Currency

OUTLOOK

HSBC Global Research

Macro
Currency Strategy
January 2012

2012 – the euro is here to stay

Euro – here to stay

We have brought together four reports on the euro to give insights into the forces currently acting on the euro and some indications of where it may go next. In short we believe the euro is here to stay.

RMB – less appreciation

Lower inflation and a move close to equilibrium mean that RMB will see less appreciation and more volatility in 2012. Internationalisation will be the key focus of RMB policy. RMB is still more attractive than many peers and remains a core favourite.

Best and worst of 2012

We give our views on our most and least favourite currencies in 2012.

Long-term forecasts

We publish our long-term forecasts up to 2018.

Summary

Precious metals in 2012 (pg 35)

Our predictions for the precious metals market in 2012. We also present our updated forecasts for gold, silver and the PGMs.

Long-term forecasts (pg 37)

Given the problems of forecasting out even one year, many are understandably reluctant to venture a view for further out. However, we are aware that a number of our customers have a need for some indication of the likely FX market direction over a longer-term horizon for planning purposes. So again, with some trepidation, we publish these longer-term forecasts.

Dollar Bloc (pg 40)

AUD – Global contagion – We believe the backdrop for the currency has weakened, and with risk on-risk off dynamics being the main driver of price action, we retain our bearish bias on the AUD.

NZD – Can't escape RORO – The outlook for New Zealand economy looks relatively good, but as long as the RORO paradigm remains the dominant force in the market, global stresses will push the NZD lower.

Key events

Date	Event
12 January	BoE rate announcement
12 January	ECB rate announcement
17 January	BoC rate announcement
21 January	21st OECD Global Forum on Public Debt Management
24 January	BoJ rate announcement
25 January	FOMC rate announcement
25 January	World Economic Forum Meeting (to 29 Jan)
26 January	RBNZ rate announcement
7 February	RBA rate announcement
9 February	BoE and ECB rate announcements

Source: HSBC

Central Bank policy rate forecasts (end quarter)

	Last	Q1 2012(f)	Q4 2012(f)
USD	0-0.25	0-0.25	0-0.25
EUR	1.00	0.50	0.50
JPY	0-0.10	0-0.10	0-0.10
GBP	0.50	0.50	0.50

Source: HSBC forecasts for Fed funds, Refi rate, Overnight Call rate and Base rate

Consensus forecasts for key currencies vs USD

	3 months	12 months
EUR	1.310	1.325
JPY	76.68	78.01
GBP	1.532	1.576
CAD	1.031	1.010
AUD	0.970	0.995
NZD	0.758	0.789

Source: Consensus Economics Foreign Exchange Forecasts December 2011

Euro: here to stay

- Chapter 1: Lessons from the past
- Chapter 2: Euro resilience
- Chapter 3: Valuing EUR-USD
- Chapter 4: Where core-EUR might have been

Euro: Where next?

The euro has been at the centre of financial market developments since the sovereign debt crisis intensified anew in July 2011. Gyrating expectations about the prospects for crisis resolution have placed the euro as central to the "risk on-risk off" dichotomy that continues to drive financial market prices. When prospects for a long-term solution improve the markets move into "risk on" mode with rising equities, commodities, peripheral bonds and 'growth' currencies (such as EUR, SEK and AUD). When prospects for a solution fade, the markets move to "risk off" mode with falling equities, falling commodities, and rises in 'safe havens' such as US treasuries and defensive currencies (such as USD, JPY and NOK).

The early months of 2012 again look likely to be dominated by developments in the Eurozone, so here we have brought together four reports on the euro to give insights into the forces currently acting on the euro and some indications of where the euro may go next.

Our conclusions

Chapter 1: Lessons from the past

The political will to make the euro a long-term success is very strong and the response to crisis is to forge closer integration within the Eurozone, not less

Chapter 2: Euro resilience

The euro is likely to continue showing resilience as its external position is strong, and the speculative market is already very short

Chapter 3: Valuing EUR-USD

Unless one is prepared to assign a high probability to euro break-up and default, it is difficult to see EUR-USD weakening much in coming months

Chapter 4: Where core EUR might have been

The behaviour of CHF in 2011 is indicative of the violent currency appreciation that 'core' Eurozone countries might experience should the euro break up. This is likely to make Eurozone leaders even more determined to work towards a long-term solution

1. Lessons from the past

The long and winding road

The process of monetary integration in Europe has a long and chequered history. Here we give a brief outline of the developments from the Werner Report of 1970 to the current sovereign debt crisis and try to draw out some lessons from this for the current situation.

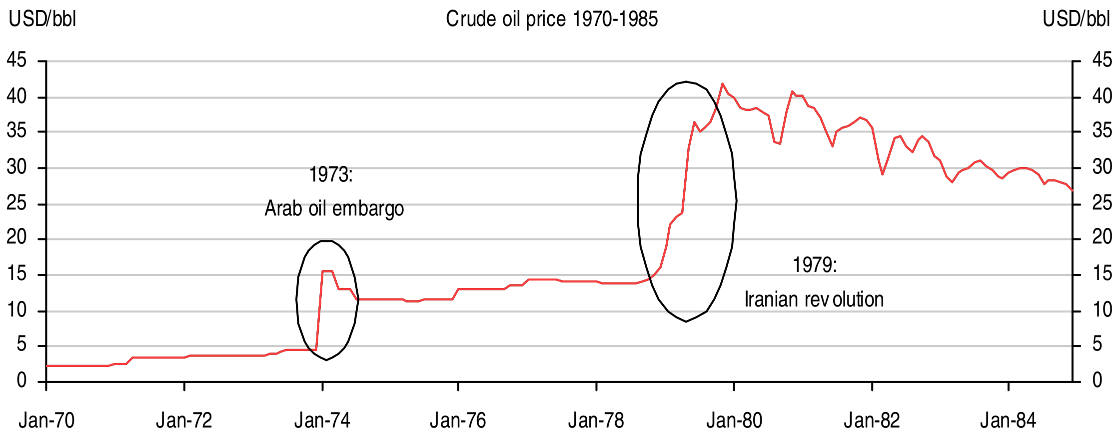
When the European Economic Community (EEC) was established by the Treaty of Rome in 1957, there was little focus on exchange rates and monetary integration, because the currencies of the six founding members (Germany, France, Italy, Belgium, the Netherlands and Luxembourg) were locked in the Bretton Woods system which pegged currencies to gold via the dollar. This changed as the Bretton Woods system came under increasing strain in the late 1960s with a revaluation of the Deutschmark and a devaluation of the French franc. Exchange rate volatility became even more important once the Bretton Woods system collapsed in the early 1970s

The idea of monetary integration in the EEC was seen as a natural consequence of the development of the common market, and an economic and monetary union (EMU) became a formal policy goal in 1969. The Werner Report of 1970 envisaged a three-stage process over 10 years that would end with the locking of exchange rates, or perhaps a single currency.

Oil price shock intrudes

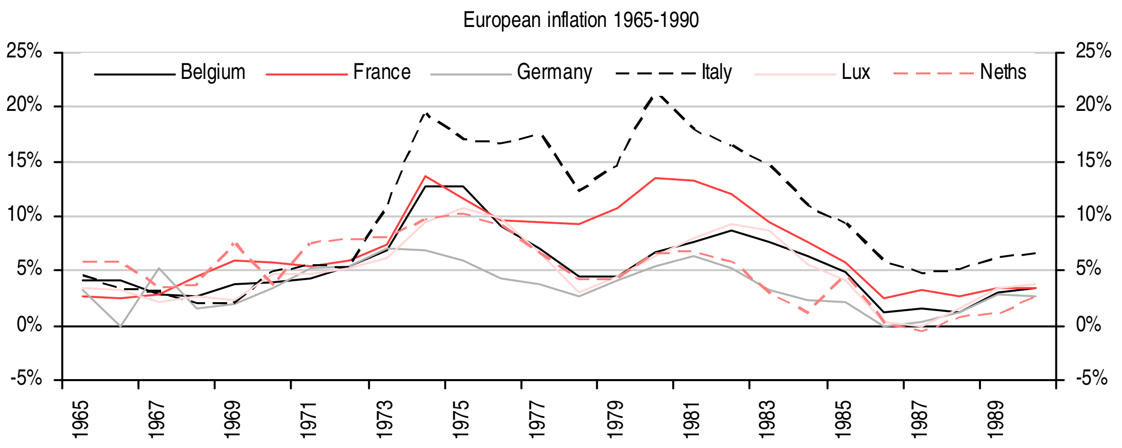
The Werner plan was never implemented, partly because of US objections, but mostly because of the impact of the oil price shock of 1973. The Yom Kippur war of October 1973 saw an Arab oil embargo against those in the West seen as supporting Israel and resulted in a fourfold increase in oil prices (chart 1).

1. Oil price jumps of 1973 and 1979



Source: HSBC, Thomson Reuters Datastream

2. Different policy responses to the oil shocks meant very different inflationary experiences



Source: HSBC, Thomson Reuters Datastream

With European economies heavily energy dependent, the oil price rise had a dramatic impact. Inflation rose and economic output fell. The inflationary response varied substantially across Europe with German inflation reaching 7% and Italian inflation reaching nearly 20% (chart 2).

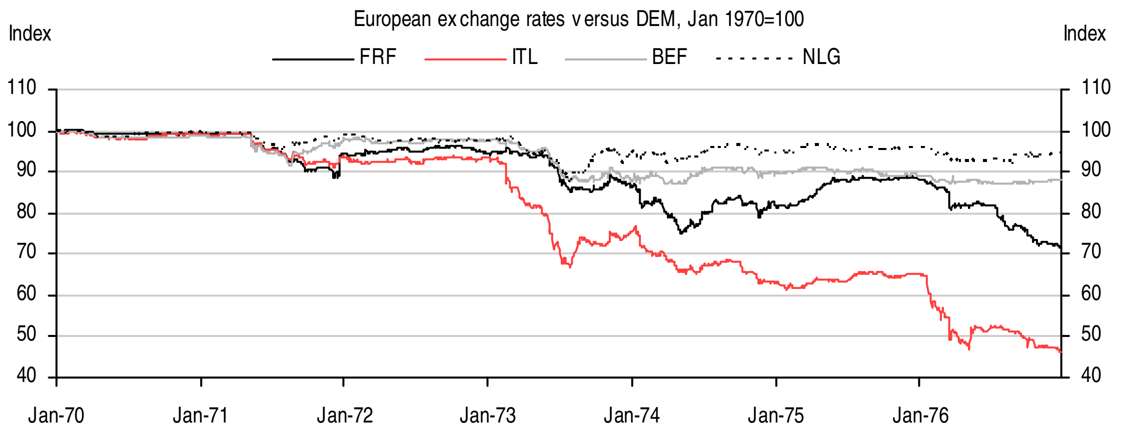
The wide divergence in inflation rates generated substantial exchange rate volatility (chart 3).

