Foreign Exchange Outlook

AMERICAS

The USD is showing broad-based strength. Relative growth dynamics and deep structural liquidity support a bullish trend for the USD. The CAD offers limited upside potential after testing strong technical resistance. The MXN and CLP are casualties of a sudden move in UST bond markets. The BRL and COP are relatively well supported by outright government intervention and attractive interest rates.

EUROPE

The EUR has entered a long-awaited weakening phase versus core peer currencies. The RUB maintains a weakening bias due to potential capital outflows linked to sanctions by the US and European Union targeting the defence, energy and financial sectors. The GBP rally is showing signs of exhaustion following a period of strong growth and yield-driven capital inflows.

ASIA / PACIFIC

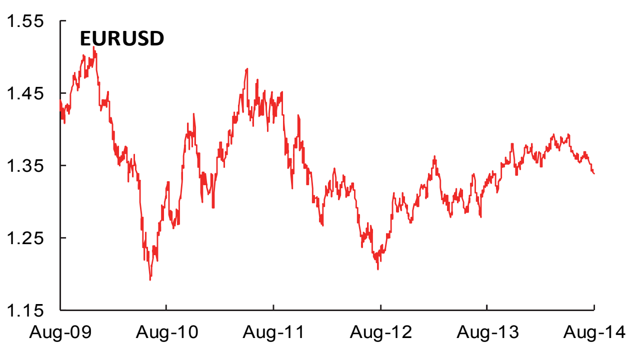
The JPY has resume a weak tone against the USD, yet it has gained value versus the EUR. Japanese economic activity will continue to suffer the negative impact from an increase in the sales tax. The CNY abandoned its stable trading mode and resumed an appreciating trend, shrugging off credit quality concerns in the banking sector. Outperformers INR and KRW reached resistance points and enter a consolidation phase.

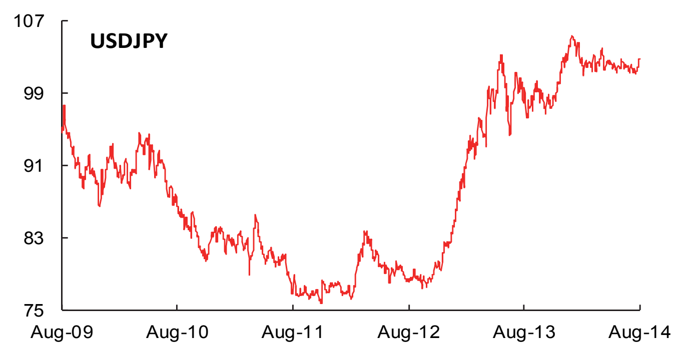
Contents

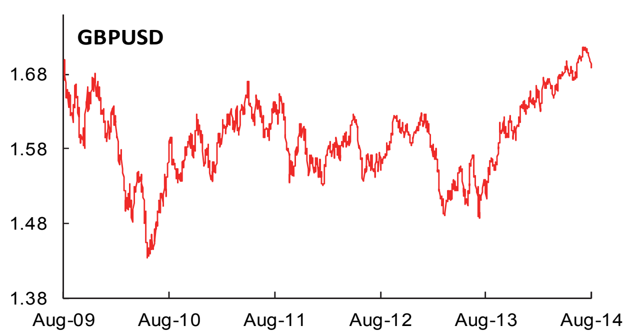
Core Exchange Rates

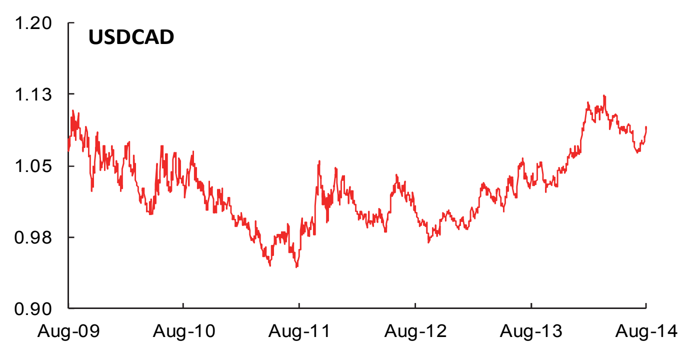
Global Foreign Exchange Outlook

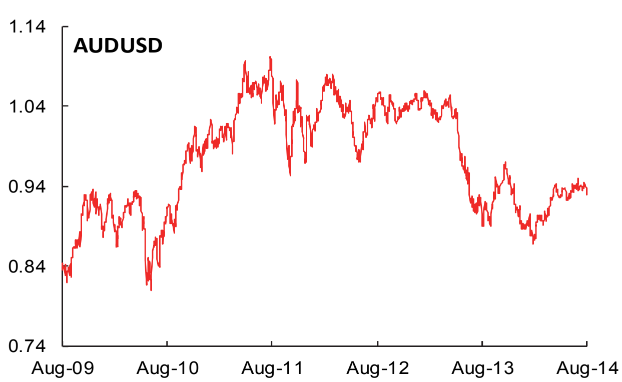
July 31, 2014		Spot	2014f Q1a	2014f Q2a	2014f Q3	2014f Q4	2015f Q1	2015f Q2	2015f Q3	2015f Q4
EURUSD	Scotiabank	1.34	1.38	1.37	1.34	1.30	1.28	1.26	1.25	1.24
	Consensus*				1.34	1.33	1.31	1.30	1.30	1.30
USDJPY	Scotiabank	102.8	103	101	104	109	110	111	112	113
	Consensus*				104	106	107	108	108	108
GBPUSD	Scotiabank	1.69	1.67	1.71	1.73	1.72	1.70	1.69	1.68	1.68
	Consensus*				1.70	1.69	1.68	1.67	1.66	1.66
USDCAD	Scotiabank	1.09	1.11	1.07	1.08	1.10	1.12	1.12	1.11	1.11
	Consensus*				1.10	1.11	1.12	1.12	1.12	1.11
AUDUSD	Scotiabank	0.93	0.93	0.94	0.94	0.92	0.91	0.90	0.90	0.89
	Consensus*				0.92	0.90	0.89	0.88	0.88	0.87
USDMXN	Scotiabank	13.23	13.06	12.97	13.07	13.22	13.28	13.15	13.19	13.36
	Consensus*				12.95	12.89	12.86	12.84	12.79	12.73











(*) Source: Consensus Economics Inc. July 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

The US dollar (USD) is showing broad-based strength as we move into August, supported by an improved economic outlook in the United States coupled with firming inflation and labour market indicators that are shifting the focus toward monetary policy normalization at the US Federal Reserve (Fed). US yields have responded, providing for a fundamentally-driven USD rally on the back of interest rate differentials. Additionally, heightened tensions in the Middle East (linked to Israel's offensive into Gaza), deeper joint economic/financial sanctions against the Russian Federation by both the US and the European Union (EU), and increasing violence in Syria have escalated geopolitical factors in the global risk equation, placing selective asset classes (emerging markets) on the defensive.

Relative growth and structural liquidity provided by the deepest capital markets in the world are the primary factors supporting a bullish trend for the US currency. The US economy expanded by 4% on a quarter-to-quarter annualized basis, prompting a revision to our forecast to 2% for the year as a whole before accelerating to 3.2% in 2015.

Momentum in the NAFTA currencies is primarily influenced by US economic news and expected monetary policy shifts by the Fed. The Canadian dollar (CAD) tested strong technical resistance levels and somewhat weakened versus the USD as North American energy prices have failed to maintain gains resulting from global turmoil. Divergent timing in monetary policy shifts, challenging conditions for Canada's export sector and technically inspired flow of funds movements will weigh on the CAD. We estimate USDCAD to close the year at 1.10. The Mexican peso (MXN) has been a major casualty of a sudden move in US treasury (UST) bond markets triggered by the US central bank rhetoric and stronger economic data. We estimate that the MXN may be subject to temporary overshooting waves before reaching a stabilizing trading range through the remainder of the year. Mexico will undoubtedly benefit from steady progress in the structural reform agenda, yet the MXN may not receive the benefits of such developments up until foreign capital flows enter the country. Meanwhile, the potential for partial repatriation of short-term US-based portfolio investment flows may weigh on the MXN in the coming months.

The euro (EUR) has entered a long-awaited weakening phase versus core peer currencies. Widening US-European interest rate differentials as the euro zone recovery remains soft and slow are weighing on the EUR which has depreciated against all major currencies since may: the EURUSD rate declined from 1.40 (intra-day trading on May 8) to 1.34 (end of July). The escalation of military tensions in Eastern Ukraine and the implied support of the Russian government to separatist groups have added other risk-sensitive events to global financial markets. The Russian ruble (RUB) has weakened on the grounds of potentially destabilizing economic effects from the recently announced sanctions by the US and EU targeting the defence, energy and financial sectors. Further depreciation towards the USDRUB36.5 level is likely in the near term; however, CDS markets do not imply a high risk of a distressed credit event in Russia. The British pound (GBP) has entered a negative correction phase after sustaining strong gains from April to mid-July.

The Japanese yen (JPY) retains a weak tone against the USD, yet it has gained value versus the EUR. Japanese economic activity will continue to suffer the negative impact from an increase in the consumption tax. We hold a USDJPY 109 rate for the end of this year. On a positive note for emerging-market assets, the Chinese yuan (CNY) and equity securities have regained a strengthening trend of late. The CNY abandoned its stable trading mode and resumed an appreciating trend, as we previously anticipated. After testing a three-month high of 6.27 in early May, USDCNY declined to 6.17 at the end of July. Elsewhere in developing Asia, the Indian rupee (INR) and the Thai baht (THB) were slightly under downward pressure consolidating some of the previous monthly gains, while the Korean won (KRW) retained a market-favourite status.

