Additionally, further credit flows will be allocated to major projects under way. China counts on a fairly robust fiscal position and massive foreign exchange reserves totaling US$3.3 trillion (equivalent to one-third of the world's total foreign exchange reserves) to direct exchange rate trends at leisure. The recent widening of the exchange rate trading bands allows the renminbi (CNY) to move in any direction. A weaker CNY could be a policy of choice if trade activity does not rebound quickly.

AUSTRALIA - The Australian dollar (AUD) has been in steady depreciation mode since early February, reaching a level as low as US$0.9582 per AUD. Proximity does count for the Australian economy. Evident signs of economic deceleration in both China and India are mirrored in Australia, influenced by commodity price deflation and lower export revenue. Since February 24th, the aggregate CRY commodity price index has been on a steady decline; copper prices have virtually erased all gains achieved in 2012. Gold prices have also suffered a similar decline, yet the renewed phase of global financial stress may increase demand for gold as a temporary safe-haven asset in the near term. Declining retail sales, downward adjustment in housing prices and lower manufacturing activity compound the challenges affecting the Australian macroeconomic landscape. Nevertheless, the resource-based economy remains supported by vast mining-related investment projects. On the monetary front, global market participants have fully discounted the likelihood of deeper monetary easing as a means of counteracting economic deceleration forces. As a result of a material deterioration in the Asian growth scenario, we now expect the Reserve Bank of Australia to maintain a monetary easing bias by further reducing its reference benchmark rate to 3% by the end of the year. The narrowing of interest rate differentials will also reduce the attractiveness of the AUD, so we are also adjusting our currency view for the next 18 months.

NEW ZEALAND - New Zealand's economic scenario will be shaped by the regional growth downturn and the government's reconstruction efforts following the natural disasters of 2010 and 2011. Post-earthquake reconstruction investment may reach US$15 billion in the next 18 months, becoming a major driver of economic activity. The fiscal stimulus measures will undoubtedly erode the already weak fiscal base, with the budget gap possibly reaching 7% of GDP by the close of the year. Gross fixed investment, rather than net exports, will become the major driver of economic growth, expected to reach 2.5% this year. On the external front, the widening current account deficit (projected to close the year near the 4% of GDP mark) will be a negative factor weighing on the currency outlook. Nevertheless, interest rate differentials in a context of ultra-low global interest rates may drive demand for the NZD in the months to come. Manageable price pressures may pave the way for monetary stimulus should the regional growth scenario continue to deteriorate. The short-term policy rate has been left at 2.5% since March 2011. 10-year government securities are yielding 3.3%, a relatively attractive rate for high-grade fixed-income investors. Although Fitch and S&P both downgraded the country's rating to "AA" last September, Moody's still places New Zealand in the "Aaa"-rated category. Looking ahead, the widening twin (fiscal and current account) deficit position may trigger further downgrade revisions and impair the outlook for the NZD.

DEVELOPING ASIA
Currency Outlook

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INDIA - RBI measures put in place to arrest INR selling have been unable to sustainably ease pressure on the currency. This is a direct result of a lack of natural INR demand onshore, due to India's wide current account deficit. Capital outflows resulting from global market upset have exacerbated this weakness, rendering the RBI's measures ineffective. With local markets under pressure and portfolio outflows driven by European-sourced risk aversion, it is unlikely that INR can stabilize without a shift in the global macro environment. We hold a Q4 2012 USDINR target of 55.50.

KOREA - KRW was predictably a regional underperformer in May, as global risk aversion drove the heaviest won selling since the last flare-up in the European financial crisis in the fall/winter of 2011. Official efforts to cap USDKRW's topside have constrained the pair from surging over the 1185 price point on a sustained basis. However, the global macro dynamic will eventually force such a move, if only in the near term, so long as indicators of global risk aversion remain as extended as they have been at the outset of June. We expect USDKRW to end Q4 2012 at 1160.

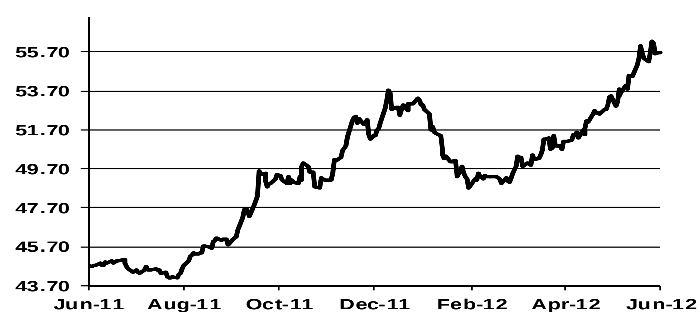
THAILAND - The Thai baht (THB) lost 3% in May, a mid-performer among the Asian currencies. Entering June USDTHB is trading near its 2012 highs on the back of risk aversion and a loss of momentum in the Asian growth outlook. The May 2012 rally in USDTHB failed to breach resistance at 31.90, a level that also held in January, solidifying it as a level of resistance. Policymakers at the BoT have stated their comfort with the recent rise in USDTHB (depreciation of THB), given that it has been in line with that seen in other Asian FX peers; while exporters are rumored to be using recent weakness to repatriate foreign income. USDTHB is expected to close the year at 31.00.

