Foreign Exchange Outlook

As central banks take the first steps away from ultra-accommodative policy, we expect those currencies with stronger fundamentals, political stability and/or credible central banks to outperform those whose fundamentals are weak and external positions are vulnerable. Accordingly, this positions NZD, GBP, MXN, KRW, CAD, AUD, CNY and a few others ahead of those like EUR, JPY, CHF, THB, BRL, ZAR, TRY.

AMERICAS

Entering February CAD is the worst performing primary currency year-to-date. Bearish pressure has built on the back of relative monetary policy and economic fundamentals. We expect ongoing CAD weakness in the first six months of the year followed by stabilization; we have adjusted our quarterly targets lower.

The core group of Latin American currencies remain vulnerable to heightened stress affecting emerging markets worldwide. The MXN has the potential to be a regional outperformer. The BRL is the only one which approached the 2009 crisis weak level. FX policy shifts led to sharp ARS weakness.

ASIA / PACIFIC

JPY weakness will resurface throughout the remainder of the year. A slow and steady pace of CNY appreciation continues as other regional currencies come under pressure. The AUD has potential to stabilize from the recent bearish tone.

We have shifted most of our emerging Asian forecasts weaker on the back of escalating risk aversion and domestic developments. The most significant change was to THB, which will be subject to further depreciation as political unrest intensifies.

EUROPE / AFRICA

In Europe, FX traders are differentiating between the stronger (GBP) and weaker (EUR) fundamental stories. We kept our bearish EUR outlook unchanged. As for the UK, building evidence of a firming in the economic backdrop and a less dovish Bank of England has prompted us to adjust higher our GBP outlook.

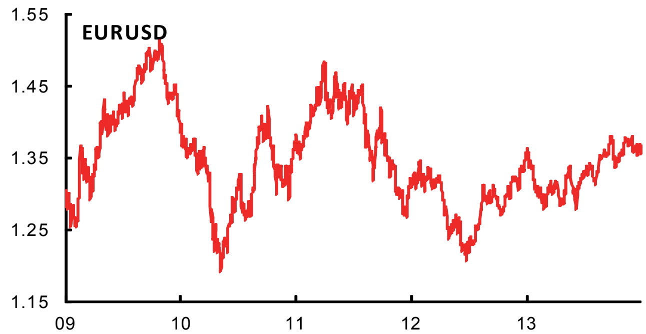
Increased volatility in FX markets amid global portfolio rebalancing has weighed heavily on the currencies of emerging markets with pronounced structural fragilities, already weak investor sentiment and subdued growth prospects. Among the most vulnerable are the RUB, the TRY and the ZAR, for which the trend of depreciation will likely extend throughout the forecast horizon despite decisive official intervention.

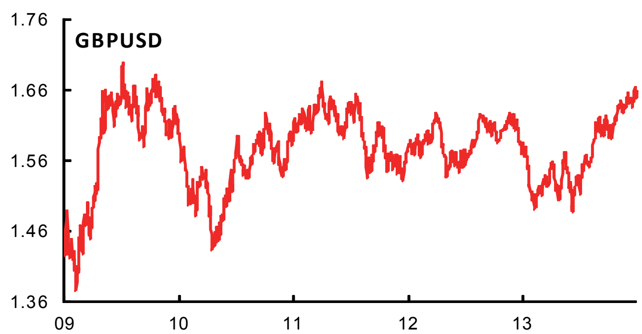
Contents

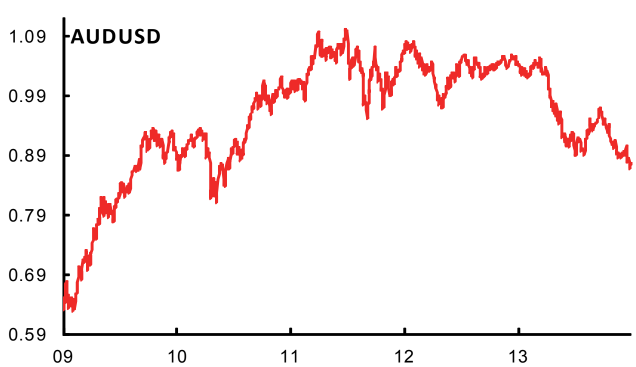
Core Exchange Rates

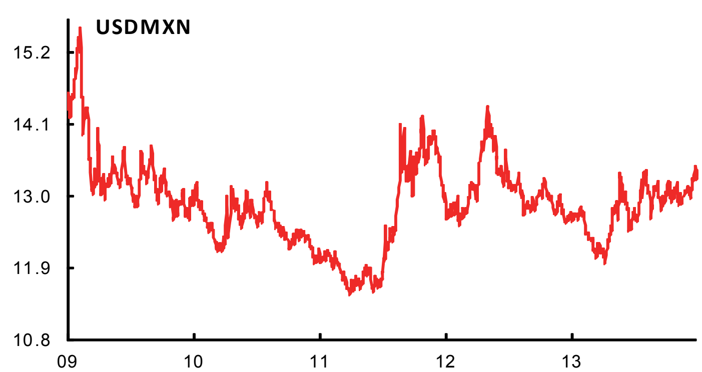
Global Foreign Exchange Outlook

January 30, 2014		Spot	2014f Q1	2014f Q2	2014f Q3	2014f Q4	2015f Q1	2015f Q2	2015f Q3	2015f Q4
EURUSD	Scotiabank	1.35	1.33	1.30	1.27	1.25	1.25	1.24	1.24	1.23
	Consensus*		1.34	1.32	1.31	1.29	1.29	1.28	1.28	1.28
USDJPY	Scotiabank	102.7	102	104	107	109	110	111	112	113
	Consensus*		104	105	106	107	108	108	108	109
GBPUSD	Scotiabank	1.65	1.65	1.66	1.65	1.64	1.64	1.63	1.61	1.59
	Consensus*		1.63	1.61	1.60	1.59	1.59	1.60	1.60	1.60
USDCAD	Scotiabank	1.12	1.13	1.15	1.12	1.11	1.10	1.10	1.10	1.10
	Consensus*		1.07	1.07	1.08	1.08	1.08	1.08	1.08	1.07
AUDUSD	Scotiabank	0.88	0.87	0.86	0.88	0.88	0.89	0.89	0.89	0.89
	Consensus*		0.90	0.89	0.88	0.88	0.87	0.87	0.87	0.87
USDMXN	Scotiabank	13.33	13.45	13.10	13.20	13.35	13.40	13.40	13.50	13.52
	Consensus*		12.90	12.83	12.70	12.58	12.55	12.57	12.59	12.61









(*) Source: Consensus Economics Inc. January 2014

Market Tone & Fundamental Focus

Pablo F.G. Bréard (416) 862-3876
pablo.breard@scotiabank.com

Camilla Sutton (416) 866-5470
camilla.sutton@scotiabank.com

Renewed volatility in emerging-market currency and securities markets is unlikely to be the catalyst to derail the upswing in global economic activity. Momentum is picking up in most regions within the high-income world. The United States is at the core of the broad-based global growth pick-up. We view the sharp adjustment in emerging-market valuations as a natural phase of risk repricing and potential demand for US financial assets.

We maintain our view that the US dollar (USD) will strengthen against the major currencies over the next 12 months, supported by widening and increasingly attractive growth and interest rate differentials. The trade-weighted DXY index has been in range trading mode over the past three months, following a steep decline from July to October 2013. The ongoing normalization of monetary conditions in the US — reflecting an improved US economic outlook — will continue to sway near-term capital flows, and more relevant, opening the debate about the timing and sequence of upward moves in administered short-term interest rates by the US Federal Reserve, the Bank of England and the European Central Bank (ECB).

The Canadian dollar (CAD) is expected to weaken against the USD throughout the first half of the year on the back of energy-related trade flows and policy uncertainties as well as long-term interest rate differentials and a relatively weaker growth pattern. However, the CAD should stabilize in the second half of the year as the combination of a US recovery and a weak CAD support the export sector. In addition, Canada as a sovereign credit retains a secondary safe haven bias. We estimate that CADUSD will close the year at 0.90.

The Mexican peso (MXN) will remain under pressure in the near term, influenced by generalized financial stress in emerging-market jurisdictions. Nevertheless, investors remain very sensitive to the structural reform process underway and the potential for higher GDP growth rates once key reforms (energy, financial sector, telecommunications) are implemented. Brazil has been at the forefront of the heightened emerging-market stress; however, decisive central bank intervention should help stabilize the Brazilian real (BRL) within the 2.45-2.50 range during the second half of the year.

Commodity price adjustments are not following a uniform pattern, instilling an added dose of volatility and uncertainty to currencies such as the Australian dollar (AUD), the Chilean peso (CLP) and the South African rand (ZAR). The likelihood of crude oil price decline is on global investors' radar screens whereas copper prices have experienced a somewhat volatile range-trading path over the past six months. Energy-exporting nations (such as Russia, Venezuela and Colombia) might see their commodity-linked currencies adversely affected by a downward directional trend.

Within Europe, there is a clear distinction between flows in core currencies in advanced nations versus top-tier emerging-markets. The EUR has been supported by the ongoing economic recovery and a return of flows; however, the fundamental backdrop continues to struggle which we expect will leave the ECB dovish for longer and weigh on the euro, pushing the EURUSD rate down to 1.25 by the end of the fourth quarter of 2014. Meanwhile, the Russian ruble (RUB) and the Turkish lira (TRY) have been major casualties in this renewed phase of global risk aversion, and there are no signs of an imminent stabilization phase. The UK outlook has improved, providing a lesson to USD watchers who are eyeing an improving fundamental backdrop. We have revised higher our British pound (GBP) outlook on the back of an expected interest rate hike in the first quarter of 2015 and improved investor sentiment; however, we caution that the currency is already priced to perfection and accordingly upside is likely to prove temporary. We expect GBPUSD to close the year at 1.64.