Latin America has been rather unfazed by the adverse credit event leading to a selective default of Argentine debt securities. The Brazilian real (BRL) remains relatively well supported on the back of inflation-sensitive government intervention in financial markets aimed at moderating exchange rate volatility ahead of the presidential elections scheduled for October 2014. A high interest rate environment coupled with sizable foreign exchange reserves provide elements of support to the BRL, but we believe that the widening current account deficit and persistently poor economic growth conditions will place the BRL on a weakening trajectory throughout the remainder of the year. As for the rest of the Latin American currencies, the Chilean peso (CLP) has been negatively affected by monetary easing and decelerating growth whereas the Colombian peso (COP) maintains a near-term appreciating bias on the grounds of strong growth and expectation of sizable foreign direct and portfolio investment inflows.

Canada

Currency Outlook

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

After weakening aggressively in late 2013 and early 2014 the Canadian dollar (CAD) has retraced half of its fall. The stronger currency has come on the back of several developments, including: 1) surprisingly strong domestic data; 2) building upward pressure on inflation; 3) oil prices above US$100; 4) profit taking on short CAD positions; and 5) strong CAD positive flows and a shift in investor sentiment. However, July marked a period of stabilization, followed by decline.

The stronger domestic environment and shift in sentiment changes the outlook for the CAD to a less bearish one, decreasing the risk of CAD trading sustainably through the lows of the year (0.88). However, as long as the Bank of Canada (BoC) maintains its firmly neutral tone and prepares to lag the Fed in interest rate hikes, substantial CAD strength is also unlikely to materialize. In its most recent comments, the BoC highlights that the recent uptick in inflation has been driven by temporary effects (higher energy, FX pass through and other sector specific shocks) and remains ‘preoccupied with downside risks to economic activity’.

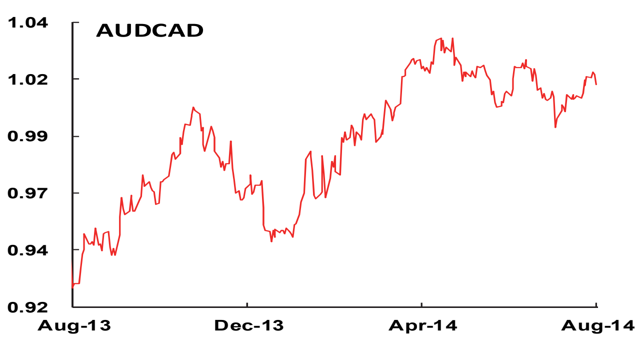
In addition, the repeated disappointment that the economy has been slow to shift towards exports and business investment, weighs heavily on the BoC. The tie in between exports and the level of the CAD is not lost on markets and accordingly any upside CAD pressure is met with building concern over how a strong CAD will impact the BoC policy decision and exports. Judging the path of the CAD is tied with the BoC outlook; in the current environment we would expect BoC policy versus Fed policy to prove a weight for the CAD.

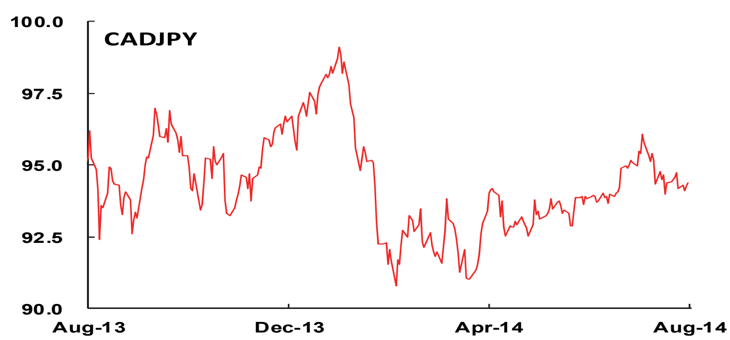
Many of the other core drivers of the CAD, including global growth, oil prices and FX sentiment have improved. Recent high-frequency data lend to a strengthening global economic outlook but one that remains vulnerable to downside shocks. Oil prices are elevated but driven higher by supply as opposed to the more CAD positive demand side. Sentiment has shifted to a net CAD long position (a reflection of building near-term positive momentum), but longer term forecasts continue to call for CAD weakness. In addition, looming geopolitical risks and subdued market volatility remain important in the evaluation of CAD’s path.

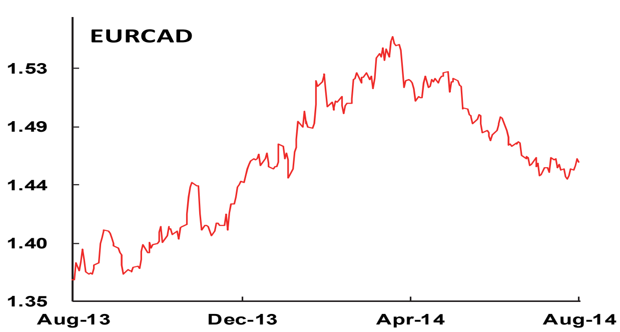
We expect the CAD to close Q3 at 0.9260 (1.08 in USDCAD terms) and the year at 0.91 (1.10 in USDCAD terms).

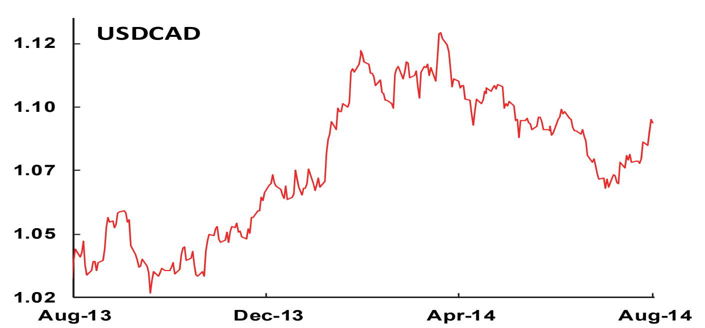
Canadian Dollar Cross-Currency Trends

FX Rate	Spot 31-Jul	14Q1a	14Q2a	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
AUDCAD	1.01	1.02	1.01	1.02	1.01	1.02	1.01	1.00	0.99
CADJPY	94.4	93.4	95.0	96.3	99.1	98.2	99.1	100.9	101.8
EURCAD	1.46	1.52	1.46	1.45	1.43	1.43	1.41	1.39	1.38
USDCAD	1.09	1.11	1.07	1.08	1.10	1.12	1.12	1.11	1.11









United States and Canada

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

Fundamental Commentary

UNITED STATES — The US economy rebounded strongly following weather-related disruptions at the turn of the year. Real GDP increased an annualized 4% q/q in Q2, with broad-based gains across sectors. Improving labour market conditions, wealth gains from rising home and equity prices, and the unleashing of pent-up demand for motor vehicles and other consumer durables are underpinning consumer confidence and spending. Motor vehicle sales in June rose to their highest level in eight years. Nonfarm payrolls rose by 288,000 in June, bringing the year-to-date average gain to 231,000 and driving down the unemployment rate to 6.1%, an almost six-year low. The US economy has now more than recouped the nearly 9 million jobs lost during the recession. Consumer confidence has trended higher to its best level in over six years. The US housing sector has been slower to regain momentum. Home sales and construction are grinding higher, but remain well below normal levels, with affordability pressured by rising home prices and higher mortgage rates over the past year. Industrial activity also is recovering from its winter slump. US producers are benefitting from rising domestic and foreign sales, improved cost competitiveness and a well-diversified export base. Production gains are being led by motor vehicles & parts and energy products. The ramping up in US oil and gas production in recent years has steadily trimmed oil imports and contributed to a notable improvement in US external accounts. Meanwhile, strong capital goods orders, alongside healthy corporate balance sheets and reduced political uncertainty, point to a further acceleration in business investment in the coming months. The 2014-2015 recovery also will get a boost from a sharply reduced pace of fiscal restraint. Inflation is trending up alongside higher food, energy and housing costs, though excess capacity and still modest wage growth should keep overall price pressures in check.

CANADA — The Canadian economy continues to post moderate growth, with real GDP tracking around 2¼% y/y in the first half of 2014. Consumer spending remains reasonably buoyant. Supported by attractive pricing, motor vehicle sales in June hit another record for the month. Housing activity also is fairly robust, with aggressive mortgage rate discounting helping to maintain affordability. However, consumer confidence and buying intentions have recently softened amid growing pessimism over labour market conditions. Combined with limited pent-up demand, consumers are expected to be relatively cautious spenders in the year ahead. Exports and manufacturing shipments are showing some recent signs of improvement, with producers of motor vehicles and building materials benefitting from strengthening US auto sales and residential construction. Even so, the recovery to date remains weak relative to prior cycles. Export volumes as of May 2014 were still marginally below their pre-recession peak, restrained by the slow pace of global growth as well as domestic competitiveness challenges. Meanwhile, higher energy prices are supporting a modest improvement in Canada's terms of trade and overall merchandise trade balance. Resource-related activity remains relatively buoyant, and earlier transportation bottlenecks hampering the energy sector have eased. At the same time, excess capacity combined with moderate sales growth continue to weigh on business hiring and capital spending plans, notwithstanding improving business sentiment, healthy corporate finances and favourable financing costs. The investment outlook should gradually firm up over the coming year as strengthening global demand underpins a stronger export recovery. Inflation trends have accelerated since the start of the year. While led by higher food and energy costs, core prices also have drifted higher toward the mid-point of the Bank of Canada's 1-3% target range, reflecting sector-specific shocks and the passthrough of a weaker Canadian dollar to a range of imported goods prices. At the same time, persistent excess capacity, ongoing retail competition and soft wage gains should limit price pressures.