TAIWAN - TWD has been allowed to weaken to its lowest level since early January as the central bank accommodated selling pressure, in line with the rest of the regional currencies. The regional economic deceleration is likely playing a part in the decision to allow for TWD weakness, as exports also remain under significant pressure. Accordingly, stabilization in medium term production indicators would bode well for TWD, as would smoother financial market conditions as at the outset of June, cumulative net foreign equity flows turned negative for Taiwan. We hold a Q4 2012 USDTWD forecast of 29.25.

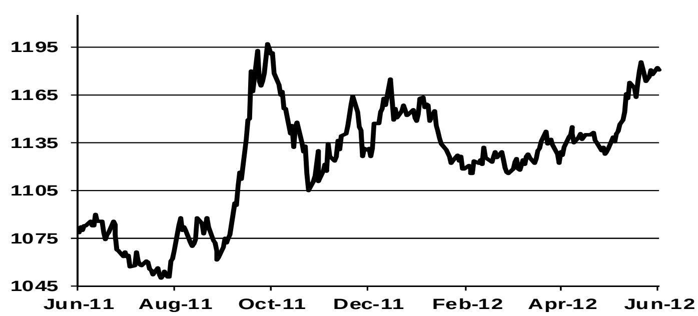
Currency Trends

FX Rate	Going Back			Spot	Outlook			FX Rate
	12 m	6 m	3 m	5-Jun	3 m	6 m	12 m	
USDINR	44.76	51.42	50.29	55.65	56.33	55.67	55.08	USDINR
USDKRW	1078.10	1131.35	1124.80	1180	1173	1163	1142	USDKRW
USDTHB	30.30	30.84	30.74	31.60	31.67	31.17	30.58	USDTHB
USDTWD	28.64	30.22	29.54	29.98	29.58	29.33	28.94	USDTWD

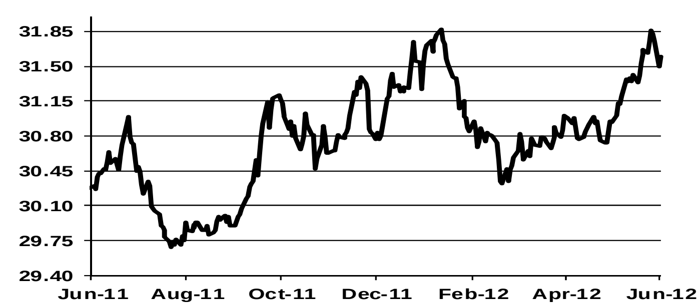
USDINR



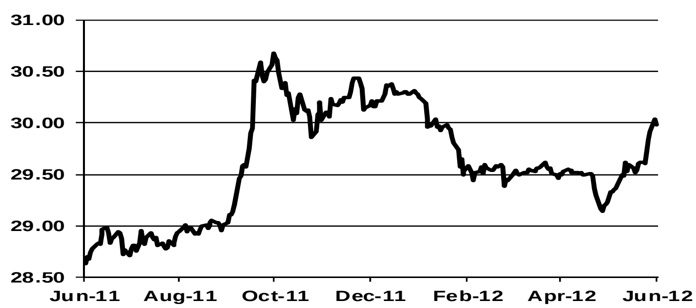
USDKRW



USDTHB



USDTWD



DEVELOPING ASIA
Fundamental Commentary

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INDIA - The Indian rupee (INR) has been steadily depreciating against the US dollar (USD) since early February, prompting the central bank to step up intervention and administrative measures, which included obligating exporters to convert 50% of foreign exchange earning held in bank accounts into rupees. India's macroeconomic and governance landscape is deteriorating. A sharp contraction in economic momentum materialized in the first quarter of 2012 driven by weak activity in the manufacturing and agricultural sectors: real GDP expanded by 5.3% y/y. The twin (fiscal and current account) deficit position is a big drag on growth prospects. The current account deficit (4% of GDP) is a natural result of persistent export sector deceleration and a significant energy import bill. The fiscal gap is nearing the 6% of GDP mark. We have revised our growth projection downwards to 6.0% and 6.5% in 2012 and 2013, respectively. Currency weakness and declining equity valuations (in place since February) highlight investor/creditor uneasiness. At the end of April, Standard and Poor's downgraded the country's rating outlook to "negative" citing widening twin deficits and deteriorated economic growth prospects. A more interventionist policy stance is in prospect. The Reserve Bank of India may reduce the policy-setting reference rate from 8% at a time when price pressures remain in place: wholesale price inflation recorded a 7.2% y/y rate in April. Reserve requirements on banking sector deposits will likely be lowered to reinforce monetary stimulus measures.