In the Asia/Pacific region, China remains a factor of stabilization in times of disorderly global currency adjustments. With US$3.8 trillion in foreign exchange reserves (20% higher than 12 months ago), the Chinese authorities maintain enough power to dictate the Chinese yuan (CNY) exchange rate versus the USD at leisure. We believe that the gradual appreciation phase may be temporarily interrupted should the process of asset price correction in emerging-market assets escalate further. We expect the USDCNY rate to close the year at 5.98. In January, the Japanese yen (JPY) came off its lows on risk aversion, reminding markets that it faces two-way risk. From here the combination of loose monetary policy, the implementation of the sales tax increase and government policy are likely to support a further depreciation in JPY in the second half of 2014. The Reserve Bank of Australia appears to be attempting to implement a verbal 0.90 ceiling on the currency; accordingly near-term pressure is likely to be lower but as the global economy improves the Australian dollar (AUD) should stabilize.

For emerging Asian currencies, those who are more vulnerable from a political, current account or fundamental perspective are most at risk. Accordingly, we expect ongoing depreciation in the THB, IDR and MYR, while the KRW and CNY are expected to appreciate on the back of much stronger fundamentals. HKD has depreciated fairly sharply over the past 2 weeks, rebounding in the past couple of sessions somewhat. The move has very significantly been driven by liquidation in the Hang Seng that has come over the past few sessions.

Canada

Currency Outlook

Eric Theoret (416) 863-7030
eric.theoret@scotiabank.com

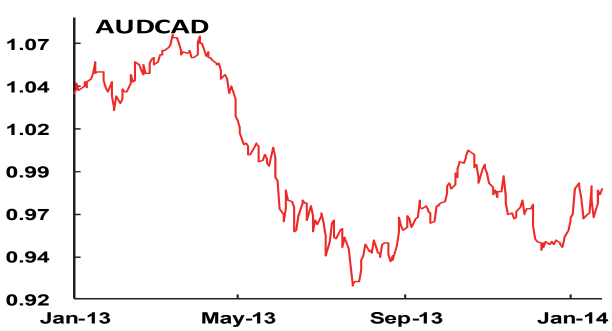
Camilla Sutton (416) 866-5470
camilla.sutton@scotiabank.com

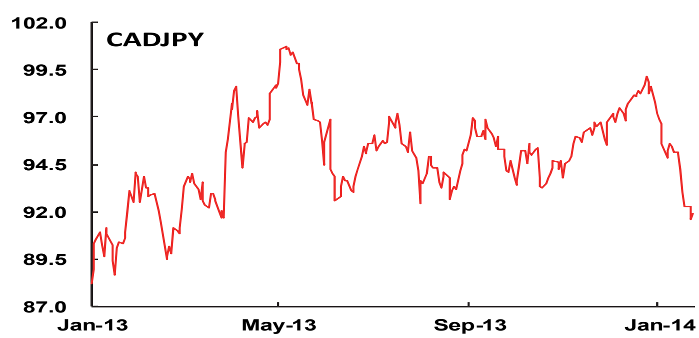
CAD — We expect CAD to weaken in the first half of 2014, stabilize at mid-year and eventually retrace some of its losses into year-end. For the first six months of the year, CAD is likely to fall victim to a dovish Bank of Canada (BoC) juxtaposed against the US Fed who has begun to taper its bond buying program. From the BoC's perspective even a 10% depreciation in CAD between September 2013 and January 2014, leaves the currency as strong and posing competitive challenges for Canada's non-commodity exports. In addition, a generally dovish tone to the January update pushed out the expectations for higher interest rates in Canada well into 2015; providing an additional weight to the currency. Fundamental data releases have proven uneven, which have exacerbated uncertainty over the economic outlook for Canada. In addition, ongoing uncertainty in the Canadian oil sector at a time of rising US domestic production increases has also played a hand in shifting sentiment towards a more bearish stance. Investors favour short CAD positions leaving the market still bearish but also one-sided. Together, these factors are expected to continue to weigh on CAD in the first half of the year.

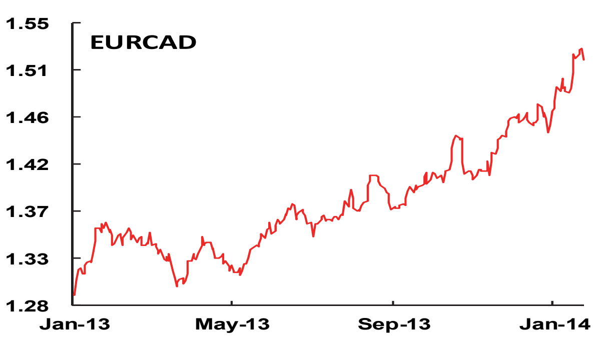
By the second half of 2014, the fundamentals pressuring CAD are expected to shift. An improving US economic landscape and a weaker CAD are a powerful combination that is expected to support Canadian exports and the economic backdrop. However it is interest rate policy that is likely to be the most important driver of CAD. As the Fed's bond buying program slows and fundamentals in Canada firm monetary policy in both the US and Canada is likely to stabilize. It is this that will be the key to stabilizing CAD. Leading into 2015 global growth is expected to improve; historically CAD has traded as a pro-cyclical currency, strengthening in times of global growth and weakening when global fundamentals are weak. Accordingly, the evolving global backdrop, still viewed as fragile, should also begin to support CAD. In addition, an improvement in oil pricing, with a narrowing in spread between Brent and Canadian Western Select priced oil combined with more clarity over Canadian oil infrastructure plans should remove some of the uncertainty around the currency. Accordingly we hold a Q214 USDCAD target of 1.15 with a Q414 target of 1.11.

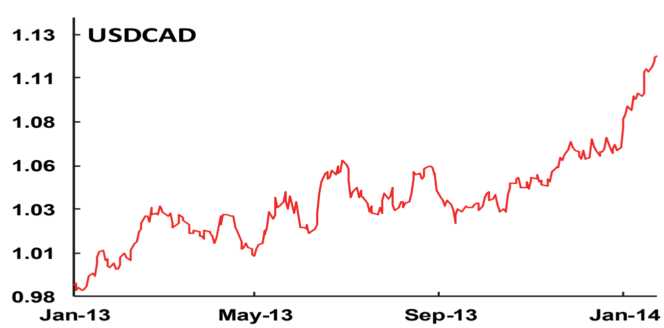
Canadian Dollar Cross-Currency Trends

FX Rate	Spot 30-Jan	14Q1f	14Q2f	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
AUDCAD	0.98	0.98	0.99	0.99	0.98	0.98	0.98	0.98	0.98
CADJPY	91.9	90.3	90.4	95.5	98.2	100.0	100.9	101.8	102.7
EURCAD	1.51	1.50	1.50	1.42	1.39	1.38	1.36	1.36	1.35
USDCAD	1.12	1.13	1.15	1.12	1.11	1.10	1.10	1.10	1.10









Canada and United States

Fundamental Commentary

Erika Cain (416) 866-4205
erika.cain@scotiabank.com

Adrienne Warren (416) 866-4315
adrienne.warren@scotiabank.com

UNITED STATES — US real GDP advanced a stronger than anticipated 3.2% in Q4, with positive contributions from consumer spending, exports and business investment. However, economic growth moderated from 4.1% in Q3, held back by less inventory accumulation and greater fiscal drag imposed by the federal government's16-day partial shutdown in October – the latter subtracting a percentage point off GDP growth. Construction was also surprisingly soft, due to a nearly double-digit decline in residential investment and a 1.2% contraction in non-residential structures. Unseasonably cold weather across much of the US was likely a factor and also played a role in dampening growth in employment, retail sales, particularly auto sales, and durable goods orders in December. Nevertheless, the US economic recovery continues to prove resilient as fiscal headwinds have abated and incoming data suggests private sector demand is gaining momentum. During the fourth quarter, growth in consumer spending accelerated 3.3%, marking the strongest quarterly gain in three years. Net exports provided a further boost to Q4 GDP, as the US trade deficit narrowed to a 4½ year low, driven by a revival in US export receipts. Meanwhile, despite weakness in construction and existing home sales, Q4 housing starts climbed to the highest level since mid-2008. Business investment in machinery and equipment also strengthened, contributing modestly to growth. Although, declining capital goods (nondefense ex-air) orders in December as well as motor vehicle production schedules point to a softer outlook for Q1 2014. This notwithstanding, US real GDP is forecast to accelerate from 1.9% in 2013 to 3% in 2014 and 2015, as fiscal restraint subsides, consumer and business confidence improves, and Americans continue to unleash pent-up demand for housing and consumer durables. This should support a pick-up in US business investment and a gradual rise in inflation through 2015.

CANADA — Canada's economic performance remains mixed. Domestic demand is relatively buoyant, though more moderate job growth suggests consumers will be cautious borrowers and spenders in the year ahead. Monthly employment gains averaged less than 10,000 last year, roughly one-third the 2012 gain, alongside a reduced pace of private and public sector hiring. Housing activity remains supported by historically low borrowing costs, though sales and construction have slowed as high home prices and moderately higher mortgage rates pressure affordability. Limited pent-up demand and high household debt burdens suggest Canadian consumer and housing activity will lag the US trend over the forecast horizon. Economic uncertainty, excess production capacity and softer commodity prices have dampened business investment, notwithstanding healthy corporate balance sheets and favourable financing costs. We expect business confidence and capital outlays will gradually firm up over the coming year, piggybacking on a stronger trend in commodity and non-commodity exports as the global recovery gathers momentum. Exports have lagged prior recovery cycles, held back by the slow pace of global growth and domestic competitiveness challenges. Even so, manufacturing sales are slowly beginning to pick up, with producers of motor vehicles and building materials benefitting from strengthening US auto sales and residential construction. Exporters should get a further lift from a weaker Canadian dollar. Meanwhile, non-residential construction remains supported by industrial, commercial and infrastructure spending. Resource-related activity has moderated, reflecting less buoyant commodity prices as well as temporary production disruptions and supply bottlenecks, but remains a source of ongoing support. Real GDP growth is expected to pick up to around 2½% this year, following an estimated 1.8% advance in 2013. Heightened retail competition, muted wage gains, and softer food and energy prices have depressed price trends, with both core and headline inflation falling to the lower bound of the Bank of Canada's 1-3% target range at year-end.