Monetary Policy Commentary

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

Dov Zigler (212) 225-6631
dov.zigler@scotiabank.com

UNITED STATES — We think that the debate regarding US monetary policy will become increasingly focused on the timing (and extent) of monetary policy lift-off. With the economy functioning well and QE3 set to conclude in October, the debate will increasingly move to the Fed's revised 'exit principles' and the timing for their implementation. There are technical issues regarding policy lift-off (how will the Fed deploy its tools, including the ON RRP rate and IOER?) as well as issues regarding the likely extent of eventual policy normalization (the Fed has reduced its view on appropriate neutral long-run rates – and could do so further). But the debate will now tilt to hashing out these issues – and not wondering whether rate adjustments will happen at all. We continue to anticipate a rate hike early in Q2 of next year.

CANADA — The Bank of Canada (BoC) remains extremely dovish. Yes, it amended its rate guidance in its most recent statement, but the message seems consistent with its former bent: it wants to be seen as on hold for a long time and to maintain 'optionality' in either direction with respect to its next move on interest rates (not that a cut seems likely...). The BoC's latest statement amended its rate guidance to state that it is 'neutral' with respect to the timing and direction of the next change to the policy rate; formerly the BoC said that 'downside risks to the inflation outlook [are] as important as before'. Either way, the BoC's latest MPR did such a thorough job of arguing that downside risks to inflation are still present and that inflation is lower than it seems that it's hard to make too much of this change. We continue to see the BoC on protracted hold, and likely lagging the Fed both in the timing and extent of rate hikes.

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

Europe

Currency Outlook

EURO ZONE — Euro zone fundamentals are weak and would typically be associated with a period of currency depreciation; however, financial flows into Europe have supported the currency and slowed the pace of depreciation. There are early signs that some of the more vulnerable flows are dissipating. Sentiment, as measured through the CFTC positioning data, has moved from a large net long of US$13 billion in October 2013 to a newly formed net short of US$10 billion. In mid-July, the EUR broke below its two-year uptrend, warning of mounting downside risk. We hold a Q3 2014 target of 1.34 and a year-end forecast of 1.30.

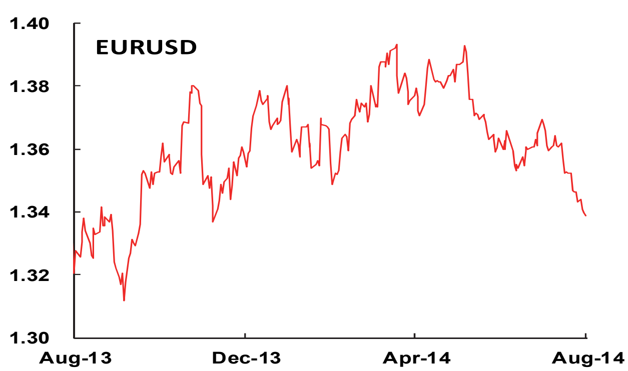
UNITED KINGDOM — The fundamentals in the UK are strong and the Bank of England (BoE) is expected to be the first of the G4 central banks to enter its interest rate hiking cycle, which has supported the GBP's year-long rally. However, the upward trend is being tested, and bullish CFTC sentiment appears to be fading. In addition, consensus forecasts suggest a weakening bias into 2015. Near-term risks have shifted to the downside; nevertheless, this is likely to prove temporary and we hold a Q3 2014 target of 1.73 and a year-end forecast of 1.72.

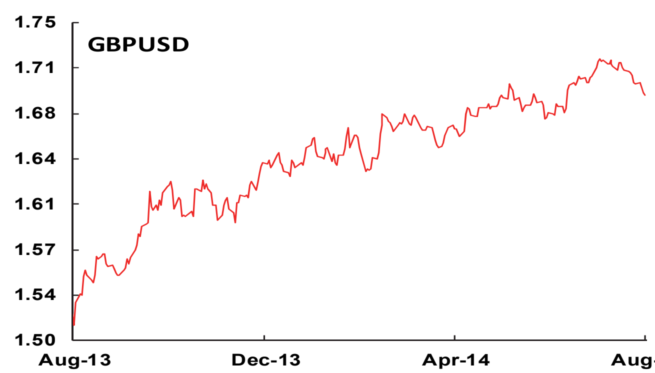
SWITZERLAND — EURCHF traded in a relatively tight range during most of July as rising geopolitical risks and soft inflation data supported the view that the Swiss National Bank is unlikely to adjust the current EURCHF 1.20 floor. We expect it to be maintained and accordingly target EURCHF at 1.22 by the end of Q3.

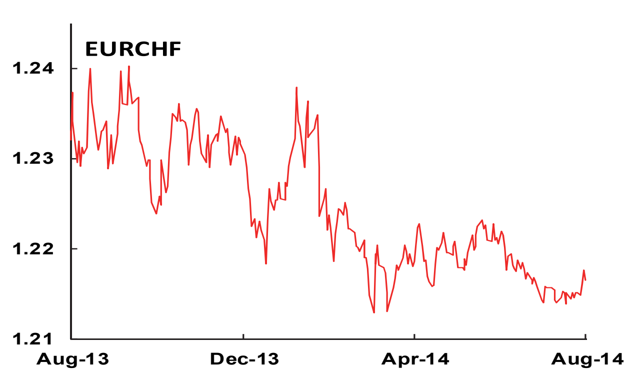
NORWAY — Since the release of a cautious monetary policy statement on June 19th, which suggested a slightly lower growth profile, contained inflation and the risk that policy rates abroad would prove slow to rise has weighed heavily on the NOK. Sentiment is mixed and technicals are not providing a clear direction. We are optimistic that Norway's relatively strong fundamentals will ultimately support the currency and accordingly hold a Q314 forecast of 6.10 and a year-end target of 6.00.

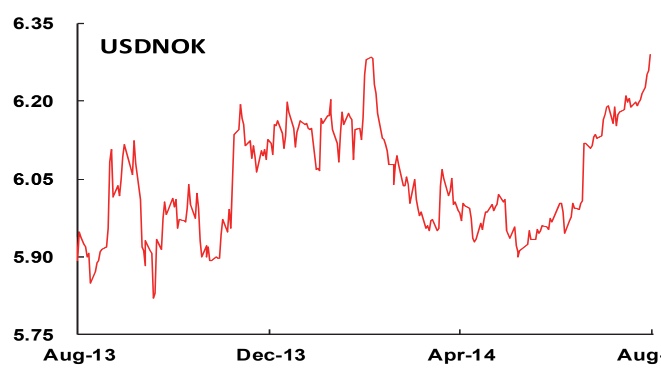
Currency Trends

FX Rate	Spot 31-Jul	14Q1a	14Q2a	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
EURUSD	1.34	1.38	1.37	1.34	1.30	1.28	1.26	1.25	1.24
GBPUSD	1.69	1.67	1.71	1.73	1.72	1.70	1.69	1.68	1.68
EURCHF	1.22	1.22	1.21	1.22	1.24	1.25	1.26	1.26	1.27
USDNOK	6.29	5.99	6.13	6.10	6.00	5.80	5.70	5.70	5.60









Europe

Fundamental Commentary

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

Alan Clarke (44 207) 826-5986
alan.clarke@scotiabank.com

Frédéric Prêtet (00 33) 17037-7705
frederic.pretet@scotiabank.com

EURO ZONE — Euro zone headline inflation surprised once again on the downside in July, dropping to 0.4% y/y, its lowest reading since October 2009. The annual inflation rate could face further downside risk over the next two months as food and energy prices remain subdued. We expect a gradual pickup thereafter, with headline inflation edging up to 0.7% by the end of the year. In June, the European Central Bank (ECB) launched a new round of measures – including cutting its benchmark interest rate to 0.15%, reducing its deposit rate to -0.10%, ending the SMP sterilization program and promising banks billions in cheap loans to lend to businesses – designed to boost growth and gradually increase inflation toward its 2% y/y target. While the ECB has refrained from launching a bolder program of large-scale asset purchases, ongoing deflationary risk could put pressure on the ECB to initiate some form of quantitative easing to help shore up the bloc's weak fundamentals. There are also concerns that escalating tensions between Russia and Ukraine could adversely impact trade and business investment. Nevertheless, the improvement in July's PMIs suggests the euro zone recovery should regain momentum. Euro zone unemployment fell by 152,000 in June, bringing the jobless rate to 11.5%, its lowest level since September 2012. The ECB's second-quarter bank lending survey indicated a pickup in demand for corporate loans, suggesting the ECB's new program, due to start in September, is well-timed. Real GDP is forecast to advance 1.1% this year, before accelerating to 1.4% in 2015.

UNITED KINGDOM — The UK economy has continued to expand at a very respectable pace. Consumer spending remains the primary driving force, thanks mainly to the combination of a falling savings ratio, coupled with super-strong employment growth helping to buoy disposable income growth. Meanwhile, investment is very strong but net exports are sluggish due to a lack of import demand from the UK's main trading partner, the Eurozone. While we estimate a lot of the momentum in growth has been maintained into the second quarter and beyond, we suspect that the pace of expansion will cool a little and the best news for growth is probably right here right now. Inflation is essentially drifting sideways with a mild upward bias and copious month-to-month noise. We expect this trend to continue as slack is eroded and the drag from non-core components fades. We expect the BoE to begin hiking rates in February 2015, though with a significant risk of an earlier move. The timing will depend on whether the MPC pays more attention to rampant increases in employment versus non-existent wage inflation - both of which are sending conflicting signals about the pace at which economic slack is being eroded. Ultimately we believe that lack of wage inflation will dominate.

