Foreign Exchange Outlook

Global growth differentials between emerging and developed countries, normalization of monetary policy in high-income economies, ongoing guided official intervention and leadership transition in core emerging market jurisdictions are some of the primary near-term drivers of foreign exchange flows.

An improved US economic outlook and broad-based USD strength will guide trading patterns within the NAFTA zone. Attractive interest rates and earnings potential will trigger repatriation flows into USD assets. Top-tier currencies (CAD, MXN & BRL) will suffer a soft tone in the first quarter of the New Year.

Europe is in a nascent economic recovery. However, we project a weakening tone for the core currencies (EUR, GBP) and top-tier regional emerging-market currencies (RUB, TRY) as US economic and market strength drives capital flows back into the USD and interest rate differentials weigh on the EUR.

The Asian currency landscape will be dominated by resurging CNY appreciating forces and JPY weakness versus the USD. Competitive realignment forces may weaken those regional currencies aligned to the JPY. The THB will retain a negative tone until political risks and uncertainties dissipate.

Forecast Highlights

Americas	USD	Expected to strengthen broadly on relative central bank policy & growth.
	CAD	Weakens as Canadian growth underperforms & BoC remains dovish.
	BRL	Slight weakening profile in the year ahead.
Asia / Pacific	CNY	A slow measured pace of appreciation in 2014, closing at 5.98.
	JPY	Vulnerable to weakness on a more aggressive BoJ and risks to growth.
	NZD	Financial stability risk is likely to drive the RBNZ to hike rates in 2014, in turn supporting.
Europe / Africa	EUR	Flows have supported EUR but the dovish turn at the ECB & growth should weigh heavily.
	GBP	The currency has been priced to perfection, leaving it vulnerable to downside risk in 2014.
	TRY	Political instability amplifies weakening bias in TRY derived from current account deficit.

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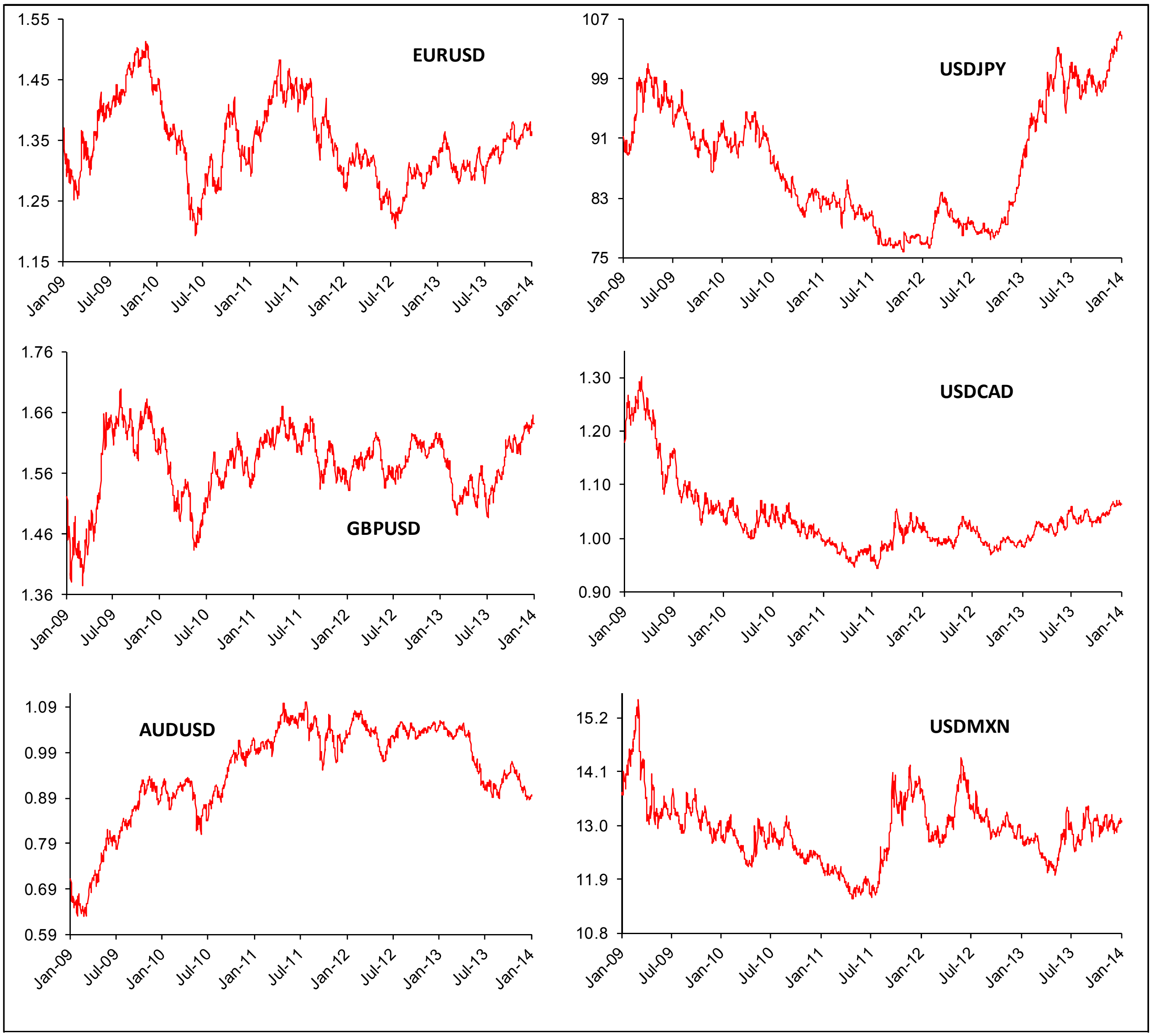
CORE EXCHANGE RATES

Global Foreign Exchange Outlook

January 6, 2014		Spot	Q1f 14	Q2f 14	Q3f 14	Q4f 14	Q1f 15	Q2f 15	Q3f 15	Q4f 15
EURUSD	Scotiabank	1.36	1.33	1.30	1.27	1.25	1.25	1.24	1.24	1.23
	Consensus*		1.32	1.31	1.29	1.28	1.28	1.27	1.27	1.27
USDJPY	Scotiabank	104.3	102	104	107	109	110	111	112	113
	Consensus*		102	103	104	106	106	107	108	108
GBPUSD	Scotiabank	1.64	1.63	1.61	1.60	1.59	1.58	1.57	1.56	1.55
	Consensus*		1.59	1.59	1.58	1.57	1.57	1.57	1.57	1.57
USDCAD	Scotiabank	1.06	1.07	1.08	1.07	1.07	1.06	1.06	1.06	1.06
	Consensus*		1.05	1.06	1.06	1.07	1.07	1.07	1.07	1.07
AUDUSD	Scotiabank	0.90	0.87	0.88	0.89	0.90	0.90	0.90	0.90	0.90
	Consensus*		0.90	0.89	0.88	0.88	0.87	0.87	0.86	0.86
USDMXN	Scotiabank	13.08	13.23	13.13	13.21	13.39	13.40	13.40	13.50	13.52
	Consensus*		12.88	12.75	12.63	12.50	12.48	12.46	12.44	12.42



