# Foreign Exchange Outlook

The USD is strengthening broadly, supported by steadily improving fundamentals that are driving an ongoing reassessment of relative monetary policy among the advanced economies as well as a reconsideration of growth differentials vs. developing economies. These developments are weighing on global commodity prices within an environment of heightened geopolitical risk and rising volatility.

The USD remains in demand versus core peer currencies. The EUR and the JPY are poised to continue in depreciation mode. The GBP has stabilized following the Scottish referendum, and interest rate differentials are expected to support Sterling in the coming months. The CNY retains a revaluation tone against core currencies, aided by renewed stimulus measures by China.

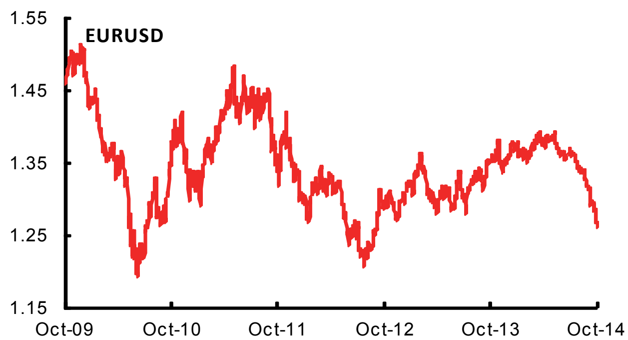
The RUB remains on the defensive, prompting intervention and capital control risks. The BRL became a casualty of election-related policy uncertainty and subdued growth. The MXN and INR will regain an appreciating tone once the Fed-induced volatility subsides and market participants favour reform-oriented economies. The ZAR, the CLP and the PEN are vulnerable to commodity-induced weakness.

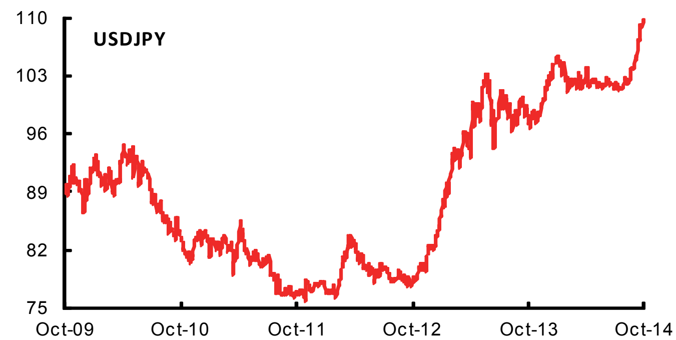
## Contents

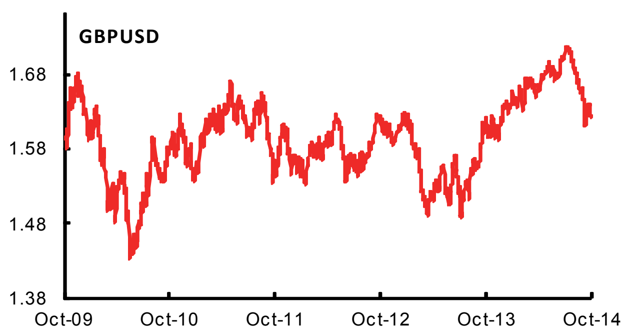
## Core Exchange Rates

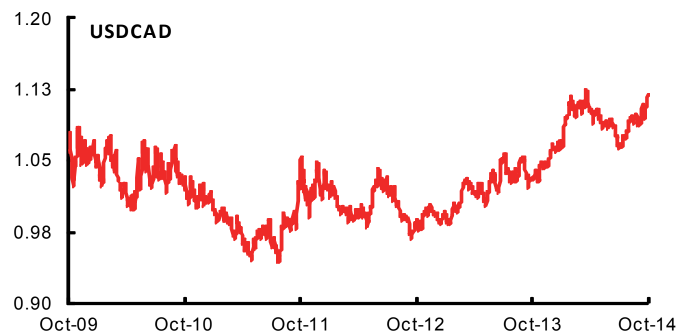
### Global Foreign Exchange Outlook

| October 1, 2014 | | Spot | 2014f Q1a | 2014f Q2a | 2014f Q3a | 2014f Q4 | 2015f Q1 | 2015f Q2 | 2015f Q3 | 2015f Q4 |
|---|---|---|---|---|---|---|---|---|---|---|
| EURUSD | Scotiabank | 1.26 | 1.38 | 1.37 | 1.26 | 1.25 | 1.24 | 1.23 | 1.22 | 1.21 |
| | Consensus* | | | | | 1.30 | 1.29 | 1.28 | 1.28 | 1.28 |
| USDJPY | Scotiabank | 109.1 | 103 | 101 | 110 | 109 | 110 | 111 | 112 | 113 |
| | Consensus* | | | | | 106 | 107 | 107 | 108 | 108 |
| GBPUSD | Scotiabank | 1.62 | 1.67 | 1.71 | 1.62 | 1.65 | 1.67 | 1.68 | 1.67 | 1.66 |
| | Consensus* | | | | | 1.66 | 1.66 | 1.65 | 1.64 | 1.64 |
| USDCAD | Scotiabank | 1.12 | 1.11 | 1.07 | 1.12 | 1.10 | 1.12 | 1.12 | 1.11 | 1.11 |
| | Consensus* | | | | | 1.11 | 1.11 | 1.12 | 1.12 | 1.12 |
| AUDUSD | Scotiabank | 0.87 | 0.93 | 0.94 | 0.87 | 0.87 | 0.86 | 0.86 | 0.87 | 0.88 |
| | Consensus* | | | | | 0.91 | 0.90 | 0.89 | 0.88 | 0.87 |
| USDMXN | Scotiabank | 13.46 | 13.06 | 12.97 | 13.43 | 13.24 | 13.33 | 13.20 | 13.24 | 13.36 |
| | Consensus* | | | | | 12.88 | 12.85 | 12.81 | 12.77 | 12.73 |






(*) Source: Consensus Economics Inc. September 2014

## Market Tone & Fundamental Focus

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Broad US dollar (USD) strength continues to set the tone in global foreign exchange markets. Interest and growth differentials in favour of US$-denominated tradable assets coupled with persistent weakness in the euro zone and decelerating activity in Japan have been key factors instilling a positive tone into the USD vis-à-vis all other global currencies, with the distinct exception of the Chinese renminbi (CNY). Escalating military tensions in the Middle East and Eastern Europe may generate, at times, bouts of high volatility in core currencies. Meanwhile, ongoing commodity price adjustments reflecting world supply and demand conditions are also shaping directional shifts in selected currencies.

In the Americas, currency trading dynamics continue to be shaped by the relentless appreciation of the USD on the back of a steady improvement in macroeconomic fundamentals and the broad-based expectations of higher US growth rates and interest rates in 2015. The pursuit of yield amongst developed-market portfolio investors compounds the attractiveness of the USD. The trade-weighted USD index (DXY) has gained 9.3% over the last five months. Given the consumer-intensive nature of the US economy, disinflation dynamics fuelled by currency strength may deepen in the new year, somewhat offsetting the intensification of demand-side pressures. We project that the US economy will expand by 3.2% in 2015 following an estimated 2.2% expansion for the current year. The Canadian dollar (CAD) has weakened in the midst of the broad based USD rally; this pressure will likely continue until there is some stabilization in the appreciating USD momentum. For the CAD, the economic environment should be supported by the weakness already sustained in the currency and a strengthening US economic backdrop; however, this is offset by the moderation in global growth dynamics and the tone emanating from the Bank of Canada.

The Mexican peso (MXN) remains subject to higher volatility caused by shifting monetary conditions in the US, profit-taking in local equity markets and broad-based USD strength, somewhat exacerbated by the relatively large foreign holdings of local-currency securities which may lead to bouts of capital repatriation flows. The MXN is one of the core emerging-market currencies to be affected by shifting monetary policy conditions in the US, once the Federal Reserve begins the process of gradual tightening by mid-year in 2015. In Brazil, the presidential elections (scheduled for October 5th and 26th) will be the dominant event affecting investor/creditor sentiment toward the Brazilian real (BRL); we maintain a bearish view for this year and next and have adjusted our growth and currency forecast accordingly. The Peruvian sol (PEN) will not be immune to the headwinds caused by a concerted move in favour of the USD, yet it is the Latin American currency experiencing the least volatility in relative terms; we have revised our Peruvian GDP growth forecast for this year and next taking into account a weakening investment context.

In Europe, prolonged economic weakness, deeper monetary policy accommodation and heightened geopolitical events are driving currency market sentiment. With the fundamentals and flows having both shifted more negatively against the euro zone economic environment, the euro (EUR) has lost significant ground. Looking ahead, the softening trend is likely to slow, yet the EUR is still vulnerable to downside pressure. The British pound (GBP) came under significant pressure in September as the Scottish vote for independence increased uncertainty; some of the downside pressure eased once the vote was rejected. However, in the context of broad USD strength, the GBP remains vulnerable in the near-term. Over the medium-term, the Bank of England (BoE) is likely to be the first of the major central banks to increase interest rates, which should support the GBP against both the EUR and the Japanese yen (JPY) allowing it to stabilize once the broad wave of USD strength eases. The Russian authorities may opt to introduce control mechanism in response to the bearish trend affecting the ruble (RUB) which edged the 40 per USD mark in late September.

Asian currency dynamics will be shaped by the opposing forces of a weaker JPY and a strengthening CNY. The Chinese currency has regained an appreciating trend, but questions loom over the health of the banking sector and whether stimulus delivered to date will be enough to maintain official growth projections. We expect the recent volatility in USDCNY to continue driving the yuan to close the year at 6.10 before reaching 5.92 per USD by the end of 2015. The weakening yen may help boost Japanese exports at a time when the economy is decelerating as a result of tax adjustments earlier in the year. Competitive realignment forces may deepen currency weakness in selected currencies within the Asia/Pacific region; indeed, the most vulnerable currencies to a Japanese-led competitive adjustment are the Taiwanese dollar (TWD) and to a lesser degree the South Korean won (KRW). The Australian (AUD) and New Zealand (NZD) dollars proved particularly vulnerable to currency weakness in September as the global growth outlook deteriorated and the Fed interest rate hiking cycle appeared to be nearing. This pushed volatility higher and threatened the carry trade. The Reserve Bank of New Zealand even moved to extremes and confirmed that they had intervened in markets.