SWITZERLAND — Given its safe haven status, the conflict between the Ukraine and Russia has driven up demand for the Swiss franc (CHF), particularly from eastern Europe, renewing upside pressure on the currency. Since the beginning of 2014, the franc has appreciated 2.3% against the euro, rallying near the Swiss National Bank's CHF1.20 per euro currency floor. Heightened risk aversion and the threat of escalating US and EU sanctions against Russia will continue to reinforce capital inflows into Switzerland. Accordingly, we expect the CHF will maintain its current level over the coming months. Nevertheless, with Swiss assets remaining highly inflated by ultra-loose monetary policy and significant safe haven inflows, we maintain our view that the franc will depreciate against the euro over our forecast horizon, as the economic recovery in Europe gains momentum and the raft of stimulus measures announced by the European Central Bank on June 5th continues to bolster the region's bond and equity markets, shifting international capital into higher yielding European assets. The hawkish bias of other central bank authorities in advanced economies, such as the US and the UK, should further dent the appeal of overvalued Swiss assets. Despite the soft patch, the Swiss economy will remain among the top performing advanced countries through 2015, amid favourable labour markets and credit growth dynamics.

NORWAY — Economic activity in Norway has lost some steam recently. Industrial production in May recorded its largest drop since August 2010, declining 5.9% m/m, following a downwardly revised contraction of 0.4% in April. May's weakness largely reflected a sizeable decrease in oil and gas extraction, which accounts for over 72% of the index, as well as a decline in manufacturing output. Consumer prices also fell by 0.2% m/m, underpinned by lower prices for food and non-alcoholic beverages, clothing and footwear, and transport. However, annual headline inflation edged up to 1.9% – its the highest rate in three months – and the unemployment rate unexpectedly fell to 3.2%. Business confidence has also improved in the second quarter, rising to 7.30 from 6.80 in the January-March period. We expect real GDP growth in Norway to advance by 1.6% in 2014, and to accelerate to 2.0% in 2015. The wealth fund, into which Norway channels its oil and gas wealth, has 65 investments in Russia, with its most significant holding in VTB Bank (according to its 2013 annual report), which has become the latest target of US sanctions, as well as a 0.5% stake in OAO Gazprom. The conflict between Russia and Ukraine has negatively impacted the fund's first quarter returns. Amid the threat of escalating sanctions, downside risks will likely persist.

Asia / Pacific
Currency Outlook

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

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

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

JAPAN — A swift, near 2% decline in the JPY through the latter half of July suggests a renewed focus on fundamentals following a constrained multi-month trading range resulting from offsetting geopolitical concerns and waning bearish sentiment, with the net short CFTC position narrowing to US$6.6 billion as of late July. Key multi-month technical levels have been broken, and we expect fundamentally-driven upside in USDJPY, holding a Q3 target of 104.

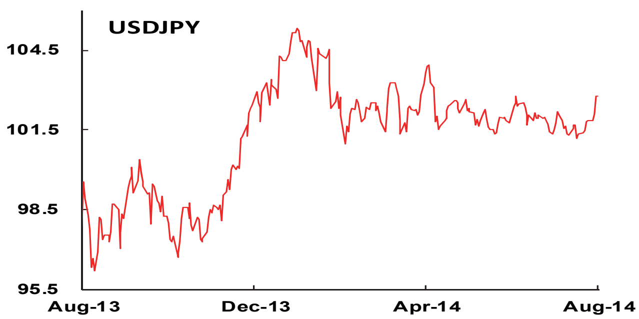
CHINA — Despite significant net fixings higher in USDCNY in July, spot trading continued to be pressured substantially lower, likely reflecting improved current account flows as preliminary Q2 BoP data depicted a resurgent current account, offsetting minor and temporary capital account outflows. We are likely to see resurgent capital inflows as an appreciatory path becomes more obviously established, albeit with the higher volatility that has been evident not only in daily spot trading, but also fixing behaviour. We continue to target 6.10 in USDCNY for the end of Q4.

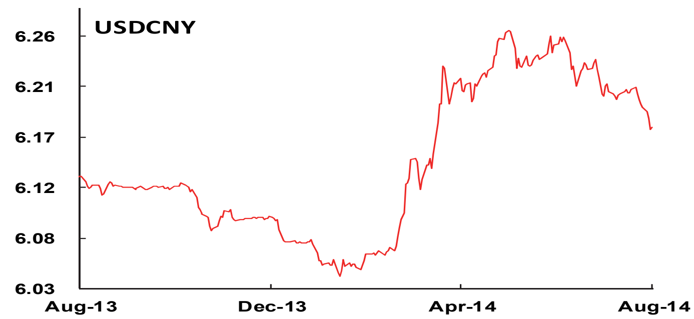
AUSTRALIA — The AUD is entering July on a weaker footing, decisively breaking through its 100 day MA and trading below this key technical level for the first time since mid-March. AUD supportive flows appear to be waning, with a rising AUD correlation to the Australia-US 2Y yield spread that suggests a re-orientation toward fundamentals. Bullish CFTC sentiment has stalled, the net long position stable around US$3.6 billion as of late July. We hold a year-end AUD target of 0.92.

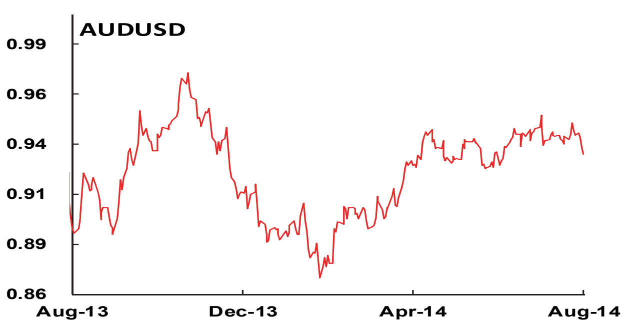
NEW ZEALAND — A one-year rally in the NZD reversed in early July, driven by fundamentals as a softened external outlook was compounded by domestic developments that included a pause in the RBNZ tightening cycle and a downgrading of dairy prices. Options prices highlight a rising desire to protect against NZD downside, leaving some market participants vulnerable as we consider a CFTC net long position of US$1.3 billion as of late July. We are comfortable with the NZD close to current levels, holding a Q3 target at 0.85.

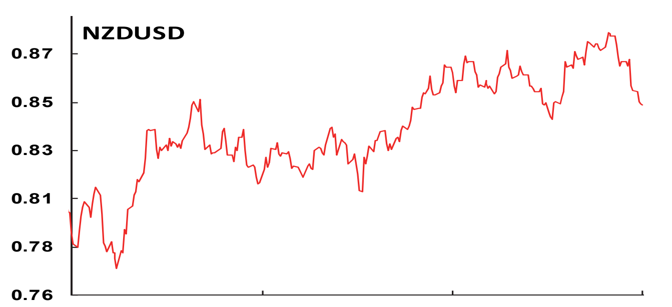
Currency Trends

FX Rate	Spot 31-Jul	14Q1a	14Q2a	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
USDJPY	103	103	101	104	109	110	111	112	113
USDCNY	6.17	6.22	6.20	6.16	6.10	6.06	6.01	5.97	5.92
AUDUSD	0.93	0.93	0.94	0.94	0.92	0.91	0.90	0.90	0.89
NZDUSD	0.85	0.87	0.88	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
Neil Shankar (416) 866-6781
neil.shankar@scotiabank.com

JAPAN — The “third arrow” of Japan’s economic revival plan that complements fiscal and monetary measures was unveiled at the end of June; it includes three components — growth strategy, fiscal reform and deregulation — containing a corporate tax rate cut and restructuring of such areas as labour, agriculture and healthcare. High frequency indicators imply that a partial reversal of the strong growth momentum experienced in early 2014 — ahead of the April consumption tax rate increase — likely took place in the April-June period. We expect Japan’s real GDP to advance by 1.6% in 2014 as a whole. While the announced structural reform plans are encouraging, successful productivity-boosting reforms take time to be reflected in stronger economic activity; therefore, growth momentum will likely decelerate to 1.2% in 2015. The consumption tax rate increase will temporarily keep inflation above the Bank of Japan’s (BoJ) 2% target. Headline inflation stood at 3.6% y/y in June, yet price gains fail to be demand-driven. The BoJ expects underlying inflation, which excludes the impact of the tax hike as well as fresh food costs, to remain relatively stable in the near term at around 1¼% y/y, thereby failing to meet the authorities’ target. The BoJ will continue its monetary easing scheme in the coming quarters, expanding the nation’s monetary base at an annual pace of ¥60-70 trillion (30-35% in 2014 as a whole). There is potential for further stimulus measures in the second half of 2014 if the tax hike leads to a prolonged stalling of economic momentum.

CHINA — The Chinese economy has stabilized over the past few months, responding favourably to the government’s fiscal stimulus initiatives and targeted monetary easing measures. Leading indicators point to a relatively stable outlook for the remainder of the year. Nevertheless, a housing market correction poses the largest downside risk to China’s economic outlook, considering the possible adverse impacts on the construction sector and related industries, as well as on household wealth and local government finances through decreased land sales. Furthermore, property developers’ potential financial difficulties would negatively affect banking industry asset quality. China’s real GDP expanded by 7.5% y/y in the second quarter following a 7.4% gain in the first three months of the year. The services sector continues to increase in importance as an economic motor, exceeding the industrial sector in size and pace of growth. Chinese policymakers continue to emphasize that a favourable economic environment is needed for implementing planned structural reforms; accordingly, we assess that they remain committed to supporting the economy through stimulus measures if needed, with the country’s output likely increasing by 7.4% this year. In 2015, real GDP growth will likely ease to 7.2% as the country gradually transitions to a new stage of economic development that relies more on productivity improvements than factor inputs such as investment.