Monetary Policy Commentary

Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

UNITED STATES — With strains appearing in select emerging markets, a key question is: will the weakness in EM impact the Fed's conduct of monetary policy. We don't think so for the following reasons: a) Delaying tapering would not negate the fact that the market views the spread between growth in the US economy and growth across many EM economies as narrowing; b) it is not clear that giving emerging markets more time to adjust their own policies by delaying Fed tapering will be met with an adequate response in EM; c) EM complaints did not stop the Fed over the QE entry phase; d) the Federal Reserve does not have all-encompassing responsibility (or ability) to solve the world's troubles. Of course, a full-blown EM crisis could change the course of monetary policy in the US, but that is not Scotiabank's base case and unlikely to be the Fed's for the time being.

CANADA — The major question for the Bank of Canada (BoC) in 2014 is how it will deal with extremely low inflation (CPI averaged 0.9% y/y in 2013) – and whether or not the BoC will actually cut the Bank Rate, as some market participants are beginning to speculate that it may. We think that the bar for a rate cut is high. For a rate cut to happen: a) Low inflation levels would need to persist; b) growth would have to remain subpar; c) the housing market would need to show signs of cooling down; and d) the impact of the already depreciated CAD on inflation would have to be muted. While not our base case, that does not seem like an impossible series of events by any stretch of the imagination – which is why we expect the market to bet on rate cuts and continue to price a modest probability of easing.

Europe

Currency Outlook

Eric Theoret (416) 863-7030
eric.theoret@scotiabank.com

Camilla Sutton (416) 866-5470
camilla.sutton@scotiabank.com

EURO ZONE — The EUR traded comfortably between 1.35 and 1.38 in January, supported by ongoing capital flows. Technically there are no major EUR patterns but January did mark a more bearish turn in sentiment, with the CFTC reporting a shift from net long to net short. For the EUR the combination of low inflation and subdued credit dynamics are likely to see the ECB turn to more accommodative policy, perhaps through President Draghi's suggestion of the purchase of private sector loans. We are not encouraged and expect the EUR to trend lower, closing Q114 at 1.33.

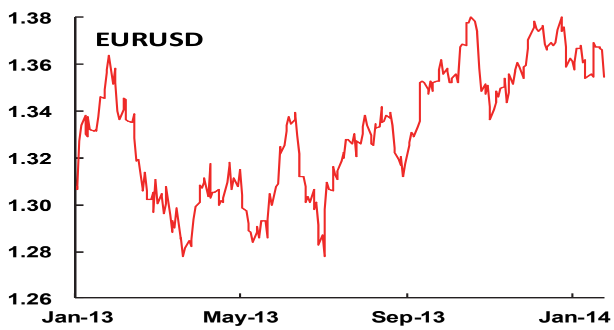
UNITED KINGDOM — The GBP has had a strong start to the year, trading to a new multi-year high in mid-January. Technically, the upward trend is strong but sentiment is mixed. The CFTC reports that the GBP is the only major currency held long against the USD and the option market continues to price for upside GBP risk; but consensus forecasts are calling for a 1.2% drop in GBP before year-end. We have revised higher our year-end GBP target, adjusting for an improvement in the economic outlook and a BoE who is now expected to hike rates in the first quarter of 2015. We hold a Q114 target of 1.65.

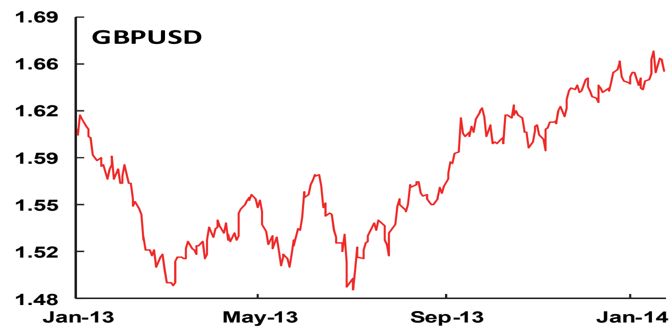
SWITZERLAND — As EM risk aversion increased in January EURCHF trended lower as markets were reminded that tail risks remain and safe haven demand can re-emerge rapidly. We do not expect any change in SNB policy and hold a Q114 EURCHF forecast of 1.23.

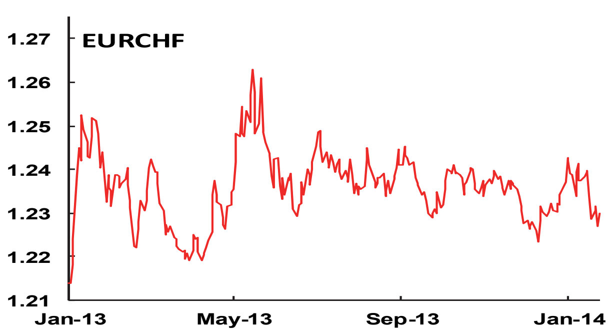
NORWAY — A softening in the inflationary trend, a rise in unemployment and decreasing anticipation of an interest rate hike weighed heavily on the NOK in January. USDNOK is trending higher and consensus is calling for USDNOK to close the year at 6.30. We hold an off consensus view, expecting fundamentals to eventually support a retracement and expect USDNOK to close Q114 at 6.00.

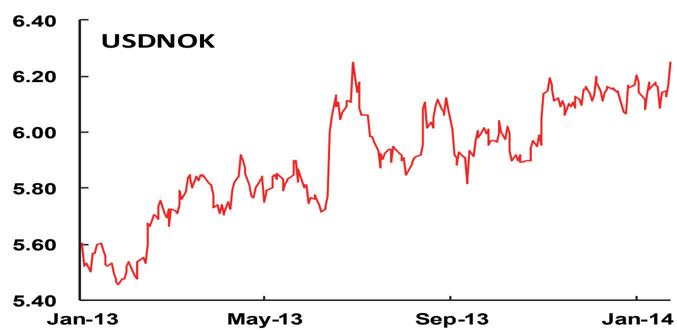
Currency Trends

FX Rate	Spot 30-Jan	14Q1f	14Q2f	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
EURUSD	1.35	1.33	1.30	1.27	1.25	1.25	1.24	1.24	1.23
GBPUSD	1.65	1.65	1.66	1.65	1.64	1.64	1.63	1.61	1.59
EURCHF	1.22	1.23	1.24	1.25	1.25	1.25	1.26	1.26	1.27
USDNOK	6.25	6.00	5.90	5.80	5.80	5.70	5.65	5.65	5.60









Europe

Fundamental Commentary

Sarah Howcroft (416) 862-3174
sarah.howcroft@scotiabank.com

EURO ZONE — The lingering threat of deflation combined with the ongoing contraction in bank lending has fuelled increasing pressure on the European Central Bank (ECB) to provide additional monetary stimulus. Headline inflation dipped to 0.8% y/y at the end of 2013, and our projection shows the pace remaining below 1% for most of 2014. While unconventional measures are the more likely policy choice in the current environment, we see scope for rate cuts should inflation and/or survey data disappoint in the coming months. Speaking at the World Economic Forum in Davos, ECB President Draghi dismissed speculation of traditional quantitative easing, saying that a more reasonable option would be for the ECB to buy packages of bank loans to the private sector. Since such a market does not currently exist, this prospect remains some way off. For now, sentiment indicators continue to trend gradually upwards, while industrial production data have begun to show a material improvement. The first member state to report fourth-quarter GDP results was Spain, where a 0.3% q/q expansion marked the second quarter of positive growth following nine quarters of recession. We have adjusted our euro area growth forecasts somewhat higher for 2014, from 0.8% to 0.9%, to reflect the improving performances in the peripheral economies where robust net exports have defied the pressure of a strong currency. Improving investor sentiment on the heels of successful bailout completions in Ireland and Spain has supported a further decline in sovereign bond yields across the periphery.

UNITED KINGDOM — The UK recovery is well underway; the economy registered four straight quarters of output gains in 2013, marking the first calendar year of continued expansion since 2007. Real GDP picked up 0.7% q/q in the October-December period according to the advance estimate (UK growth figures are notoriously subject to revision). Surging survey data toward the end of 2013 depicted a stronger performance, but the booming sentiment did translate into equivalent vigor in the real economy. The construction and services sectors both disappointed in the quarter, in spite of PMI readings at near-record highs in both segments. Looking ahead, we expect the quarterly pace of growth to continue to moderate gradually over the course of 2014 (leading to an overall expansion of 2.5%), before leveling out next year around 0.4-0.5% q/q (a yearly gain of 1.8%). The recovery is being driven by domestic forces (including thriving labour and housing markets), while persistent currency strength and still fragile conditions in the euro area play negatively into the outlook for exports. Consumer price inflation ended 2013 at 2% y/y, down from 2.7% in end-2012, and is set to remain around the 2%-mark throughout 2014. With the Bank of England's (BoE) 7% unemployment rate threshold likely to be reached in the very near future (as of November the rate had fallen to 7.1%), much earlier than anticipated when forward guidance was initiated, we expect the bank to revert to a more conventional rate-setting policy. The first benchmark interest rate hike will likely take place in early 2015.