(*) Source: Consensus Economics Inc. December 2013

Scotiabank

Market Tone & Fundamental Focus

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Improving global growth dynamics and the ensuing, yet gradual, normalization of monetary policy conditions in high-income economies (except Japan and the euro area) and developed financial markets will guide direction and momentum in global foreign exchange markets during the first months of the new calendar year. Outright intervention in securities and currency markets by monetary authorities in both well-established and developing markets aided by still imperfect forward-guidance practices will remain the norm for now. Counterbalancing supply and demand forces in both energy and metal prices might make commodity prices a factor of lesser influence to exchange rate trends in the near term. The degree and intensity of the financial market response to increasing long-term US interest rates will keep emerging-market currencies with fragile macroeconomic conditions on the defensive during the first half of the year.

The currency environment in the Americas will be strongly influenced by a favourable macroeconomic outlook in the United States (US) as well as lower budget-related policy uncertainties. Scotiabank anticipates that the US economy will expand by 2.7% and 3.0% in 2014 and 2015, respectively. Steady improvements in labour market conditions and fiscal management coupled with a stronger outlook in the housing, auto and household spending market segments bode well for the US dollar (USD) in the current year. We project that the US currency will show an improving trend in the first quarter of the year: the USD will appreciate against the euro (EUR), the Japanese yen (JPY) and the British pound (GBP) and converge towards an end-year rate of EURUSD 1.25, USDJPY 109, and GBPUSD 1.59.

Canada and Mexico will benefit from a stronger US economy due to well-entrenched structural production and trade interdependence. Nevertheless, repatriation forces coupled with monetary normalization trends will lead to minor adjustments in both the Canadian dollar (CAD) and Mexican peso (MXN) versus the USD in the year ahead. The CAD is expected to come under pressure, particularly in the first six months of the year. The Canadian economy will underperform the US while the Bank of Canada maintains its dovish stance as Canada enters 2014 with inflation levels below the control band of 1 to 3%. Complicating the CAD's outlook is how US domestic oil production combined with ongoing pipeline uncertainty will impact Canadian produced oil. As for the MXN, improved US growth prospects are both a positive and negative factor given the potential for increased trade-related activity (positive) and the potential for capital outflows as the US government yield curve normalizes (negative). It is worth noting the relatively better performance of the MXN versus the Brazilian real (BRL). As for the rest of the core currencies in the Americas, attention will be placed on Brazil due to weak growth in the midst of two important events which will guide intervention and policy action: presidential elections in October and the FIFA World Cup in June/July. We forecast an end-year rate of USDBRL 2.50.

The European currency map presents a divergent trend. The overriding influential factor is the expected strength of the USD versus both developed and developing currencies in the region. Both the EUR and GBP will underperform the USD in the year ahead. The surprise of 2013 was the EUR's strength - we expect this to be reversed this year as the European Central Bank keeps a dovish stance for longer than the US Federal Reserve, compounded by US growth outperformance. Investment portfolios with EUR long positions are vulnerable in 2014 and this unwinding is likely to aggravate the shift lower in the EUR. The nascent, yet still timid, recovery of the European peripheral countries may help to limit EUR losses, as global investors execute diversification strategies (mainly in equity securities markets) and the EUR benefits from intensifying issuance of government fixed-income securities to alleviate multilateral lending facilities (please note that Greece, Portugal and Ireland account for the bulk of IMF outstanding loans). On a negative tone, both the Russian rubble (RUB) and the Turkish lira (TRY) have been earmarked as “fragile” emerging-market regional currencies, vulnerable to deeper negative adjustments in the current phase of US-led global monetary policy normalization.

The Asian currency outlook will be determined by developments in high-income economic regions (i.e., the US and Europe) as well as the somewhat divergent economic and policy trends in both China and Japan. Our outlook for China incorporates sustainable growth (subject to mild deceleration in 2014/15) as well as a resumption of a very modest appreciation versus the USD guided by Chinese interventionist policies. However, we remain sensitive to the risk of adverse developments in security markets as investors assess credit growth trends in China and repatriation flows to deeper financial markets in both US and Europe. We forecast an end-year rate of USDCNY 5.98. As for Japan, the JPY will be influenced by market participants’ readings of the macroeconomic impact of higher tax rates as well as progress on the structural reform agenda of Shinzo Abe’s administration. Finally, the Australian dollar (AUD) will be under near-term pressure, especially as the Reserve Bank of Australia attempts to put a verbally supported ceiling on AUDUSD at 0.90; however, later in the year it is expected to stabilize as global growth continues to improve. The New Zealand dollar (NZD) should outperform, particularly as the Reserve Bank of New Zealand becomes the first major central bank to hike interest rates in the new global monetary cycle.