AUSTRALIA — Monetary conditions in Australia will remain accommodative in the coming quarters with the cash target rate likely to be kept at 2.50%. We have postponed our expectation for the Reserve Bank of Australia’s (RBA) first benchmark interest rate hike, and now anticipate monetary normalization to begin in the second quarter of 2015. The RBA considers the current policy stance to be appropriate for supporting domestic demand; nevertheless, the central bank acknowledges the uncertainty regarding the extent to which low interest rates can offset the anticipated decline in mining investment combined with the government’s plans for fiscal consolidation. Consumer price inflation will likely remain consistent with the RBA’s 2-3% target; we expect the headline rate to close the year at around 2 ¾% y/y, easing slightly from the 3.0% y/y advance in the second quarter. Australia maintains a robust rate of economic growth in comparison to many other advanced economies. Nevertheless, the very strong momentum experienced in the first quarter of 2014 will likely prove to be a temporary phenomenon as it was underpinned by rapidly rising resource exports that reflect increased mining capacity following investment project completions. We expect the country’s output growth to reach 3.0% in 2014, followed by a 2.8% advance in 2015. The RBA assesses that real GDP gains will remain somewhat below trend over the next year or so.

NEW ZEALAND — Monetary conditions continue to tighten in New Zealand. The Reserve Bank of New Zealand (RBNZ) raised the official cash rate by 25 basis points to 3.5% following the monetary policy meeting on July 24th, 2014, making this the fourth consecutive increase. However, Governor Graeme Wheeler signaled that the RBNZ will likely take a break from further monetary tightening until the end of the year. Inflation continues to accelerate, reaching 1.6% y/y in the second quarter of 2014 up from 1.5% in the previous quarter, but still falling short of the central bank’s prior estimate of 1.7%. Increasing construction costs, net immigration and robust growth in household demand will continue to place moderate upward pressure on prices. We expect inflation to hover near the central bank’s mid-point target of 2% towards the end of 2014, at which time the RBNZ will likely resume its monetary tightening cycle. New Zealand continues to enjoy solid growth momentum. Following an expansion of 3.1% y/y in the first quarter of 2014, the country’s real GDP growth is expected to pick up, likely averaging 3.5% through 2014. Consumer spending momentum will likely be sustained in the near term, driven by strong confidence and continued labour market strengthening. The New Zealand dollar (NZD) has fallen 2.3% since July 24th, 2014, following Governor Graeme Wheeler’s statement describing the NZD’s strength to be unjustified and unsustainable in the long term.

Developing Asia
Currency Outlook

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

INDIA — The new budget has had little impact on the INR, despite its external deficit-positive pledge to consolidate the fiscal deficit and open up FDI channels. INR weakness has been consistent with higher US yields, which have to some degree offset strong debt-buying inflows. That we haven't seen a consistent INR appreciation suggests that the economic acceleration that appears to be underway may be driving a widening of the current account deficit and offsetting capital flows. This remains the key INR risk, and we believe USDINR will hit 63.00 by the end of Q4.

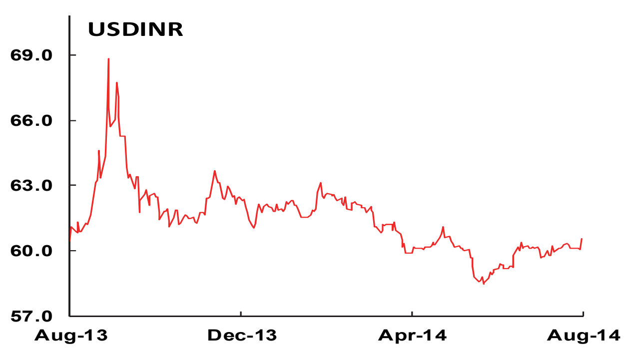
KOREA — KRW continues to be supported by the expanding current account surplus, which is keeping downside pressure on the won, despite the weakening in the currency in mid-July. Domestic demand weakness has been more sustained than expected, and the government has enacted a stimulus to address the matter by putting some degree of pressure on the Bank of Korea to ease policy. We expect that a pickup in domestic demand, and higher US yields, will eventually push a move higher in USDKRW in H2 of this year, and target 1040 by Q4.

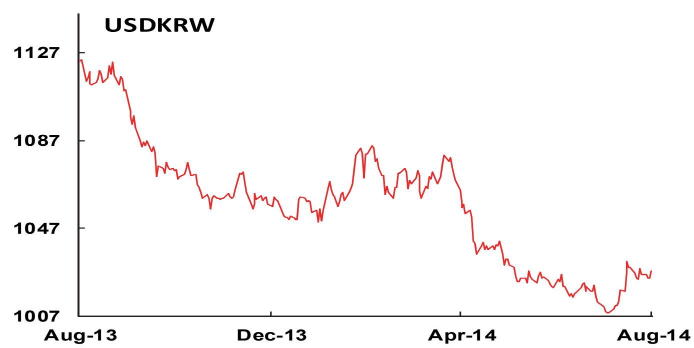
THAILAND — Recent data has shown that Thailand's post-coup economic recovery remains nascent. This has left the current account buoyant as import demand remains restrained by sluggish domestic demand. Bond inflows, on further monetary easing risk and solid yield pick-up, have been the key driver of THB strength in July. When the economic 'restart' takes hold, we expect significant THB-negative current account flows to push USDTHB higher towards our end of year target of 33.50.

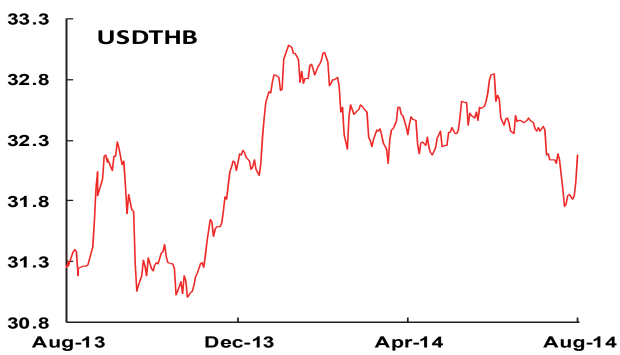
INDONESIA — Positive sentiment boosted foreign buying of Indonesian assets as it became evident that Joko Widodo was headed towards a presidential victory, reversing outflows caused by the prospect of a less market-friendly winner. Though USDIDR has moved away from our end of year target, we expect the lack of significant economic reform for the duration of 2014 to imply a still wide current account deficit, with less accommodative funding conditions on the back of higher US yields to drive USDIDR back to our Q4 target of 12000.

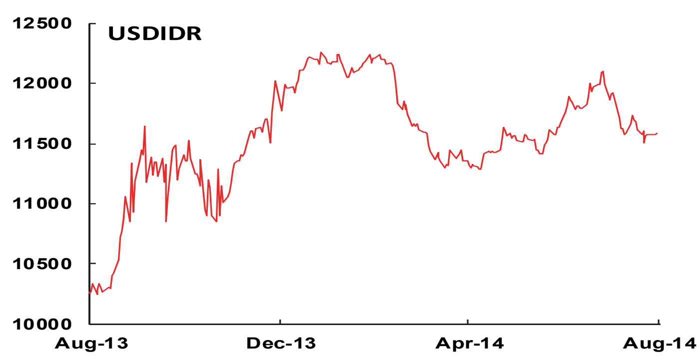
Currency Trends

FX Rate	Spot 31-Jul	14Q1a	14Q2a	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
USDINR	60.6	59.9	60.2	62.0	63.0	63.3	63.5	63.8	64.0
USDKRW	1028	1065	1012	1030	1040	1038	1035	1033	1030
USDTHB	32.2	32.4	32.4	33.0	33.5	33.6	33.8	33.9	34.0
USDIDR	11580	11361	11875	12000	12000	11900	11800	11700	11600









Developing Asia
Fundamental Commentary

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

INDIA — India's economic growth outlook is recuperating as indicated by improved high-frequency indicators, such as purchasing managers' indices for the manufacturing and services sectors, as well as industrial production volumes. Indeed, with the new BJP government pledging to prioritize economic reforms and growth revival, business sentiment is getting a boost. The government's first budget, unveiled on July 10th, focuses on simplifying the tax system, rationalizing the country's subsidy programme, attracting higher foreign direct investment, and boosting infrastructure spending. We expect the country's real GDP expansion to reach 5.2% this year (up from 4.6% in 2013) and 5.7% in 2015. Indian inflationary pressures eased in June with the whole-sale price index registering a 5.4% y/y increase compared with 6.0% gain the month before. Meanwhile, consumer price inflation slowed to 7.3% y/y from 8.3%. We expect price gains to close the year near the current levels. Nevertheless, the potential adverse impact on food prices resulting from drought-like conditions caused by the El Niño weather phenomenon is a major risk factor for the inflation outlook. The Reserve Bank of India has noted that conditional on enduring disinflation further monetary tightening is not anticipated; the policy repo rate has been at 8.0% since January. We expect lower inflationary pressures to allow cautious monetary easing in early 2015.

KOREA — South Korean economic momentum remains intact despite a slight deceleration in output growth over the past few months; the country's real GDP expanded by 3.6% y/y in the second quarter of 2014 following a 4.0% gain in the prior three months. We expect the South Korean economy to grow by close to 3.5% through 2014-15. To counterbalance slowing growth, the government unveiled a US$40 billion economic stimulus package on July 24th that aims to underpin domestic demand, particularly business spending, in order to complement robustly growing export sector. South Korean inflation remains low with consumer prices rising by 1.7% y/y in June, recording a gradual pick-up from the average pace of 1.3% over the prior six months. Near-zero producer price inflation 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 and monetary policy outlook: the Bank of Korea's policymakers assess that while the gap is getting smaller, its "pace of narrowing will be moderate". We expect prices to climb gradually in the coming months, with inflation closing the year slightly above 2% y/y, and further accelerating to around 2.5% by the end of 2015, thereby reaching the lower boundary of the 2.5-3.5% target range. The central bank's monetary policy stance will likely remain accommodative in the coming months, with the benchmark rate set at 2.50%.