## Canada

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### Currency Outlook

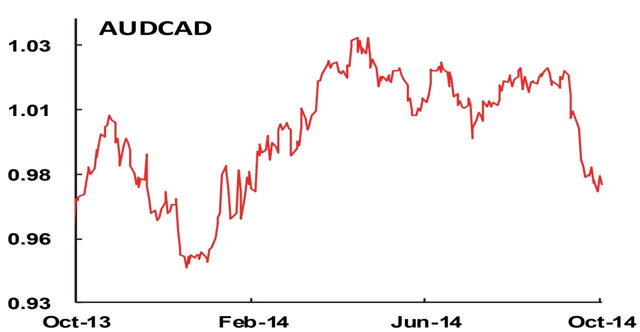
The CAD weakened almost 5% in the third quarter of 2014, entering October close to its year-to-date lows. The recent drivers of CAD weakness have included: 1) broad based USD strength, where in the third quarter of 2014 every primary currency lost ground, as the US economy outperformed and the Fed moved closer to interest rate hikes; 2) a deterioration in the outlook for global growth, with Europe moderating further, building concerns over the outlook for China and a still vulnerable Japan; 3) a few recent signs that Q3 growth in Canada has had a difficult start, including the July GDP release, which highlighted a disappointing level of growth at 0%m/m and 2.5%y/y; 4) soft commodity prices as the USD rallies and global growth outlook fades; 5) sentiment and technicals which turned increasingly USD bullish in the third quarter; and 6) the dovish tone emanating from the Bank of Canada. Based on purchasing power parity, CAD is now just 5% overvalued and closer to fair value than the other primary currencies.

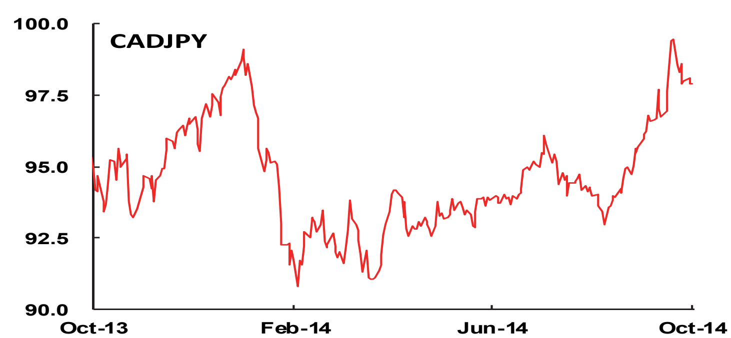
Entering October, the USD rally is strong and the CAD is likely to weaken further in the near-term on the back of it. However, the CAD is expected to outperform on its crosses and eventually stabilize against the USD as: 1) the Canadian economic backdrop will benefit from the already sustained weakening in the CAD combined with a US recovery; 2) flows into CAD have been stronger than expected, with the International Monetary Fund's release of Q2 2014 FX reserve data suggesting that managers are increasing their exposure to CAD, a trend we expect to continue as EUR depreciates; 3) oil prices are off their highs, however spreads are still favourable for Canada and exports into the US continue to rise; and 4) the Bank of Canada, who have been widely credited with supporting a weaker CAD, will also recognize that with inflation at 2.1% a weaker CAD risks accelerating inflationary pressures.

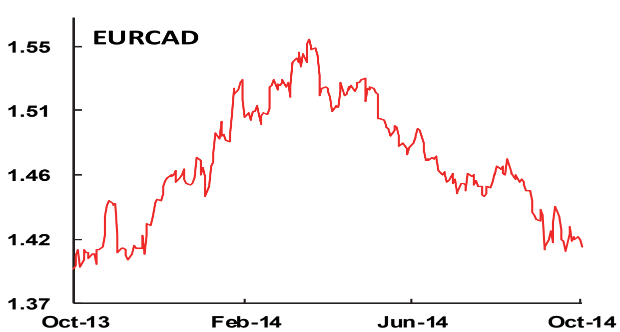
We expect the CAD to weaken further in the near-term against the USD, but then to retrace some of the most extreme weakness; while we expect CAD to gain against EUR and JPY.

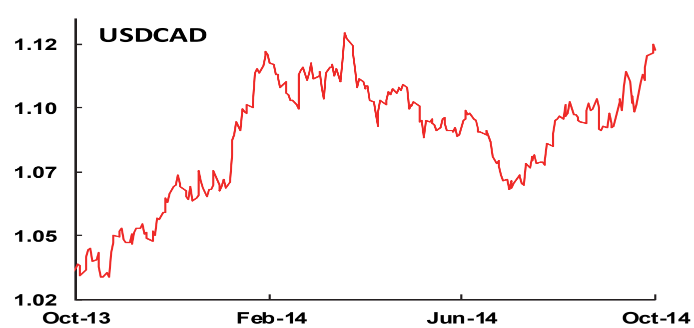
**Canadian Dollar Cross-Currency Trends**

| FX Rate | Spot 1-Oct | 14Q1a | 14Q2a | 14Q3a | 14Q4f | 15Q1f | 15Q2f | 15Q3f | 15Q4f |
|---|---|---|---|---|---|---|---|---|---|
| AUDCAD | 0.98 | 1.02 | 1.01 | 0.98 | 0.96 | 0.96 | 0.96 | 0.97 | 0.98 |
| CADJPY | 97.7 | 93.4 | 95.0 | 97.9 | 99.1 | 98.2 | 99.1 | 100.9 | 101.8 |
| EURCAD | 1.41 | 1.52 | 1.46 | 1.41 | 1.38 | 1.39 | 1.38 | 1.35 | 1.34 |
| USDCAD | 1.12 | 1.11 | 1.07 | 1.12 | 1.10 | 1.12 | 1.12 | 1.11 | 1.11 |



## United States and Canada

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### Fundamental Commentary

**UNITED STATES** — The US economy has regained broad-based momentum, with the recovery appearing more entrenched and sustainable. Second-quarter real GDP growth was revised higher to an annualized 4.6% q/q, and despite a few disappointing data reports, most recent indicators point to another solid output increase for the current quarter. 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 August reached their highest level in over eight years. Monthly job gains averaged 215,000 from February through August, helping to drive the unemployment rate toward a six-year low of just over 6%. Broader measures of unemployment have also improved, though alongside still weak wage gains are consistent with continued labour market slack. Consumer confidence in turn has trended up to cycle highs. US home sales and construction are gradually regaining momentum, supported by improving labour markets, a partial retracement of last year's mortgage rate rise, and a modest easing in lending conditions. Despite a stalling in industrial activity in August, production is running essentially at record levels, led by motor vehicles & parts, business equipment and energy products. US producers are benefitting from rising domestic and foreign sales, improved cost competitiveness and a well-diversified export base. A surge 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, point to a further acceleration in business investment in the coming months. The recovery in 2014-15 will also get a boost from a sharply reduced pace of fiscal restraint. Inflation trends remain well behaved on the back of excess capacity, still modest wage growth and the recent easing in pump prices.

**CANADA** — The Canadian economy is posting moderate growth averaging around 2½% y/y. Consumer spending remains reasonably buoyant. Supported by heavy discounting, motor vehicle sales in August set a new record for the month. Housing activity is also quite robust, with low mortgage rates maintaining affordability in the face of high home prices. However, consumer confidence and buying intentions have softened in recent months amid growing pessimism over labour market conditions. Monthly employment growth through August has averaged just 10,400, less than half the growth in the labour force population. Combined with limited pent-up demand (car sales and homeownership rates are at record levels), consumers are expected to be relatively cautious spenders in the year ahead. At the same time, exports and manufacturing shipments are showing steady signs of regaining momentum, with producers benefitting from strengthening US auto sales and residential construction and a more competitive currency. Export volumes as of mid-2014 had finally surpassed their pre-recession peak. As a result, Canada's merchandise trade balance has moved from a modest deficit to a modest surplus position this year. Resource-related activity remains relatively buoyant notwithstanding more muted commodity prices. At the same time, excess capacity combined with moderate sales growth continue to weigh on business hiring and capital spending plans, despite 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 drifted higher this year, reflecting rising food and energy costs, and the passthrough of a weaker Canadian dollar to a range of imported goods prices. However, persistent excess capacity, ongoing retail competition, soft wage gains and recent gasoline price declines are expected to contain both headline and underlying inflation around the mid-point of the Bank of Canada's 1-3% target range into next year.

### Monetary Policy Commentary

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**UNITED STATES** — We're anticipating a volatile Q4 when it comes to US monetary policy expectations. The Federal Reserve will conclude its asset purchase program in October. We think that market attention will then shift to speculation regarding when the Fed will engage in 'lift-off' and raise the policy rate from the zero bound. Policy officials are increasingly expressing discomfort with maintaining the policy rate at an emergency level when the economy is no longer in crisis. We expect that the Fed will move in Q2 of 2015 as an improving economy and solid labor market give it cover to take the initial steps towards policy normalization – with risks tilted to sooner.

**CANADA** — We think that the Bank of Canada (BoC) will lag the Fed with respect to policy rate increases both in terms of timing and extent. The Canadian economy looks like it will underperform the U.S. economy during H2014, adding to the BoC's confidence that it need not rush a change in the policy rate. The path, however, could be bumpy: inflation is likely to rise in year-on-year terms during Q4 as the full impact of the CPI spurt during H1 2014 factors into the year-on-year comps. Trade data are showing improvement too. We expect the BoC to look through the increase in CPI and to judge it as a temporary affair that will fade as next year begins. Markets, however, may not be as certain and volatility could rise.

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## Europe
### Currency Outlook

**EURO ZONE** — As of October 1st, the EUR has collapsed 9% since early May, when President Draghi initially warned of ECB action. Since then the fundamentals have deteriorated further, disinflationary pressures are building; economic momentum is stalling; and geopolitics are complicating the growth outlook further. Flows out of Europe have accelerated the EUR's slide and warn of building negative sentiment. By the end of September the CFTC reported the net short EUR position at -23bn and recent reserve data from the IMF confirms that FX managers have diversified away from the EUR. We hold a relatively modest year-end forecast, expecting the EUR to close the year at 1.25.