CANADA
Currency Outlook

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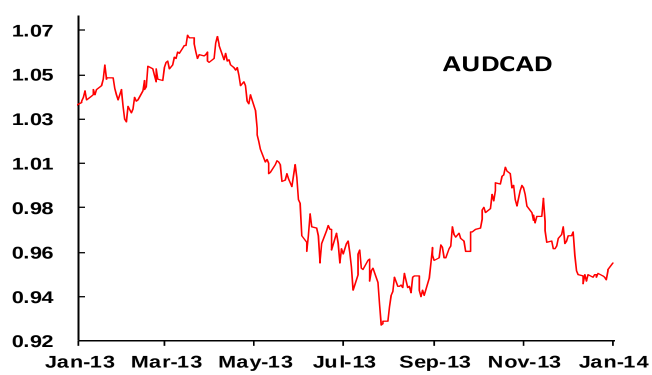
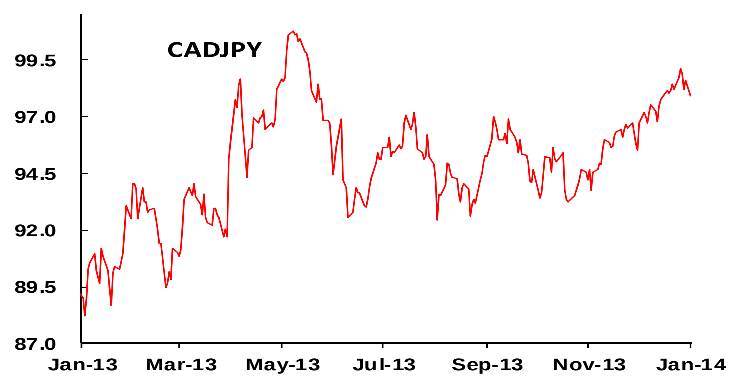
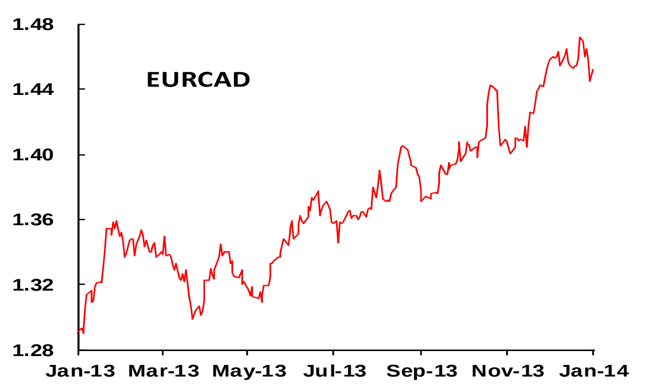
The Canadian dollar (CAD) closed 2013 down 6.6% against the USD, marking its high in January and then trending down all year to its low in late December. Entering 2014, the CAD is trading above its ten-year average but trending lower. We expect the first six months of 2014 to be marked by CAD weakness. Fundamentally, the most important CAD driver is the outlook for interest rates. With inflation falling below the Bank of Canada's control range of 1 to 3% in 2013, Governor Poloz has turned increasingly dovish. We expect a similar tone entering 2014, which is likely to weigh on the CAD early in 2014. As long as inflation remains subdued the Bank of Canada will likely err on the side of dovishiness; accordingly it is Canadian inflation metrics that will prove a key input to the path of the CAD in 2014. In terms of US central bank policy, Janet Yellen takes over as Chair on February 2nd, with the pace of tapering likely the most important near-term USD driver. With a US recovery unfolding, a slow measured pace of tapering is the core view, which should help support USD. A surprisingly strong US recovery would drive a stronger USD, but an expected or slightly softer recovery would simply limit USD gains as oppose to drive USD weakness. The US is expected to post economic growth of 2.7% in 2014 and 3.0% in 2015, outperforming what we anticipate from Canada and helping to support a stronger USD. A strengthening US outlook is ultimately positive for Canada, particularly when combined with a weaker CAD, though this will take time to flow through. One of the most important uncertainties for Canada is the outlook for oil pricing in North America. To date, rising US domestic production and falling imports has impacted oil exporters in Mexico more than Canada. However, with ongoing uncertainty over this as well as pipeline and rail debates, Canada is vulnerable to the near-term oil future and this uncertainty weighs on the CAD. Market sentiment is relatively bearish CAD, with the CFTC reporting a net short CAD position of $5.5 billion as of late December and consensus estimates (from Bloomberg) calling for a 3% decline in 2014. We expect the CAD to close the second quarter of 2014 at 0.93 (or in USDCAD terms at 1.08).

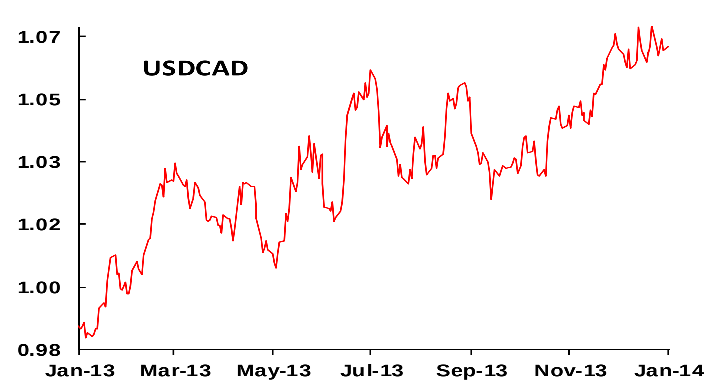
Canadian Dollar Cross-Currency Trends

FX Rate	Spot 6-Jan	14Q1f	14Q2f	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
AUDCAD	0.95	0.93	0.95	0.95	0.96	0.95	0.95	0.95	0.95
CADJPY	98.0	95.3	96.3	100.0	101.9	103.8	104.7	105.7	106.6
EURCAD	1.45	1.42	1.40	1.36	1.34	1.33	1.31	1.31	1.30
USDCAD	1.06	1.07	1.08	1.07	1.07	1.06	1.06	1.06	1.06









CANADA AND UNITED STATES
Fundamental Commentary

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UNITED STATES - US Q4 real GDP growth is forecast to moderate to less than half the 4.1% advance posted in Q3, held back by less inventory accumulation and Washington's fiscal gridlock in October that resulted in a 16-day shutdown of nonessential government services and dampened consumer and business confidence. Nevertheless, the US economic recovery has proven more resilient than expected as significant headwinds have abated. US lawmakers agreed to spending limits for this fiscal year and next in mid-December, which eases the sequester. As a result, the fiscal drag in 2014 should be at least half of last year's negative real GDP contribution of over 1½% percentage points. Meanwhile, the recent string of incoming economic data suggests the US private sector is gaining momentum, with better-than-expected employment growth – up 203,000 in November, bringing the unemployment rate to a five year low – as well as retail sales and industrial production. US net exports should further boost Q4 GDP, with growth in real exports starting the quarter off strong and tracking above real imports. In addition, despite weakness in building permits and existing homes sales, the US housing recovery also appears to be gaining some momentum, with housing starts climbing to the highest level since June 2008 and home builders' confidence at an eight-year high. Notwithstanding these positive developments, inflation remains well below the Fed's 2% target, dampened by lower energy and food prices, alongside softer global economic growth, this year's bumper crop and limited wage pressures. Looking ahead, while inflation should remain muted, the US economy is expected to continue to gain traction. US real GDP is estimated to have accelerated from 1.8% in 2013 to 2.7% this year and 3% in 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 reinforce stronger global economic activity, providing further support for a pick-up in US business investment through 2015.

CANADA - The Canadian economy showed some resilience heading into year-end. Domestic demand remains relatively buoyant, though moderate job growth suggests consumers will remain cautious borrowers and spenders. Monthly employment gains averaged 13,000 in the year to November, half 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 are expected to soften in 2014 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. However, we expect capital outlays will gradually firm up over the coming year, piggybacking on a stronger trend in 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 beginning to pick up, with producers of motor vehicles and building materials in particular benefitting from strengthening US auto sales and residential construction. Exporters should get a further boost from a weaker Canadian dollar. Meanwhile, non-residential construction remains supported by industrial, commercial and infrastructure spending. Resource-related activity has moderated, reflecting a less buoyant commodity price outlook, though remains a source of ongoing support. With federal and provincial fiscal restraint also weighing on overall activity, real GDP growth is estimated to have advanced just 1.8% in 2013, before picking up to 2.4% this year and 2.5% in 2015. Retail discounting, 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.