KOREA - The trade-intensive South Korean economy is suffering from an evident global economic slowdown and sharp shifts in emerging-market currencies linked to global trade and commodity markets. According to the latest central bank projection, the economy will expand by 3.5% in 2012. For now, South Korean monetary authorities seem to opt for maintaining current liquidity conditions. An easing in crude oil prices will also reinforce the official bias to maintain monetary conditions unchanged. The reference interest rate has been kept at 3.25% since June 2011 due to well contained price pressures (2.5% y/y headline inflation rate in May) within the 2-4% official target. We expect that short-term rates will remain unchanged after the policy announcement scheduled for June 8th. The recent decline in crude oil prices, if sustainable, is a positive development for the energy-importing South Korean economy. Ongoing signs of export sector deterioration are also a major incentive to keep an accommodating monetary stance; in fact, exports have declined for a third consecutive month on a year-over-year basis, although the government still forecast a trade surplus for the year as a whole. Finally, the direction of the strong Japanese yen remains another factor influencing KRW trading dynamics given the competitive nature of both economies. The Korean won will not be immune to another round of global financial market stress, yet the country is structurally better prepared to withstand external financial shocks.

THAILAND - A sharp economic rebound is taking place in Thailand as a result of decisive policy actions adopted after the devastating floods occurred at the end of 2011. The Thai economy advanced by 0.3 % y/y during the first quarter of this year, driven by an 11% quarter on quarter expansion. The increase in economic activity was mainly fuelled by domestic consumption and investment, which helped offset the deteriorating export sector performance linked to softer demand in China and the US. The Bank of Thailand projects a 6% economic growth rate for 2012 to be driven primarily by private investment activity and rebounding local consumption. On the monetary front, the central bank will likely leave its policy-setting reference rate unchanged at 3% on June 13. The government is optimistic about the full normalization of manufacturing activity during the second half of this year. Meanwhile, the projected current account deficit may weigh on the currency outlook. The Thai Baht has been under pressure in line with regional trends affecting Asian floating currencies, yet there is no evidence of material pass-through to prices. The headline inflation rate increased by 2.5% y/y in May, even after the government announced an adjustment to minimum wages. Governance issues are also a source of currency market instability although for now the ruling party seems totally focused on restoring growth and employment following the devastating natural disasters.

TAIWAN - Increasing concerns about global growth have affected the perception of risk in the non-pegged currencies in Asia including the Taiwanese dollar, which has weakened in line with peer currencies during the month of May. Nevertheless, we are of the view that the country is structurally well prepared to weather the global financial market stress and recover a path of low-inflation sustainable growth supported by large-scale foreign exchange reserves and a current account surplus. After expanding at a 4% rate, the Taiwanese economy is showing signs of softness that will take growth rates to 2.5-3% this year before accelerating again in 2013 above the 4% mark. Exports are declining as overseas demand, particularly from OECD member countries, remains sluggish. The manufacturing sector declined in April and growth in the construction sector slowed down markedly. The country still enjoys a large current account surplus position (in excess of 9% of GDP) which bodes well for the currency outlook, yet Taiwan cannot be immune to the asset price deflation dynamics affecting emerging-market Asian economies. A manageable inflation context and relatively low unemployment allows the central bank to adopt a pro-growth policy. Monetary conditions –with a reference rate set at 1.875%– remain accommodating. Consumer price inflation reached 1.4% y/y in April, and a similar rate is forecast for May. The TWD is also supported by a substantial pool of foreign exchange reserves totaling US$395 billion.

DEVELOPING AMERICAS

Currency Outlook

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BRAZIL - The Brazilian real (BRL) accelerated its depreciating trend during May, accumulating a loss of 16% in the last six months. Continued weakening in local economic conditions, narrower interest rates spreads and the intensifying pressures emerging from Europe have been affecting the BRL. We expect the USDBRL to limit its recovery and to close the year at 1.95.

MEXICO - The Mexican peso (MXN) has been under a lot of pressure due to European financial distress, lower oil prices and some negative economic data in the US. The MXN declined 10.5% against the US dollar in the last three months, one of the biggest losses in the region. We expect a gradual recovery of the currency in the coming months, which could accelerate after the presidential election is over and the new President is elected. We maintain our view that the USDMXN will close the year slightly above 13.10.