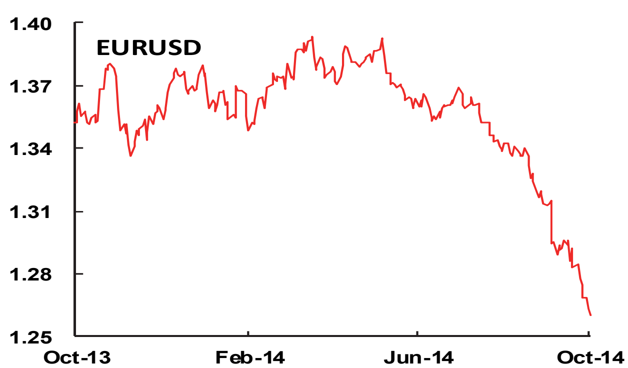
**UNITED KINGDOM** — In September, uncertainty around the Scottish election and a broad rally in the USD weighed heavily on the British pound (GBP). Sentiment deteriorated and the large net long position was sold off in September with the CFTC reporting a flat GBP position by month end. Technicals are providing little in terms of guidance. Fundamentally the BoE is likely to be the first of the G4 to enter its hiking cycle, accordingly, once the broad USD rally eases, the GBP should retrace some its recent losses. We expect the GBP to close the year at 1.65.

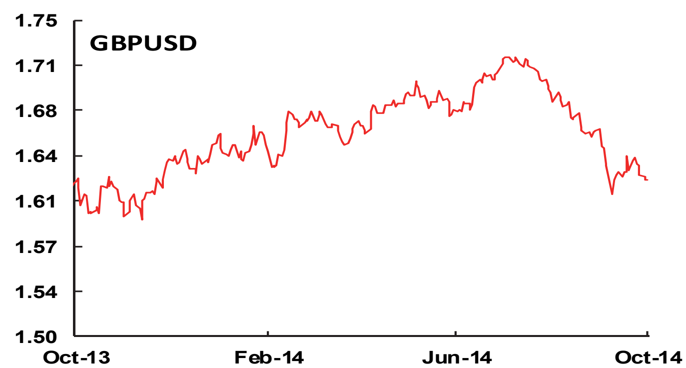
**SWITZERLAND** — The Swiss National Bank (SNB) is committed to the 1.20 EURCHF floor, which we expect to hold. The Swiss fundamentals have deteriorated, as growth has evaporated and the threat of deflation has failed to ease. In September EURCHF shifted lower, increasing the risk that the SNB will be forced to act aggressively to defend it. We hold a year-end target for EURCHF of 1.21, which drives USDCHF to 0.97.

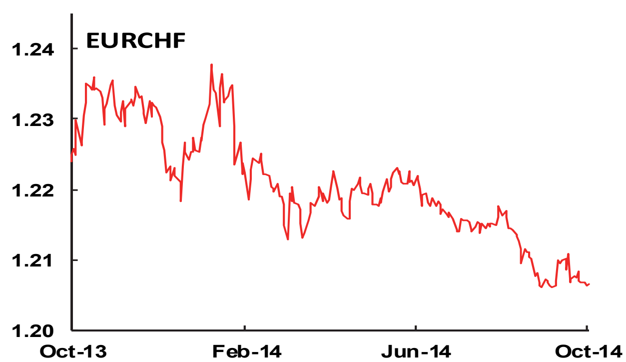
**SWEDEN** — At the end of the third quarter of 2014, the SEK was the worst performing primary currency year-to-date. The country faces a mixed fundamental outlook with ongoing risk of deflation and a central bank who expects to enter a hiking cycle by late 2015. Sentiment is generally bearish, with the mean consensus forecast expecting the currency to trend lower against the USD in 2015. Technicals also warn of a strong down trend. We expect SEK to weaken against the USD into year-end and hold a target of 7.20.

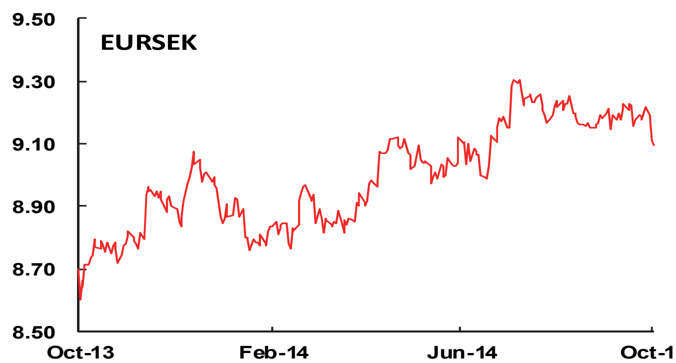
**Currency Trends**

| FX Rate | Spot 1-Oct | 14Q1a | 14Q2a | 14Q3a | 14Q4f | 15Q1f | 15Q2f | 15Q3f | 15Q4f |
|---|---|---|---|---|---|---|---|---|---|
| EURUSD | 1.26 | 1.38 | 1.37 | 1.26 | 1.25 | 1.24 | 1.23 | 1.22 | 1.21 |
| GBPUSD | 1.62 | 1.67 | 1.71 | 1.62 | 1.65 | 1.67 | 1.68 | 1.67 | 1.66 |
| EURCHF | 1.21 | 1.22 | 1.21 | 1.21 | 1.21 | 1.22 | 1.22 | 1.22 | 1.23 |
| EURSEK | 9.11 | 8.91 | 9.15 | 9.11 | 9.00 | 8.93 | 8.98 | 9.03 | 8.95 |



## Europe
### Fundamental Commentary

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**EURO ZONE** — Following a lackluster start to 2014, leading economic indicators and geopolitical tension point to little payback in the second half of the year. Euro zone economic sentiment dropped by 0.7 points to 99.9 in September – the lowest level in 10 months and below the long-term average of 100 – on the back of weaker consumer confidence and retail sector sentiment. Markit's flash PMIs also edged down, with the euro zone composite index falling to its lowest level this year, dampened by declines in both manufacturing and services activity. This comes amid extraordinarily low inflation, with euro area HICP in September advancing at a mere 0.3% y/y rate, the weakest performance in five-years and far below the European Central Bank's (ECB) target of close to 2%. Against the backdrop of persistently low inflation, moderating economic momentum, and subdued monetary and credit dynamics, the ECB announced further monetary stimulus at its latest meeting in September. It will begin its purchasing program of non-financial private sector asset-backed securities (ABS) and covered bonds this month in an attempt to support lending to the real economy and enhance the functioning of the monetary policy transmission. These initiatives are intended to complement and strengthen the Targeted Long-Term Refinancing Operations (TLTRO) announced in June. The ECB's first allotment of its TLTRO program in September was disappointing, with European banks borrowing €82.6bn out of a possible €400bn. Market participants will pay close attention for more details on the ABS and covered bond purchasing program after the Governing Council meets on Thursday, October 2nd.

**UNITED KINGDOM** — The UK economy continues to expand at an above trend pace, though there have been tentative signs of a mild cooling off into year-end. Manufacturing sector confidence has suffered somewhat and the stellar pace of hiring has softened. Thus far, service sector sentiment has remained elevated, though the more forward looking components of surveys suggest that this will probably not last. Inflation has slowed consistently over the past year, largely due to weaker energy and food prices. Meanwhile, the more domestically generated components of the CPI basket (i.e. core inflation) have been stable with a mild upward bias, a trend that we expect to continue as residual economic slack is eroded. We expect the first Bank of England rate hike to be delivered in February 2015, though the continued lack of wage inflation and downward surprises on CPI inflation could delay the move slightly. The UK public finances have continued to improve helped by lower benefits payments and stronger consumption tax receipts. There remains plenty of room for improvement in that department, particularly once wage inflation accelerates and boosts income tax receipts.

**SWITZERLAND** — The economic outlook in Switzerland has grown more uncertain alongside weaker growth prospects in the euro zone and heightened geopolitical uncertainty. Swiss real GDP growth stagnated during the second quarter, posting its weakest performance in two years, underpinned by a sharp drop in export demand from the European Union. Forward-looking indicators are also discouraging, with Switzerland's manufacturing PMI declining to a 3-month low in August, while its trade surplus plunged by more than 50% m/m to CHF1.4bn and the unemployment rate edged up. Meanwhile, inflationary pressures remain subdued, with CPI gains remaining close to zero in August (0.1% y/y) and the forward-looking KOF indicator of economic performance forecast to dip further below its long-term average of 100 in September. Amid a deteriorating economic outlook and weaker external conditions, the Swiss National Bank (SNB) reaffirmed its pledge to enforce a minimum exchange rate of CHF1.20 per euro and decided to keep its target range for three-month Libor unchanged at 0-0.25% at its quarterly monetary policy assessment on September 18th. The SNB highlighted that "the risk of deflation has increased again" and that the economic outlook has "deteriorated considerably". In the September inflation forecast, the SNB kept its 2014 inflation outlook unchanged at 0.1% y/y, but lowered its inflation projection to 0.2% y/y in 2015 (from 0.3% in the June report) and trimmed its forecast for GDP growth to "just below 1.5%" in 2014, down from its prior estimate of 2%. We continue to believe the SNB will maintain its exchange-rate cap throughout 2014 and 2015.