MONETARY POLICY COMMENTARY

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UNITED STATES - With the tapering of asset purchases having now started, the next question is whether the pace of the asset purchase tapering will be scaled up – or remain at the tame rate of US$10 billion per FOMC meeting that the US Federal Reserve announced (and which Chairman Bernanke implied would continue) at the most recent FOMC meeting. At a US$10 billion per meeting pace, asset purchases would not conclude until Q4 2014, and would cumulatively put the QE3 program into the US$1.6 trillion area. The key factor is how the new Fed Chair Yellen treats the program. We expect her to be cautious about ending purchases too rapidly – even as her rumored Deputy Governor Fischer is thought to favour a more swift end to asset purchases.

CANADA - The major question for the Bank of Canada (BoC) in 2014 is how it will deal with extremely low inflation (CPI has averaged 0.9% y/y with 11 months worth of data available for 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. Essentially, low inflation levels would need to persist, growth would have to remain subpar, and the housing market would need to show signs of cooling down. While not our base case, that does not seem like an impossible trifecta by any stretch of the imagination either – which is why we expect the market to bet on rate cuts and continue to price a modest probability of easing.

EUROPE
Currency Outlook

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EURO ZONE – Entering 2014, the periphery bond yields (Spanish and Italian) are lower and yield spreads with Germany are below 2%, suggesting the reallocation back into the European crisis zones continues and is a near-term EUR positive. As of late December, the CFTC was reporting a net long $5.5bn position and the EUR was strong. However, we expect the currency to soften in 2014 on the back of relative monetary policy, with the ECB likely to remain dovish for longer than the Fed; relative economic performance and politics, including upcoming hurdles to the banking union. We hold a Q114 target of 1.33.

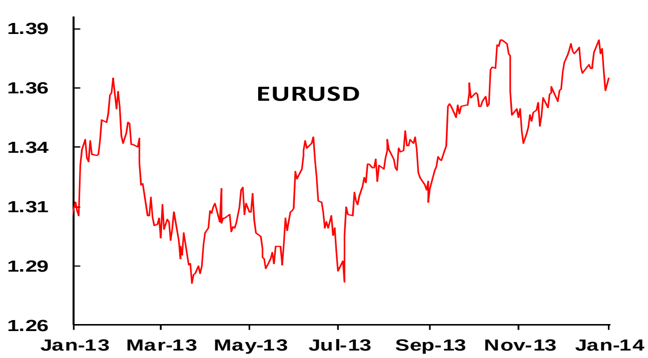
UNITED KINGDOM – Entering 2014 investors favour long GBP positions, with the CFTC reporting a net long position of $1.5bn as of late December. Technically, the GBP outlook is bullish as it has maintained a strong uptrend. Fundamentally, a stronger than expected recovery, including the unemployment rate's fall to 7.4%, has increased speculation that the BoE will lower its 7.0% unemployment threshold. We view the GBP as being priced for perfection and expect it to weaken by year-end. We hold a Q114 target of 1.63.

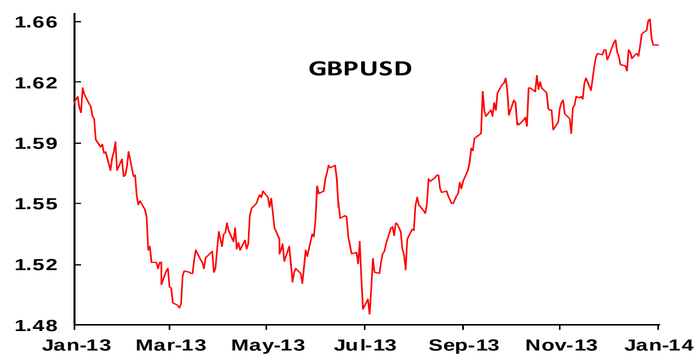
SWITZERLAND – We expect the Swiss National Bank to maintain the EURCHF floor in 2014, leaving the CHF to trade as a proxy of the EUR. We are in line with the analyst community, who expect EURCHF to slowly trend higher with the 1.20 floor failing to be challenged. We hold a Q114 USDCHF target of 0.92 and a EURCHF target of 1.23.

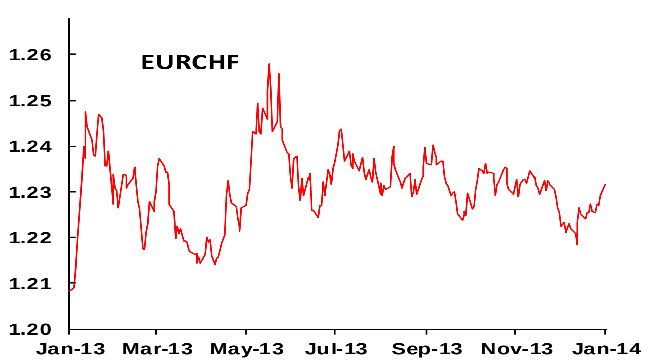
SWEDEN – The SEK is entering 2014 at its one year average level. The Riksbank's decision to cut interest rates in December failed to generate SEK weakness. Technically, there are no major trends in place with the currency range trading. We expect a relatively quiet first quarter and hold a Q114 EURSEK target of 8.65 and a USDSEK target of 6.50.

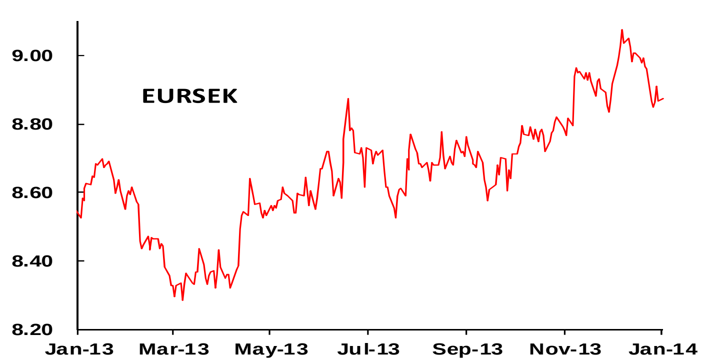
Currency Trends

FX Rate	Spot 6-Jan	14Q1f	14Q2f	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
EURUSD	1.36	1.33	1.30	1.27	1.25	1.25	1.24	1.24	1.23
GBPUSD	1.64	1.63	1.61	1.60	1.59	1.58	1.57	1.56	1.55
EURCHF	1.23	1.23	1.24	1.25	1.25	1.25	1.26	1.26	1.27
EURSEK	8.87	8.65	8.60	8.55	8.50	8.45	8.40	8.30	8.25









EUROPE

Fundamental Commentary

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EURO ZONE - After losing momentum in the third quarter of 2013, the euro area recovery is poised to remain muted over the coming two years. The fourth quarter likely saw modest real GDP growth of 0.1% q/q (to match the pace of the prior three months), leading to a -0.5% result for the year as a whole. We expect a return to growth this year led by Germany, with a mild gain of 0.8% followed by 1.3% in 2015. In December, the currency union's finance ministers agreed on a framework for the single resolution mechanism and resolution fund for banks. Though this represents a step forward in the formation of a banking union, the transition period is long (progressive mutualization over 10 years), over which time national authorities must cover any capital shortfalls that arise among local banks. Thus, the link between sovereigns and distressed banks has not been fully severed, suggesting that borrowing costs will remain higher and investment prospects subdued in member states with relatively weaker public finances and banking sectors. The upcoming asset quality review and subsequent stress tests for EU banks may contribute to heightened volatility in European markets over the coming months (certain technical details remain ambiguous), in addition to US economic and Fed policy developments and the EU parliament elections in May. High unemployment, large output gaps and falling wages have mollified underlying inflationary pressures across the region while broadly stable energy prices will also help to keep inflation below the European Central Bank's "below, but close to, 2%" target through 2015.