THAILAND — Recent improvements in confidence and leading indicators imply that Thailand's growth momentum will likely begin rebuilding in the coming months, as the military administration prioritizes an economic revival. We expect Thailand's real GDP gains to average 2% in 2014, followed by a pick-up to 4% next year. The recovery will be driven by exports and public outlays. The tourism industry is set to start regaining strength in the near term following the removal of a curfew that the army had imposed in May. The country adopted a temporary constitution in July, while the military aims to appoint an interim government by October. Inflation remains manageable; the headline consumer price index increased by 2.4% y/y in June, recording a modest deceleration from prior months on the back of price controls implemented by the military administration. We expect inflation to hover near 2½% y/y through 2015. Given the moderate inflationary pressure in the economy, combined with subdued, yet recovering, economic momentum, the Bank of Thailand (BoT) will likely maintain a loose monetary policy stance, keeping the benchmark interest rate at 2.0% for an extended period of time. We do not foresee any monetary easing as the BoT continues to highlight its independence and the military administration uses fiscal stimulus, particularly infrastructure spending, as a means to boost economic activity.

INDONESIA — Indonesia has completed an election cycle. Results following the July 9th presidential vote indicate that international investors' preferred candidate, Joko Widodo from the Indonesian Democratic Party-Struggle, will become the country's next president after winning 53% of the vote. Nevertheless, his opponent Prabowo Subianto of the Great Indonesia Movement Party has challenged the result; the Constitutional Court is expected to release its decision by August 21st. Tight monetary conditions will be maintained in Indonesia due to high, yet easing, inflationary pressure and the need to attract capital inflows to finance the country's current account deficit (of around 3% of GDP in 2014). We expect the central bank's reference rate to remain at the current level of 7.5% as further tightening is unwarranted due to gradually decelerating inflation, which reached 6.7% y/y in June compared with a 8.2% gain in January. A further drop is likely as the effect of the fuel subsidy cut in mid-2013 falls out of the consumer price index. Regardless, annual inflation will likely continue to exceed the central bank's target corridors, which are set at 3.5-5.5% for 2014 and 3-5% for 2015. We expect consumer price gains to ease gradually towards 5.5% y/y by the end of 2015; nevertheless, any further progress on the fuel subsidy reform would temporarily be reflected in inflation dynamics. The economy continues to perform relatively robustly, expanding on average by 5.7% y/y in 2014-15, virtually in line with the mean pace over the past 10 years.

Developing Americas
Currency Outlook

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

BRAZIL — Intervention by the BCB (US$80 billion in outstanding swaps), and high yields (5yr local yields near 11.5%) have kept the BRL supported, with many market players attributing the government support for the currency to an attempt to control inflation. While the International Monetary Fund's estimates pin the real's valuation at around 5%-15% "overvalued" from a real effective exchange rate perspective, we don't expect BCB to allow the real to materially weaken heading into the October 5th presidential elections, particularly with inflation near the top of the BCB range.

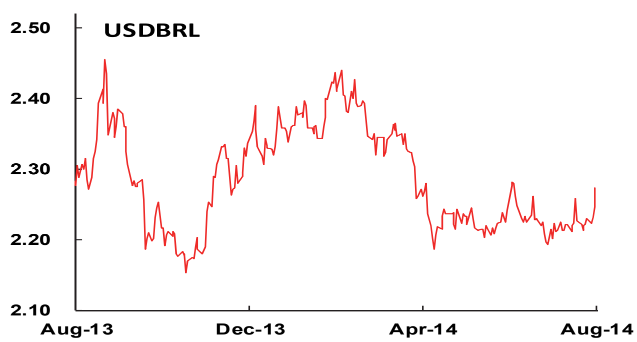
MEXICO — USDMXN has been trading in a fairly wide 12.81 – 13.15 range since the end of March, but recent geo-political concerns and uncertainty over the Fed's exit strategy have recently pushed to cross towards the top end of its range. The peso has had trouble gaining appreciating momentum, which we believe could be due to local assets seemingly offering high value (like much of the rest in EM), after a strong rally over recent weeks. In our view, the major positive shock, if any, would likely come from reactions to the energy reform approval.

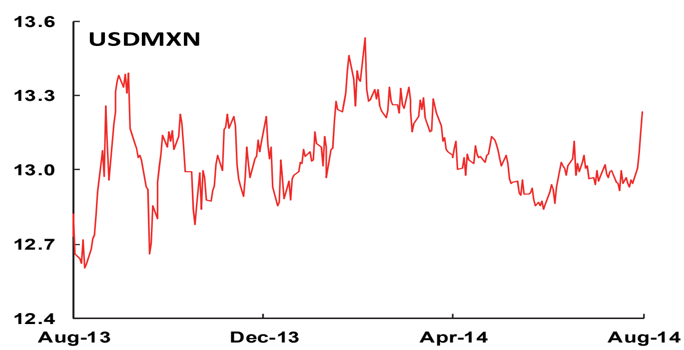
CHILE — After a very weak start to the year, the Chilean peso's USD cross has recently stabilized in a 545 – 556 range, although risks appear tilted towards testing the range to the top-side. The major drivers appear to remain concerns over the terms of trade impact of China's growth strategy change, and concerns over FDI flows weakening due to tax changes and the deteriorating cost structure of Chile's mining sector. In addition, market players expect the central bank to deliver additional 1-3 25 bps cuts.

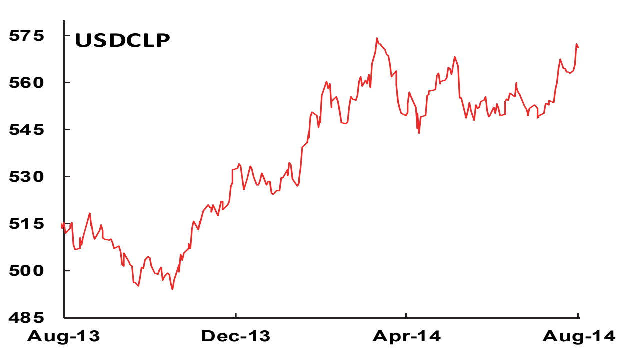
COLOMBIA — Fundamentally, the COP has a number of supporting factors, including a central bank in tightening mode, supportive capital flows derived from the GBI EM rebalancing, and strong growth. However, on July 28th, Moody's upgraded Colombia's credit ratings to Baa2 (equal to Brazil's), which failed to spark a rally in the peso, as global concerns over geo-political events and the US Fed's policy weighed on the peso. We believe this event highlighted how LATAM FX is still vulnerable to global sentiment shifts, which can overrule domestic fundamentals.

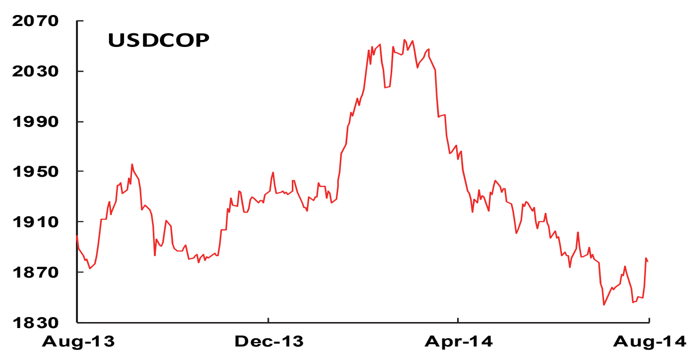
Currency Trends

FX Rate	Spot 31-Jul	14Q1a	14Q2a	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
USDBRL	2.27	2.27	2.21	2.40	2.40	2.48	2.48	2.50	2.50
USDMXN	13.2	13.1	13.0	13.1	13.2	13.3	13.2	13.2	13.4
USDCLP	571	549	553	555	565	570	572	575	575
USDCOP	1879	1971	1877	1955	1950	1965	1970	1985	1990









Developing Americas

Fundamental Commentary

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

BRAZIL — The Brazilian real (BRL) remains trapped in relatively narrow trading band of 2.20 – 2.30 per US dollar (USD). Increasing evidence of technical overvaluation is emerging in core emerging market currencies, placing the BRL on a defensive position and vulnerable to correction forces. Although interest rate differentials place the BRL in a comfortable zone (the short-term reference SELIC rate at 11%) to prevent speculative capital outflows, the rally in core floating Latin American currencies seems to be approaching a solid resistance point. The economic environment continues to show signs of weakness, prompting downward revisions to growth prospects for the 2014-05 period. Derivatives markets have begun to discount the likelihood of a rate cut (around 25 basis points) in the coming months; nevertheless, the weekly survey of economic projections conducted by the Brazilian central bank still highlights the broad-based expectation that the SELIC rate will close 2015 at 12%. We are of the view that the domestic exchange rate context is strongly influenced by the electoral cycle leading to the October presidential elections, where the incumbent President Dilma Rousseff will seek re-election. We are of the view that, irrespective of who is in power from January 2015 onward, profound structural and policy changes will be implemented to place the Brazilian economy on a sustainable growth trajectory. We expect USD/BRL to close the year at 2.40.

MEXICO — The Mexican peso (MXN), which was immersed in a stable trading environment, ranging between 12.80 and 13.10 per USD, over the past few months, reacted negatively to the spike in long-term US interest rates and stronger US economic data. A combination of exogenous (i.e. US economic and monetary developments) and domestic factors are influencing the Mexican currency market sentiment. The structural reform agenda (targeting the energy, telecommunication and utility sectors) continue to influence market expectations of long-term foreign capital inflows. Banco de México's unexpected decision to lower its short-term interest rate by 50 bps to 3% on June 6th served to shake up sentiment and has impact the local currency market. Since then, forward-guidance communication effectiveness has been subject to ongoing investor scrutiny. The current monetary context implies a negative real interest rate when incorporating the 12-month inflation rate ahead. The MXN has barely been influenced by the policy action; however, it has prompted market participants to believe that the current economic environment is weaker than originally anticipated. Given the vast foreign holdings of Mexican short-term government securities, any unexpected US monetary shift in favour of USD assets may prolong the MXN defensive position. On the economic growth front, we estimate Mexican real GDP to expand by 2.7% y/y in 2014 as the economy begins to pick up momentum in the second half of the year.