Between mid 1971 and the end of 1976 the Italian lira lost more than half its value against the DEM and the French franc fell by 30%. These moves came despite EEC attempts to limit exchange rate movements between European currencies (the 'snake' and the 'snake in the tunnel').

On no, not again...

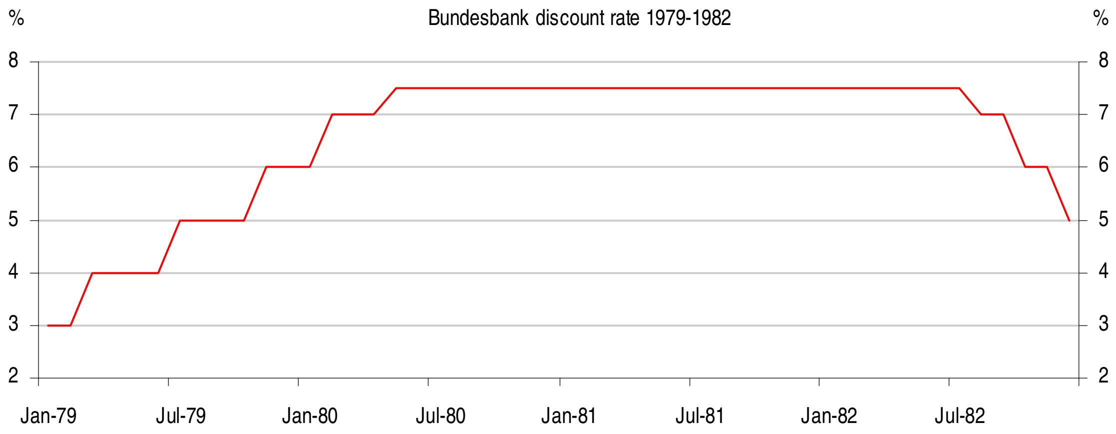
In the late 1970s European leaders tried again to create 'a zone of monetary stability' in Europe with the establishment of the European Monetary System (EMS). Central to this was the Exchange Rate Mechanism (ERM), which set tight limits for exchange rates (±2.25% except Italy, which was ±6%) around a central parity. Intervention and bilateral loans were to be used to keep currencies within their bands. The ERM was established in March 1979 and was immediately hit by the

3. The breakdown of Bretton Woods and the impact of the first oil shock saw large FX moves in Europe



Source: Bundesbank, HSBC

4. The Bundesbank tightened policy aggressively in response to the second oil shock



Source: Bundesbank

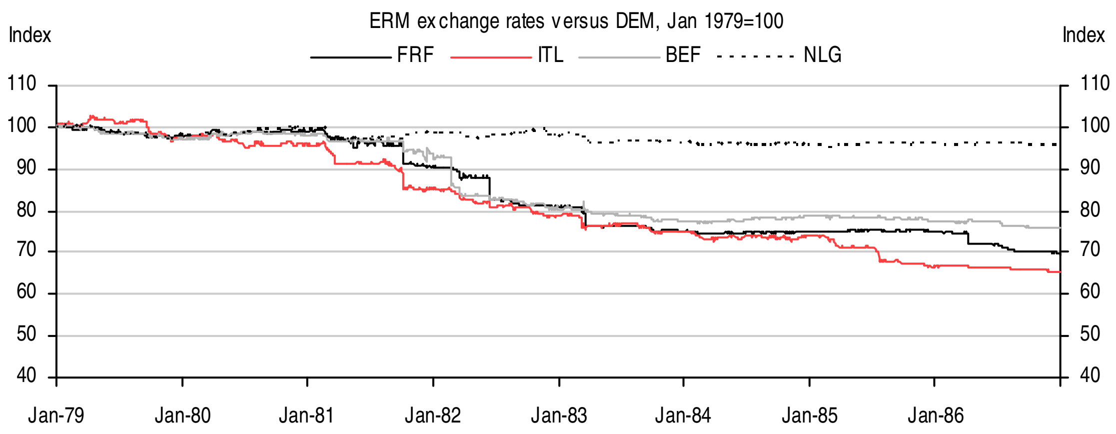
second oil shock resulting from the Iranian revolution and the Iran/Iraq war. This resulted in a further doubling of oil prices (see chart 1 again).

Intent on limiting the inflationary consequences of the oil price rise, the Bundesbank tightened policy aggressively (chart 4). European inflation again diverged significantly (chart 2 again), and the ERM came under intense pressure.

The response to this was to keep the ERM framework, but agree regular 'realignments' at week-end meetings when new central parities were set. There were 12 realignments between 1979 and 1987. The resulting exchange rate movements against the DEM are shown in chart 5. Compared with the early 1970s, exchange rates were less volatile, but the regular step changes in parities still meant that countries such as France and Italy had to operate with a significant risk premium in terms of higher interest rates compared to those in Germany.

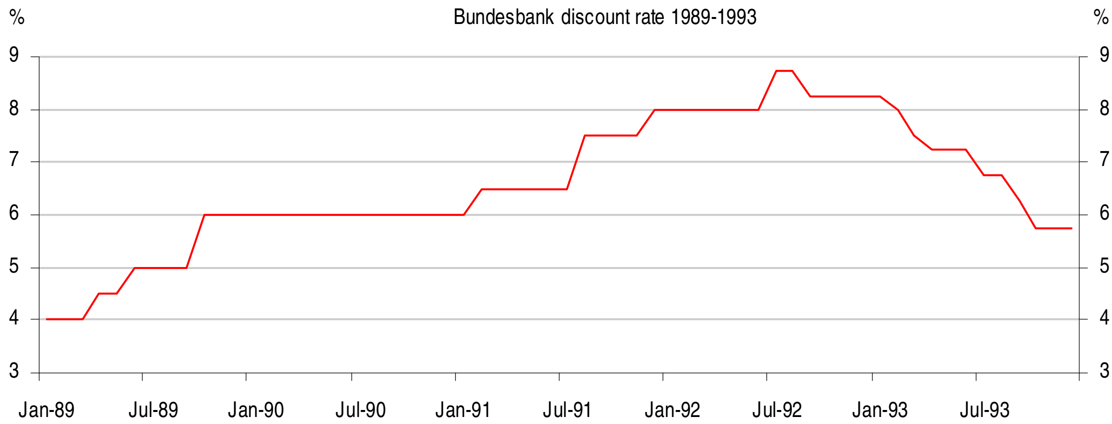
From 1987 to 1991, the commitment to nominal exchange rate stability increased the belief that a strong currency policy would permanently eliminate inflationary pressures (epitomised by France's 'franc fort' policy). This process was helped by the 1985 oil price fall following an

5. The early years of the ERM saw regular 'realignments'



Source: Bundesbank, HSBC

6. The Bundesbank tightened again in response to the 'reunification boom'



Source: Bundesbank

increase in Saudi production which reduced inflation across Europe. Risk premia declined and interest rate differentials narrowed. During this period there was also a large increase in capital flows within Europe, with sharply increased borrowing in DEM to fund assets in higher yielding currencies.

New Germany, new strains

German reunification introduced new strains into the system. The fall of the Berlin wall in 1989 led rapidly to reunification (October 1990) and had a big impact on the German economy in terms of large infrastructure spending in the East and new consumption spending by East Germans who had most of their Ostmarks converted to DEM at 1:1 when the black market rate was between 5 and 10 to 1.

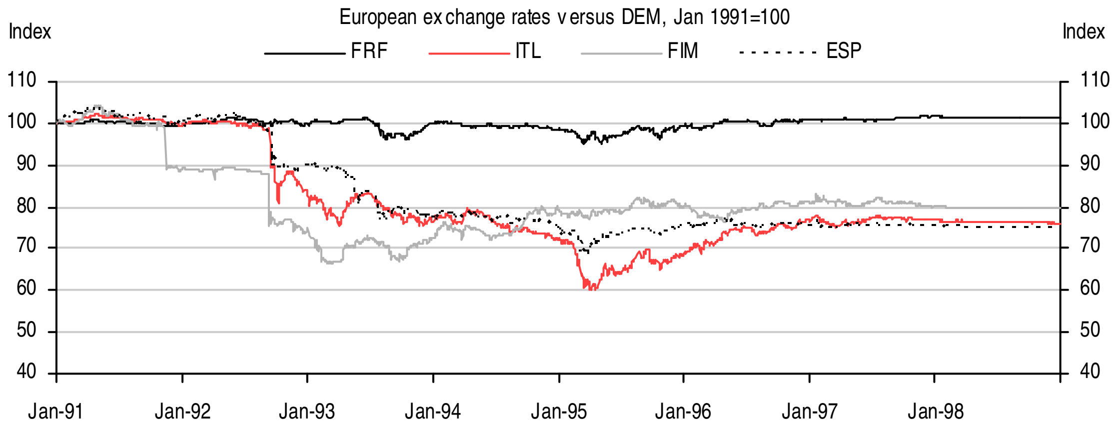
The Bundesbank tightened policy again in response to the 'reunification boom' and the rising fiscal deficit. Rates were pushed up from 4% in 1989 to a peak of 8.75% in 1992. Other European central banks followed suit and this put new strains both on the ERM and on those currencies that had been shadowing the system. The Finns had been following a strong currency policy in the late 1980s and in 1991 they pegged the markka to the ECU. However, economic weakness (banking problems and the collapse of the Soviet Union) forced them to devalue in 1991 in the first signal that nominal exchange rate stability in Europe was by no means certain to continue. This new sign of instability came despite the fact that the Maastricht Treaty, which set out a roadmap for monetary union in Europe, was signed in January 1992.

Contagion, Crisis and Response

Strains continued to build in 1992 until September when both Sterling (a member only since 1990) and Italy were forced to leave, and other currencies were devalued. Strains did not subside, especially as it was far from clear that the Maastricht Treaty would be ratified in referenda in Denmark and France, and in August 1993 the ERM bands were widened from ±2.25% to ±15% (chart 7).

The political response to this crisis was to push ahead with renewed determination towards EMU. Exchange rate instability was seen as so disruptive to economic performance that all efforts should be made to eliminate it. By the late 1990s the economic recovery and the policy drive towards EMU had helped stabilise exchange rates again and in 1999 the euro was launched with the

7. Successive crises hit the ERM in 1992 and 1993



Source: Bundesbank, HSBC

locking of exchange rates and then the replacement of national currencies with the euro.