UNITED KINGDOM - Guided by a thriving domestic labour market, the UK economy will maintain a robust pace of expansion through the first part of 2014. The pound sterling is poised to remain strong, though it will likely lose some ground against the US dollar over the course of the year in view of the strengthening economic environment in that economy accompanied by gradual monetary stimulus withdrawal. Revisions to historical real GDP have pushed up the annual growth estimate for 2013 to 1.9% (our previous estimate was 1.5%), though with an unchanged quarterly profile, the adjustment leaves our 2014 projection intact at 2.5%. Growth is currently being driven by consumer spending, while net exports subtract from the headline pace due to still weak conditions elsewhere in Europe and the strength of the currency. With wage inflation still quite subdued, increases in household spending have come at the cost of reduced savings; however, this is unlikely to persist over the longer-term as the housing market stabilizes and household disposable income growth picks up. Thus, despite the rapidly falling unemployment rate (having dipped to 7.4% in October, the jobless rate is set to reach the 7% threshold as early as the first quarter of this year), the Bank of England (BoE) will likely wait for signs of accelerating wage growth and improving investment and export prospects before considering any policy tightening. Nevertheless, we have brought forward the expected profile for the BoE's rate-hiking cycle, with the first rate increase coming as early as the first quarter of 2015.

SWITZERLAND - Swiss monetary authorities remain committed to the minimum exchange rate policy in place since September 2011. The floor, set at 1.20 francs (CHF) per euro (EUR), has been an effective buffer for the economy over the last two years – supporting estimated real GDP growth of around 1¾% in 2013 – and will likely be upheld throughout 2014. The exchange rate was tested in the lead up to the US Federal Reserve's latest policy meeting on December 18th as speculation mounted regarding when asset purchase tapering would commence. After reaching its strongest level vis-à-vis the EUR since late April (and since November 2011 versus the US dollar), the CHF quickly – though only partially – snapped back when the Fed announced that it would begin to scale back its quantitative easing program in January. Deflation concerns persist; although the consumer price index posted its first yearly gain in 26 months in November (0.1% y/y), inflation outcomes in recent months have been lower than anticipated by the Swiss National Bank. The bank's December assessment showed a slightly lower price projection, with inflation likely to remain below 1% y/y through 2015. The economy maintained momentum in the third quarter, with goods exports rebounding to offset a smaller contribution from domestic demand. The growth rate will likely soften in the fourth quarter; however, survey data and leading indicators continue to suggest a robust performance in 2014 (around 2%), conditional on improvements in the global economy.

SWEDEN - Notwithstanding continued concern over rising house prices and household indebtedness, the Swedish central bank – the Riksbank – opted to ease monetary policy in December in response to a reduced inflation trajectory. Inflation unexpectedly fell to -0.1% y/y in October before recovering modestly to 0.1% in November (the underlying measure dipped to 0.6% followed by an uptick to 0.7%). The central bank stated that even with economic growth expected to accelerate in 2014, inflationary pressures will likely be softer than earlier anticipated as companies face difficulty passing on labour cost increases. The benchmark repo rate was thus cut by 25 basis points to 0.75% while the expected path for interest rates going forward was also lowered; the first tightening move is now foreseen around the beginning of 2015. Meanwhile, the Riksbank continues to stress that rising real estate prices and household debt amid continued low interest rates pose a threat to financial stability and sustainable long-term growth prospects. According to survey data, households' expectations of mortgage rates in five years are lower than what would correspond with the bank's expected repo rate level, which could lead to excessive borrowing. Third-quarter real GDP was weaker than expected (output expanded 0.1% q/q); however, upward revisions to data from the first half of 2013 imply that the economy is still on track to register full-year growth of ¾-1%, in line with earlier Riksbank projections. The pace will likely accelerate to around 2½% in 2014.

ASIA / PACIFIC
Currency Outlook

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JAPAN – USDJPY has entered 2014 with an upward bias, marking new multi-year highs (JPY lows) despite waning momentum indicators. Fundamentals are suggestive of continued gains for USDJPY as the Bank of Japan is to remain increasingly accommodative when compared to a taper-focused policy at the Fed. Meanwhile, bearish investor sentiment continues to build, with the late December net short US$17.3 billion position closing in on the US$18.8 billion record from 2007. We hold a Q114 target of 102, expecting some stabilization in the near-term before USDJPY can take another leg higher.

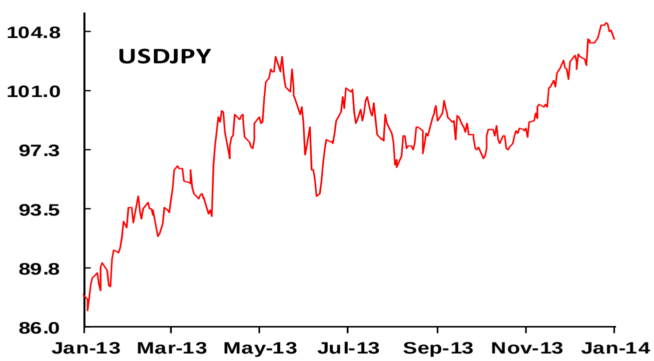
CHINA – The yuan strengthened 3% in 2013, following a relatively regular pattern of strength, followed by stabilization. The People's Bank of China continues to guide market participants that China is continuing on its path towards currency and interest rate liberalization. We expect the slow and measured pace of CNY appreciation to continue in 2014, with USDCNY closing the year at 5.98.

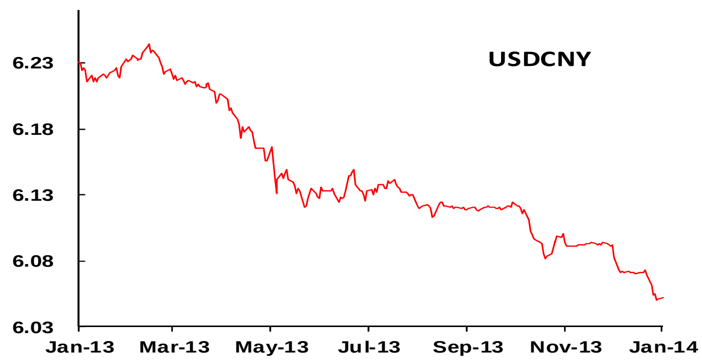
AUSTRALIA – The AUD is showing some signs of near-term stabilization in the first few sessions of 2014, following a near-worst performance in 2013 when measured against its primary currency peers. However, explicit concerns of the reserve Bank of Australia surrounding the exchange rate will likely restrain AUD gains above 0.90. Bearish investor sentiment continues to build, as the net short US$4.8 billion position from late December approaches the August 2013 record at $7.0bn. We expect near-term AUD weakness and hold a Q1 0214 forecast of 0.87.