SWITZERLAND — The Swiss economy continues to demonstrate resilience in the face of subdued conditions in Europe. For this reason, and given the nation's entrenched triple-A rating status, the franc (CHF) has been at the receiving end of the intensified global capital flight-to-safety in recent weeks. Real GDP expanded by 0.5% q/q (seasonally adjusted) in the third quarter and by 1.9% in year-over-year terms; the expansion in 2013 overall will likely measure 1.8%. The broad-based buoyancy in the economy is underpinned by low unemployment, real wage growth, a supportive fiscal and monetary stance and reasonably firm net exports (thanks in part to the currency floor at 1.20 francs per euro). Looking ahead, firming sentiment portends continued domestic momentum; the KOF leading indicator has increased in each of the last ten months. Inflationary conditions remain very subdued. The headline CPI grew for a second month in a row in December, though the 0.1% y/y gain was minimal and prices actually fell in month-over-month terms. The Swiss National Bank (SNB) will thus maintain the target for the Libor rate at effectively zero for a prolonged period to come. However, the bank has become increasingly concerned about continued high growth in house prices and mortgage volumes (driven by low interest rates, rising incomes and immigration), and has advised the government to increase the required capital buffer applied to banks' mortgage loans from 1% to 2%. A further adjustment (of up to two percentage points) is possible should this move fail to curb mortgage lending.

NORWAY — Norwegian monetary authorities will leave monetary conditions loose for longer than previously envisioned, as the medium-term outlooks for both inflation and growth have been revised modestly lower. Not too long ago it looked as though Norway would be among the first developed-market central banks to raise interest rates in the latter half of this year; however, at its last policy-setting meeting in December the Norges Bank once again shifted out the expected timeline for the hiking cycle, indicating that monetary tightening wouldn't likely begin before mid-2015. The economy is set to maintain a solid growth pace of around 2-2½% in 2014-15, with outcomes remaining highly dependent on the strength of the recovery in the euro zone given the lesser contribution from investment in the energy sector. Inflation remains in manageable territory, ending 2013 at 2% y/y. House prices have begun to soften, falling in December for the first time in year-over-year terms since 2009, though they gained nearly 5% in 2013 overall. Notwithstanding the IMF's warning last year that real estate prices may be overvalued by as much as 40%, only a modest single-digit correction is likely in 2014. Should a more disorderly scenario materialize, the authorities remain well-positioned to address any negative systemic repercussions, with a large fiscal surplus (in excess of 10% of GDP) and the world's largest sovereign wealth fund (valued at roughly US$815 billion).

Asia / Pacific
Currency Outlook

Eric Theoret (416) 863-7030
eric.theoret@scotiabank.com

Sacha Tihanyi (852) 6117-6070
sacha.tihanyi@scotiabank.com

Camilla Sutton (416) 866-5470
camilla.sutton@scotiabank.com

JAPAN — The The JPY is outperforming on a year-to-date basis, entering February up 3.1% vs the USD having been supported by short covering, rising risk aversion and a steady stance from the BoJ. Bearish JPY sentiment waned through January, with the CFTC net short position narrowing from $16.1bn on December 31st to $13.8bn as of January 21st. Technically recent USDJPY weakness has done little to shift the one year uptrend, leaving USDJPY trending higher. We hold a Q114 target of 102, expecting near-term stabilization before it enters another upswing in the spring of 2014.

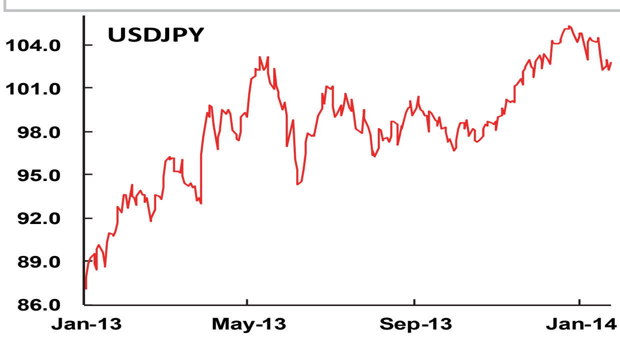
CHINA — USDCNY traded back above 6.00 at the end of January, but overall the performance of the CNY into the Lunar New Year was relatively stable. Both external and internal factors suggest that policymakers will favour a slow and steady appreciation in the CNY, one that ensures hot money flows remain checked and see policymakers adding to reserves. We target USDCNY at 5.98 in Q4.

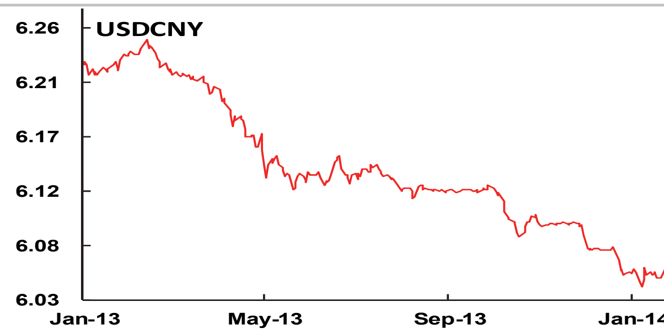
AUSTRALIA — The AUD has underperformed on a year-to-date basis, falling 1.7% vs the USD as of January 29th. Bearish sentiment is strong and increasing as the January 21st release from the CFTC showed a building net short position and consensus forecasts take a bearish turn calling for the AUD to close the year at 0.85. We are not as bearish as consensus, expecting the RBA to back away from potential interest rate cuts and for the economic fundamentals to improve. We hold a Q114 target of 0.87.

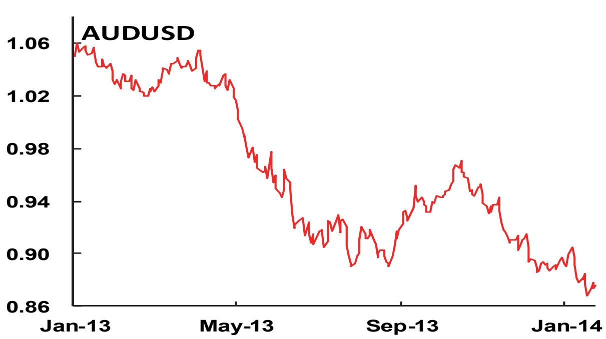
NEW ZEALAND — The NZD is entering February at the lower end of its year-to-date 0.8138 to 0.8432 range. Sentiment towards the NZD is bullish but has drifted lower. As of the end of January the CFTC continued to report a net long NZD position, but having narrowed, while the option market continue to price for NZD upside risk. We expect the RBNZ to be the first advanced economy central bank to hike interest rates; this combined with New Zealand's fundamental backdrop should support the NZD. We hold an above consensus Q114 forecast of 0.83.

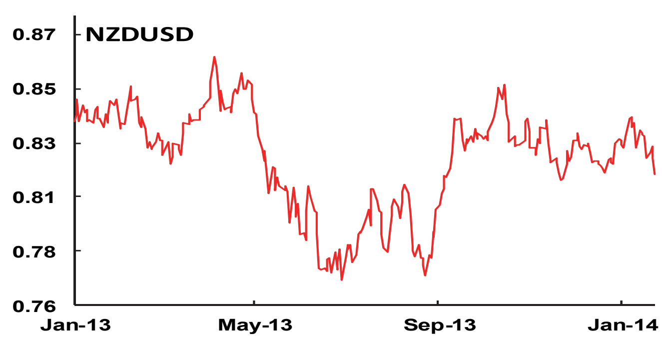
Currency Trends

FX Rate	Spot 30-Jan	14Q1f	14Q2f	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
USDJPY	103	102	104	107	109	110	111	112	113
USDCNY	6.06	6.06	6.03	6.01	5.98	5.94	5.90	5.86	5.86
AUDUSD	0.88	0.87	0.86	0.88	0.88	0.89	0.89	0.89	0.89
NZDUSD	0.81	0.83	0.84	0.85	0.85	0.86	0.86	0.87	0.87









Asia / Pacific
Fundamental Commentary

Tuuli McCully (416) 863-2859
tuuli.mccully@scotiabank.com

JAPAN — Japan's real GDP growth will likely record a marked pick-up in the run-up to the April 2014 increase in the consumption tax rate (from 5% to 8%), particularly in terms of household spending, to be followed by a reversion after the hike. We expect Japanese output to expand by 1¾% in 2014, in line with the performance in 2013. In 2015, economic growth will likely decelerate to around 1¼% in the absence of various successfully implemented productivity-boosting reforms. Inflation is slowly approaching the Bank of Japan's (BoJ) 2% inflation target. The consumer price index (of all items less fresh food) increased by 1.2% y/y in November, after emerging from deflationary territory in mid-2013. The April tax rate increase will temporarily bring inflation to the BoJ's target in mid-2014. Apart from this, significant yen depreciation combined with the central bank's monetary stimulus efforts should translate into modest price gains in the coming quarters, though the inflation rate will likely hover around 1½% y/y at the end of 2014. Accordingly, the BoJ will continue its quantitative and qualitative monetary easing scheme in the coming quarters, expanding the nation's monetary base at an annual pace of ¥60-70 trillion. In our view, there is potential for further monetary easing measures in the first half of 2014 if the tax rate hike leads to a stalling of ongoing economic momentum.