Lessons from the past

The brief history of European monetary developments since 1970 outlined has three important lessons that are relevant for the current situation:

1. Monetary stability in Europe has been a driving objective for 40 years, and will not be abandoned

The development of a single market in Europe has been the driving force behind European political co-operation since the formation of the EEC, and monetary stability within Europe is seen as essential to the operation of this market. Through a variety of crises generated by a number of internal and external shocks European leaders have maintained their commitment to this. The response to crises has been to draw together and try to promote stability. Having established EMU, we should expect everything to be done to maintain it, despite the depths of the problems that Europe faces. It seems extremely unlikely that there will be a disintegration of the euro, even if the sovereign debt crisis gets worse.

2. Contagion is a genuine risk

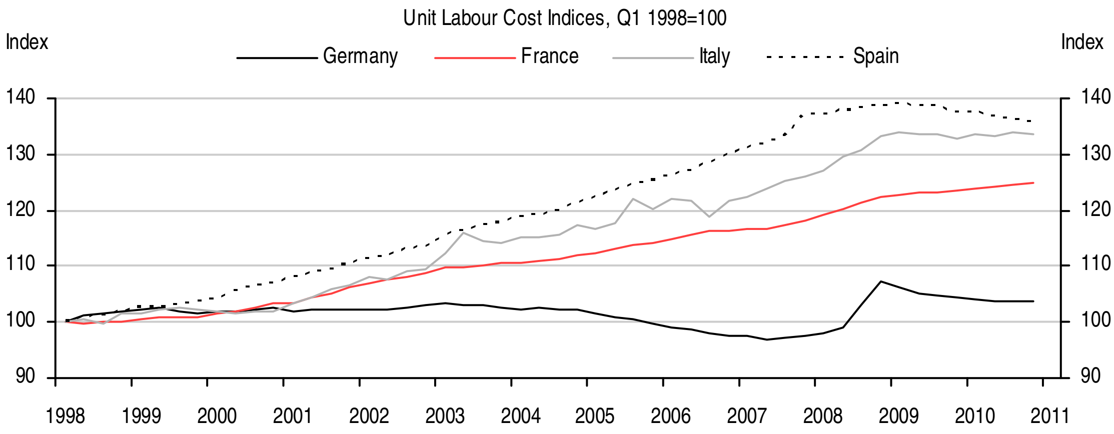
Some have suggested that it might be possible for one country to leave the euro without there being major problems for the remaining members. However, as we saw with the Finnish devaluation in 1991, a seemingly small change can be a signal that leads to a radical change in expectations about what is possible, and to changes in behaviour that make much bigger changes inevitable. The same effect was also seen during the Asian crisis, when the problems in Thailand rapidly spread across the region.

If one country were to leave the euro then the risk would be that the pressures on others would build to such an extent that further exits become much more likely. For this reason, we would not expect to see any euro members leaving.

3. Competitiveness problems have not been solved by EMU

During the period of floating exchange rates, and during the period of fixed but adjustable pegs, the nominal exchange rate acted much as a fault line between tectonic plates. When relative competitiveness imbalances built they could be relieved (at least temporarily) by exchange rate changes. Since 1999 such adjustments have not been possible, yet changes in relative

8. Divergences in competitiveness have not been eliminated in the Eurozone



Source: OECD, HSBC

competitiveness have not been entirely eliminated. Chart 8 shows OECD unit labour cost indices for the major euro area economies based on 1998 (when nominal exchange rates were fixed).

As can be seen from the chart, there has been a significant relative rise in unit labour costs in Italy, Spain and France compared with Germany over the period. These divergences could be overlooked in an environment of easy access to credit, but will be much more important in a period of fiscal retrenchment and will need to be addressed if the long-term stability of the euro is to be assured.

Conclusion

The objective of European economic integration was born out of a response to the horrors of the two world wars. What started as co-operation in the coal and steel industries became a common market and then a tighter political union. Monetary integration has long been seen as essential to making overall European integration work, and the response to a variety of crises over the past thirty years has been to move towards ever closer integration. The response to the latest crisis should be seen in this context – a move towards closer fiscal integration (at least for most EU members).

2. EUR resilience

Introduction

When the Eurozone sovereign credit crisis first emerged in 2010, the EUR fell by about 10% trade weighted and by 14% against the dollar from (1.37 to 1.19). Recent developments strongly suggest that the crisis is deeper and politically more intractable than was apparent in 2010 and yet the euro has proved remarkably resilient.

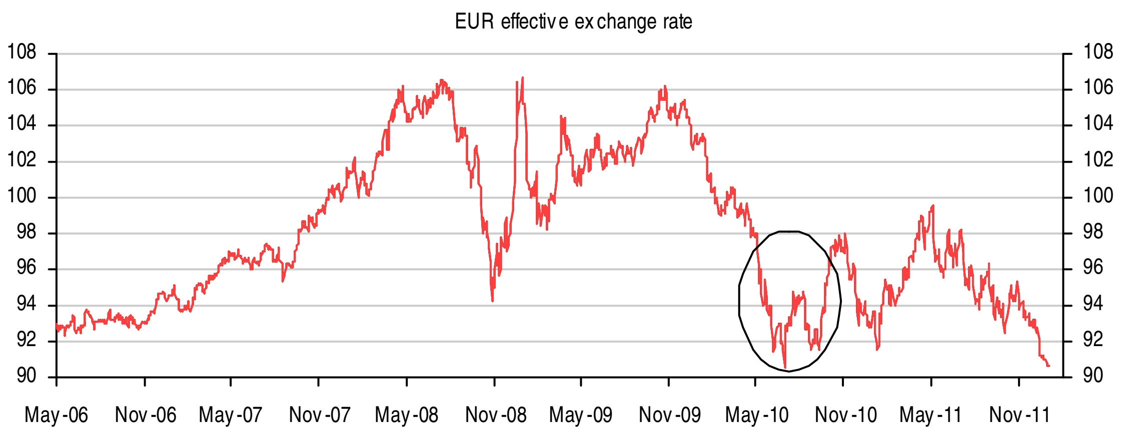
There are two principal reasons why the EUR is holding up and why, in our view, it is more likely to rise than to fall in coming months:

1 **The EUR has a strong 'external' position**. Viewed as a whole, the Eurozone has a current account that is close to balance, and positive portfolio and M&A inflows. In addition, speculative positions (as measured by CFTC data) are record short. Should the 'internal' problems begin to be resolved, the EUR would likely come under upward pressure.

2 **Crisis resolution is in the interests of all concerned**. The potential economic consequences of allowing the crisis to go unresolved are so dire for all the Eurozone economies (and beyond) that some sort of 'solution' seems very likely. While there have been moves towards closer fiscal coordination, this may need to be supplemented by increased ECB bond buying in the short term and some form of common bond issuance longer term.

In the worst case scenario of one or more members being forced, or choosing, to leave, the revised euro would have a stronger internal and external position. Any euro exit would no doubt be accompanied by intense uncertainty which would see investors retreat to the dollar initially, but once the situation became clearer the revised euro would likely strengthen. While we would assign a low probability to a euro exit, the risk has to be factored into current market prices.

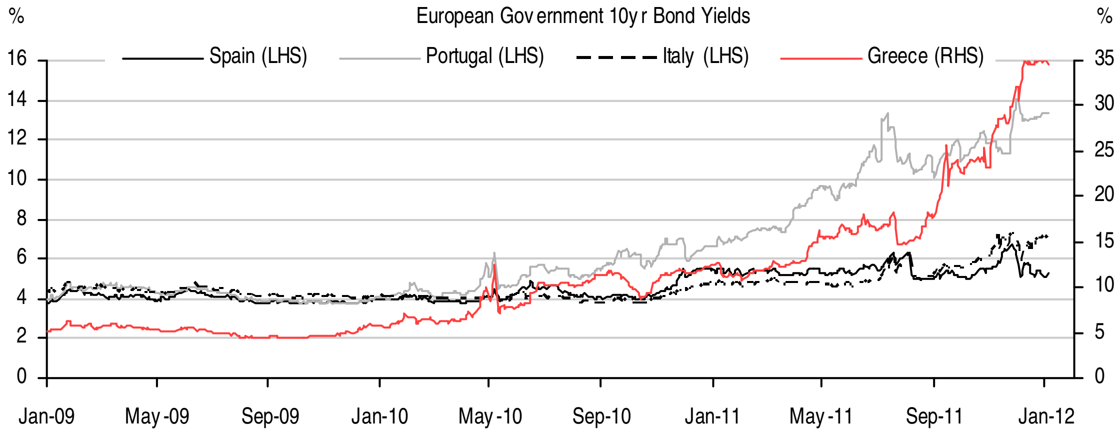
1. EUR weakness in 2010 has not been repeated this time...



Source: IMF, HSBC

HSBC

2. ...despite a deepening crisis



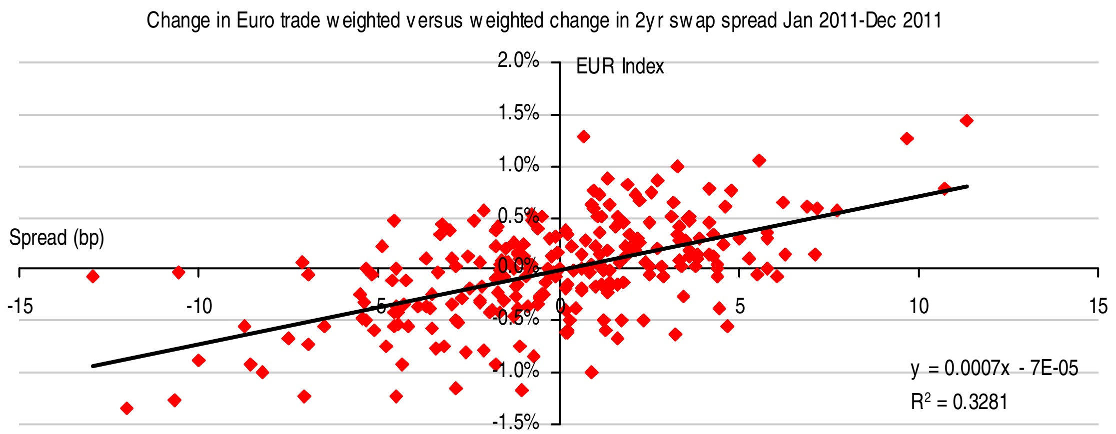
Source: Bloomberg, HSBC

The bond, equity and credit markets have been heavily influenced by developments in the Eurozone, but the FX market has remained comparatively stable. Many have been looking for the euro to fall heavily in response to the crisis. However, we think that the euro will more likely move higher again as there are moves to address the fiscal issues in Europe and as the market focuses again on the problems of public finances in the US.