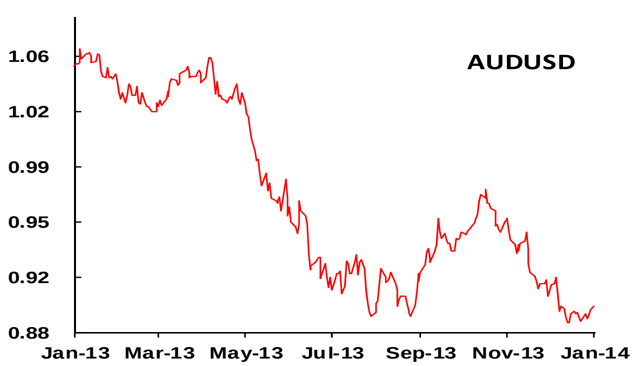
NEW ZEALAND – The NZD is at the mid-point of its range from mid-September, limiting the use of technical indicators as we begin 2014. Investor sentiment is generally neutral, and fundamentals are bullish as the support provided by a hawkish, financial-stability-focused RBNZ is reinforced by a firm domestic outlook. We expect Q114 to be marked by ongoing NZD range trading, with the currency closing the quarter at 0.83.

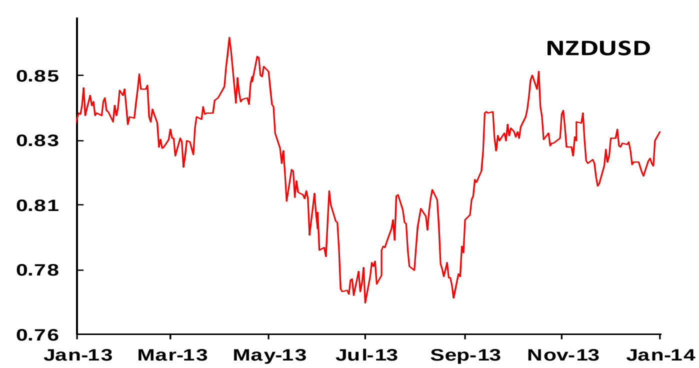
Currency Trends

FX Rate	Spot 6-Jan	14Q1f	14Q2f	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
USDJPY	104	102	104	107	109	110	111	112	113
USDCNY	6.05	6.04	6.02	6.00	5.98	5.94	5.90	5.86	5.86
AUDUSD	0.90	0.87	0.88	0.89	0.90	0.90	0.90	0.90	0.90
NZDUSD	0.83	0.83	0.84	0.85	0.85	0.86	0.86	0.87	0.87









ASIA / PACIFIC

Fundamental Commentary

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JAPAN - The Japanese economy continues to recover at a moderate pace. Real GDP growth in the third quarter was revised down to 0.3% q/q from an earlier assessment of 0.5%. This led to a modest downgrade of our 2013 growth estimate for Japan; the country's output likely expanded by 1.8% in 2013 as a whole, with a similar pace anticipated for 2014. We assess that economic activity will record a marked pick-up in the run-up to the April 2014 hike in the consumption tax rate, particularly in terms of household spending. To cushion a subsequent adverse impact of the rate increase on domestic demand, the government approved in December supplementary fiscal stimulus measures worth ¥5.5 trillion (equivalent to 1.1% of GDP), which add to the previous package of ¥13.1 trillion put together in January 2013. The additional public spending will mainly be directed to infrastructure. The stimulus package does require issuance of new government bonds due to a pick-up in tax revenues that reflect the ongoing economic recovery. The consumer price index (of all items less fresh food) increased by 1.2% y/y in November, up from 0.9% the month before, slowly approaching the Bank of Japan's (BoJ) 2% inflation target. 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 (by 35% in 2014 as a whole). 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 - In its efforts to limit rapid credit growth, the People's Bank of China is tightening monetary conditions by withdrawing liquidity from the banking system, which caused the one-month Shibor-rate to touch a six-month high in December at 7.66%. China's economic growth trajectory is structurally shifting lower due to a transition to a new stage of economic development that relies more on productivity improvements than factor inputs (such as fixed capital formation). In this context, the government's economic reform plan shows determination to increase the role of markets in resource allocation, which will lead to efficiency gains and a more sustainable growth model. As policymakers continue to rein in credit expansion, we foresee a slowdown in investment gains, causing China's real GDP growth rate to decelerate to 7⅓% y/y in 2014-15. Rising incomes and robust job creation will continue to support household spending, as indicated by sustained strength in retail sales, while the external sector will continue to recover gradually reflecting improving demand conditions globally. Structural reforms have been suggested in such areas as the financial and external sectors and fiscal policy; in the near term, we anticipate that the trading band of the Chinese yuan will be widened, while the interest rate liberalization process will move ahead with an eventual removal of the ceiling on deposit rates. The inflation outlook in China is manageable, with consumer prices increasing by 3.0% y/y in November; we expect that headline inflation will remain below 4% through 2015.

AUSTRALIA - Australian real GDP expanded by 0.6% q/q (2.3% y/y) in the third quarter of 2013, remaining virtually in line with the performance in the April-June period when output grew by a revised 0.7% q/q (2.4% y/y). Increased mining capacity is reflected in strong net exports, whose favourable impact is partially offset by declining investment, particularly in the mining sector. Household spending remains muted due to labour market softness. We estimate that output expanded by 2.4% in 2013, with the pace picking up to an average of 2.8% in 2014-15. The inflation outlook remains manageable, with consumer price gains likely hovering within the central bank's 2-3% target through 2015. We estimate that inflation closed 2013 at 2.5% y/y. Accommodative monetary conditions are set to remain in place in Australia in the coming quarters. Following the December 5th policy meeting, the Reserve Bank of Australia (RBA) maintained its earlier view that it would not close off the possibility of reducing rates further should the economic recovery require further support. At the same time, however, the RBA highlighted that a "substantial degree of policy stimulus" had been implemented, and its potential effects on the economy require continued vigilance. The cash rate is at 2.50%, with the most recent reduction having taken place in August. In terms of the Australian dollar, monetary authorities consider it to be uncomfortably strong, assessing that a lower level might be needed "to achieve balanced growth in the economy".