CHILE - After trading in a very stable range, the Chilean peso (CLP) depreciated vis-à-vis the US dollar and erased almost all of its gains accumulated in the year, responding to the fall in copper prices, a moderation in developing Asia growth and the European uncertainty. We anticipate that the USDCLP will stabilize as economic fundamentals remain strong and will likely close the year at 498.

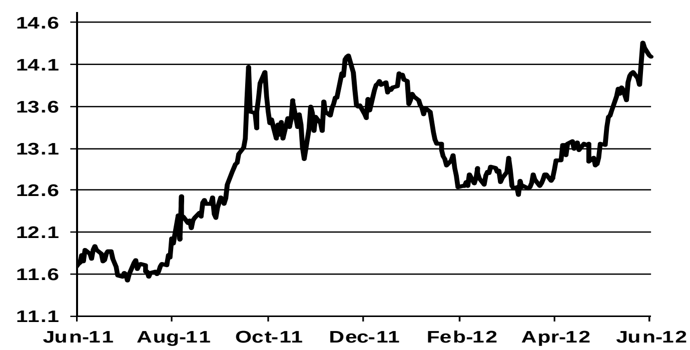
COLOMBIA - With the risk-off mode in financial markets and the retracement in oil prices, the Colombian Peso (COP) followed the regional adjustments and lost ground against the USD; however, it has been the least affected currency in the developing Americas. We expect that relatively stronger economic fundamentals in Colombia will drive the COP to a recovery and project a year-end rate of 1,800.

Currency Trends

FX Rate	Going Back			Spot	Outlook			FX Rate
	12 m	6 m	3 m	5-Jun	3 m	6 m	12 m	
USDBRL	1.58	1.79	1.77	2.02	1.97	1.95	1.89	USDBRL
USDMXN	11.75	13.48	12.87	14.22	13.45	13.16	13.11	USDMXN
USDCLP	468.45	512.15	489.73	512	504	499	502	USDCLP
USDCOP	1783.00	1933.40	1768.80	1792	1793	1793	1817	USDCOP

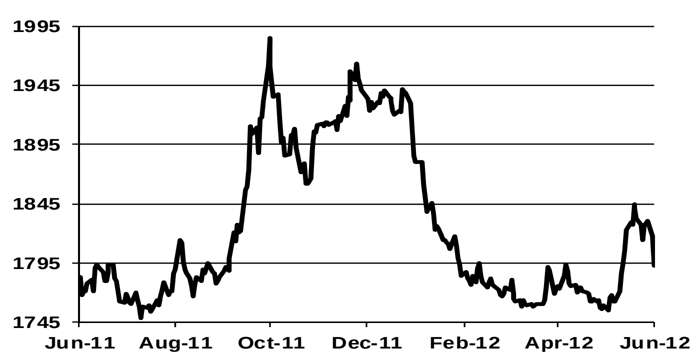
USDBRL

USDMXN



USDCLP

USDCOP



DEVELOPING AMERICAS
Fundamental Commentary

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BRAZIL - For the third consecutive month, the Brazilian real (BRL) lost ground against the US dollar, reaching its weakest level in 12 months. Deterioration in local economic conditions, narrower interest rates differentials, loose monetary policy, less appetite for riskier assets and uncertainty regarding European sovereign debt solutions have weighed on the BRL. The Brazilian economy has been decelerating since the end of last year and the latest data do not suggest an imminent recovery. GDP grew by 0.8% y/y in the first quarter of the year - the lowest annual rate since the third quarter of 2009 - with gross capital formation and the agricultural sector as the major contributors to the slowdown. Both the government and the central bank continue to implement measures to support economic growth. The government recently announced tax cuts for automotive sector loans, while the central bank maintains a loose monetary policy stance. In late May the central bank announced its seventh consecutive reference rate cut (a cumulative 400 bps in eight months) to a record low of 8.5%. Inflation continued to moderate in April; however the pace of deceleration has slowed. We maintain our view that the central bank may be reaching the end of the loosening cycle and that both the fiscal and monetary policies will have a real effect by the second half of the year. We are lowering our 2012 GDP growth forecast to 2.4% and to 3.5% for 2013.