Resilient euro

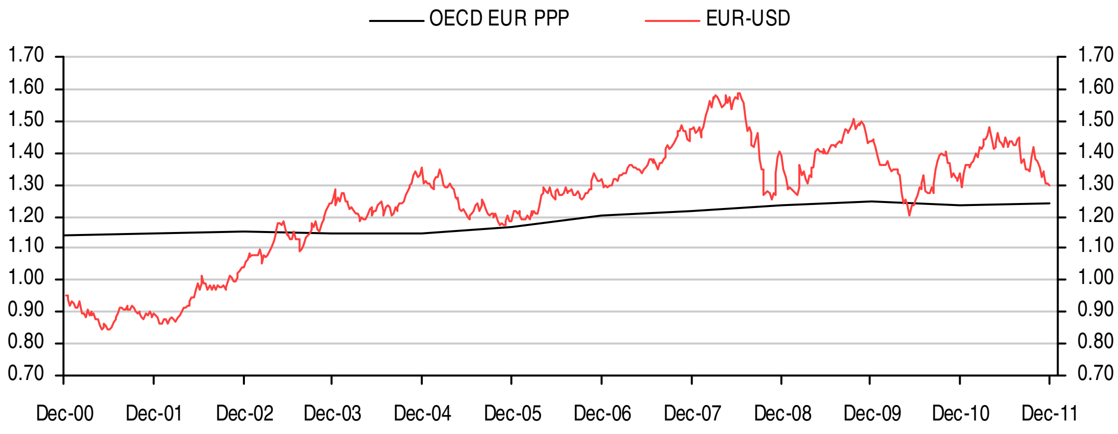
When the European sovereign bond crisis started in 2010 with Greece admitting that its public sector deficit was much larger than previously reported, the euro fell hard. Between the middle of March and the end of June 2010, the euro fell by 10% on a trade-weighted basis, and by 14% against the dollar (chart 1). Recent developments strongly suggest that the public finance problem in some Eurozone countries is much more serious and intractable than had originally been thought.

3. EUR has been trading in a surprisingly 'normal' way



Source: Bloomberg, HSBC

4. The euro is still trading above 'fair value'



Source: Bloomberg, HSBC

While austerity measures will help reduce new borrowing requirements, they will do nothing to help service the existing very large outstanding stocks of debt. These are manageable as long as yields remain low, but debt dynamics rapidly become unsustainable as yields rise. The more debt looks unsustainable, the less investors want to hold the bonds, and the higher the yields move. In addition, fiscal austerity measures are more likely to mean that the economy is unable to grow rapidly enough to service the debt. Fears of debt unsustainability have driven bond yields to unprecedented levels (chart 2).

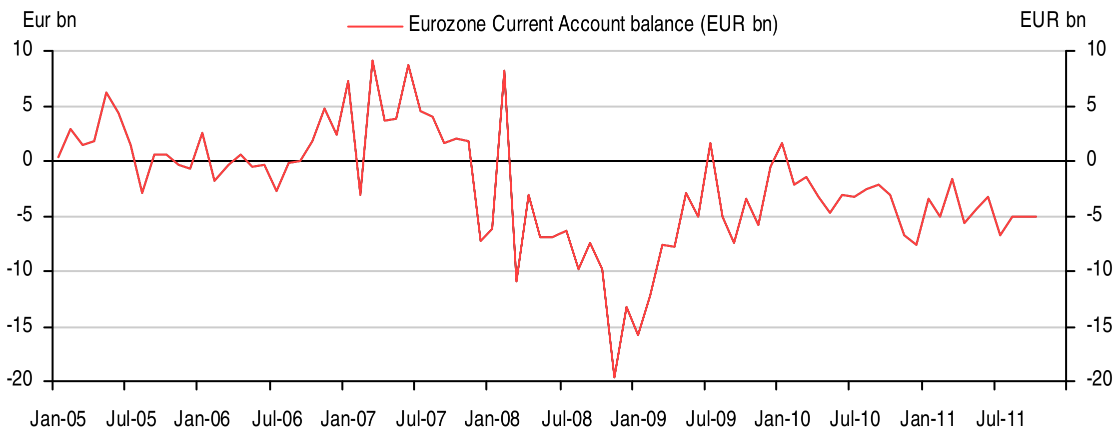
The deepening fiscal crisis has been met with what are widely regarded as, thus far, unconvincing policy responses from Eurozone officials (see, for example, *How to solve the euro's problems,* 30 September 2011 and The euro: from 'too big to fail' to 'too big to save', 9 November 2011). Nevertheless, the euro as a currency has performed relatively well. On a trade-weighted basis the euro is down only about 5% since mid-July, though it is down nearly 10% against the dollar.

At the same time, it has been trading in a 'normal' way. Chart 3 shows the relationship between daily changes in the euro and daily changes in the 2 year swap spread (both trade-weighted) since the beginning of the year. The relationship is strong and shows a relative move higher in euro rates is associated with a move up in the euro.

The strength of this relationship may reflect the dominance of the 'risk on-risk off' phenomenon. When the markets are 'risk on' they expect the ECB to continue to normalise rates and both swap rates and the euro move higher. When the markets are 'risk off' they fear a continued reversal of course by the ECB and both swap rates and the euro move lower.

Finally, the euro is still trading in 'overvalued' territory, despite the crisis. Chart 4 shows EUR-USD compared with the OECD PPP level. The fact that the euro still manages to trade above 'fair value' is either saying something very negative about the dollar (which is possible) or that the FX position of the euro is not as dire as it is popularly assumed to be.

5. Eurozone current account is close to balance



Source: Bloomberg, HSBC

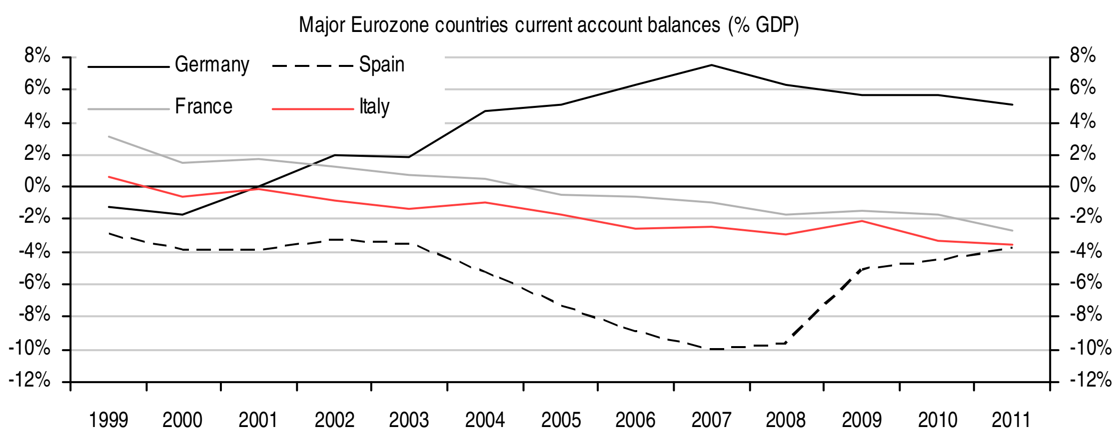
Given the depth and severity of the fiscal crisis in the Eurozone, the resilience of the euro and the normality of its trading behaviour are notable. How can this be explained and will it continue? There are two main reasons for the euro's performance and they suggest the euro is more likely to rise than to fall in coming months.

1. The euro has a strong external position

From an external point of view, the euro is indivisible. It is impossible to buy or sell a 'Greek euro' or a 'German euro'. For the FX market, then, it is the position of the Eurozone as a whole that matters, not its component parts. On this basis, the euro is in a strong position. As can be seen from chart 5, the current account position of the euro is close to flat.

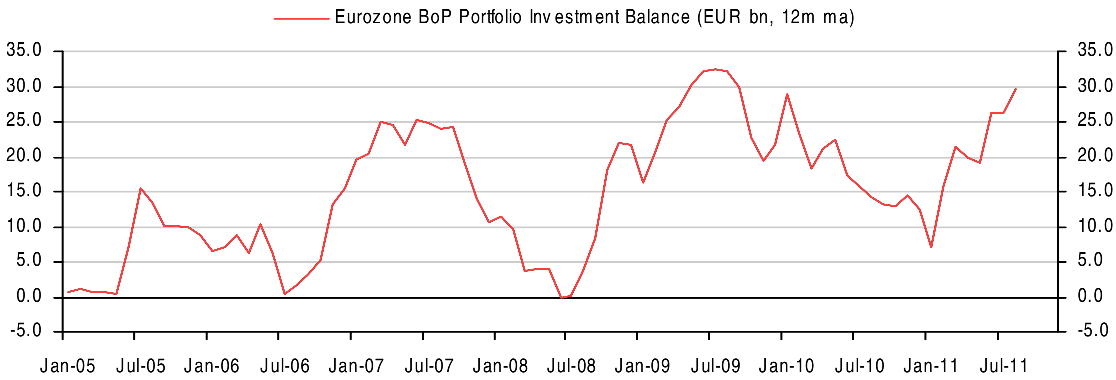
Chart 6 shows the extent of the internal imbalances in the Eurozone, by showing the current account balances of the major Eurozone countries. While Germany has a current account surplus of over 5% of GDP, France, Italy and Spain have deficits of between 2% and 4% of GDP. The challenge for the Eurozone policymakers is to manage these internal imbalances through transfers or changes in relative competitiveness.

6. The imbalances are internal rather than external



Source: IMF, HSBC

7. Portfolio inflows have picked up in recent months



Source: Bloomberg, HSBC

While the current account balance is close to flat, net portfolio flows into the Eurozone are positive and have been trending higher in recent months (chart 7).

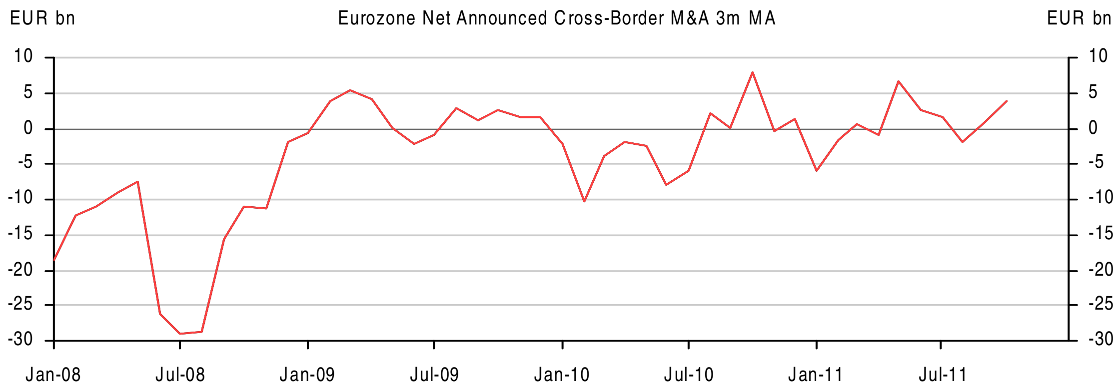
Positive portfolio flows

Some have argued that the strength of the euro merely reflects banks repatriating capital to shore up their balance sheets, and that it will fall once this is complete. While it is difficult to disentangle the portfolio flows, there is no clear sign that inflows only reflect bank capital repatriation. Even if the repatriation argument was holding the euro up, it is difficult to argue that it will end soon.