**SWEDEN** — Sweden's economic performance was better-than-expected during the first half of 2014, with real GDP growth for the second quarter revised up to 0.7% q/q from an earlier estimate of 0.2% q/q. However, the decline in the country's latest PMI, industrial production and new orders, and the NIER's economic tendency indicator signals a more moderate expansion in the second half of the year. The deterioration reflects a decline in manufacturers' confidence, alongside weaker expected demand from the EU and heightened geopolitical tension with Russia concerning Ukraine. Meanwhile, tighter banking sector regulations have tempered private service sector confidence. Retail sector and consumer confidence have ticked higher, supported by rising employment and real wages, though could fail to sustain momentum as political uncertainty continues to weigh on consumers' minds. Following the general election on September 14th, a coalition government between the Social Democratic Party (SAP) and the Green Party will likely take office, with SAP-leader Stefan Lofven as prime minister (pending an election in Parliament). However, its minority status and the rise of the far-right Sweden Democrats in parliament could undermine the new government's effectiveness and support for its budget, which will be presented in November and voted on in December. While consumer price inflation remains stubbornly low, better-than-expected retail sales growth, higher labour costs, and a weaker Swedish krona should help alleviate pressure on the central bank for a looser policy stance. We maintain our forecast for real GDP growth of around 2% in 2014, before modestly accelerating to roughly 2½% in 2015 as fears relating to the geopolitical risk and Sweden's political stability recedes. The Riksbank should begin a gradual monetary tightening cycle near the end 2015.

## Asia / Pacific
### Currency Outlook

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**JAPAN** — The JPY is entering October at six-year lows, having registered three consecutive months of decline in an environment of broad-based, fundamentally-driven USD strength. Traders have maintained a short JPY all year and during September this was relatively stable at about $12bn. Flows have been mixed, but are largely expected to shift increasingly negative as the final rules around the Government Pension Investment Fund drive international diversification. Technically, USDJPY is in the midst of a substantial leg higher. We expect an upward USDJPY trend with it closing this year at 109 and next at 113.

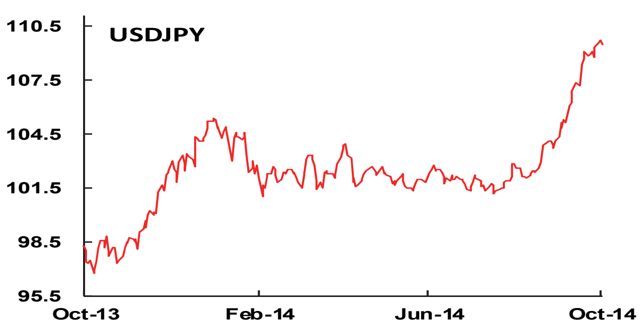
**CHINA** — Policymakers continued with the strategy of significantly increased fixing volatility, driving USDCNY's fixing substantially lower in early September following the release of a record monthly trade surplus. It is unlikely that we see continued buoyancy in the surplus, though the trajectory thus far this year underpins appreciatory pressure in the CNY. Rising US yields have had a minimal impact on the CNY, reinforcing its safe haven appeal should broad USD strength against Asia become extended. We target USDCNY at 6.10 by Q4 2014.

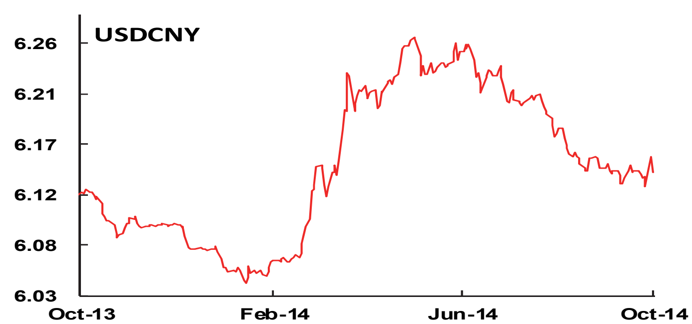
**AUSTRALIA** — The AUD fell 6.5% in September as global growth concerns weighed on commodity prices and the U.S. outlook pressured interest rate differentials. In addition rising volatility and a collapsing currency saw the more vulnerable long holders (and carry traders) close out positions. The CFTC reported that over September the net long AUD position had dropped from $4.5bn to $0.7bn by month end. At the beginning of October, the AUD was testing technical support at its year-to-date low of 0.8660; the risk is further near-term downside before it stabilizes. We hold a year-end AUDUSD target of 0.87.

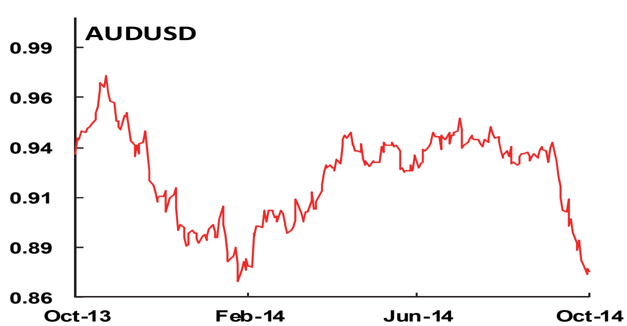
**NEW ZEALAND** — The NZD underperformed all of the G10 currencies in September, falling 6.7% as an aggressive RBNZ tone regarding overvaluation was reinforced by the acknowledgement of FX intervention. Market participant have shifted away from NZD risk, with the CFTC reporting a flattening in the net long NZD position as of the end of September. The downward technical trend is strong and warns of near-term downside risk. Once the broad period of USD strength eases, we expect NZD to stabilize, and much like AUD and CAD, retrace some of its more exaggerated losses. We hold a year-end target of 0.78.

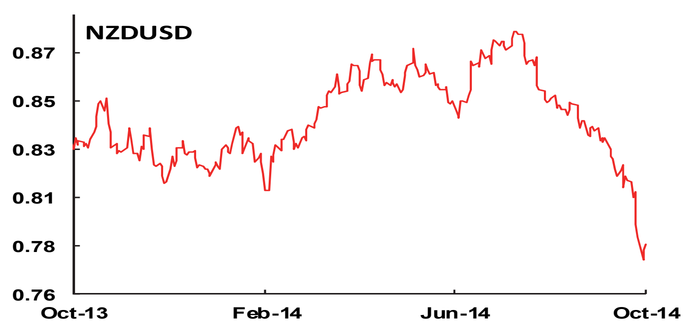
**Currency Trends**

| FX Rate | Spot 1-Oct | 14Q1a | 14Q2a | 14Q3a | 14Q4f | 15Q1f | 15Q2f | 15Q3f | 15Q4f |
|---|---|---|---|---|---|---|---|---|---|
| USDJPY | 109 | 103 | 101 | 110 | 109 | 110 | 111 | 112 | 113 |
| USDCNY | 6.14 | 6.22 | 6.20 | 6.14 | 6.10 | 6.06 | 6.01 | 5.97 | 5.92 |
| AUDUSD | 0.87 | 0.93 | 0.94 | 0.87 | 0.87 | 0.86 | 0.86 | 0.87 | 0.88 |
| NZDUSD | 0.78 | 0.87 | 0.88 | 0.78 | 0.78 | 0.77 | 0.80 | 0.81 | 0.82 |



## Asia / Pacific

**Fundamental Commentary**

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**JAPAN** — The Bank of Japan (BoJ) remains fairly confident about Japan's inflation and economic prospects. Nevertheless, BoJ Governor Kuroda has stated that the central bank would not hesitate to act if it assessed that achieving the 2% price stability target was under threat. The BoJ expects underlying inflation, which excludes the impact of the April 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, before approaching the 2% mark in 2015. Japan's headline inflation remains temporarily elevated: consumer prices rose by 3.3% y/y in August and we expect annual inflation to decelerate to 2½% by the end of the year. We maintain our view that the BoJ may provide additional stimulus by potentially extending or increasing its asset purchase program in the coming months. Japan's economic outlook remains challenging. Revised second quarter data show that real GDP contacted by 1.8% q/q (0.0% y/y) following a 1.5% q/q (2.7% y/y) advance in the first quarter. With elevated inflation, real wage growth remains in negative territory, thereby limiting household spending prospects. We expect the Japanese economy to advance by 1.6% in 2014 as a whole. Successful productivity-boosting structural reforms are vital for improving the longer-term outlook. Nevertheless, output growth momentum will likely decelerate to 1.2% in 2015 as these reforms will take time to be reflected in stronger activity.

**CHINA** — The Chinese economy remains on a path of gradual deceleration as it transitions toward a more consumer-based system. While various high-frequency indicators imply slowing in economic momentum in August, we maintain our view that the country's real GDP expansion will average 7.4% in 2014 as a whole, in line with the government's growth target of around 7½%. As a favourable economic environment is required to successfully implement the nation's multifaceted reform agenda, we assess that the likelihood of further targeted fiscal and monetary stimulus measures remains high in the near term. The property market poses the largest risk to China's outlook; a deeper housing market correction would have adverse impacts on the construction sector and related industries, as well as on household wealth. It would also worsen local government finances, which are fairly dependent on revenues from land sales to developers. Furthermore, property developers' potential financial difficulties and bankruptcies would negatively affect financial stability through weaker banking industry asset quality. Nevertheless, various factors mitigate the threat of a deeper crisis: Chinese banks have been raising capital lately to strengthen their balance sheets and the Chinese government has the means to provide support to the financial sector if needed. Moreover, consumer spending remains sound, driven by solid employment conditions and rising wages. We view that a controlled housing correction is an important step in the process of introducing adequate risk pricing into the economy as China prepares itself for interest rate liberalization and other financial reforms.

**AUSTRALIA** — Economic growth in Australia was relatively strong in the second quarter of 2014, with real GDP expanding by 3.1% y/y. Momentum slowed in the April-June period when compared to the prior three months – resulting in a mere increase of 0.5% q/q. The slowdown was expected as weaker commodity prices, notably that of iron ore, contributed to a downturn in the mining sector and lower investment activity. Further, the strong currency drove imports higher while bringing down the level of exports. Nevertheless, robust gains realized in the housing market have translated into higher consumer spending despite slow wage growth and the relatively high unemployment rate – 6.1% in August. We expect the country's output to increase by 3.0% y/y in 2014, followed by a 2.8% y/y advance in 2015. Monetary conditions in Australia are set to remain accommodative in the coming months with the benchmark cash target rate likely to be kept unchanged at 2.50%. Indeed, the Reserve Bank of Australia considers the current policy stance to be "appropriate" for supporting domestic demand; however, the central bank has emphasized that there is considerable uncertainty about the outlook given the number of forces working in different directions, such as the extent to which low interest rates can offset the 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 through 2015; we expect the headline rate to close the year at around 2¾% y/y, easing slightly from the 3.0% y/y advance in the second quarter.