CHINA — China's economic momentum remains solid for the time being, though high frequency indicators imply that the pace is decelerating somewhat. Fourth quarter real GDP increased 7.7% y/y following a 7.8% gain in the July-September period. In 2013 as a whole, output expanded by 7.7%, in line with the performance in 2012. Nevertheless, the nation's growth structure is changing, resulting in lower output gains in the coming years as the economy transitions to a new stage of development that relies increasingly on productivity improvements. In this context, we expect the rate of expansion to decelerate to 7¼% y/y in 2014-15. The services sector continues to increase in importance as a source of growth; it has exceeded the industrial sector in terms of size, and is also the economy's largest employer. The services sector's growth rate surpassed that of the industrial sector last year (8.3% y/y compared to 7.8%). Ongoing efforts by policymakers to rein in credit growth (aggregate financing contracted by 14% y/y in the May-December period, compared with an increase of 63% y/y in the first four months of 2013) will be doing their part to re-align the economy by slowing investment gains. At 2.5% y/y in December, inflation remains manageable; headline inflation will likely remain below the 3½% mark through 2015. The People's Bank of China is tightening its monetary policy stance by withdrawing liquidity from the banking system, which has caused the one-month Shibor-rate to spike in end-December to a six-month high of 7.66%, and remain elevated in January.

AUSTRALIA — Intensifying inflationary pressures in Australia are lowering the likelihood of further monetary stimulus by the Reserve Bank of Australia (RBA). Consumer price inflation accelerated to 2.7% y/y at end-2013 from 2.2% in the third quarter. Core prices rose by 2.6% y/y, remaining within the RBA's 2-3% inflation target. Persistently weak labour market (at 5.8% in December, the jobless rate is at the highest level since 2009) implies that demand-driven inflation will not be a cause for concern any time soon; consumer price gains will likely remain around the 3% mark through 2015. Accordingly, we expect that the country's monetary conditions will stay loose in the coming quarters in order to underpin relatively subdued economic momentum. The benchmark cash rate is at 2.50%, with the most recent reduction having taken place in August 2013. In recent months, RBA policymakers have intervened verbally to weaken the Australian dollar as they assess that a lower level might be needed "to achieve balanced growth in the economy". Indeed, the currency depreciated by 14% vis-à-vis the US dollar in 2013, with another 1.5% lost so far this year. We estimate that Australian real GDP expanded by 2.4% in 2013. The pace will likely pick up slightly in 2014-15 to an average of 2.8% as household spending and the external sector recuperate.

NEW ZEALAND — The Reserve Bank of New Zealand (RBNZ) signaled an impending tightening of monetary policy at its last meeting on January 30th, being the first central bank within the developed economies to hike rates. The official cash rate is currently at 2.50%. The RBNZ noted that "there is a need to return to more normal levels" and that it "expects to start this adjustment soon" in order to maintain inflation near the central bank's 2% target mid-point. Consumer price inflation accelerated to 1.6% y/y in the final quarter of 2013 from 1.4% in the July-September period; the headline inflation rate will likely close the year at slightly above 2%. The RBNZ expects upside pressure on prices stemming from firms' higher pricing intentions and increasing construction costs, while the strong New Zealand dollar should simultaneously alleviate imported inflation. Accordingly, we expect monetary conditions to be tightened gradually through 2014. New Zealand's economic activity remains solid; real GDP is set to increase by around 3% y/y through 2015, underpinned by robust household spending and investment growth. Buoyant consumer and business confidence together with improving labour market conditions indicate maintained momentum in the near term. Moreover, the commodity-producing economy will benefit from an upturn in the global growth and trade cycles. The RBNZ's implementation of loan-to-value restrictions on mortgage lending last October has successfully resulted in a moderation in the housing market.

Developing Asia
Currency Outlook

Sacha Tihanyi (852) 6117-6070
sacha.tihanyi@scotiabank.com

INDIA — The INR's surprising stability for most of January was upset by the late January broad pressures on EM. However, the RBI's "surprise" rate hike helped to stabilize the currency, as did the notion that India would stay its hand on further hikes in the near term, which should be less deleterious for foreign equity and fixed income investors. While temporary government measures have helped significantly reduce the current account deficit, a weaker rupee remains necessary to ensure a sustained rebalancing of external accounts. We target USDINR at 65.00 by Q4.

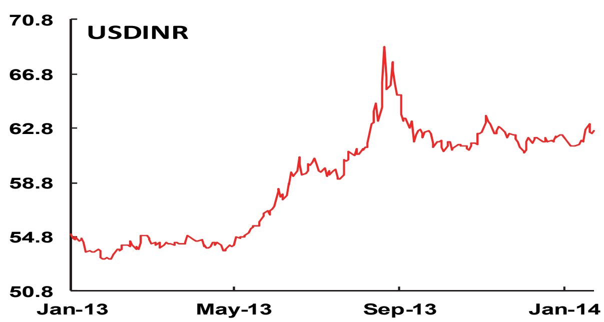
KOREA — The won was one of the worst hit by the end of month pressure on EM, with USDKRW surging to four-plus month highs. Korea's external accounts are still very supportive; however, policymakers are beginning to take greater concern in the level of the KRW relative to the JPY. The won should continue to outperform other Asian currencies over the medium term thanks to the sizable external surplus, notwithstanding periods of high volatility. We target 1060 in USDKRW by Q4.

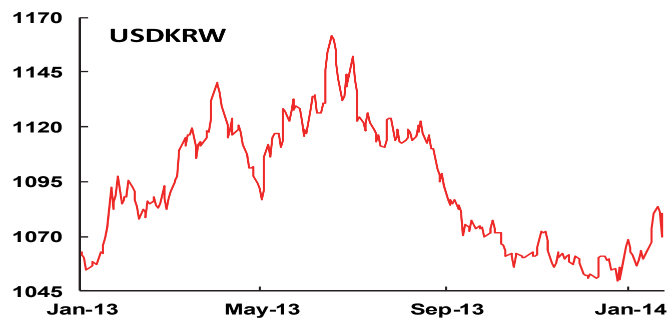
THAILAND — Political tensions have hurt Thai equities and kept the THB on the defensive through January, and a bias in the market to expect monetary easing from the central bank. However, the THB has held in fairly well as portfolio outflows moderated from their more rapid pace during late 2013. Thailand's current account reached a multi-year deficit low of 1.5% of GDP in Q3, and now looks like more of a challenge given that FDI and portfolio flows will be restrained due to the negative economic impact of the slowly intensifying political tensions. We target USDTHB at 34.00 by Q4.

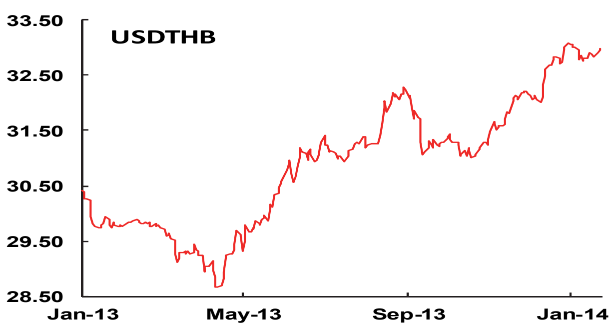
INDONESIA — The IDR withstood January pressures admirably, very much unlike previous periods of broad global macro pressure on EM. It is crucially important that slowing domestic demand continues to repress imports, as the external funding environment may be challenging over the course of the year, and a new ban on certain unprocessed commodities exports takes hold. Sustained IDR depreciation is still likely as currency fundamentals continue to suggest the need for external rebalancing for Indonesia. As such we target USDIDR at 12500 by Q4.

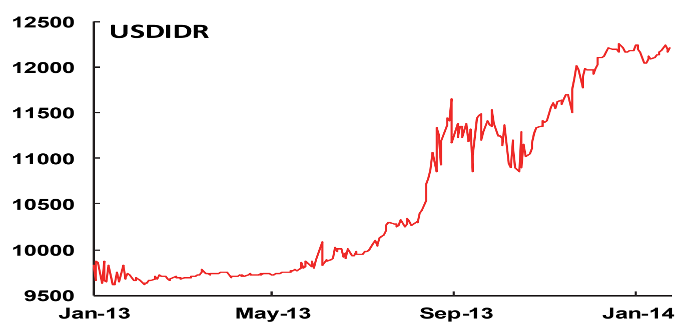
Currency Trends

FX Rate	Spot 30-Jan	14Q1f	14Q2f	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
USDINR	62.58	63.50	64.00	64.50	65.00	65.00	65.25	65.50	66.00
USDKRW	1081	1080	1080	1070	1060	1050	1045	1040	1040
USDTHB	32.99	33.00	33.50	33.75	34.00	34.10	34.20	34.30	34.30
USDIDR	12213	12300	12300	12400	12500	12400	12300	12200	12200









Developing Asia

Fundamental Commentary

Tuuli McCully (416) 863-2859
tuuli.mccully@scotiabank.com

INDIA — Indian policymakers tightened monetary policy on January 28th despite an easing in inflation at the end of 2013. The policy repo rate was increased by 25 basis points to 8.0% in order to set the economy firmly on a disinflationary path. The Reserve Bank of India (RBI) acknowledges that curbing price gains has a priority over promoting economic growth; the central bank aims to guide consumer price inflation to below 8% by January 2015 as part of its gradual process to move toward an inflation-targeting monetary policy framework. As a favourable monsoon is limiting food cost increases, consumer price inflation dropped to 9.9% y/y in December from 11.2% a month before, while wholesale price inflation eased to 6.2% y/y from 7.5%. The RBI noted that conditional on enduring disinflation further monetary tightening is not anticipated in the near term. With the services sector performance soft and industrial production declining, the country's economic growth outlook remains relatively fragile. Nevertheless, an improving agricultural performance, a recuperating export sector, combined with an anticipated pick-up in investment – reflecting authorities' efforts to clear structural bottlenecks – should translate into a modest acceleration in real GDP growth. We expect the Indian economy to expand by 5½% on average in 2014-15 following an estimated expansion of 4½% in 2013.