CHILE — The hitherto stable Chilean currency environment has been unsettled by monetary policy developments in the US and increase global risk aversion linked to global geo-political risks despite positive trends in relevant export commodities and ongoing strength in Asia/Pacific markets. The CLP broke through the 550-570 range against the USD which was in place for the last three months. The domestic fundamental context has been adversely affected by decelerating economic activity (exacerbated by cyclical conditions in the mining industry and adverse tax reform effects), eroding terms of trade and higher headline inflation. The Chilean central bank eased monetary conditions recently on the assumption that price pressures are temporary and that they do not pose a threat for the 24-month convergence towards the 3% target, clearly favouring a pro-growth policy stance. Domestic consumption remains in gradual deceleration mode, while the positive impact from the monetary stimulus strategy will begin to be felt in the second half of the year. We have revised downward our estimate for GDP growth and we now expect the Chilean economy to expand by just 3% this year before accelerating to 4% in 2015. On the monetary front, the central bank has embarked on a stimulus phase with multiple and consecutive cuts in the policy-setting short-term interest rate. We expect that the monetary easing cycle has not been completed weighing on the CLP in the near term.

COLOMBIA — The Colombian peso (COP) has been in steady appreciating mode since February, prompting the central bank to increase the warnings of potential outright intervention. The country is experiencing a strong economic recovery following a major increase in GDP growth during the first quarter of the year (up 6.4% y/y). We estimate that the economy will expand near the 5% mark this year, the strongest performance amongst core Latin American peer countries. The monetary authorities have responded to this economic rebound with a decisive tightening of monetary conditions in an attempt to combat a potential deterioration in the inflation outlook; due to these developments, we see the central bank policy rate closing 2015 at 5%. The headline inflation rate, which reached 2.8% y/y in June, is estimated to remain within the 2-4% official target range set by the central bank. Moreover, the scheduled rebalancing of the benchmark emerging debt market indices to increase the Colombian share may also trigger a sudden injection of portfolio investment inflows which will exacerbate the strengthening bias of the COP. The recent sovereign debt rate upgrade by Moody's, which has kept a "positive" outlook on the country's Baa3 rating since July 2013, is yet another factor supporting the currency outlook. Finally, political developments in Colombia remain tied to the peace negotiation between the government and the insurgent groups operating in the country.

Developing Europe & Africa
Currency Outlook

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

Neil Shankar (416) 866-6781
neil.shankar@scotiabank.com

RUSSIA — The Russian ruble (RUB) continued to weaken against the US dollar (USD), retreating 4½% to 35.5 per USD over the past month – its worst performance since January. Amid a backdrop of escalating political tension, high inflation, lackluster economic growth and ongoing capital outflows, sentiment towards Russian assets also continued to sour, prompting the central bank to unexpectedly tighten interest rates on July 25th for the third time this year to 8% from 5.5% in March. Concerns about escalating sanctions should continue to weigh on the ruble, which is forecast to end the year at 35.6 USDRUB.

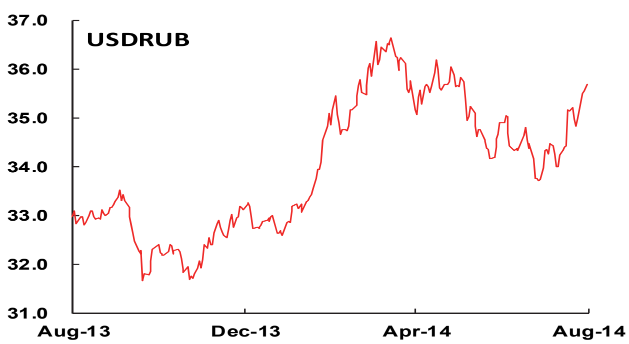
TURKEY — Since depreciating to a record low of 2.34 per USD in late January, the Turkish lira (TRY) continued to trim its losses. Tight monetary policy, renewed easing by the ECB and adequate global liquidity has helped stabilize the lira and supported demand for Turkish assets. However, the TRY could face a modest depreciation bias amid the risk of prolonged instability in Iraq and concerns of government influence in monetary policy. Authorities' pro-growth bias could further destabilize investor sentiment by slowing Turkey's external rebalancing and keeping inflation above its 5% y/y target. Turkey's reliance on short-term inflows and vulnerability to capital flight will continue to justify the large risk-premium on lira-denominated assets.

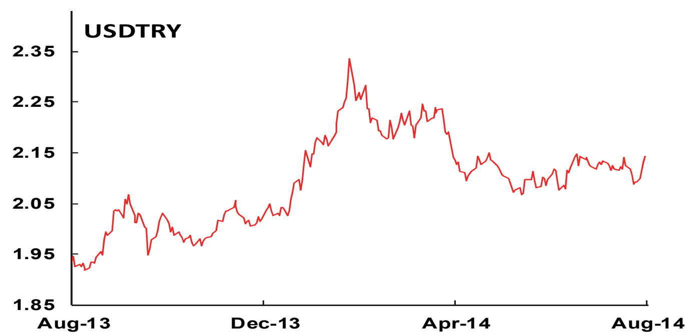
HUNGARY — The currency environment in Hungary remains fragile, underpinned by persistent spare capacity, lackluster inflation and political tension. However, markets seemed heartened by the central bank's decision to cut rates on July 22nd and end its two-year easing cycle, while suggesting it will keep borrowing costs unchanged until the end of 2015. The forint ended the month on a sour note, depreciating 3½% against the USD due to a dollar comeback. We expect the HUF will continue to face headwinds over the coming months due to the expectation of more hawkish Fed policy and continued euro strength.

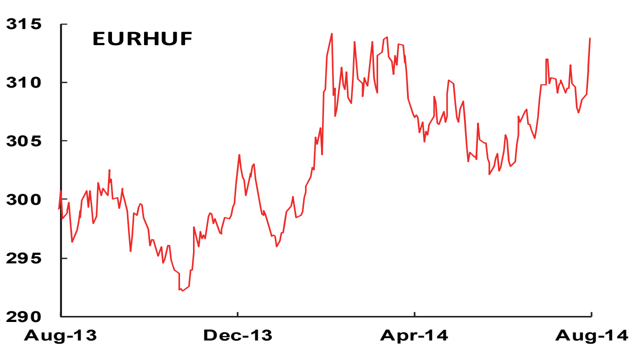
SOUTH AFRICA — The currency environment in South Africa remains vulnerable as impacts from the protracted labour disputes, which plagued the economy for the first half of the year, are now being realized. Nevertheless, a monetary tightening bias will provide support to the ZAR. We expect the USDZAR rate to close the year at 10.60.

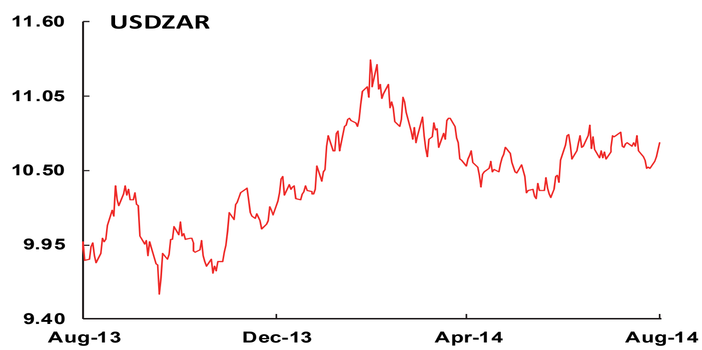
Currency Trends

FX Rate	Spot 31-Jul	14Q1a	14Q2a	14Q3f	14Q4f	15Q1f	15Q2f	15Q3f	15Q4f
USDRUB	35.7	35.2	34.0	36.2	36.5	36.7	37.0	37.2	37.4
USDTRY	2.14	2.14	2.12	2.17	2.20	2.21	2.23	2.24	2.25
EURHUF	314	307	310	305	304	303	302	305	307
USDZAR	10.7	10.5	10.6	10.7	10.6	10.6	10.5	10.5	10.4









Developing Europe & Africa
Fundamental Commentary

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

Neil Shankar (416) 866-6781
neil.shankar@scotiabank.com

RUSSIA — A moderate economic recovery has been observed in Russia over the past few months. This largely reflects a pick-up in industrial production and manufacturing activity, as the weaker Russian ruble has given a boost to exporters. Leading indicators have also shown signs of improvement, with the composite PMI edging back into expansionary territory for the first time since January. Nevertheless, we have lowered our real GDP growth forecast for 2014 to 0.3% amid a backdrop of increasing downside risks and escalating political tensions between Russia and the West following the downing of a Malaysian commercial flight over rebel-held territory in eastern Ukraine on July 17th. This has prompted the European Union to impose its widest-ranging sanctions yet, causing sentiment towards Russian assets to deteriorate and reverse much of the recovery witnessed in recent months. After reaching a near-term peak on July 8th, the benchmark Russian equity market MICEX index has declined by over 9½%, while yields on 10-year government bonds have risen 63 basis points to 5%. Trading at 35.5 against the US dollar at the time of writing, the ruble has virtually eliminating gains posted in May and June. Meanwhile, the Russian economy continues to suffer from the dual negative effect of subdued economic activity and persistent inflationary pressures, while investment demand remains tempered by low business confidence and limited access to long-term financing. Amid heightened geopolitical tension and a slower-than-expected deceleration in consumer price inflation in July, the central bank of Russia unexpectedly hiked its repo rate by 50 bps to 8.0% on July 25th in order to alleviate downward pressure on the ruble.