**NEW ZEALAND** — New Zealand continues to enjoy solid growth momentum, with real GDP expanding by 3.3 % y/y in the April -June period of 2014. Remarkable growth in the services sector, particularly in the advertising, employment services and software development industries steered growth to a two-year high. Nevertheless, we expect the country's real GDP growth to pick up further, likely averaging 3.5% through 2014. Growth will continue to be driven by solid demand for the country's exports (mainly dairy, meat and wood products), persistent increases in construction levels and net immigration over the medium term. Re-election of the National Party's Prime Minister, John Key, for a third consecutive term following the September 20th general election will likely place New Zealand's public finances on track to return to a surplus by the end of the year. Inflation continues to accelerate gradually, reaching 1.7% y/y in July. During the September 11th monetary policy meeting, The Reserve Bank of New Zealand (RBNZ) indicated that it will take a break from the monetary tightening cycle initiated in March following a 100 basis point increase to the benchmark interest rate. Rising 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.

## Developing Asia
### Currency Outlook

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**INDIA** — The INR saw surprising stability in September, despite being pressured by rising US yields and the less than favourable trade dynamics of increased core (non-oil, non-gold) imports plus a loss of momentum in export growth. Portfolio investors remain buyers of Indian bonds and equities, providing funding of the external deficit, helping bolster the INR. We expect the INR to continue to be pressured by rising US yields and target 63.00 by Q4 2014.

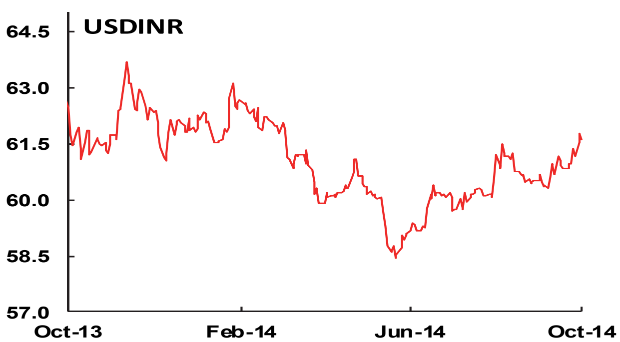
**KOREA** — USDKRW has moved higher in line with broad USD strength against Asia, underperforming the region during September. The external accounts however remain supported by still strong trade results which should see a seasonal pickup in Q3 and Q4, partially offsetting potential weakness in capital flows. The Bank of Korea's dovish stance suggests little duration risk for foreign portfolio investors as fixed income flows are currently matching last year's pace. We target 1060 in USDKRW by the end of the year.

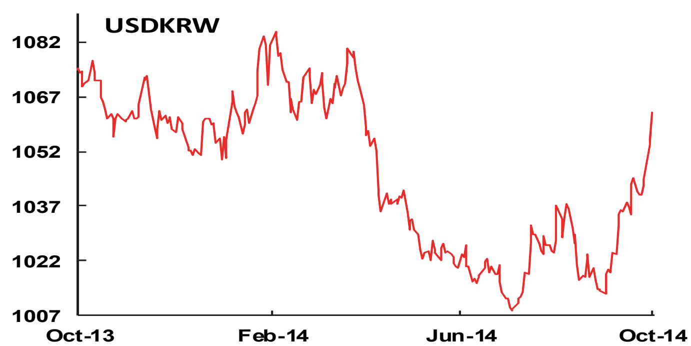
**THAILAND** — The delayed economic restart has continued to push import weakness and thus more THB-supportive flow across the trade accounts. While equity flows have trickled in in September, the more important foreign bond buying that drove THB strength in June and July has stabilized, and even receded to some degree, as US yields have risen over September. With the central bank likely to keep policy accommodative in the near term, we see current trends pushing USDTHB to our end of year target of 33.50.

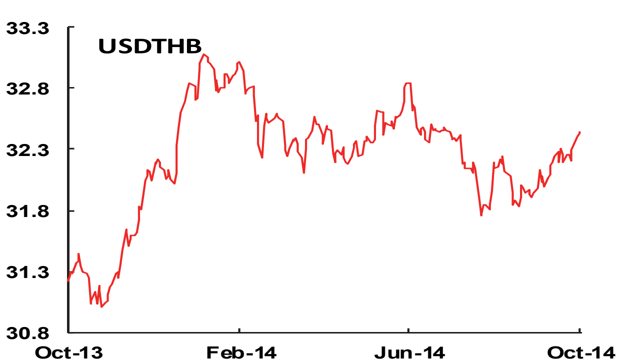
**HONG KONG** — The HKD has remained near the strong side of the HKMA's convertibility undertaking bolstered by solid equity performance from the Hang Seng into early September. Equity market weakness and rising US yields have pressured the HKD away from the strong side of its trading band towards the end of the month, but the relative stability in the HKD has been surprising. We target USDHKD at 7.78.

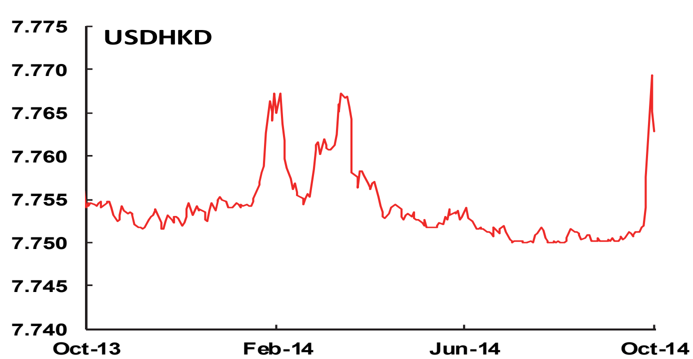
**Currency Trends**

| FX Rate | Spot 1-Oct | 14Q1a | 14Q2a | 14Q3a | 14Q4f | 15Q1f | 15Q2f | 15Q3f | 15Q4f |
|---|---|---|---|---|---|---|---|---|---|
| USDINR | 61.6 | 59.9 | 60.2 | 61.8 | 63.0 | 63.3 | 63.5 | 63.8 | 64.0 |
| USDKRW | 1062 | 1065 | 1012 | 1055 | 1060 | 1053 | 1045 | 1038 | 1030 |
| USDTHB | 32.4 | 32.4 | 32.4 | 32.4 | 33.5 | 33.6 | 33.8 | 33.9 | 34.0 |
| USDHKD | 7.77 | 7.76 | 7.75 | 7.77 | 7.78 | 7.78 | 7.78 | 7.78 | 7.78 |



## Developing Asia

**Fundamental Commentary**

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**INDIA** — Evidence of economic revival in India is accumulating. Real GDP growth picked up significantly in the second quarter of 2014 to 5.7% y/y from 4.6% in the January-March period, the fastest pace in nine quarters. The acceleration reflected stronger investment activity as private sector sentiment improved following the new government's promise to prioritize economic reforms and enhance the country's business environment. In addition, public sector spending was stepped up. Accordingly, we have revised our forecasts for India's 2014 and 2015 real GDP growth to 5.5% (from 5.2%) and to 5.8% (from 5.7%), respectively. Nevertheless, strong commitment to reform implementation by the new government is necessary in order to place India back onto a fast-growth trajectory in a sustainable manner. The Reserve Bank of India (RBI) will likely maintain monetary conditions unchanged in the near term as authorities focus on prioritizing inflation containment over supporting economic growth. The benchmark policy rate has been kept at 8.0% since January 2014. Lower inflationary pressures may lead to cautious monetary easing in early 2015. The consumer price index advanced by 7.8% y/y in August (down from 8.0% y/y in July), thereby staying below the RBI's 8% inflation target for January 2015. Meanwhile, whole-sale price inflation decelerated to 3.7%y/y in August from 5.2% a month earlier. While low global energy prices bode well for India, potential subsidy cuts create a major upside risk for the inflation outlook.

**KOREA** — Monetary conditions in South Korea are set to remain unchanged in the coming months as we consider the August benchmark interest rate reduction of 25 basis points to 2.25% to be a one-time action. South Korean monetary authorities maintain their view that the domestic economy's negative output gap will continue to narrow, yet only gradually. In this context, inflationary pressures will likely remain absent, assisted by near-zero producer price inflation (-0.2% y/y in August) and relatively low global energy prices. Consumer price inflation hovered at a low level of 1.1% y/y in September. We expect prices to climb only gradually in the coming months, with inflation closing the year at 1½% y/y and accelerating to around 2½% by the end of 2015, thereby reaching the lower boundary of the Bank of Korea's 2½-3½% target range. South Korea's economic momentum remains intact, yet domestic demand growth has eased slightly; revised data show that the country's real GDP expanded by 3.5% y/y in the second quarter of 2014 following a 4.0% gain in the prior three months. Nevertheless, high frequency sentiment indicators point toward an improved business environment for both the manufacturing and non-manufacturing sectors. We expect the nation's output growth to average close to 3.5% through 2014-15, outperforming the average annual pace of 3.2% recorded over the past five years.

**THAILAND** — Thailand's economic growth momentum will continue to rebuild gradually in the coming months as the military administration prioritizes an economic revival. We expect output gains to average 1.6% in 2014, followed by a pick-up to close to 4% next year. The recovery will be driven by net exports and public outlays, while improving private sector confidence bodes well for consumption and investment prospects. At the end of August, Thailand's military government selected a new cabinet consisting of various leading military figures. Prime Minister General Prayuth Chan-ocha has indicated that democracy will be restored by the end of 2015, yet uncertainty in this regard persists. In the meantime, the administration aims to focus primarily on structural reforms and the drafting of a new constitution. Inflation remains manageable; the headline consumer price index increased by 1.8% y/y in September, recording a deceleration from prior months on the back of price controls implemented by the military rule as well as lower food costs. We expect inflation to hover in the 2%-2½% y/y range through 2015. Despite the moderate inflation environment, the Bank of Thailand will likely keep the benchmark interest rate unchanged at 2% in the coming months. We do not foresee any monetary easing as the central bank continues to highlight its independence and the military administration uses fiscal stimulus, particularly infrastructure spending, as a means to boost economic activity. The most recent interest rate cut of 25 basis points took place in March 2014.