KOREA — South Korea's economy is performing well with momentum remaining broadly-based; real GDP expanded by 2.8% in 2013 as a whole. The nation's output increased by 0.9% q/q (4.0% y/y) in the final three months of 2013 compared with a 1.1% gain (3.3% y/y) in the prior quarter. We expect the economy to grow by 3½% on average in 2014-15 on the back of an improvement in private consumption and stronger global demand conditions. Inflationary pressures in South Korea remain low with consumer price inflation at 1.1% y/y in December. Persistent deflationary pressures further up the distribution chain together with a relatively stable energy price outlook indicate that significant upside pressure on consumer prices will remain absent in the medium term. A negative output gap plays a key role in the inflation outlook: the Bank of Korea's authorities assess that while the gap is narrowing, it will be maintained in the domestic economy "for the time being". We expect headline inflation to climb gradually towards 2½% y/y by the end of 2015 along with a strengthening of the South Korean economy. The central bank's monetary policy stance will likely remain accommodative in the coming quarters, with the benchmark rate set at 2.50%. Despite a recent adjustment, the Korean won continues to be a regional outperformer on the back of a relatively healthy macroeconomic context; indeed, the currency is supported by a solid current account surplus that increased to 5.8% of GDP in 2013 from 4.2% the year before.

THAILAND — Thailand's economic outlook is weakening given persisting social and political unrest that is eroding consumer and business confidence and adversely impacting the vital tourism industry. Following continuing protests, the country's administration has declared a state of emergency; meanwhile, it remains uncertain whether planned general elections will reverse the currently negative investor mood. Accordingly, we have revised our Thailand real GDP growth forecast for 2014, and now expect the economy to expand by 3½%, compared with an earlier assessment of 4%. Momentum is expected to pick up to 4½% in 2015. Despite a weaker economic outlook, the Bank of Thailand (BoT) opted not to provide further monetary stimulus following its Monetary Policy Committee meeting on January 22nd. Reflecting a 4-to-3 vote, the benchmark interest rate was held at 2.25%; the most recent rate cut took place at end-November. Thailand's inflationary pressures remain low, with the headline rate closing 2013 at 1.7% y/y. Core inflation (at 0.9% y/y in December) remains within the BoT's 0.5-3.0% target range. The political uncertainty, combined with Thailand's weaker external position and capital adjustments related to the US Federal Reserve's monetary policy, have been reflected in the value of the Thai baht. If the political turmoil persists, the currency will likely continue to face both increased volatility and a depreciating bias against the USD. Nevertheless, the BoT stands ready to intervene in the foreign exchange market to smooth excess currency moves.

INDONESIA — A monetary tightening bias will remain in place in Indonesia. The reference rate was raised by 175 bps between June and November to the current level of 7.50%, and another small increase may take place in the coming months. Tighter monetary conditions will help limit inflationary pressures and stabilize the Indonesian rupiah, which has faced a persistent weakening bias in recent months. Nevertheless, annual inflation will likely continue to exceed the central bank's target corridors, which are set at 3½-5½% for 2014 and 3-5% for 2015. Consumer price inflation closed 2013 at 8.4% y/y, up from around 5.5% in the first half of the year. Indonesia's current account deficit increased to 3.5% of GDP in 2013 from 2.8% the year before, mainly reflecting a wider trade gap, though the trend is expected to be reversed as the export sector performance picks up. Economic growth momentum continues to be driven by household spending, as indicated by solid consumer confidence and retail sales data. Credit growth continues to exceed the 20% y/y mark, though signs of deceleration are evident. While investment momentum is slowing, government spending will underpin activity on the back of pre-election outlays; this, combined with a gradually recovering export sector, will translate into an average real GDP growth of 5⅔% in 2014-15. General elections will be held in April 2014, followed by a presidential vote in July.

Developing Americas
Currency Outlook

Eduardo Suárez (416) 945-4538
eduardo.suarez@scotiabank.com

BRAZIL — The government has gone on a strong offensive to signal more prudence on the fiscal front, and a greater willingness to accommodate private sector needs in its public-private partnerships on the infrastructure front. However, our sense is that market players remain hesitant to take the signaled shifts as meaningful until further evidence that the government will "walk the talk" materializes. Among the LATAM FX5 (most liquid regional currencies), the real has been the choppiest over the past EM correction, partly due to poor confidence.

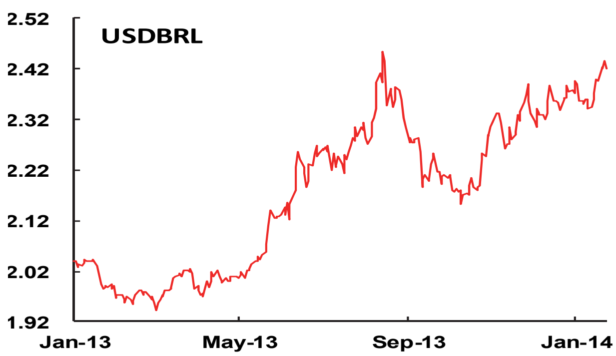
MEXICO — This week's statement by Banxico is likely to be watched for signs of what the central bank's reaction function is to a still weak economy, and an inflation spike derived from the tax changes that were introduced for 2014. Our sense is that Banxico could signal inflation vigilance but will ultimately rely on external disinflationary forces to serve as the means for containing the spike. Despite a very positive domestic story, the peso remains vulnerable to external headwinds, and is likely to lose further ground against the greenback. Our bias is to trade MXN longs vs. other regional currencies.

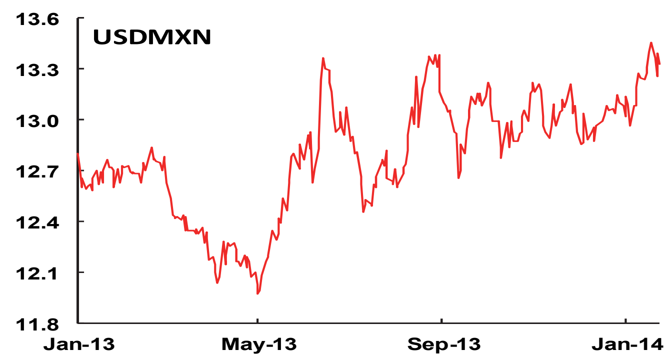
CHILE — The clear signals from the central bank that additional rate cuts are very likely in the cards, has helped renew pressures on the Chilean peso, contributing to the break of 550 in its USD cross. Our sense is that the peso's headwinds have some additional components, including what are likely to be much less supportive terms of trade going forward than what we saw over the past 10-years (where a positive shock of roughly +100% was recorded), while FDI could be hit by higher taxes (suggested by the incoming government) and lower base metals prices.

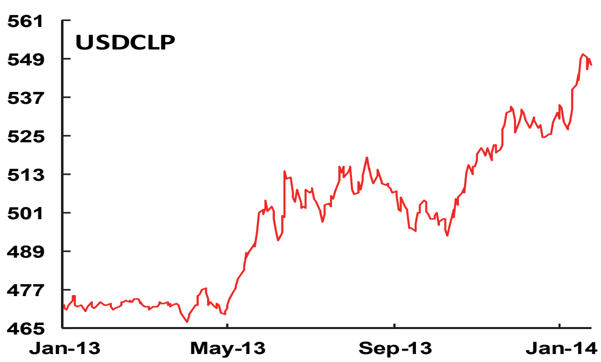
COLOMBIA — The government has signaled it is very comfortable with USDCOP trading somewhere in the 2000 – 2100 range, but there have also been hints that if the peso's weakness persists, we could see the USD purchase program from BanRep unwound. Although its relatively low beta status should somewhat isolate the peso against USD strengthening, relative to some other LATAM currencies, the high oil dependency of Colombia's exports can be a source of vulnerability (at the end of the day, oil is USD-denominated).

Currency Trends

FX Rate	Spot 30-Jan	14Q1f	14Q2f	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
USDBRL	2.42	2.55	2.40	2.45	2.50	2.52	2.55	2.55	2.60
USDMXN	13.3	13.5	13.1	13.2	13.4	13.4	13.4	13.5	13.5
USDCLP	547	560	530	540	545	550	555	560	560
USDCOP	2004	2010	1940	1950	1980	1985	1990	2000	2000







Developing Americas
Fundamental Commentary

Daniela Blancas (416) 862-3908
daniela.blancas@scotiabank.com

Pablo F.G. Bréard (416) 862-3876
pablo.breard@scotiabank.com

BRAZIL — The bearish tone affecting the BRL remains intact. Lacklustre growth, persistent inflationary expectations, eroding fiscal profile and election-linked policy uncertainties are all endogenous factors weighing on market sentiment and currency weakness. The resurgence of financial market and socio-political turmoil south of the border adds to the cautious investor mood towards emerging-market assets. Argentina's steep currency devaluation is a reminder of the adverse macroeconomic impact of erratic policies. Trade-related links with Argentina will suffer as a result of the weakened economic environment in both countries. FIFA World Cup and presidential elections are also two dominant local events shaping domestic confidence. Moreover, the already discounted gradual unwinding of monetary policy stimulus by the US central bank will deepen broad-based demand for US dollar-denominated assets through the first half of the year. In the context of exacerbated financial market volatility, the Brazilian central bank has firmly adopted a monetary tightening bias, raising the policy-setting SELIC rate by 325 bps to 10.50% over the past nine months. In line with market consensus, we believe that further rate hikes in store when the Monetary Policy Committee meets again on February 26th.