MEXICO - The Mexican peso (MXN) has been vulnerable to adverse conditions in global financial markets. With European sovereign debt problems reemerging and dampening risk perception, together with less optimistic global economic growth, the MXN lost 7.5% against the US dollar in the last month, posting the biggest decline among its Latin American peers. For the first time in six months, the currency surpassed the 14.30 mark. Despite the FX market reaction, the local economy remains solid. GDP grew by 4.6% y/y in the first quarter of the year - the highest rate since the third quarter of 2010 - with local demand providing the strongest contribution to growth. Additionally, inflation decelerated for the fourth consecutive month in April to 3.4% y/y, the lowest y/y level since last October. With only one month ahead of the July 1st presidential elections, attention will be focused on the closing campaigns of the three main candidates (the new president will likely be known by the time our next report is released). So far, various polls still suggest that the PRI candidate, Enrique Peña Nieto, will likely win the elections; however, the difference between the first and second place has been very volatile between different polls. We still believe that the election could be another factor contributing short-term currency volatility; nevertheless, we do not foresee any shifts in the current path for macroeconomic policy for the coming years.

CHILE - Responding to financial market distress, a decline in copper prices and a less promising outlook for the fast-growing Asian economies, the Chilean peso (CLP) broke from its stable pattern, losing 6.2% vis-à-vis the US dollar in May, the second biggest loss among its Latin American peers. With this, the CLP has erased almost all the gains obtained in January and its volatility has increased. Economic fundamentals in Chile remain solid with the economic activity index increasing by 4.8% y/y in April, a marginal deceleration compared to the previous month's increase of 5.0% y/y. On the inflation front, price pressures continue to ease with annual inflation falling from 3.8% y/y in March to 3.5% in April and inflation expectations for the year-end decreased for the first time in two months. However, inflation excluding food and fuel has not shown signs of deceleration. Even so, amid the current volatile environment and higher uncertainty in Europe, the central bank has left unchanged the reference rate at 5.0%. In the latest monetary policy minutes, the central bank governors highlighted that the reference rate could be increased in the case of a clear stabilization of the international environment or further acceleration of domestic economic conditions, which have not yet been observed. We maintain our view that the Chilean economy will grow by 5.4% on average in 2012-2013; however, we are lowering our 2012 annual inflation expectation to 3.2% and to 3.1% for 2013 and, accordingly, we anticipate a smoother monetary policy tightening cycle.

COLOMBIA - In line with the rest of the Latin American currencies, the Colombian peso has lost ground vis-à-vis the US dollar; however, the reaction has been less aggressive than other currencies. The COP lost 3.2% in May, while currencies such as the BRL and the CLP have lost around 6.0%. Before the latest adjustment, authorities expressed their concerns over the currency strength – COP has gained 6.7% year to date, the only currency in Latin America with a positive six month return – which prompted authorities to extend again the daily USD purchase program until November. The deceleration in inflation moderated in April (3.4% y/y) and has converged with the mid-point of the official target range. The central bank has left the reference rate unchanged at 5.25% at the last two monetary policy decisions (April and May) after raising rates in the first months of the year. With inflationary pressures dissipating somewhat, commodity prices decreasing slightly, uncertainty over European debt problems and given the recent measures of the Ministry of Finance to increase the reserve requirements to curve consumption loans, we expect the reference rate to be maintained at its current level for the rest of the year. However, if the pace of household consumption accelerates again in the coming months and inflation fails to continue its stabilization process, monetary authorities may restart the tightening cycle. Despite the recent contraction in oil prices, we maintain our view that the Colombian economy will grow by 5.0% in 2012.

DEVELOPING EUROPE/AFRICA

Currency Outlook

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RUSSIA - May was a difficult month for the Russian ruble (RUB). A sharp deterioration in financial market sentiment on the back of renewed Euro break-up and global growth fears sent the price of oil down and USDRUB tumbling past the 33-mark (and well past its late-2011 lows). We expect the ruble to close this year around 32, with depreciation forces to take hold in 2013.

TURKEY - The Turkish lira (TRY) was affected by the recent flight to quality, though to a lesser extent than many of its European currency peers thanks to countervailing measures by the central bank. The lira lost 5.5% versus the US dollar in May, but remains nearly 4% above its late-December low. The TRY will remain vulnerable to developments in global financial markets, particularly as its current account deficit remains large. We look for USDTRY to close the year at 1.85.

CZECH REPUBLIC - The Czech koruna (CZK) has recently come under pressure from both external (euro crisis fears) and domestic factors (political upheaval). After regaining 5% versus the euro from the start of the year through mid-March, the currency has subsequently weakened, retracing its earlier gains. Continued reassurances by the governing coalition that fiscal consolidation objectives will be upheld should guide the koruna to a year-end rate of 24.8 per EUR.