NEW ZEALAND - New Zealand's economic activity remains solid. Real GDP (on an expenditure basis) increased by 3.1% y/y in the third quarter, a marked pick-up from the average growth rate of 2½% in the first half of the year. Performance was underpinned by solid household spending and investment. Buoyant consumer and business confidence together with improving labour market conditions indicate that momentum will be maintained through the coming quarters. We expect New Zealand's output growth to average 3% in 2014-15 following an estimated 2¾% expansion in 2013. Sound domestic demand combined with persistently high house price inflation will likely cause more evident upside pressure on consumer prices in the coming months. This is causing the Reserve Bank of New Zealand (RBNZ) to signal a monetary tightening bias; following the December 12th monetary policy meeting, RBNZ officials noted that the official cash rate, currently at 2.50%, will be increased as needed to anchor future inflation. Based on our assessment that consumer price inflation reached 2% y/y, the midpoint of the RBNZ's 1-3% target range, at end-2013 (up from 1.4% y/y in the third quarter), we expect that the first benchmark interest rate hike will take place in the first quarter of 2014. Nevertheless, the disinflationary impact of the strong New Zealand dollar (NZD) will allow monetary conditions to be tightened only gradually through 2014. The RBNZ believes that the current value of the NZD is not sustainable in the long run.

DEVELOPING AMERICAS
Currency Outlook

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BRAZIL - The Brazilian real remained under pressure, driven by weak growth expectations (central bank's survey shows +1.95% consensus growth rate for 2014), fiscal concerns (which have triggered credit ratings warnings), and high household leverage fears. These factors, combined with the start of Fed tapering have led the USDBRL cross to continue to test the upper band of its 2.31 – 2.40 range, in place since the end of November. Our bias for the BRL to continue trading within that range, with risks skewed to the top-side.

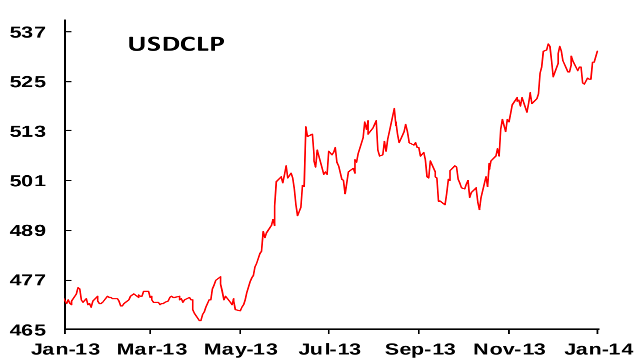
MEXICO - Despite positive credit rating guidance from Moody's (upgrade to the "single-A" range possible in the near term) and an upgrade to BBB+ from S&P in December, the MXN started the year on a weaker note, but remains the second best performing major global currency since the start of December (after the NZD). Positive sentiment towards the MXN is supported by a strong reform track record, but the question now is whether successful reform negotiation translates into sound implementation – if it does, the MXN should remain a top performer.

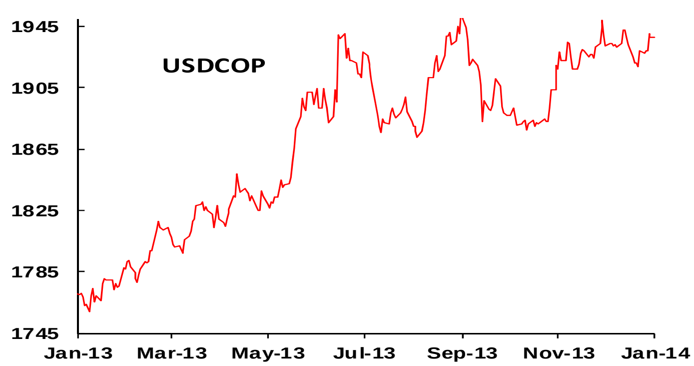
CHILE - President Piñera proposed Pablo Garcia to replace Manuel Marfan in the central bank's board, which is unlikely to be a major market moving piece of news. In our view, market sentiment will likely hinge on reform plan indications from incoming President Bachelet, as well as how strong the support for her plans in the legislature appears to be. Her coalition's majority is not large enough to push through all her plans on their own, so some watering down is possible – CLP positive in our view.

COLOMBIA - The central bank has seemingly taken rate cuts off the table, and has instead extended FX intervention, which appears like a sensible response to us, given a weak manufacturing sector and strong domestic demand. In addition, the government has continued to signal that it is comfortable with the USDCOP cross trading near 1,950. In our view, despite cold US weather potentially being oil positive, we see limited upside for the COP as the above factors combine with a Fed-triggered broad USD gain.

Currency Trends

FX Rate	Spot 6-Jan	14Q1f	14Q2f	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
USDBRL	2.38	2.38	2.40	2.45	2.50	2.50	2.45	2.45	2.40
USDMXN	13.1	13.2	13.1	13.2	13.4	13.4	13.4	13.5	13.5
USDCLP	532	530	530	540	540	535	530	525	525
USDCOP	1938	1920	1920	1930	1940	1930	1920	1900	1900





DEVELOPING AMERICAS
Fundamental Commentary

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BRAZIL - The financial market tone in Brazil remains relatively weak. Securities and currencies seem to be on the defensive in the first week of the New Year influenced by a myriad of endogenous and exogenous factors. Inflation metrics and growth dynamics indicate the strong likelihood that the central bank will deepen its tightening stance longer than originally priced in by market participants. The rate of consumer price inflation in Sao Paulo was 0.65% m/m in December, fuelling expectations that the fight against inflation is far from over. IPCA-based annual consumer price inflation will likely close 2013 above the 6% mark. The Brazilian Monetary Policy Committee (COPOM) has raised its policy-setting SELIC rate by 275 basis points since April 2013 to the current level of 10%; further hikes are in store in the coming months. The latest Central Bank survey of market analysts indicate that the SELIC rate would close the year at 10.5%. In terms of economic activity, real GDP growth will remain soft through the early months of 2014, with an estimated expansion rate of 2-2.5% for 2013-14. The FIFA World Cup and the October presidential elections are two key domestic events shaping the government policy environment during the first half of the year. The Brazilian president has reiterated its administration's firm commitment to controlling inflation. Externally, Brazil will be sensitive to emerging-market investors' reaction to the expected pace of unwinding of monetary stimulus in the US and to swings in risk aversion.

MEXICO - Economic activity in Mexico remains sluggish with only few signs of recovery; which in our view will be slow in the first months of 2014 before accelerating in the second quarter of the year. Industrial output advanced by a mild 0.1% y/y in October, the first increase in the last three months and the biggest in monthly terms since last February. Once again, the construction sector lagged manufacturing, a trend that we expect to continue in the coming months. Headline inflation accelerated in November to 3.6% y/y from 3.4% the previous month, and although this was the highest level in four months, factors affecting prices were seasonal and do not anticipate a derailment in the inflation trend. We expect consumer prices to accelerate in 2014 as a result of the fiscal reform approved last year; nonetheless, CPI will remain within the official target range. In mid-December, the Congress approved the energy reform, probably one of the most important reforms in many years. We anticipate that the major impact will be seen in the coming years in terms of elevating Mexico's potential GDP. The currency continues to trade within the range observed since last September, remaining close to the 13 pesos per US dollar (USD) mark. Although the currency lost 5% vis-à-vis the USD in 2013, it was one of the best performers in Latin America, losing less than other currencies such as the Colombian and Chilean pesos. We anticipate that the currency will lose some ground against the USD throughout the coming year as a result of US monetary policy; however, so far, the reaction has been fairly muted.