MEXICO — Mexican economic activity remains subdued with a rebound still yet to be seen. Output expanded by an average rate of 0.7% y/y in the October–November period (measured by the Global Economic Activity Index), with industrial production decreasing by 0.6 y/y in the same period. Despite the expansion of the retail sector - fundamentally due to the "Buen Fin" sale weekend that took place in November - the economic pickup remains weak. In our view, the rebound will be more evident in the first two quarters of the year. With US real GDP growth accelerating to 3.0% in 2014, together with higher local government spending, Mexico will likely advance by 3⅓% this year. Headline inflation accelerated in the last two months of 2013, reaching 4% y/y by December, mainly as a result of tax hikes approved at the end of last year. Although this should prove to be temporary, inflation will likely continue to increase in the coming months, fuelled as well by the recent depreciation of the currency. We do not anticipate any changes to the monetary policy stance in the first half of the year; however, the authorities could opt to increase the reference rate by the third-quarter. The Mexican peso (MXN) has been negatively impacted by higher volatility in global financial markets, losing 2% against the USD in the first month of the year. Nevertheless, the MXN has been one of the less affected currencies among its Latin American peers, together with the Peruvian sol.

CHILE — The Chilean peso (CLP) has been materially affected by the combined effect of emerging-market volatility, shifting monetary conditions in the United States, pension funds asset reallocation and heightened political and economic stress in the largest Southern cone economies. It is worth noting that copper prices, traditionally a driver of currency adjustments in the CLP, have not been a primary factor swaying flows over the past few months. In fact, copper prices increased by 12% between August and December 2013, before modestly adjusting during last month. Futures markets anticipate copper price stability over the next quarter. The Chilean economy is well positioned to expand by 4% in 2013-14 before accelerating to a potential growth rate of 4.5% in 2015-16, aided by an uptick in all economic regions around the globe and normalized monetary policy conditions in high-income countries. Domestic pension funds, which have at present US$85 billion in assets under management, have shown an increasing preference for a higher rate of dollarization of investment portfolios. On the political front, President-elect Michelle Bachelet will take office in early March. While it is premature to affirm the priorities of the new administration, tax, education and political (perhaps constitutional) reforms will likely be in the agenda.

COLOMBIA — After a very stable start to the year, the Colombian peso (COP) has been subject to global currency volatility, as market sentiment loses risk appetite. US dollar (USD) strength across the board caused by improved US outlook and the Federal Reserve's monetary policy has knocked the COP down by close to 5% since mid-January, reaching for the first time in more than three years levels above the 2,000 mark. As a result of the recent depreciation, we are revising our USDCOP forecast to average 1,980 in 2014. Nonetheless, in our view the Colombian economy is well prepared to face a period of international volatility, with solid macroeconomic fundamentals. Foreign reserves reached US$43.6 by the end of 2013, 16.5% more than in 2012 and close to 80% above the level five years ago. Additionally, Colombia's current account deficit of 3½% of GDP and central government fiscal deficit of close to 2.3% of GDP remain at manageable levels. An economic recovery is underway, led by construction and public and private spending, while industrial activity remains subdued. Headline inflation closed 2013 slightly below the 2-4% official target range, prompting concerns for policymakers. Nevertheless, with activity rebounding in 2014 and the recent depreciation of the currency, consumer price inflation will accelerate to close to 3% over the next 12-months. Although some central bank board members have highlighted that low inflation could trigger rate cuts, in our view, the current stable monetary policy stance will likely remain in place in the first six months of the year.

Developing Europe & Africa

Currency Outlook

Sarah Howcroft (416) 862-3174
sarah.howcroft@scotiabank.com

RUSSIA — The Russian ruble (RUB) faces several sources of volatility this year, including continued uncertainty over the pace of monetary stimulus withdrawal in the US, the strength of the global recovery and thus the outlook for energy prices, the extent of central bank intervention in the foreign exchange market and the resilience of the local economy. The currency has already lost over 6% against the US dollar this year and although we expect a partial correction in the coming months, with the authorities seemingly inured to the depreciation trend, it will likely close this year with a considerable loss. We hold a year-end USDRUB forecast of 35.0.

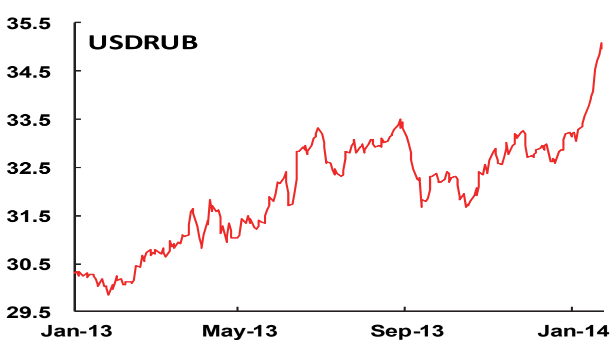
TURKEY — A late attempt by the Turkish central bank to stabilize the lira (TRY), which has lost roughly 20% in US dollar terms since mid-2013, will likely reduce the currency's volatility somewhat over the short term. However, the weakening trend in the currency is set to extend over the forecast horizon given pronounced fundamental weaknesses, namely, Turkey's large current account deficit and external financing needs, political unrest and the deterioration in the domestic economic outlook. We expect the USDTRY rate to close 2014 around 2.35.

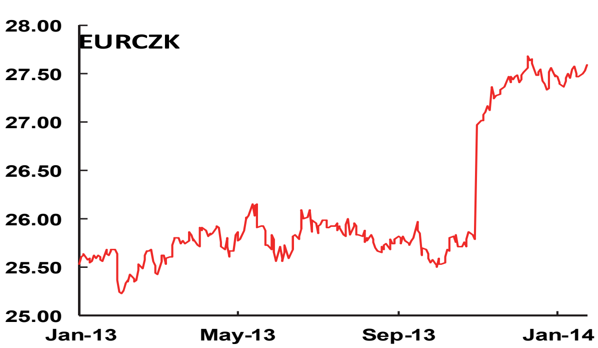
CZECH REPUBLIC — Following the central bank's decision to use foreign exchange intervention to weaken the Czech koruna (CZK) in November, the currency has traded around 27.5 per euro (EUR). The authorities have indicated that this policy, used as an additional monetary policy tool as the policy interest rate is already at zero, will remain in place until at least 2015, thereby providing a degree of protection to the CZK – alongside the more secure political environment – during what may be another turbulent year for certain emerging-market currencies. We expect the EURCZK rate to end the year at 27.0.

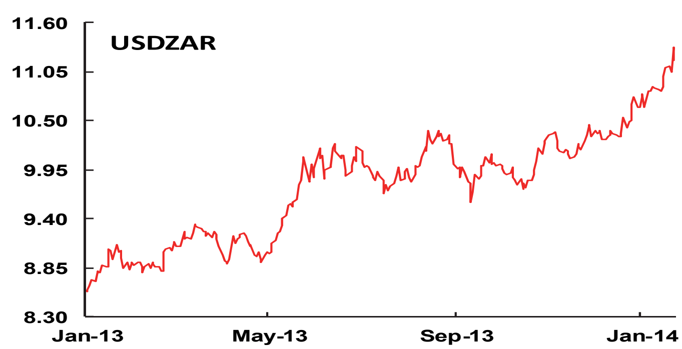
SOUTH AFRICA — Notwithstanding a surprise increase in the benchmark interest rate by 50 basis points at the end of January (with additional tightening likely forthcoming), the downward adjustment in the South African rand (ZAR) will continue over the coming months. In addition to shifting capital flows related to liquidity withdrawal in the US, domestic headwinds will also weigh on the currency, including structural imbalances, renewed labour unrest and political uncertainty in the lead-up to the general election in April or May. We project an end-2014 USDZAR rate of 11.50.

Currency Trends

FX Rate	Spot 30-Jan	14Q1f	14Q2f	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
USDRUB	35.0	35.2	34.5	34.8	35.0	35.1	35.2	35.3	35.4
USDTRY	2.24	2.28	2.30	2.33	2.35	2.37	2.38	2.39	2.40
EURCZK	27.6	27.5	27.3	27.2	27.0	26.6	26.3	26.0	25.8
USDZAR	11.2	11.4	11.3	11.4	11.5	11.6	11.6	11.7	11.7







Sarah Howcroft (416) 862-3174
sarah.howcroft@scotiabank.com

Developing Europe & Africa

Fundamental Commentary

RUSSIA — After a brief respite in December, the Russian ruble (RUB) extended its slide in the beginning of 2014, with the currency posting multi-year lows against the US dollar and record lows versus the euro. Aside from the pressure of an emerging-market selloff prompted by disappointing Chinese manufacturing data combined with the unwinding of the US Fed's quantitative easing program, the RUB is also responding to domestic factors. Firstly, the economic outlook is relatively weak; after expanding by an estimated 1½% in 2013, real GDP will likely accelerate only modestly to 2-2½% on average in 2014-15, notwithstanding the Sochi Winter Olympics in February. Domestic consumption and investment will be restrained by slowing wage growth, falling corporate profits, lackluster investor sentiment and tight fiscal policy (as per the oil price-based fiscal rule). Moreover, energy prices, which historically have provided support to the economy and the RUB in times of accelerating global growth, are set to remain roughly constant. Finally, as the central bank aims to complete the transition to a fully free-floating currency regime by 2015, the degree of foreign exchange intervention has been scaled back allowing market forces to impact the currency more directly. Inflation remains above target, ending 2013 at 6.5% y/y, and according to the central bank, inflation expectations are running at above 10%. Monetary officials will therefore have little opportunity to stimulate the economy in the near term.