**HONG KONG** — An escalation of social unrest is clouding Hong Kong's near term outlook, particularly if the protests are prolonged and reflect adversely in business and consumer sentiment. Increasing local demonstrations in favour of introducing greater democratic representation in the territory will maintain pressure on the government to move ahead with its electoral reform agenda. Nevertheless, the process continues to be controversial as mainland China has indicated that it will continue to supervise electoral candidate appointments. Hong Kong's economic outlook has become somewhat more challenging in the near term. The territory's real GDP growth decelerated to 1.8% y/y in the second quarter of 2014, following a 2.6% y/y expansion in the January-March period, on the back of weaker tourism spending and domestic demand momentum. While tourism activity remained healthy prior to the escalation of the protests — arrivals increased by 12.3% y/y in the first eight months of the year — mainland China's anti-corruption campaign is reflected in Hong Kong's retail sales, particularly in the luxury goods segment. Exports will continue to pick up, yet private consumption will remain the main growth pillar as tight labour supply supports household income gains. The unemployment rate, at 3.3% in August, remains low by historical standards. Headline inflation has remained fairly persistent over the past few months, hovering at 3.9% y/y in August. We expect consumer price gains to ease slightly in the remaining months of 2014, with the headline inflation rate closing the year near 2½% y/y.

## Developing Americas

**Currency Outlook**

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**BRAZIL** — Presidential election polls, along with Fed-watching, continue to dominate Brazilian asset price action, with the uncertainty on both fronts leading the real to be the worst performing emerging market currency in the month of September (-8.4%; worst among the top 24 emerging market currencies). With electoral polls suggesting a second round run-off will be necessary after the October 5th vote, politically driven volatility may remain high until after the October 26th second round. If the pressure on the real remains, a key question will be whether additional central bank intervention is in the cards.

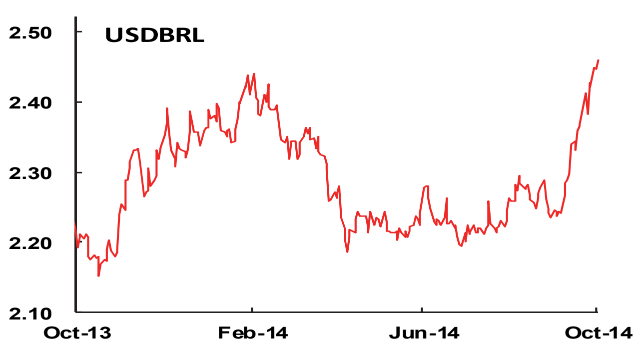
**MEXICO** — Despite its high beta nature, MXN held-up well in the current volatile environment, performing as a "middle of the pack" emerging market currency in September (13th out of 24), while being outperformed mostly by currencies with highly active central banks. The foreign holdings of Mexico's bonds are heavy, but have proven to be steady given much of the holdings are benchmarked to both developed and emerging market indices. However, if USD appreciation pressures remain, the MXN could be hit due to its use for hedging these holdings, and other less liquid regional currencies.

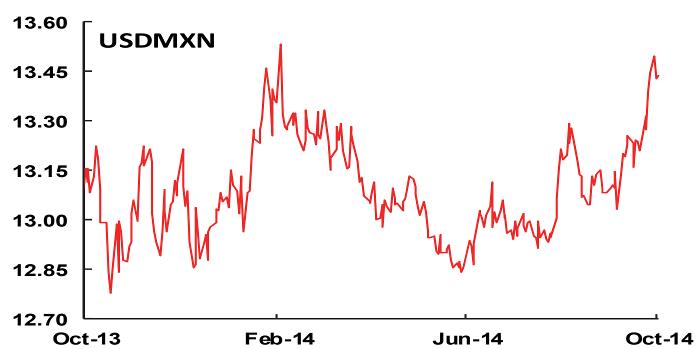
**CHILE** — USDCLP has stabilized somewhat after a steep drop to 600. The Chilean peso is arguably both the highest beta to the China story among the 5 major LATAM FX, and the most dependent on the price of a single commodity (in Chile's case copper). However, Chile's interest rates may be the most isolated of the LATAM economies from the move in US rates due to low foreign involvement in local markets, and the size of domestic pension funds. Netting these two, we believe that although the peso is vulnerable, its price action will be steadier.

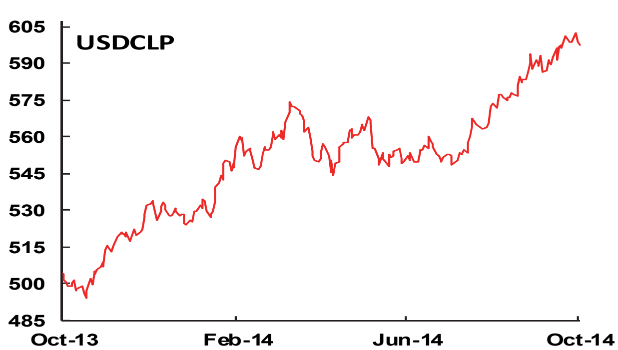
**PERU** — Economic growth deceleration, coupled with a widening current account deficit, eroding terms of trade, and increased global demand for US dollar assets, have intensified a temporary negative tone in the Peruvian sol (PEN). We estimate that the PEN will trade between 2.85 and 2.95 per USD in the next 6 months in line with market sentiment and consensus. The central bank will not hesitate to intervene to moderate FX market volatility.

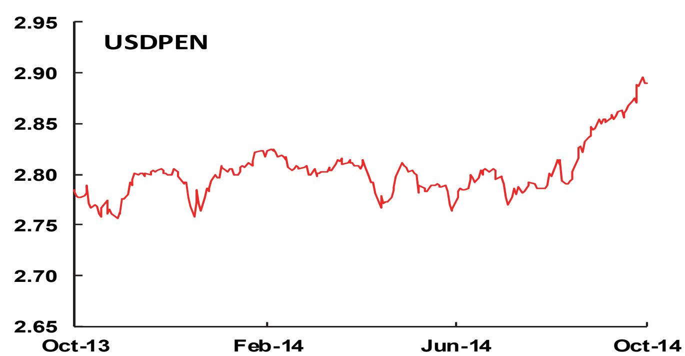
**Currency Trends**

| FX Rate | Spot 1-Oct | 14Q1a | 14Q2a | 14Q3a | 14Q4f | 15Q1f | 15Q2f | 15Q3f | 15Q4f |
|---|---|---|---|---|---|---|---|---|---|
| USDBRL | 2.49 | 2.27 | 2.21 | 2.45 | 2.45 | 2.50 | 2.55 | 2.55 | 2.60 |
| USDMXN | 13.44 | 13.06 | 12.97 | 13.43 | 13.24 | 13.33 | 13.20 | 13.24 | 13.36 |
| USDCLP | 597 | 549 | 553 | 598 | 591 | 594 | 596 | 598 | 600 |
| USDPEN | 2.89 | 2.81 | 2.80 | 2.89 | 2.88 | 2.85 | 2.90 | 2.85 | 2.90 |



## Developing Americas

### Fundamental Commentary

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**BRAZIL** — The presidential elections (on October 5th + runoff vote on October 26th) will be the dominant event affecting investor sentiment in the coming quarter. Irrespective of who is elected as the country's leader for the next four years, structural reforms and policy adjustments will be required to restore investor confidence and avert further deterioration of Brazilian credit ratings. Balancing the budget through an improvement in the primary surplus is at the core of such potential progress. Massive long-term capital investment will need to be deployed to revamp the country's transport, communication and electricity infrastructure. The world economy will provide a faster growth trajectory in the coming years, yet the cost of funds will tend to increase as the US Federal Reserve begins a process of interest rate hikes. The economy will emerge from technical recession in the second half of the year, yet faster growth momentum will be delayed until the new administration implements the needed policy adjustments. The Brazilian real (BRL) is vulnerable to depreciation headwinds in the coming 12 months, and we have adjusted our forecast accordingly. Congressional control will be a key factor to global market watchers, as most of the structural adjustment measures will need to be endorsed by legislative action. The BRL may be adversely affected by a potential credit rating adjustment: on September 9th, Moody's downgraded the outlook of Brazil's Baa2 rating to "negative".

**MEXICO** — The Mexican peso (MXN) remains subject to higher volatility caused by shifting monetary conditions in the US, profit-taking in local equity markets and broad-based USD strength, somewhat compounded by the relatively large foreign holdings of local-currency securities. Despite the US-led weakening of the MXN, the Mexican economy is well positioned to surprise with higher than anticipated rates of economic growth. Improving economic and labour market conditions in the US bode well for the outlook of Mexican manufacturing and auto exports. Moreover, the ongoing implementation of structural reforms is a magnet for foreign direct investment flows in key sectors of the economy such as upstream oil, natural gas pipelines, power generation and telecommunications. On the inflation front, we estimate that the 3% official target will not be met through the end of 2015, and that Banco de Mexico will begin adjusting policy-setting short-term interest rates upwards once the US Fed tightening cycle starts. We project a consumer price inflation rate of 4.2% y/y for this year and next. Our forecast also estimates that real GDP will grow by 2.7% in 2014 and expand by 3.7% next year, with a bias towards faster growth. Despite temporary bouts of currency market volatility, we project that the MXN will close the year at a rate of 13.2 per USD and modestly weaken in nominal terms toward 13.4 by the end of 2015.

**CHILE** — The Chilean peso (CLP) has been depreciating versus the USD for the last three months, breaching the 600 per USD mark at the end of September. The major factors affecting such negative market tone are the broad-based move in favour of US$-denominated tradable assets and a sharp deceleration in local economic activity caused by the combined effect of tax adjustments, eroding business confidence and the end of the mining investment cycle. Market participants didn't welcome the combination of increasing headline inflation (which reached 4.5% y/y in August) and steady monetary easing by the central bank (which reduced its policy-setting reference rate by 175 bps to 3.25% over the past 12 months). Looking ahead, we maintain a bearish short-term view, which will gradually reverse once regional currency markets incorporate in full the impact of increasing US interest rates. The Chilean economy will experience one of the lowest growth rates in 2014 (bordering the 2% mark) and will reaccelerate modestly toward a 3-3.5% rate in the next year. On the inflation front, we estimate that subdued domestic demand will guide the headline rate toward the official 3% target in 2015. Renewed directional weakness in copper prices (somewhat tempered by declining oil prices) also affected investor sentiment toward the CLP, a similar adverse market reaction also evidenced in many other commodity-sensitive currencies such as the Australian dollar and South African rand.