Timely data on direct investment flows are not available, but a proxy can be constructed using net announced cross-border M&A deals. These show a direct investment outflow in 2008, but this has become flat to slightly positive in recent months (chart 8).

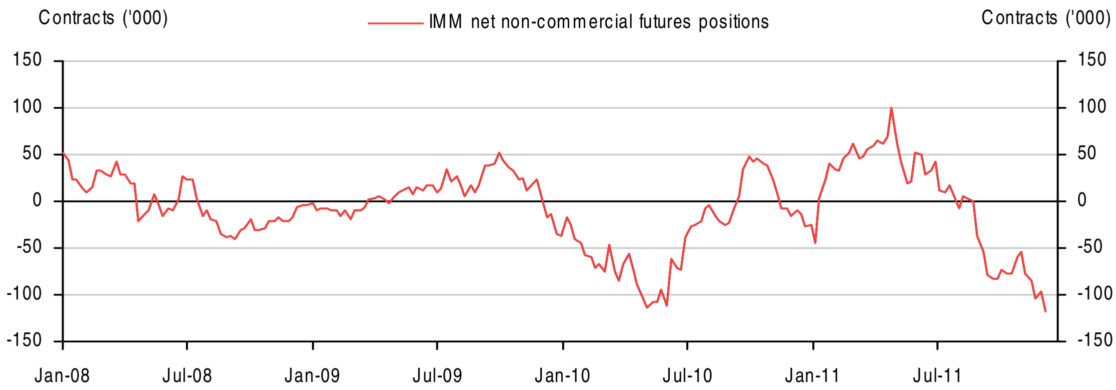
If current account flows are flat and longer-term capital flows (portfolio and direct investment) are positive, then short-term money flows must be negative. If the euro were being supported primarily by bank repatriation, then this should be seen in money inflows, but this is not the case.

8. Net cross border M&A flows are mildly positive



Source: Bloomberg, HSBC

9. Speculative market is short EUR



Source: Bloomberg, HSBC

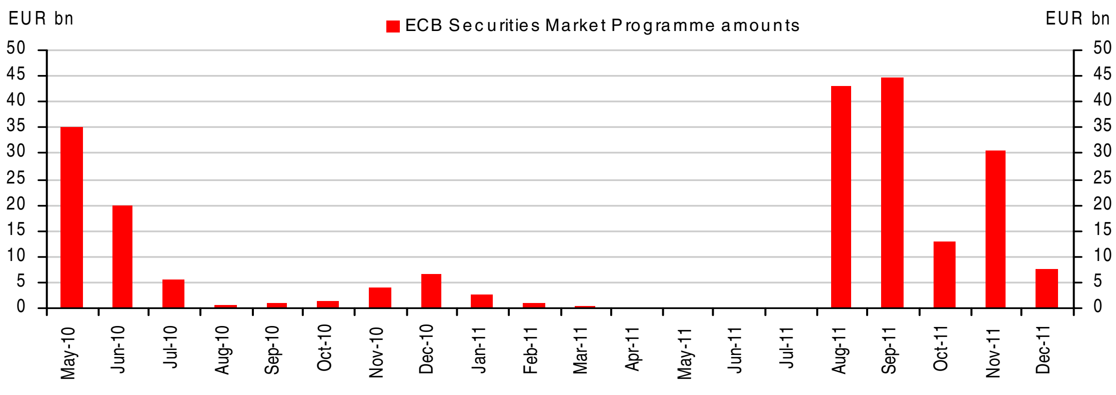
Chart 9 shows the net non-commercial IMM futures positions in the euro. The market is currently net short by record amounts (about 115,000 contracts or USD 20bn). Given the very rapid growth in volumes in the futures market it is reasonable to assume that this reflects the wider market, and suggests that 'speculators' have already sold the euro, looking for it to weaken as the public finance crisis develops.

The combination of positive longer-term flows and a 'short' speculative market suggests that the euro may come under strong upward pressure should the news flow become less negative.

2. A resolution is in the interests of all

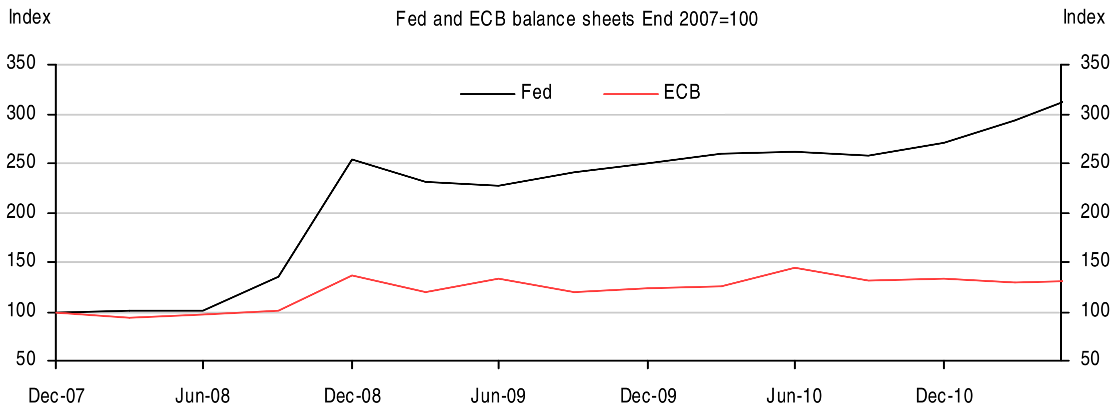
While the politicians around the Eurozone have to respond primarily to the demands placed on them by their domestic electorates, they are well aware that the interdependencies are such that a resolution must be found. It cannot simply be a choice between 'bailing out profligate governments without limit' (the Northern European fear) and 'killing the economy with austerity' (the Southern European fear). As Stephen King and Janet Henry argued in *How to solve the euro's problems*, 30 September 2011, the costs involved in fixing the institutional weaknesses of the Eurozone are far lower than the costs of failure. For this reason, we expect a lasting resolution to be found. However, political

10. ECB bond buying may be expanded



Source: Bloomberg, HSBC

11. Fed balance sheet has expanded much more than the ECB



Source: Bloomberg, HSBC

decisions like this will almost certainly take far more time than the markets will be willing to wait, so an interim solution involving a reluctant ECB seems inevitable.

The ECB has already been engaged in sterilised government bond buying (chart 10). However, it would be possible for it to do much more.

The ECB could do more

Chart 11 shows the size of the Fed balance sheet and of the ECB balance sheet indexed to 100 at the end of 2007. In response to the financial crisis, both central banks have increased the size of their balance sheets substantially, but the Fed has done much more with its QE programme. If the ECB were to increase its balance sheet in the same proportion, this would imply a potential EUR2tr of additional bond buying would be possible. While such an enormous change in ECB activities seems very unlikely, it suggests that the ECB does have room to do more while a longer-term solution is found.

What if countries leave the euro?

The 'worst case' scenario of members choosing or being forced to leave the euro has been given more credence by Chancellor Merkel's reaction to the prospect of a Greek referendum. While there is nothing in the EMU treaty about a country leaving, it is a theoretical possibility. We do not attach a very high probability to such a move, but we have already analysed the possible market implications of a euro split into a 'core' and a 'periphery' (see Chapter 4).

Any euro exit would undoubtedly be surrounded by severe market uncertainties that would cause a 'risk off' retreat into the dollar in the short term, but the revised euro may then begin to rise.

Conclusion

The Eurozone fiscal crisis has deepened substantially in recent months, and politicians have been slow and faltering in their response. However, while Eurozone bonds and equities have been badly affected, the euro has proved resilient. This reflects the strong external position of the euro, and expectations that a lasting resolution will have to be found. In our view, a gradual move towards a resolution is the most likely outcome, and as the news flow becomes less negative then the euro is more likely to rise than to fall in coming months.

3. Valuing EUR-USD

A debt repayment model

An investor buying say 5-year US or Eurozone government bonds faces four possible outcomes in terms of the repayment of principal:

1. **Borrow:** Repayment is made by renewed market borrowing. While it has normally been assumed that governments will always be able to roll over debt by issuing new bonds, recent developments in the Eurozone show that this may not always be the case.
2. **Surplus:** Repayment is made as debt is retired. If fiscal policies start generating budget surpluses then the bond can be repaid out of net tax receipts.
3. **Print:** Repayment is made as the central bank buys government debt from the market. If the central bank is pursuing a long-term QE policy, then repayment is essentially backstopped by the central bank.
4. **Default:** Repayment is not made in full. 'Default' could come in the form of a 'haircut' or by being repaid in a (depreciated) new national currency.

The appropriate market value of EUR-USD can be thought of as a function of its expected value under each of the 16 possible combinations of outcomes for the US and Eurozone weighted by the probability of each outcome. In order to make the problem tractable, we look at each outcome relative to the 'business as usual' case of both the US and Eurozone being able to continue borrowing in the market, in which case we assume EUR-USD will settle at OECD 'fair value' of 1.25.

In order to assist thinking on this issue we have constructed a spreadsheet (*click here to download*), which allows users to enter their own expected values and probabilities and which then calculates their implied valuation for EUR-USD.

Our own best guesses at the values and probabilities result in an implied valuation of EUR-USD of 1.34, which supports the idea that the euro is unlikely to suffer large falls in the coming months despite the Eurozone bond crisis.

Valuing EUR-USD

How will you get your money back?

While there are many ways in which prices in the FX market may be analysed, one useful way of thinking about the appropriate valuation for EUR-USD is to consider the way in which a government bond investor may expect to get repaid at the end of the bond's term. While focusing only on government bonds omits consideration of equity and non-government bond flows, government bond markets are the biggest investment sector and questions over fiscal sustainability currently dominate investor thinking for both the Eurozone and the US. We are essentially trying to construct an FX answer from a series of bond market questions.

There are four possible outcomes that an investor has to consider for bond repayment, each of which may be associated with a different likely outcome for the currency at the point of repayment. We consider each of these in turn and try to assign both values and probabilities to each outcome. This can then be used to generate an implied valuation for EUR-USD.