TURKEY — The prolonged monetary easing context in the US and Europe has been a critical driver of capital flows to emerging-market assets, and Turkey has benefitted from such trends. On July 17th, the Turkish Monetary Policy Committee opted to reduce its one-week repurchase rate for the third consecutive time by 50 basis points to 8.25%. Looking ahead, the need to correct the large current account deficit plus the growing expectation of a dovish central bank will likely re-instil a negative tone for the Turkish lira (TRY). While weak domestic demand and accelerating export growth should continue to support external rebalancing, authorities' pro-growth bias will slow progress and keep inflation above its 5% y/y target. This, combined with ongoing pressure from Prime Minister Recep Tayyip Erdogan for more aggressive monetary easing to stimulate growth ahead of the presidential elections in August, could temper the bank's credibility. As a result, Turkey's economic growth trajectory is expected to remain volatile and the country will continue to be highly susceptible to capital outflows. We expect real GDP will expand around a 2½% this year, well below its ten-year average of 4.9%. While authorities remain committed to limiting exchange rate volatility, the TRY could face a modest depreciation bias over the near term amid the risk of prolonged instability in Iraq and ongoing government influence. We estimate that the USDTRY will weaken to 2.20 by the end of 2014.

HUNGARY — Due to its high debt refinancing needs, Hungary remains one of the most vulnerable countries in central Europe and is highly susceptible to changes in global risk sentiment. Against a backdrop of lackluster inflation and tepid economic growth, the Hungarian central bank of lowered its policy rate by a larger-than-expected 20 bps on July 22nd, bringing the two-week deposit rate to a record low of 2.1%. We believe the central bank's aggressive two-year easing cycle has now come to an end. While Hungary's current account surplus and softening consumer prices gave the Monetary Council greater flexibility to reduce rates, critics have argued that the central bank's stance was too aggressive and its independence was undermined by political pressure during an election year. Heightened geopolitical risks have also increased volatility in investor sentiment over the past few months. The combative nature of Prime Minister Viktor Orban, as well as the country's new advertising tax and opposition to Jean-Claude Junker's bid for the European Commission President continues to strain Hungary's relationship with the EU, posing significant downside risks to the outlook. Meanwhile, Hungary's relatively pro-Russia stance during the Ukraine crisis has increased concerns of diplomatic isolation in the region, making it less effective in furthering its interest at the EU level. Hungary's real GDP advanced a surprisingly solid 3.5% y/y in Q1; however, we don't expect this momentum to last. Output is forecast to grow by roughly 2% this year from 1.1% in 2013, with the acceleration largely driven by increased government spending rather than a broad-based improvement.

SOUTH AFRICA — Monetary authorities in South Africa are increasingly concerned about inflation. The South African Reserve Bank increased the benchmark repurchase rate on July 17th by 25 bps to 5.75%, resuming the monetary tightening cycle that was initiated in January 2014 with a 50 bps hike. Inflation containment is taking priority over economic growth as the country's headline inflation continues to remain above the upper end of the central bank's 3-6% target range, measuring 6.6% y/y in June; this has been driven by persistent exchange rate depreciation and rising food prices. Growth continues to remain depressed as protracted labour disputes in the metals and mining sectors have affected industry prospects. Nevertheless, the recent end to both strikes will likely allow the economy to recuperate in the second half of the year following relatively weak economic performance in the first quarter — real GDP contracted by 0.6% q/q, the slowest rate since the 2009 recession. The Monetary Policy Committee expressed concern that wage settlements in the metals and mining sectors may set a precedent for wage demands more generally, causing further upward pressure on prices. Given the recent end of the metal workers strike, automobile assembly plants will likely resume production shortly, reducing pressures on the country's external sector. The current account deficit narrowed in the first quarter of 2014 to 4.5% of GDP.

Global Currency Forecast (end of period)

		2012	2013	2014f	2015f	2014f				2015f			
Major Currencies						Q1a	Q2a	Q3	Q4	Q1	Q2	Q3	Q4
Japan	USDJPY	87	105	109	113	103	101	104	109	110	111	112	113
Euro zone	EURUSD	1.32	1.37	1.30	1.24	1.38	1.37	1.34	1.30	1.28	1.26	1.25	1.24
	EURJPY	114	145	142	140	142	139	139	142	141	140	140	140
UK	GBPUSD	1.63	1.66	1.72	1.68	1.67	1.71	1.73	1.72	1.70	1.69	1.68	1.68
	EURGBP	0.81	0.83	0.76	0.74	0.83	0.80	0.77	0.76	0.75	0.75	0.74	0.74
Switzerland	USDCHF	0.92	0.89	0.95	1.02	0.88	0.89	0.91	0.95	0.98	1.00	1.01	1.02
	EURCHF	1.21	1.23	1.24	1.27	1.22	1.21	1.22	1.24	1.25	1.26	1.26	1.27
Americas													
Canada	USDCAD	0.99	1.06	1.10	1.11	1.11	1.07	1.08	1.10	1.12	1.12	1.11	1.11
	CADUSD	1.01	0.94	0.91	0.90	0.91	0.94	0.93	0.91	0.89	0.89	0.90	0.90
Mexico	USDMXN	12.85	13.04	13.22	13.36	13.06	12.97	13.07	13.22	13.28	13.15	13.19	13.36
	CADMXN	12.96	12.27	12.02	12.04	11.82	12.15	12.10	12.02	11.86	11.74	11.88	12.04
Argentina	USDARS	4.92	6.52	12.00	14.50	8.00	8.13	9.50	12.00	13.00	13.50	14.00	14.50
Brazil	USDBRL	2.05	2.36	2.40	2.50	2.27	2.21	2.40	2.40	2.48	2.48	2.50	2.50
Chile	USDCLP	479	525	565	575	549	553	555	565	570	572	575	575
Colombia	USDCOP	1767	1930	1950	1990	1971	1877	1955	1950	1965	1970	1985	1990
Peru	USDPEN	2.55	2.80	2.76	2.72	2.81	2.80	2.78	2.76	2.76	2.74	2.73	2.72
Venezuela	USDVEF	4.30	6.30	8.50	11.10	6.30	6.30	8.50	8.50	9.50	11.10	11.10	11.10
Asia / Pacific													
Australia	AUDUSD	1.04	0.89	0.92	0.89	0.93	0.94	0.94	0.92	0.91	0.90	0.90	0.89
China	USDCNY	6.23	6.05	6.10	5.92	6.22	6.20	6.16	6.10	6.06	6.01	5.97	5.92
Hong Kong	USDHKD	7.75	7.75	7.78	7.78	7.76	7.75	7.76	7.78	7.78	7.78	7.78	7.78
India	USDINR	55.0	61.8	63.0	64.0	59.9	60.2	62.0	63.0	63.3	63.5	63.8	64.0
Indonesia	USDIDR	9793	12171	12000	11600	11361	11875	12000	12000	11900	11800	11700	11600
Malaysia	USDMYR	3.06	3.28	3.30	3.20	3.26	3.21	3.28	3.30	3.28	3.25	3.23	3.20
New Zealand	NZDUSD	0.83	0.82	0.85	0.87	0.87	0.88	0.85	0.85	0.86	0.86	0.87	0.87
Philippines	USDPHP	41.0	44.4	44.5	43.0	44.8	43.7	44.3	44.5	44.1	43.8	43.4	43.0
Singapore	USDSGD	1.22	1.26	1.27	1.26	1.26	1.25	1.26	1.27	1.27	1.27	1.26	1.26
South Korea	USDKRW	1064	1050	1040	1030	1065	1012	1030	1040	1038	1035	1033	1030
Taiwan	USDTWD	29.0	29.8	30.6	30.2	30.5	29.9	30.4	30.6	30.5	30.4	30.3	30.2
Thailand	USDTHB	30.6	32.7	33.5	34.0	32.4	32.4	33.0	33.5	33.6	33.8	33.9	34.0
Europe / Africa													
Czech Rep.	EURCZK	25.1	27.3	27.0	25.8	27.5	27.5	27.2	27.0	26.6	26.3	26.0	25.8
Iceland	USDISK	128	115	115	118	113	113	113	115	116	117	117	118
Hungary	EURHUF	291	297	304	307	307	310	305	304	303	302	305	307
Norway	USDNOK	5.56	6.07	6.00	5.60	5.99	6.13	6.10	6.00	5.80	5.70	5.70	5.60
Poland	EURPLN	4.08	4.15	4.13	4.04	4.17	4.16	4.07	4.13	4.11	4.08	4.06	4.04
Russia	USDRUB	30.5	32.9	36.5	37.4	35.2	34.0	36.2	36.5	36.7	37.0	37.2	37.4
South Africa	USDZAR	8.47	10.49	10.60	10.40	10.53	10.64	10.70	10.60	10.55	10.50	10.45	10.40
Sweden	EURSEK	8.58	8.85	9.36	8.56	8.91	9.15	9.18	9.36	8.96	8.82	8.63	8.56
Turkey	USDTRY	1.78	2.15	2.20	2.25	2.14	2.12	2.17	2.20	2.21	2.23	2.24	2.25

f: forecast a: actual

International Economics Group

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

Erika Cain
erika.cain@scotiabank.com

Rory Johnston
rory.johnston@scotiabank.com

Tuuli McCully
tuuli.mccully@scotiabank.com

Estela Molina
estela.molina@scotiabank.com

Neil Shankar
neil.shankar@scotiabank.com

Canadian & U.S. Economics

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