**PERU** — The Peruvian sol (PEN) is not immune to the headwinds caused by steady global demand of USD, yet it is the Latin American currency experiencing the least volatility. Well-timed and communicated central bank intervention is at the heart of such development; the central bank has US$65 billion in international reserves to intervene in moderating currency volatility. The PEN has depreciated from 2.76 per USD (late May) to 2.90. The Peruvian economy is poised to regain a fast growth track in the second half of the year following a marked deceleration in the first semester. The central bank is adjusting monetary conditions in accordance with improving inflation expectations. On the grounds of softening domestic demand and export activity, the monetary authorities believe that the headline inflation rate will converge towards the 2% rate by the end of 2015. Accordingly, the central bank opted to reduce its benchmark reference rate by 25 basis points to 3.5% on September 11th. Following a monthly deflation reading in August, 12-month consumer price inflation registered a 2.7% y/y rate. Peru's export sector continues to be battered by softening energy and metal prices. Another factor affecting PEN movements is the increased dollarization of local pension funds' (AFP) investment portfolios; indeed, last September the central bank announced the phased-in increase of the ceiling of foreign-currency investments by AFPs from 40% to 42% in the coming three months.

# Developing Europe & Africa
**Currency Outlook**

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**RUSSIA** — The Russian ruble has continued to reach new record lows on the back of board risk aversion from Western sanctions, stagnating economic activity and speculation of capital controls. On September 30th, the ruble plunged to 44.47 against a dollar-euro basket that prompted intervention by the Russian central bank. Under its new mechanism announced on September 16th, the bank said it conducted $581.4 million of ruble-swap overnight operation to defend the currency. At the time of writing, the ruble was trading at 39.7 per USD, a depreciation of roughly 20% year-to-date. Risks to our forecast of 36.5 per USD at year-end are on the downside.

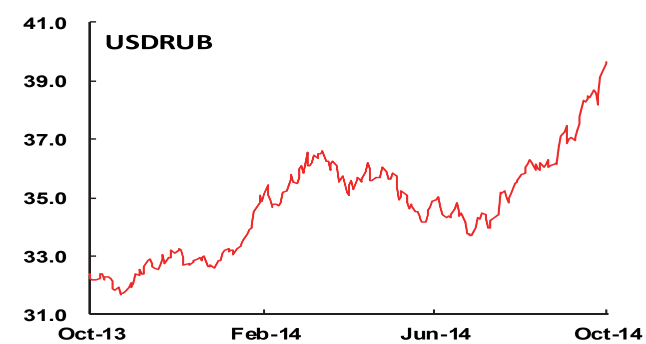
**TURKEY** — The Turkish lira has come under pressure from domestic economic concerns and expectations that the Fed is heading toward a monetary-policy exit. At the time of writing, the lira was at 2.29 per USD, its weakest level in eight months. This comes despite the recently announced efforts by the Turkish central bank to tighten liquidity. With financial markets likely to remain volatile over the near-term, Turkey's weak current account fundamentals and evaluated inflation will likely continue to weigh on the lira, which is forecast to end the year at roughly 2.19 per USD.

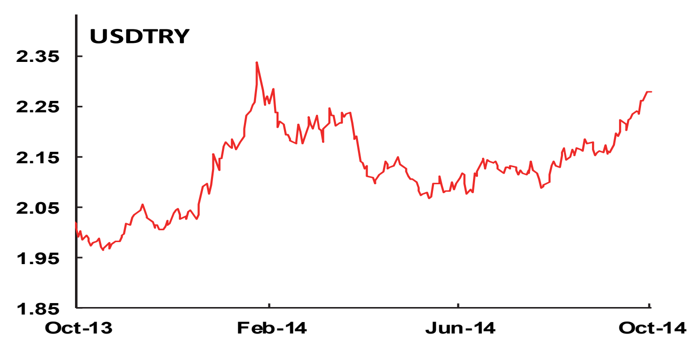
**POLAND —** Eastern European currencies have been impacted by the ECB's latest round of record monetary stimulus and deprecation of the euro. The Polish zloty is likely one of the most exposed to USD strength, with economic growth slowing in Q2, inflation turning negative in August, and rising expectations for monetary easing after the Governor of the National Bank of Poland said that rate cuts are "very probable". This presents downside risks to our zloty forecast of 3.2 per USD at the end of 2014. The zloty is expected to end-2015 at 4.13 against the euro.

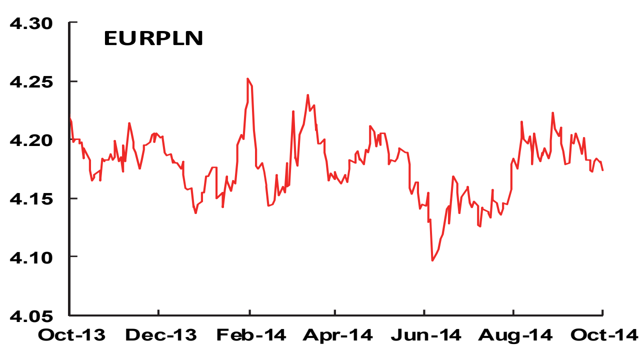
**SOUTH AFRICA** — The South African rand has depreciated sharply against the USD in September marking an end to a three-month period of relative currency stability. This stems from a mix of unfavourable domestic economic factors as well as a strengthening USD on the back of prospective monetary tightening by the US Federal Reserve in 2015 and softer commodity prices amid concerns of slowing momentum in China.

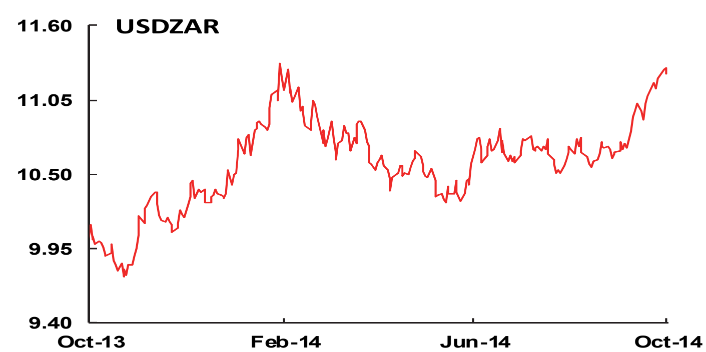
**Currency Trends**

| FX Rate | Spot 1-Oct | 14Q1a | 14Q2a | 14Q3a | 14Q4f | 15Q1f | 15Q2f | 15Q3f | 15Q4f |
|---|---|---|---|---|---|---|---|---|---|
| USDRUB | 39.7 | 35.2 | 34.0 | 39.6 | 36.5 | 36.5 | 37.0 | 37.1 | 37.1 |
| USDTRY | 2.28 | 2.14 | 2.12 | 2.28 | 2.19 | 2.21 | 2.23 | 2.24 | 2.25 |
| EURPLN | 4.17 | 4.17 | 4.16 | 4.18 | 4.13 | 4.11 | 4.08 | 4.06 | 4.04 |
| USDZAR | 11.24 | 10.53 | 10.64 | 11.29 | 10.80 | 10.70 | 10.60 | 10.53 | 10.50 |



## Developing Europe & Africa

**Fundamental Commentary**

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**RUSSIA** — Heightened geopolitical tension and Western sanctions continue to weigh heavily on economic activity and sentiment in Russia. According to official estimate, Russia's real GDP growth has come to a halt during the first half of 2014. This reflects a deceleration in private consumption alongside modest real wage gains and elevated inflation at 7.5% y/y in August – well above the Russian central bank's 5% target. Business confidence and investment has also been hit hard by the sharp rise in financing costs and the threat of harsher international sanctions. The ceasefire agreement between Ukraine, Russia and pro-Russian separatists has led to less conflict in eastern Ukraine, however, it remains fragile and international sanctions will likely remain in place through 2015. Meanwhile, despite some efforts to mend its relations with the West, Russia continues to coerce its way into Ukrainian policy. Russia and Ukraine have come to a tentative agreement to restart Russian gas supplies; however, the contract will likely prove temporary, as Russian authorities are unlikely to agree to a longer-term deal and concede its main non-military bargaining chip. The Russian government has also threatened to increase tariffs on Ukrainian imports if it implements its association agreement with the EU. As a result, financial market uncertainty will likely continue for the foreseeable future, while domestic demand will likely remain under pressure by high interest rates and soft external demand could dampen manufacturing. This combined with the government's pledge to create a bail-out fund to support companies affected by EU and US sanctions should also put increasing strain on government finances. Given these conditions, we have revised our Russian economic growth forecast down to 0.1% y/y in 2014 and to 1% in 2015 (from our prior estimate of 0.3% and 1.8%, respectively).

**TURKEY** — Second-quarter real GDP growth slowed to 2.1% y/y, down from an upwardly revised 4.7% y/y advance in the January-March period. This mainly reflects a sharp deceleration in government expenditure, which was further exacerbated by an ongoing moderation in household consumption and declining business fixed investment. However, net exports continued to provide a boost to real GDP growth, with export growth supported by a more competitive Turkish lira, while weaker domestic demand has dragged down imports. The pace of economic growth in Turkey will likely remain at bay through year-end as high inflation, elevated unemployment (9.9% in June, the highest since January 2011), and sluggish wage growth tempers household spending. Meanwhile, the recovery in business investment will likely be held back by prospects of US monetary tightening in 2015, geopolitical tensions and domestic policy uncertainty heading into the next general election in June 2015. Net exports are also not immune to the weaker growth outlook in the euro zone and the ongoing conflict in Iraq. Despite these challenges, the central bank of Turkey will likely keeps its key interest rate unchanged at 8.75%, as the weaker Turkish lira and elevated inflation (at 9½% y/y in August) support a tighter monetary policy stance. The bank's Monetary Policy Committee has warned that higher food prices have delayed the expected deceleration in inflation; however, weaker global commodity prices should limit upward risks. We believe that the Turkish central bank will keep its one-week repurchase rate unchanged through year-end 2014, before gradually easing rates as inflation subsides in 2015. Our real GDP growth forecast for Turkey remains at 2.8% in 2014 and 3.5% in 2015.