TURKEY — Turkey is among the emerging markets most vulnerable to financial market volatility in the ongoing shift in global investment portfolios. Long-standing concerns about the country's large current account deficit (at 7½% of GDP), heavy dependence on short-term foreign financing, and excessive domestic credit growth (over 30% y/y) have in recent months been compounded by an eruption of political tensions between Prime Minister Erdogan's administration and the powerful Islamist movement led by the cleric Fethullah Gulen. The sweeping sell-off in Turkish assets, and in particular the sharp depreciation of the lira, have fuelled inflation anxieties, with the headline rate having averaged 7.5% in 2013, exceeding the central bank's 5% target for a third straight year. After months of resisting calls to raise interest rates – likely at the behest of the government seeking to bolster the economy ahead of two key elections this year – the monetary authorities were finally urged to act by the spike in emerging-market risk aversion in late January. After pre-announcing an emergency meeting to be held on January 28th, the central bank surpassed expectations by raising the both ends of the overnight lending corridor (to 8-12% from 3.5-7.75%) and the one-week repo rate (from a record-low 4.5% to 10%). The bank also reverted to the conventional policy of providing liquidity at the weekly repo rate rather than the overnight rate, meaning that the effective benchmark rate increase was only 225 basis points and further hikes could be needed. Tighter monetary conditions and weaker sentiment will weigh on economic activity; we have lowered our real GDP growth forecasts to 2¾% in 2014 and 3½% in 2015.

CZECH REPUBLIC — Following a two-year recession which saw the level of output dragged 2.3% lower by declining investment and external demand, the Czech economy has begun to recover. Real GDP advanced for a second quarter in a row in the July-September period, gaining 0.2% q/q (up from an earlier estimate of -0.1% and an initial report of -0.5%), though it remained negative in yearly terms at -1.2% y/y. Following a likely 1⅓% contraction in 2013 overall, we anticipate average growth of 2% over the coming two years. The main impetus for an industrial recovery will be the stronger German economy (the destination for nearly one-third of Czech exports), while the exceptional monetary support from the central bank should also underpin a gradual resumption in consumer spending growth. Inflation reached a three-and-a-half year low of 0.9% y/y in October on the back of falling agricultural producer prices, before subsequently rising to 1.4% by December. Given the level of spare capacity in the economy, weak labour market and outlook for energy prices, inflation will remain subdued over the forthcoming period. However, this should be offset to some extent by the depreciated currency; the koruna is roughly 6.5% weaker versus the euro than the levels prevailing last year through November, when the central bank announced its FX intervention policy. With a new three-party coalition government taking power in January after seven months of upheaval following the scandal-induced resignation of the last administration, increased political stability should support the recovery going forward.

SOUTH AFRICA — After falling 19% against the US dollar in 2013, the South African rand is expected to weaken further over the coming year. The South African Reserve Bank (SARB) has likened the recent FX adjustments to a new 'phase' in the global financial crisis, which will see sharp currency depreciation and capital outflows from emerging markets as markets adapt alongside the gradual withdrawal of monetary stimulus in the advanced economies. Though the exchange-rate pass-through to consumer prices was relatively muted last year, the SARB has nonetheless raised its inflation projections significantly. Headline inflation, which ended 2013 at 5.4% y/y, is now expected to exceed the bank's 3-6% target range for much of the next two years. Furthermore, the growth outlook has weakened on account of higher inflation, low business confidence and declining terms of trade. The SARB anticipates a possible negative impact on commodity prices from increased global risk aversion, while an ongoing worker strike at major South African platinum mines also has the potential to dent exports and growth in the first quarter. Economic growth concerns likely prevented the central bank from hiking the policy rate by more than 50 basis points at its January meeting; however, we foresee further tightening in the months ahead. The African National Congress has launched its re-election campaign, but the ruling party's platform contains little by way of business-friendly reform.

Global Currency Forecast (end of period)

		2012	2013	2014f	2015f	2014f Q1	2014f Q2	2014f Q3	2014f Q4	2015f Q1	2015f Q2	2015f Q3	2015f Q4
Major Currencies													
Japan	USDJPY	87	105	109	113	102	104	107	109	110	111	112	113
Euro zone	EURUSD	1.32	1.37	1.25	1.23	1.33	1.30	1.27	1.25	1.25	1.24	1.24	1.23
	EURJPY	114	145	136	139	136	135	136	136	138	138	139	139
UK	GBPUSD	1.63	1.66	1.64	1.59	1.65	1.66	1.65	1.64	1.64	1.63	1.61	1.59
	EURGBP	0.81	0.83	0.76	0.77	0.81	0.78	0.77	0.76	0.76	0.76	0.77	0.77
Switzerland	USDCHF	0.92	0.89	1.00	1.03	0.92	0.95	0.98	1.00	1.00	1.02	1.02	1.03
	EURCHF	1.21	1.23	1.25	1.27	1.23	1.24	1.25	1.25	1.25	1.26	1.26	1.27
Americas													
Canada	USDCAD	0.99	1.06	1.11	1.10	1.13	1.15	1.12	1.11	1.10	1.10	1.10	1.10
	CADUSD	1.01	0.94	0.90	0.91	0.88	0.87	0.89	0.90	0.91	0.91	0.91	0.91
Mexico	USDMXN	12.85	13.04	13.35	13.52	13.45	13.10	13.20	13.35	13.40	13.40	13.50	13.52
	CADMXN	12.96	12.27	12.03	12.29	11.90	11.39	11.79	12.03	12.18	12.18	12.27	12.29
Argentina	USDARS	4.92	6.52	12.00	14.50	8.30	8.90	9.50	12.00	13.00	13.50	14.00	14.50
Brazil	USDBRL	2.05	2.36	2.50	2.60	2.55	2.40	2.45	2.50	2.52	2.55	2.55	2.60
Chile	USDCLP	479	525	545	560	560	530	540	545	550	555	560	560
Colombia	USDCOP	1767	1930	1980	2000	2010	1940	1950	1980	1985	1990	2000	2000
Peru	USDPEN	2.55	2.80	2.81	2.85	2.84	2.76	2.78	2.81	2.82	2.83	2.84	2.85
Venezuela	USDVEF	4.30	6.30	8.50	11.10	8.51	8.50	8.50	8.50	9.50	11.10	11.10	11.10
Asia / Pacific													
Australia	AUDUSD	1.04	0.89	0.88	0.89	0.87	0.86	0.88	0.88	0.89	0.89	0.89	0.89
China	USDCNY	6.23	6.05	5.98	5.86	6.06	6.03	6.01	5.98	5.94	5.90	5.86	5.86
Hong Kong	USDHKD	7.75	7.75	7.78	7.78	7.76	7.76	7.77	7.78	7.78	7.78	7.78	7.78
India	USDINR	55.0	61.8	65.0	66.0	63.5	64.0	64.5	65.0	65.0	65.3	65.5	66.0
Indonesia	USDIDR	9793	12171	12500	12200	12300	12300	12400	12500	12400	12300	12200	12200
Malaysia	USDMYR	3.06	3.28	3.40	3.35	3.35	3.38	3.39	3.40	3.40	3.38	3.36	3.35
New Zealand	NZDUSD	0.83	0.82	0.85	0.87	0.83	0.84	0.85	0.85	0.86	0.86	0.87	0.87
Philippines	USDPHP	41.0	44.4	46.0	46.6	45.3	45.5	45.7	46.0	46.2	46.4	46.5	46.6
Singapore	USDSGD	1.22	1.26	1.30	1.27	1.28	1.28	1.29	1.30	1.30	1.28	1.27	1.27
South Korea	USDKRW	1064	1050	1060	1040	1080	1080	1070	1060	1050	1045	1040	1040
Taiwan	USDTWD	29.0	29.8	30.6	30.2	30.3	30.4	30.5	30.6	30.5	30.4	30.3	30.2
Thailand	USDTHB	30.6	32.7	34.0	34.3	33.0	33.5	33.8	34.0	34.1	34.2	34.3	34.3
Europe / Africa													
Czech Rep.	EURCZK	25.1	27.3	27.0	25.8	27.5	27.3	27.2	27.0	26.6	26.3	26.0	25.8
Iceland	USDISK	128	115	120	118	117	118	119	120	119	119	118	118
Hungary	EURHUF	291	297	295	290	305	302	299	295	294	293	291	290
Norway	USDNOK	5.56	6.07	5.80	5.60	6.00	5.90	5.80	5.80	5.70	5.65	5.65	5.60
Poland	EURPLN	4.08	4.15	4.00	3.90	4.20	4.14	4.07	4.00	4.00	3.96	3.93	3.90
Russia	USDRUB	30.5	32.9	35.0	35.4	35.2	34.5	34.8	35.0	35.1	35.2	35.3	35.4
South Africa	USDZAR	8.47	10.49	11.50	11.70	11.40	11.30	11.40	11.50	11.55	11.60	11.65	11.70
Sweden	EURSEK	8.58	8.85	8.50	8.25	8.65	8.60	8.55	8.50	8.45	8.40	8.30	8.25
Turkey	USDTRY	1.78	2.15	2.35	2.40	2.28	2.30	2.33	2.35	2.37	2.38	2.39	2.40

f: forecast a: actual

International Economics Group

Daniela Blancas
daniela.blancas@scotiabank.com

Pablo F.G. Bréard
pablo.breard@scotiabank.com

Sarah Howcroft
sarah.howcroft@scotiabank.com

Tuuli McCully
tuuli.mccully@scotiabank.com

Estela Ramírez
estela.ramirez@scotiabank.com

Canadian & U.S. Economics

Erika Cain
erika.cain@scotiabank.com

Derek Holt
derek.holt@scotiabank.com

Adrienne Warren
adrienne.warren@scotiabank.com

Dov Zigler
dov.zigler@scotiabank.com

Foreign Exchange Strategy

Eduardo Suárez
eduardo.suarez@scotiabank.com

Camilla Sutton
camilla.sutton@scotiabank.com

Eric Theoret
eric.theoret@scotiabank.com

Sacha Tihanyi
sacha.tihanyi@scotiabank.com

Scotiabank Economics

Scotia Plaza 40 King Street West, 63rd Floor
Toronto, Ontario Canada M5H 1H1
Tel: (416) 866-6253 Fax: (416) 866-2829
Email: scotia.economics@scotiabank.com