1. Borrow – Business as usual

In normal circumstances, government debt management policies involve the regular issuance of new bonds in the market to refinance existing debt and to finance any required new borrowing. As long as debt is perceived as sustainable then the market will function smoothly. As we have seen in various countries in the Eurozone, however, the public debt markets can become effectively closed to new issuance, in which case governments are forced to rely on support from elsewhere.

If in say five years' time, both the US and the Eurozone have debt and deficit positions that are perceived as sustainable, then there seems no strong reason on this basis why EUR-USD should deviate much from long-term 'fair value' as measured by the OECD PPP value (chart 1). Another way in which the 'borrow' option may be available in the Eurozone is if governments agree on sufficient fiscal co-ordination that it becomes possible to issue common bonds which are backed by joint and several guarantees from all Eurozone governments rather than by individual countries. While this does not look likely in the short term, it may be something that becomes more likely over time.

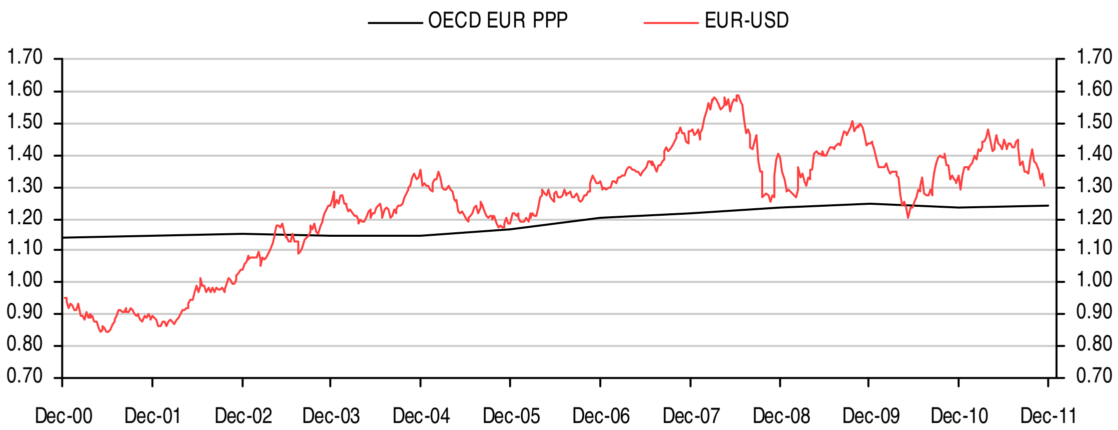
The 'business as usual' case is the starting point for the analysis, but we have assigned a probability of only 50% for the US, and 40% for the Eurozone. Users can input their own values in the spreadsheet.

In the other possible outcomes, one would expect the currency valuation to be either higher or lower than the fair value level. The second case we consider is the seemingly unlikely case where governments start running budget surpluses, and bonds are repaid out of net tax receipts.

2. Surplus – Fiscal deficits eliminated

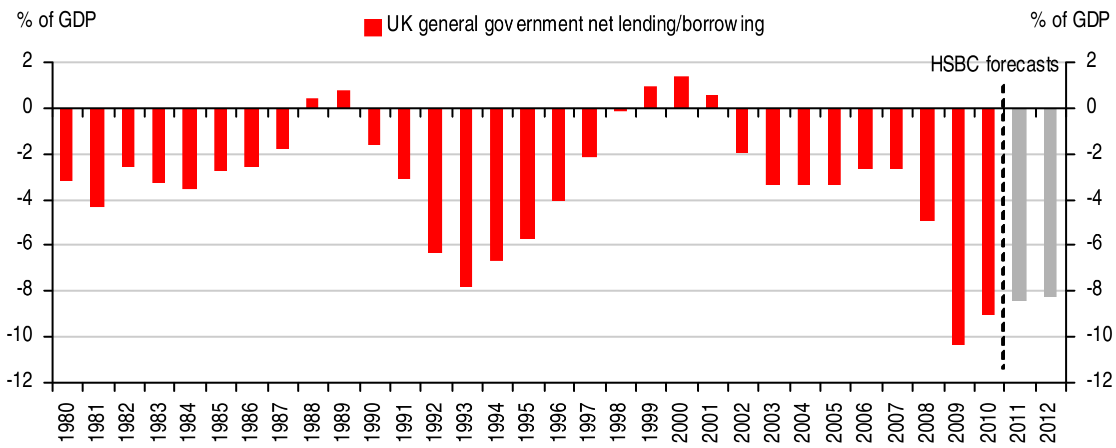
Given the scale of budget deficits being experienced in the US and in Europe it seems to strain credibility to imagine that either will be running surpluses in the next five years. However, there are historical cases where large government deficits have been eliminated in a five-year period, though this probably does rely on stronger economic growth than seems likely in the near future.

1. 'Fair value' for EUR-USD is about 1.25



Source: Bloomberg, HSBC

2. UK government had surpluses in the late 1990s



Source: HSBC, IMF

Chart 2 shows the UK government borrowing or lending as a percent of GDP back to 1980. Having run a deficit of nearly 8% of GDP in 1993, the deficit was eliminated by 1998 and the government even ran small surpluses between 1999 and 2001. Of course, UK public finances were helped by the strong growth that followed sterling's devaluation in 1992 and the robust growth in export markets at the time.

Should there be a realistic prospect of fiscal surpluses in the future, then one would expect this to be reflected in a higher currency valuation. While it is difficult to assess how much the currency valuation would be boosted by a move towards fiscal surpluses, we have assumed a 20% premium over fair value. Users can incorporate their own estimates between zero and plus 100% in the spreadsheet. We have assigned a 5% probability for this outcome for the US and a 20% probability for the Eurozone.

3. Print – the central bank acts as backstop

The third possible outcome for the bondholder is that repayment is effectively, if indirectly, made by the central bank. While we have not seen extreme forms of monetisation by any post-war developed world central bank, the QE policies being pursued by both the Fed and the Bank of England provide a backstop for the government bond markets by being a regular buyer of bonds. Should economic activity remain sufficiently weak that austerity measures to cut government borrowing are perceived as counter-productive, then it is possible to imagine the scale of central bank bond buying being increased further and becoming a more or less permanent feature of the market.

The ECB has thus far been reluctant to engage in large-scale QE, believing that the ECB is only responsible for price stability and that it is the national governments that should be responsible for ensuring that debt and deficits are sustainable. In effect, the ECB wants to reduce the probability of the 'print' option in the hope that it increases the probability of the 'surplus' option.

Long-term and continuous intervention by the central bank to buy government debt on an outright basis would most likely result in a weaker currency over time. We have assumed that this option would result in a currency 25% weaker than the base case. Again, users can incorporate

3. Eurozone government debt outstanding

	Debt (EURbn)	Pct of Eurozone total
France	1,309	21%
Germany	1,263	20%
Greece	345	5%
Ireland	110	2%
Italy	1,593	25%
Portugal	163	3%
Spain	654	10%
Others	941	15%
Total	**6,379**	**100%**
At risk'	2,865	45%

Source: Bloomberg, HSBC

their own numbers (between zero and -99%) in the spreadsheet. We have assigned only a 20% probability of this for the Eurozone and a 45% probability for the US.

4. Default – bond 'haircuts' or currency devaluation

The final possibility is a failure to return the entire principal at the end of the bond's life. This could occur either by traditional default or through the introduction of a new national currency in which case the principal is returned in this currency, but the value of the currency is significantly below that of the original currency.

Default by the US (in the sense that the dollar value of a bond is not returned at the end of its life) would seem inconceivable, but in the case of the Eurozone we have already seen a proposal for haircuts on Greek bonds, and the possibility of one or more country choosing or being forced to leave the Eurozone is not unimaginable.

What would happen to the bond investor in this case? If we assume that bond investors hold Eurozone bonds in proportion to the total outstanding debt, then a case can be made that about 45% of debt is 'at risk' (Greece, Ireland, Italy, Portugal and Spain). Total outstanding government debt in the major Eurozone economies is shown in table 3. If the recovery rate on this proportion were 50% in the event of either type of default, then the overall impact would be equivalent to about a 25% overall currency decline. Users can incorporate their own numbers (between zero and -99%) in the spreadsheet. We have assigned a zero probability of this outcome for the US, and a 20% probability for the Eurozone.

Putting it all together

On the basis of the assumptions made, it is possible to calculate an implied valuation for EUR-USD once probabilities are applied to the possible outcomes. Chart 4 is a screen shot of the spreadsheet with our sample probabilities included (*click here to download the spreadsheet*). For both the US and the Eurozone a probability of borrow, default, surplus and print are input in the top left. The 'print' probability is calculated by the sheet once the other three are input to ensure the total is 100%. Valuation variations from 'fair value' are input below that. The sheet then calculates an implied valuation.

For simplicity, we have assumed that all the four possible outcomes are mutually exclusive. While 'borrowing' and 'default' seem unlikely to be seen at the same time, and 'surplus' would mean 'borrowing' is unnecessary, it is possible that there could be a combination of 'printing' and 'borrowing' at the same time. As this would probably result in an FX value somewhere between the two outcomes, the results are unlikely to be much affected by this.

4. Valuing EUR-USD using the spreadsheet

	US	Euro
Borrow	50%	40%
Default	0%	20%
Surplus	5%	20%
Print	45%	20%

OECD Fair Value	1.25
Your implied value	1.341

$$1\,\text{EUR}(t_0) = S_0\,\text{USD}(t_0) \qquad (1)$$

$$1\,\text{USD}(T) = \Delta_U(T)\,\text{USD}(t_0) \qquad (2)$$

$$\begin{aligned} 1\,\text{EUR}(T) &= \Delta_E(T)\,\text{EUR}(t_0) \\ &= \Delta_E(T)\left[S_0\,\text{USD}(t_0)\right] \qquad \text{(from 1)} \\ &= \frac{\Delta_E(T)S_0}{\Delta_U(T)}\,\text{USD}(T) \qquad \text{(from 2)} \end{aligned}$$

	Valuation
Default	-25%
Surplus	20%
Print	-25%
Borrow	0%

US	Euro	Price	Prob	Delta_E	Delta_U
Borrow	Default	0.9375	10.0%	0.75	1
Surplus	Default	0.7813	1.0%	0.75	1.2
Print	Default	1.2500	9.0%	0.75	0.75
Default	Default	1.2500	0.0%	0.75	0.75
Borrow	Surplus	1.5000	10.0%	1.2	1
Surplus	Surplus	1.2500	1.0%	1.2	1.2
Print	Surplus	2.0000	9.0%	1.2	0.75
Default	Surplus	2.0000	0.0%	1.2	0.75
Borrow	Borrow	1.2500	20.0%	1	1
Surplus	Borrow	1.0417	2.0%	1	1.2
Print	Borrow	1.6667	18.0%	1	0.75
Default	Borrow	1.6667	0.0%	1	0.75
Borrow	Print	0.9375	10.0%	0.75	1
Default	Print	1.2500	0.0%	0.75	0.75
Surplus	Print	0.7813	1.0%	0.75	1.2
Print	Print	1.2500	9.0%	0.75	0.75

Source: HSBC

Conclusion

The analysis presented here is very much an attempt to put the current sovereign debt and deficit problems in the Eurozone and the US into an FX context. It creates a framework in which it is possible to think about FX market values in the context of several radically different possible future outcomes. The resulting implied valuation depends crucially on the probabilities that are assigned to each outcome. Those who believe that Eurozone governments will have a good chance of regaining control of their fiscal policies while the US relies on the Fed will get an implied EUR-USD valuation much higher than those who believe the Eurozone has a high risk of default while the US will be able to cut its deficit. The value of EUR-USD in the market can be thought of as the outcome of a wide range of views about a very uncertain future.