**POLAND** — The Polish economy has slowed due to recent tepid European performance. Risks to the outlook stemming from the Russia-Ukraine crisis have decreased as relations between the Russian and Ukrainian governments have stabilized, but it is not yet clear when we can expect low-level fighting and uncertainty to subside. Deflation has emerged as a issue of concern for Polish monetary authorities, as the headline inflation rate dropped to a 20-year low of -0.3% y/y in August 2014. The Narodowy Bank Polski (NBP) has an inflation target rate of 2.5% (+/- 1%) y/y and consumer price inflation had remained below that permissible band now for 19 consecutive months. Polish monetary authorities expect positive but persistently low inflation through 2015. Despite this, the overall economy maintains a strong momentum supported by solid fundamentals, with real GDP growth slowing slightly to 3.3% y/y in the second quarter of 2014 from 3.4% y/y in the first three months of the year; we expect the economy to see further gains of 3% and 3.3% in 2014 and 2015, respectively. Industrial output and construction activity both indicate a weaker third quarter, however, contracting by 1.9% and 3.6% y/y, respectively, in August 2014, down from very healthy levels at the end of the second quarter. Weaker output has negatively impacted the country's current account, which reached an all-time high surplus earlier in the year.

**SOUTH AFRICA** — The economic environment in South Africa remains challenging alongside lackluster job creation, a waning fiscal outlook and persistent current-account deficit. Successive waves of labour unrest and strikes as well as electricity outages have also dragged down growth in the mining, manufacturing and utilities sectors. Meanwhile, consumers remain squeezed by high unemployment at roughly 25% and rising food and fuel prices. Domestic challenges have put pressure on the rand, which has been exacerbated by a strengthening USD fuelled by expectations that the Fed is heading toward a monetary-policy exit, while commodity prices have been weighed down by a softer outlook in China. Market participants are also on edge following the announcement that the Governor of the South African Reserve Bank (SARB), Gill Marcus, will not seek another term. Uncertainty regarding her successor and the potential shift in monetary policy has spurred the fear of higher inflation, which increased to 6.4% y/y in August and has been tracking above the SARB's 3% to 6% target since April. The weaker rand and elevated inflation has increased expectations for a 25 basis point rate hike once the new governor takes office in November. Nevertheless, amid ongoing economic challenges, a rate hike will further impede a pick-up in domestic demand. This presents downside risks to our real GDP growth forecast at just over 1½% in 2014 and 2½% in 2015, as well as our exchange rate forecast for the rand at 10.8 and 10.6 per USD, respectively.

## Global Currency Forecast (end of period)

| | | 2012 | 2013 | 2014f | 2015f | 2014f | | | | 2015f | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Major Currencies** | | | | | | Q1a | Q2a | Q3a | Q4 | Q1 | Q2 | Q3 | Q4 |
| **Japan** | USDJPY | 87 | 105 | 109 | 113 | 103 | 101 | 110 | 109 | 110 | 111 | 112 | 113 |
| **Euro zone** | EURUSD | 1.32 | 1.37 | 1.25 | 1.21 | 1.38 | 1.37 | 1.26 | 1.25 | 1.24 | 1.23 | 1.22 | 1.21 |
| | EURJPY | 114 | 145 | 136 | 137 | 142 | 139 | 138 | 136 | 136 | 137 | 137 | 137 |
| **UK** | GBPUSD | 1.63 | 1.66 | 1.65 | 1.66 | 1.67 | 1.71 | 1.62 | 1.65 | 1.67 | 1.68 | 1.67 | 1.66 |
| | EURGBP | 0.81 | 0.83 | 0.76 | 0.73 | 0.83 | 0.80 | 0.78 | 0.76 | 0.74 | 0.73 | 0.73 | 0.73 |
| **Switzerland** | USDCHF | 0.92 | 0.89 | 0.97 | 1.02 | 0.88 | 0.89 | 0.96 | 0.97 | 0.98 | 0.99 | 1.00 | 1.02 |
| | EURCHF | 1.21 | 1.23 | 1.21 | 1.23 | 1.22 | 1.21 | 1.21 | 1.21 | 1.22 | 1.22 | 1.22 | 1.23 |
| **Americas** | | | | | | | | | | | | | |
| **Canada** | USDCAD | 0.99 | 1.06 | 1.10 | 1.11 | 1.11 | 1.07 | 1.12 | 1.10 | 1.12 | 1.12 | 1.11 | 1.11 |
| | CADUSD | 1.01 | 0.94 | 0.91 | 0.90 | 0.91 | 0.94 | 0.89 | 0.91 | 0.89 | 0.89 | 0.90 | 0.90 |
| **Mexico** | USDMXN | 12.85 | 13.04 | 13.24 | 13.36 | 13.06 | 12.97 | 13.43 | 13.24 | 13.33 | 13.20 | 13.24 | 13.36 |
| | CADMXN | 12.96 | 12.27 | 12.04 | 12.04 | 11.82 | 12.15 | 11.99 | 12.04 | 11.90 | 11.79 | 11.93 | 12.04 |
| **Argentina** | USDARS | 4.92 | 6.52 | 9.50 | 12.00 | 8.00 | 8.13 | 8.43 | 9.50 | 9.50 | 9.50 | 12.00 | 12.00 |
| **Brazil** | USDBRL | 2.05 | 2.36 | 2.45 | 2.60 | 2.27 | 2.21 | 2.45 | 2.45 | 2.50 | 2.55 | 2.55 | 2.60 |
| **Chile** | USDCLP | 479 | 525 | 591 | 600 | 549 | 553 | 598 | 591 | 594 | 596 | 598 | 600 |
| **Colombia** | USDCOP | 1767 | 1930 | 2035 | 2100 | 1971 | 1877 | 2025 | 2035 | 2040 | 2060 | 2075 | 2100 |
| **Peru** | USDPEN | 2.55 | 2.80 | 2.88 | 2.90 | 2.81 | 2.80 | 2.89 | 2.88 | 2.85 | 2.90 | 2.85 | 2.90 |
| **Asia / Pacific** | | | | | | | | | | | | | |
| **Australia** | AUDUSD | 1.04 | 0.89 | 0.87 | 0.88 | 0.93 | 0.94 | 0.87 | 0.87 | 0.86 | 0.86 | 0.87 | 0.88 |
| **China** | USDCNY | 6.23 | 6.05 | 6.10 | 5.92 | 6.22 | 6.20 | 6.14 | 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 | 7.77 | 7.78 | 7.78 | 7.78 | 7.78 | 7.78 |
| **India** | USDINR | 55.0 | 61.8 | 63.0 | 64.0 | 59.9 | 60.2 | 61.8 | 63.0 | 63.3 | 63.5 | 63.8 | 64.0 |
| **Indonesia** | USDIDR | 9793 | 12171 | 12500 | 11600 | 11361 | 11875 | 12188 | 12500 | 12275 | 12050 | 11825 | 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 | 0.78 | 0.82 | 0.87 | 0.88 | 0.78 | 0.78 | 0.77 | 0.80 | 0.81 | 0.82 |
| **Philippines** | USDPHP | 41.0 | 44.4 | 45.0 | 43.0 | 44.8 | 43.7 | 45.0 | 45.0 | 44.5 | 44.0 | 43.5 | 43.0 |
| **Singapore** | USDSGD | 1.22 | 1.26 | 1.27 | 1.26 | 1.26 | 1.25 | 1.28 | 1.27 | 1.27 | 1.27 | 1.26 | 1.26 |
| **South Korea** | USDKRW | 1064 | 1050 | 1060 | 1030 | 1065 | 1012 | 1055 | 1060 | 1053 | 1045 | 1038 | 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 | 32.4 | 33.5 | 33.6 | 33.8 | 33.9 | 34.0 |
| **Europe / Africa** | | | | | | | | | | | | | |
| **Czech Rep.** | EURCZK | 25.1 | 27.3 | 27.3 | 27.0 | 27.5 | 27.5 | 27.5 | 27.3 | 27.2 | 27.1 | 27.0 | 27.0 |
| **Iceland** | USDISK | 128 | 115 | 115 | 118 | 113 | 113 | 121 | 115 | 116 | 117 | 117 | 118 |
| **Hungary** | EURHUF | 291 | 297 | 304 | 307 | 307 | 310 | 311 | 304 | 303 | 302 | 305 | 307 |
| **Norway** | USDNOK | 5.56 | 6.07 | 6.35 | 6.00 | 5.99 | 6.13 | 6.43 | 6.35 | 6.30 | 6.20 | 6.10 | 6.00 |
| **Poland** | EURPLN | 4.08 | 4.15 | 4.13 | 4.04 | 4.17 | 4.16 | 4.18 | 4.13 | 4.11 | 4.08 | 4.06 | 4.04 |
| **Russia** | USDRUB | 30.5 | 32.9 | 36.5 | 37.1 | 35.2 | 34.0 | 39.6 | 36.5 | 36.5 | 37.0 | 37.1 | 37.1 |
| **South Africa** | USDZAR | 8.47 | 10.49 | 10.80 | 10.50 | 10.53 | 10.64 | 11.29 | 10.80 | 10.70 | 10.60 | 10.53 | 10.50 |
| **Sweden** | EURSEK | 8.58 | 8.85 | 9.00 | 8.95 | 8.91 | 9.15 | 9.11 | 9.00 | 8.93 | 8.98 | 9.03 | 8.95 |
| **Turkey** | USDTRY | 1.78 | 2.15 | 2.19 | 2.25 | 2.14 | 2.12 | 2.28 | 2.19 | 2.21 | 2.23 | 2.24 | 2.25 |

f: forecast a: actual

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