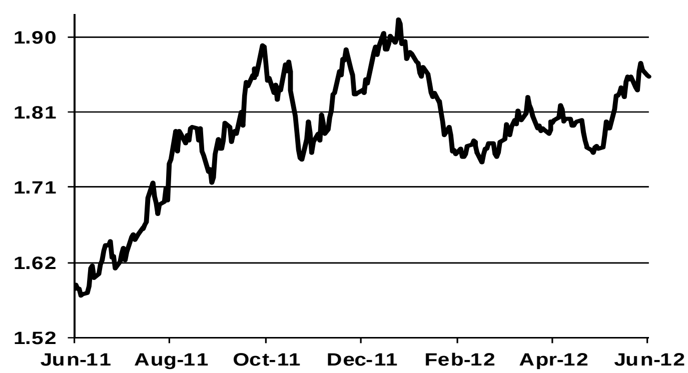
SOUTH AFRICA - The South African rand (ZAR) has succumbed to the recent resurgence in global risk aversion which has driven oil prices down almost 20%. Following a modest strengthening in the latter half of April, the ZAR weakened sharply in May, dropping roughly 10% to reach 8.58 per USD (a level not seen since November 2011). We expect the rand to remain volatile, and now project a year-end rate of 8.12.

Currency Trends

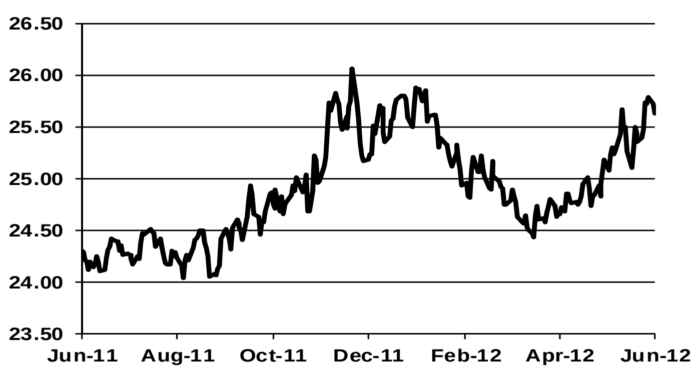
FX Rate	Going Back			Spot	Outlook			FX Rate
	12 m	6 m	3 m	5-Jun	3 m	6 m	12 m	
USDRUB	27.82	31.36	29.63	33.07	30.69	31.67	32.13	USDRUB
USDTRY	1.59	1.83	1.78	1.85	1.80	1.84	1.83	USDTRY
EURCZK	24.29	25.23	24.83	25.63	24.87	24.82	24.65	EURCZK
USDZAR	6.79	8.03	7.60	8.44	7.95	8.08	8.15	USDZAR

USDRUB

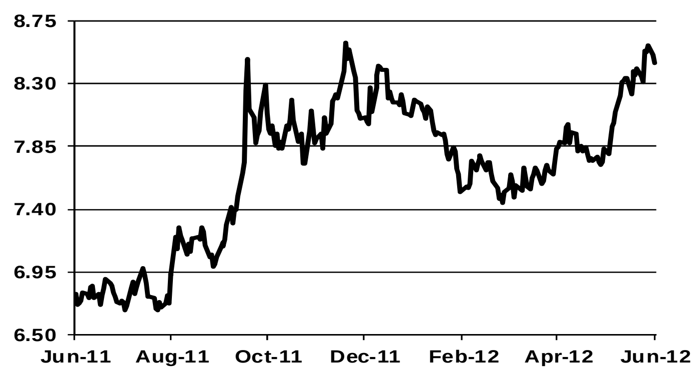
USDTRY



EURCZK



USDZAR



Developing Europe/Africa
Fundamental Commentary

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RUSSIA - The outlook for growth and the ruble is dominated by developments in the market for oil, as well as foreign portfolio flows to emerging markets. The price of Urals blend crude oil climbed nearly 15% in early 2012, but with European jitters reemerging in the last month the price of oil has sunk, more than erasing earlier gains. With oil went the ruble, dropping nearly 13% since the start of May. Russian equities have suffered too; the benchmark stock index is down more than 7% year-to-date, one of the worst performances in Europe outside of the periphery. Notwithstanding the deterioration in commodity and financial markets, the Finance Ministry is confident that the budget will remain on track in 2012 – a reasonable assertion given that the official projection is a deficit of 1.5% of GDP, and the year-to-date figure (through April) is at 0.3%. The economy maintained surprising resilience in the first quarter, with output advancing 4.9% y/y (a slight acceleration from the prior pace of 4.8%); however, we expect a slowdown in the coming quarters. GDP growth should average around 3¾% through 2013. One risk to the outlook is mounting resistance among the general public to President Putin's rule, which could disrupt the normal economic and fiscal course, particularly if it provokes an administrative response whereby power is centralized, reforms are delayed and/or government spending on special interests is expanded. Inflation is currently low (3.6% y/y), but will increase in the coming months due to ruble depreciation and a planned increase in gas prices.