4. Where core-EUR might have been

CHF and EUR

As can be seen in chart 1, Swiss interest rate policy has mirrored that seen in the Eurozone for most of the past ten years. Relative inflation experience, however, suggests that historical relationships in monetary policy are no longer valid. Whilst Swiss CPI is currently 0.6% year on year, Eurozone inflation is currently 2.7% (chart 2). Core inflation in the Eurozone is lower, at 1.5% year on year, but it is flat in Switzerland.

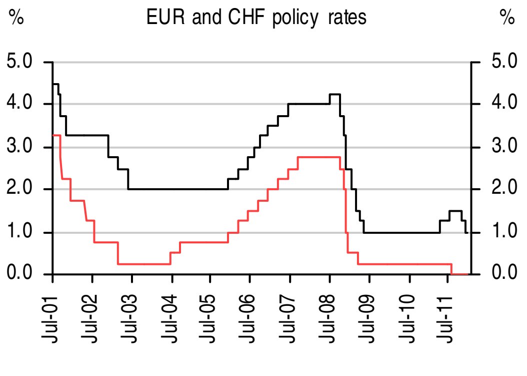
Currency performance is the key

The main driving force behind this inflation divergence is the performance of the currency. From the beginning of the sovereign credit problems in the Eurozone in 2010 until the low in EUR-CHF in August 2011, the EUR lost about 25% against the CHF, having spent much of the previous 10 years in a 1.45-1.65 range (chart 3).

The new exchange rate environment can be seen even more clearly in chart 4. This shows the six-month rolling correlation of daily changes in EUR-USD and USD-CHF. When the EUR and CHF move together, this correlation is very high, as it was for most of the 1999-2009 period. The correlation did fall to some extent during the financial crisis, but it was fully re-established during the early part of the recovery in 2009, before falling sharply once the sovereign credit issues emerged.

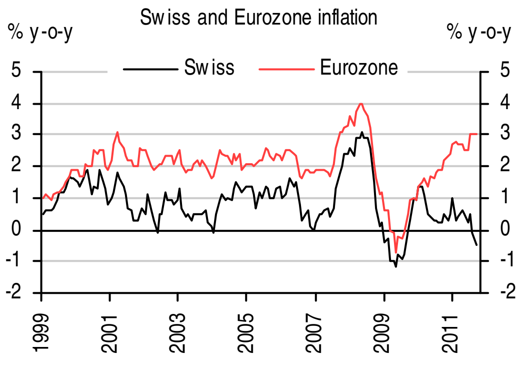
A further demonstration of the changed relationship between EUR and CHF can be seen in implied options volatility. As we argued in "Swiss Franc – the last safe haven", *Currency Weekly 4 April 2011*, central bank intervention in USD-JPY made CHF the only viable safe haven currency, which made it more susceptible to swings in 'risk on-risk off' sentiment and therefore more volatile. Chart 5 shows implied 3-month EUR-CHF compared with the average of other euro crosses (NOK, SEK, PLN, HUF, and CZK). Until the crisis and again in 2009, EUR-CHF volatility was below 5%. Since 2010, it has moved above 10% and peaked above 20% until the SNB set the EUR-CHF floor.

1. ECB and SNB policies have historically moved together



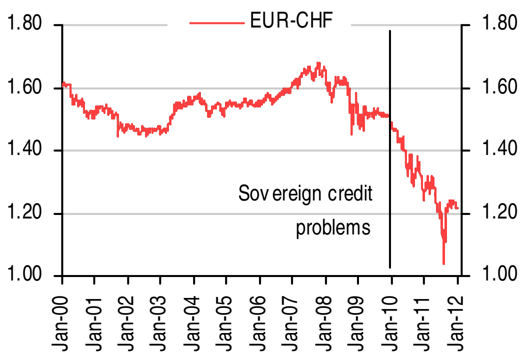
Source: Bloomberg, HSBC

2. Swiss and Eurozone inflation has diverged



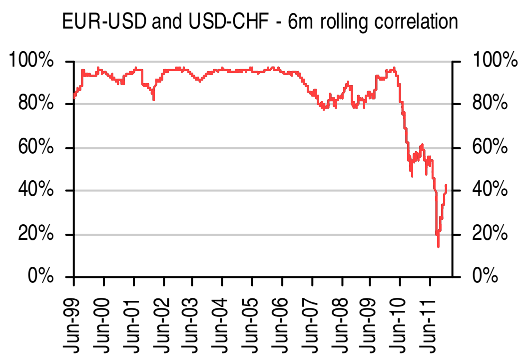
Source: Bloomberg, HSBC

3. EUR-CHF stability broke down in 2010



Source: HSBC, Bloomberg

4. The correlation between EUR and CHF movements has fallen sharply



Source: HSBC, Bloomberg

For Swiss monetary policy, the implications of this new CHF behaviour can best be analysed by using monetary conditions indices.

Monetary Conditions Index

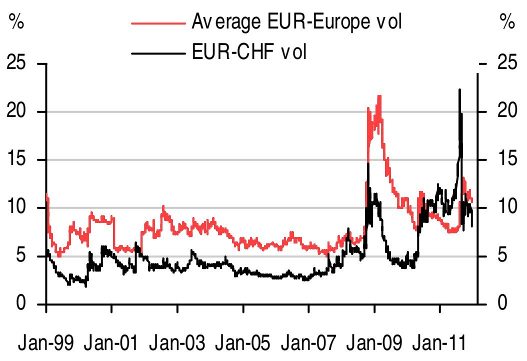
A monetary conditions index (MCI) aims to measure the effect of both real interest rate changes and exchange rate moves on the economy. If the exchange rate is strengthening then, other things being equal, monetary conditions will be tightening, and vice versa. An MCI can be used to gauge whether (relative to some benchmark period) monetary conditions are boosting or restraining the economy by combining the effect of interest rate and exchange rate movements.

Chart 6 shows an MCI for Switzerland using April 2002 as a benchmark and giving an 80% weight to changes in real interest rates and a 20% weight to changes in the effective exchange rate. As can be seen, there was relatively little change in the MCI between 2002 and 2009, but from then until July 2011 conditions tightened by the equivalent of about 750bp in interest rates. Given this, it is not too surprising that the SNB took the dramatic step of setting a floor under EUR-CHF and promising unlimited intervention to sustain it.

Where core EUR might have been

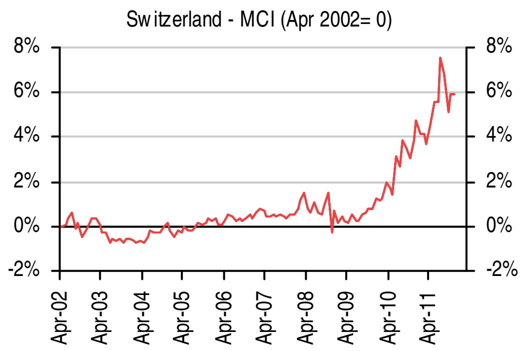
The behaviour of the EUR and CHF in 2010 and 2011 and the tightening of monetary conditions in Switzerland have interesting implications for the Eurozone. Imagine that the EUR had been split

5. EUR-CHF implied volatility spiked



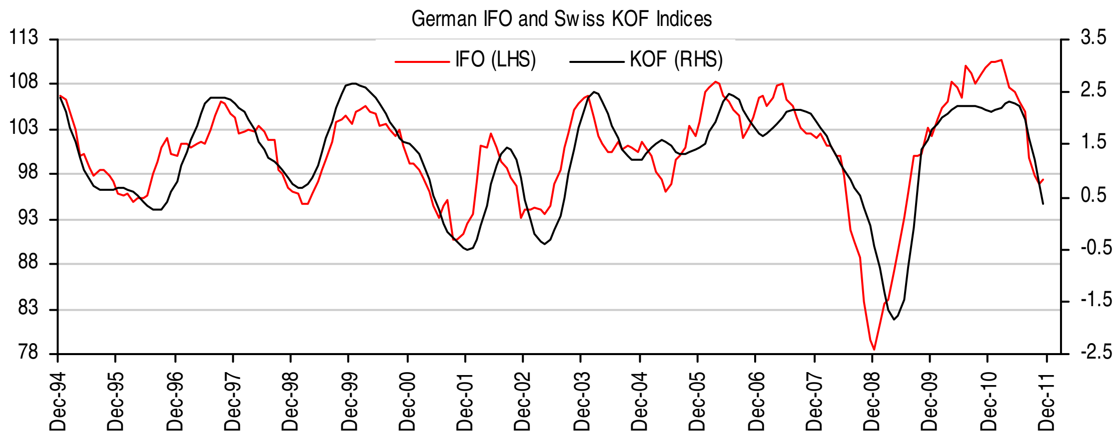
Source: HSBC, Bloomberg

6. Swiss monetary conditions tightened dramatically because of currency appreciation



Source: HSBC, Bloomberg

7. Swiss and German economies tend to move together



Source: HSBC, Bloomberg

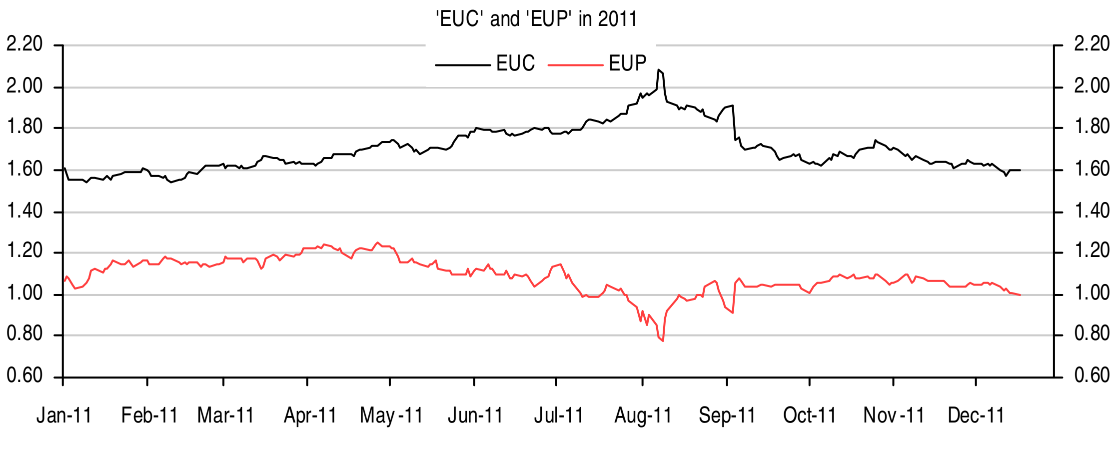
into two currencies in 2009, call them EUR-core (EUC) and EUR-periphery (EUP) where EUC members were those that had no significant public sector funding problems. Given the close association between the behaviour of the Swiss economy and the German economy (chart 7), it would not be unreasonable to suggest that EUC-CHF would have remained fairly stable.