CHILE - The Chilean currency environment has been in stabilization mode since early December, following a sharp weakening phase that materialized in October/November which pushed USDCLP to 535. Looking ahead, the trade-intensive Chilean economy (and the peso) will be influenced by the direction of copper prices, economic activity data in China (the main recipient of Chilean metals exports) and the overall financial market reaction to the normalization of US monetary policy, which will translate into higher long-term interest rates. Economic activity has been showing signs of deceleration over the past 12 months in the context of well-contained price pressures; real GDP growth will likely average between 4-4.5% in 2014-15 on the back of a more positive growth outlook for high-income economies and enhanced regional integration. However, the growth differential between developed and developing economies will narrow this year prompting asset allocation shifts in global investment portfolios. Chilean securities and currency markets will not be immune to these changing financial market conditions, as recently shown in trends in the benchmark equity index and the currency. On the political and policy front, the most relevant development is the election of Mrs. Bachelet as the new president of Chile. The pro-business policy environment will remain in place, yet there may be some renewed focus on introducing second-generation structural reforms in the health, political and education fields as the new government takes office in March 2014.

COLOMBIA - Colombian economic output expanded by 5.1% y/y in the third quarter of 2013, improving significantly from the 3.3% rate averaged in the first half of the year and the 1.6% pace observed in the same quarter of 2012. Construction and infrastructure were the main contributors to growth, while the industrial sector continues to lag, decreasing by 2.6% over a 12-month period. We maintain our view that the Colombian economy grew by 4.2% in 2013 and will likely advance by 4½% in 2014. Headline inflation remains slightly below the central bank's target range, closing 2013 at 1.9% y/y; nonetheless, we do not anticipate any reductions to the monetary policy rate (currently at 3.25%) in the coming months. The central bank of Colombia has maintained the reference rate unchanged since last April, being the only major central bank in the region to keep a stable monetary policy. Following a depreciation against the US dollar (USD) in November, the Colombian peso remained close to the 1,930-1,940 mark in December, losing 12% vis-à-vis the USD in 2013 as a whole. For 2014, congressional elections scheduled for March and the presidential ballot scheduled for May together with the peace negotiations with the armed group FARC will shape the political outlook. The sustainability of the economic recovery in addition to currency volatility derived from US Fed monetary policy and the authorities' possible measures to moderate it will remain as the main drivers for the Colombian economic and financial outlook in 2014.

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	1.59	1.55	1.63	1.61	1.60	1.59	1.58	1.57	1.56	1.55
		EURGBP	0.81	0.83	0.79	0.79	0.82	0.81	0.79	0.79	0.79	0.79	0.79	0.79
	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														
North	**Canada**	USDCAD	0.99	1.06	1.07	1.06	1.07	1.08	1.07	1.07	1.06	1.06	1.06	1.06
North		CADUSD	1.01	0.94	0.93	0.94	0.93	0.93	0.93	0.93	0.94	0.94	0.94	0.94
North	**Mexico**	USDMXN	12.85	13.04	13.39	13.52	13.23	13.13	13.21	13.39	13.40	13.40	13.50	13.52
North		CADMXN	12.96	12.27	12.52	12.75	12.37	12.15	12.35	12.52	12.64	12.64	12.74	12.75
South	**Argentina**	USDARS	4.92	6.52	7.00	8.00	6.64	6.76	6.88	7.00	7.12	7.24	7.36	8.00
South	**Brazil**	USDBRL	2.05	2.36	2.50	2.40	2.38	2.40	2.45	2.50	2.50	2.45	2.45	2.40
South	**Chile**	USDCLP	479	525	540	525	530	530	540	540	535	530	525	525
South	**Colombia**	USDCOP	1767	1930	1940	1900	1920	1920	1930	1940	1930	1920	1900	1900
South	**Peru**	USDPEN	2.55	2.80	2.70	2.65	2.75	2.73	2.73	2.70	2.68	2.68	2.65	2.65
South	**Venezuela**	USDVEF	4.30	6.30	7.90	9.50	7.90	7.90	7.90	7.90	9.50	9.50	9.50	9.50
ASIA / PACIFIC														
	Australia	AUDUSD	1.04	0.89	0.90	0.90	0.87	0.88	0.89	0.90	0.90	0.90	0.90	0.90
	China	USDCNY	6.23	6.05	5.98	5.86	6.04	6.02	6.00	5.98	5.94	5.90	5.86	5.86
	Hong Kong	USDHKD	7.75	7.75	7.75	7.75	7.75	7.75	7.75	7.75	7.75	7.75	7.75	7.75
	India	USDINR	55.0	61.8	64.5	66.0	62.5	63.2	63.8	64.5	65.0	65.3	65.5	66.0
	Indonesia	USDIDR	9793	12171	12200	11900	12185	12190	12195	12200	12125	12050	11975	11900
	Malaysia	USDMYR	3.06	3.28	3.30	3.40	3.29	3.29	3.30	3.30	3.33	3.35	3.38	3.40
	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	42.6	42.2	44.0	43.5	43.1	42.6	42.5	42.4	42.3	42.2
	Singapore	USDSGD	1.22	1.26	1.27	1.27	1.27	1.27	1.27	1.27	1.27	1.27	1.27	1.27
	South Korea	USDKRW	1064	1050	1040	1020	1048	1045	1043	1040	1030	1025	1020	1020
	Taiwan	USDTWD	29.0	29.8	29.2	29.0	29.7	29.5	29.4	29.2	29.1	29.0	29.0	29.0
	Thailand	USDTHB	30.6	32.7	33.0	34.0	33.0	33.0	33.0	33.0	33.3	33.5	33.8	34.0
EUROPE / AFRICA														
	Czech Rep.	EURCZK	25.1	27.3	26.7	25.8	27.5	27.3	27.0	26.7	26.5	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	298	297	296	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	4.18	4.15	4.07	4.00	3.98	3.95	3.93	3.90
	Russia	USDRUB	30.5	32.9	33.6	33.4	33.0	33.2	33.4	33.6	33.6	33.5	33.5	33.4
	South Africa	USDZAR	8.47	10.49	10.50	10.25	10.35	10.40	10.45	10.50	10.40	10.35	10.30	10.25
	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	2.20	2.16	2.10	2.13	2.16	2.20	2.19	2.18	2.17	2.16

f: forecast a: actual

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