TURKEY - With investors quick to react to developments in the euro crisis, and given the nation's still high (albeit, declining) reliance on short-term portfolio flows to finance the current account shortfall, the lira (TRY) remains volatile. Turkish monetary authorities will continue to use alternative policy tools, including adjustments to the overnight lending corridor, macroprudential measures and foreign exchange selling, in an aim to guide inflation lower and rebalance the economy toward external-driven growth without constricting general economic activity or destabilizing financial conditions. Meanwhile, the benchmark interest rate will be kept at a record-low 5.75%. In the central bank's projection, price pressures peaked in April (indeed, inflation eased from 11.14% y/y to 8.28% in May and is expected to fall below 7% by year-end), while the current account deficit will continue to moderate from its October high (on a 12-month basis). Economic growth likely softened considerably in the first quarter, with consumer spending in particular retreating on lower credit availability and depressed confidence. Growth in consumer lending has slowed from its year-ago rate of over 40% y/y to 18% as of mid-May. While exports have held up well through the slowdown in Europe (advancing 10.9% y/y in January-April), we nevertheless expect this moderation in domestic demand to limit the overall pace of growth to less than 2½% this year. While the current account deficit should drop to below 9% of GDP this year, the fiscal shortfall will widen toward 2% of output.

CZECH REPUBLIC - The near-term economic prospects for the Czech Republic remain subdued, with domestic demand still weak (yet to recover from the 2008/09 recession) and the external sector dampened by the downturn in the euro area. Nonetheless, the IMF's 2012 Article IV Consultation concludes that a commitment to fiscal prudence and strong fundamentals render the nation well-positioned to weather current financial and economic challenges. Real GDP dropped 1.0% q/q (seasonally adjusted) in the first quarter, which follows a 0.1% loss in the final three months of 2011 and places the economy back in recession. We expect Czech GDP to register a slight overall contraction in 2012, before rebounding by nearly 2% next year. Despite recent currency weakness, which could engender some price stickiness in the months ahead, demand-driven inflationary pressures are nonexistent. The central bank foresees inflation (currently 3.5% y/y) remaining high this year due to indirect tax increases, depreciation and lagged effects from high oil prices, and then moving below the effective 2% target in 2013 and staying there through the end of the policy-relevant horizon. Thus, there is a strong likelihood that the bank will reduce interest rates in the near term, particularly if additional fiscal consolidation measures are enacted in order to meet EU deficit targets (i.e., a 3% of GDP deficit by 2013). Ongoing political strife, as well as increasing anti-austerity backlash among the general public, may result in a change in government and/or fiscal slippages.

SOUTH AFRICA - The South African economy decelerated considerably in the first quarter, with the annual growth rate dropping from 2.9% y/y to 2.1%. The slowdown largely reflects the slump in mining production, which declined 5.5% q/q on a seasonally adjusted basis in the first three months, while the construction sector also detracted from growth. More recently, manufacturing activity and household consumption have begun to soften. The Kagiso PMI continues to portray expansionary conditions in the manufacturing sector, but the index has shed more than four points since February. Meanwhile, escalating unemployment (the jobless rate rose to 25.2% in the first quarter) is increasingly worrying for authorities. Another area of concern is the recent spike in the rate of credit extension to the private sector, particularly unsecured lending to households. Total loans to the private sector increased 9.2% y/y in March, a three-year high, and unsecured lending advanced 29.4%. The South African Reserve Bank (SARB) maintains that there are no signs of instability in the banking sector, with the non-performing loan ratio easing from 5.8% to 4.6% over the last year. Nevertheless, a sustained expansion in credit at this rate could fuel asset price inflation, putting downward pressure on the rand over the medium term. Headline inflation edged higher to 6.1% y/y in April from 6.0% in the prior month. The SARB judges the risks to the inflation outlook as tilted slightly to the upside, implying that further currency depreciation may incite monetary tightening later this year.

GLOBAL CURRENCY FORECAST (end of period)

			2010	2011	2012f	2013f	2012f				2013f			
							Q1a	Q2	Q3	Q4	Q1	Q2	Q3	Q4
MAJOR CURRENCIES														
	Japan	USDJPY	81	77	83	87	83	79	81	83	84	85	86	87
	Euro zone	EURUSD	1.34	1.30	1.23	1.21	1.33	1.22	1.23	1.23	1.22	1.22	1.21	1.21
		EURJPY	108	100	102	105	111	96	100	102	102	104	104	105
	UK	GBPUSD	1.56	1.55	1.60	1.64	1.60	1.56	1.59	1.60	1.62	1.63	1.64	1.64
		EURGBP	0.86	0.83	0.77	0.74	0.83	0.78	0.77	0.77	0.75	0.75	0.74	0.74
	Switzerland	USDCHF	0.94	0.94	1.02	1.03	0.90	0.98	1.02	1.02	1.02	1.02	1.03	1.03
		EURCHF	1.25	1.22	1.25	1.25	1.20	1.20	1.25	1.25	1.25	1.25	1.25	1.25
AMERICAS														
North	**Canada**	USDCAD	1.00	1.02	0.99	0.96	1.00	1.05	1.02	0.99	0.98	0.97	0.97	0.96
North		CADUSD	1.00	0.98	1.01	1.04	1.00	0.95	0.98	1.01	1.02	1.03	1.03	1.04
North	**Mexico**	USDMXN	12.34	13.94	13.11	13.33	12.81	13.80	13.27	13.11	13.20	13.06	13.13	13.33
North		CADMXN	12.37	13.65	13.24	13.89	12.83	13.14	13.01	13.24	13.47	13.46	13.54	13.89
South	**Argentina**	USDARS	3.98	4.30	5.50	6.00	4.38	4.69	5.09	5.50	5.50	5.69	5.88	6.00
South	**Brazil**	USDBRL	1.66	1.87	1.95	1.90	1.83	2.00	1.96	1.95	1.92	1.87	1.88	1.90
South	**Chile**	USDCLP	468	520	498	510	488	507	502	498	500	503	506	510
South	**Colombia**	USDCOP	1908	1939	1800	1850	1789	1820	1780	1800	1810	1820	1840	1850
South	**Peru**	USDPEN	2.81	2.70	2.61	2.55	2.67	2.68	2.65	2.61	2.62	2.58	2.58	2.55
South	**Venezuela**	USDVEF	4.29	4.29	5.15	5.15	4.29	4.51	4.83	5.15	5.15	5.15	5.15	5.15
ASIA / OCEANIA														
	Australia	AUDUSD	1.02	1.02	1.02	1.05	1.03	0.96	0.99	1.02	1.04	1.04	1.05	1.05
	China	USDCNY	6.61	6.30	6.25	6.10	6.30	6.35	6.30	6.25	6.25	6.20	6.15	6.10
	Hong Kong	USDHKD	7.77	7.77	7.75	7.75	7.77	7.76	7.75	7.75	7.75	7.75	7.75	7.75
	India	USDINR	44.7	53.1	55.5	54.3	50.9	57.0	56.0	55.5	55.3	55.0	54.8	54.3
	Indonesia	USDIDR	8996	9069	9400	9200	9146	9600	9500	9400	9350	9325	9250	9200
	Malaysia	USDMYR	3.06	3.17	3.10	3.02	3.06	3.14	3.11	3.10	3.07	3.06	3.04	3.02
	New Zealand	NZDUSD	0.78	0.78	0.76	0.82	0.82	0.74	0.75	0.76	0.77	0.78	0.80	0.82
	Philippines	USDPHP	43.8	43.8	42.5	41.5	42.9	42.3	43.0	42.5	42.3	42.0	41.8	41.5
	Singapore	USDSGD	1.28	1.30	1.25	1.21	1.26	1.27	1.25	1.25	1.25	1.24	1.23	1.21
	South Korea	USDKRW	1126	1152	1160	1110	1133	1180	1170	1160	1150	1138	1125	1110
	Thailand	USDTHB	30.1	31.6	31.0	30.0	30.8	32.0	31.5	31.0	30.8	30.5	30.3	30.0
	Taiwan	USDTWD	29.3	30.3	29.3	28.5	29.5	29.8	29.5	29.3	29.1	28.9	28.7	28.5
EUROPE / AFRICA														
	Czech Rep.	EURCZK	25.0	25.6	24.8	24.2	24.8	24.9	24.9	24.8	24.8	24.6	24.4	24.2
	Iceland	USDISK	115	123	118	116	127	123	121	118	118	117	117	116
	Hungary	EURHUF	279	315	295	285	294	289	292	295	295	291	288	285
	Norway	USDNOK	5.82	5.98	5.75	5.30	5.69	6.10	5.90	5.75	5.60	5.50	5.40	5.30
	Poland	EURPLN	3.96	4.47	4.25	4.00	4.15	4.19	4.22	4.25	4.25	4.16	4.06	4.00
	Russia	USDRUB	30.54	32.1	32.0	32.5	29.3	30.0	31.0	32.0	32.0	32.2	32.4	32.5
	South Africa	USDZAR	6.63	8.09	8.12	8.25	7.67	7.86	7.99	8.12	8.12	8.17	8.22	8.25
	Sweden	EURSEK	8.99	8.92	8.80	8.65	8.83	9.00	8.90	8.80	8.80	8.75	8.70	8.65
	Turkey	USDTRY	1.54	1.89	1.85	1.76	1.78	1.78	1.82	1.85	1.85	1.82	1.78	1.76

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