Assuming EUC-CHF had remained at 2009 EUR-CHF levels (1.50) this would imply a peak EUC-USD of above 2.00 in September 2011(about 45% higher than EUR) and a current level of about 1.60.

What would be the value of EUP-USD? There are several possible ways of estimating this, but the simplest assumes that the current EUR is just a simple average of the values of the hypothetical EUC and EUP. This would mean EUP-USD of about parity. The theoretical trajectories of EUC and EUP are shown in chart 8.

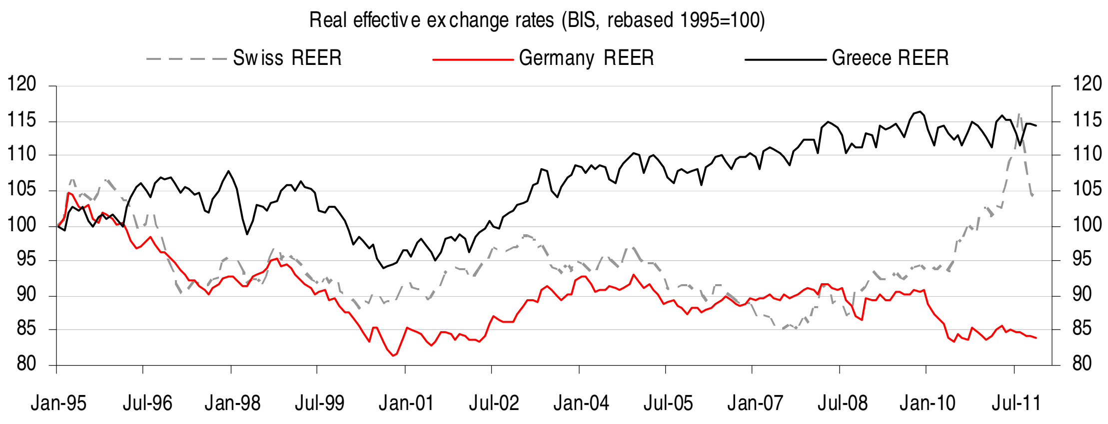
What would this mean for economic performance? With a much weaker currency, EUP area exports would probably have been performing better and fiscal consolidation may have been slightly easier if there was the prospect of stronger activity. Inflation in the EUC area would probably be very subdued

8. Had the euro been split, the currency performance probably would have been very different



Source: HSBC, Bloomberg

9. German and Greek real effective exchange rates would look very different



Source: HSBC, Bloomberg

and the EUC central bank may not have felt the need to raise rates as the ECB did in 2011. Inflation in the EUP area would probably be higher but, rather like the UK, the impact would be mostly felt on real incomes and the EUP central bank may also have been reluctant to tighten. EUC area holders of EUP bonds would, of course, have suffered a big currency loss (assuming they were not hedged) in the same way EUR holders of gilts did in 2007/08.

Relative competitive positions in the Eurozone would have been very different. Chart 9 shows the BIS real effective exchange rates for Greece, Switzerland and Germany. With higher domestic inflation, Greece's REER has moved steadily higher but Germany's has fallen, implying a stronger competitive position. With a split EUR or a situation where the peripheral Eurozone deflated internally, Germany's REER would have been higher and the Greek REER would have been significantly lower. Although the financial cost of the sovereign debt problems may be high for the core countries, they have gained a competitiveness boost from having a currency much less strong than it otherwise could have been.

Conclusion

The sharp change in behaviour of EUR-CHF since the beginning of the Eurozone sovereign debt problems raises the question of how a split euro would have performed since 2010. Assuming a core euro would have remained relatively stable against the CHF, then monetary conditions in the core Eurozone would also have been significantly tighter, and the central bank would perhaps not have decided to tighten policy in 2011. There seems little doubt that a euro-periphery currency would by now be significantly weaker than the EUR.

Would two EURs have been better than one? This is impossible to say given the counter-factual nature of the argument. The relationship between the EUR and the CHF does, however, suggest how things might have been different for the Eurozone.

RMB: Less appreciation, more volatility in 2012

- Lower inflation and a move close to equilibrium means that RMB will see less appreciation and more volatility in 2012
- Internationalization will be the key focus of RMB policy
- RMB still more attractive than many peers and remains a core favourite

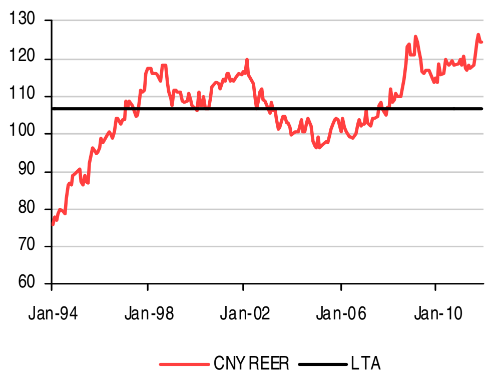
We reiterate our RMB forecast for around 3% appreciation in 2012. These expectations are based on both a decline in the inflation risk and the fact that the RMB is now closer to an equilibrium valuation. With less fundamental appreciation pressure, net flows will continue to become more volatile which will translate into greater volatility in RMB spot. Despite this, we view the RMB as one of our preferred Asian currencies in 2012, especially since other Asian currencies are at risk of trading with even greater volatility.

A secondary effect of these shifting pressures is that RMB policy will be focused on more internationalization in 2012, rather than on appreciation.

RMB story less structural, more cyclical now

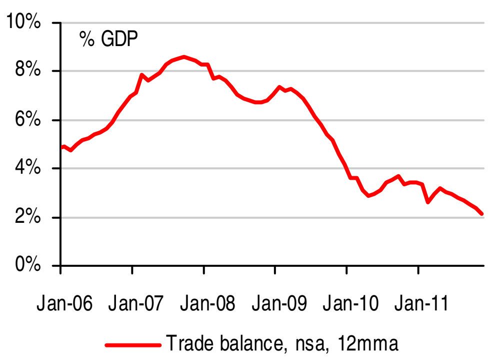
Recent evidence suggests that RMB is approaching equilibrium. When we first flagged this in 18 months ago (see "RMB… game change", 4 June 2010), it appeared to be a new and minority view. However, trends in the hard data

1. RMB valuations back at all-time highs...



Source: HSBC, CEIC

2. ...while the trade surplus make new lows



Source: HSBC, BIS

means that this view will become increasingly mainstream among policymakers. The trade-to-GDP surplus continues to decline (chart 1), REER valuations are making new highs (chart 2), while growing outward investment is recycling the dwindling trade surplus. The recent phenomenon of the near-term RMB depreciation pressures only served to reinforces this sentiment.

This suggests cyclical considerations will dominate structural ones in determining FX policy, as there is no longer a need to engineer a sustained revaluation of the currency over time. For this reason, we had long expected RMB appreciation to decline back to a 3% pace following a peak in inflation earlier this year (see *Asian FX Focus: Faster appreciation for now,* 4 May 2011).

Meanwhile, FX policy may resume delivering more two-way volatility in USD-CNY, as it did in 2H 2010, and the basket may start playing a bigger role as well. RMB volatility will not only increase because of FX policy, but because these structural trends themselves will increase the volatility of net flows.

Net flows are becoming more volatile

The most notable development for the RMB recently has been the almost persistent depreciation pressure the currency has been facing since the end of September.

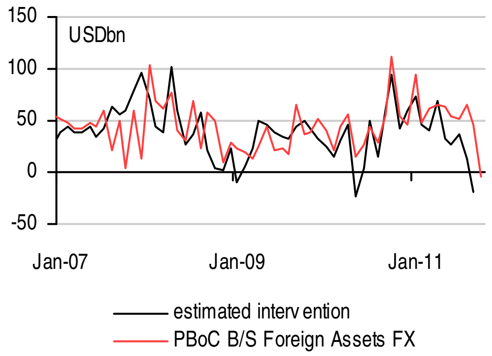
We first flagged the net outflows when the 3Q 2011 reserves report showed a September drop in reserves (chart 3). This has appeared to continue through the fourth quarter, with recent press stories highlighting declines in various measurements of official FX reserves through November (see Appendix C: "Deciphering intervention data", in the *full version* of this report).

These net outflows have led spot USD-CNY to trade above the midpoint fixings for much of the fourth quarter of 2011, persistently testing the band ceiling at times (chart 4). This has caused unusual behaviour in the management of the FX regime (an issue we address separately in "Appendix A: FX regime under siege?" the *full version* of this report)

Shifting expectations and position adjustment…

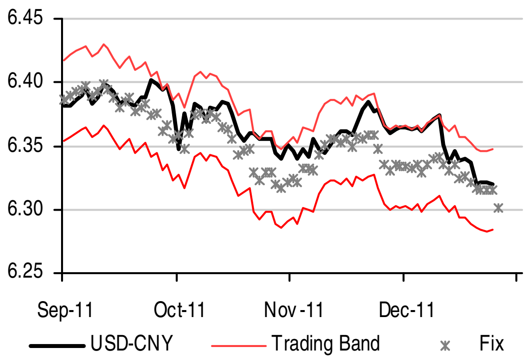
To us, what is happening is a system-wide process of reduction in long RMB positioning across the economy, due to reduced appreciation expectations (chart 5). The broader market since the second half of last year has substantially scaled back its RMB expectations (chart 5).

3. FX reserve indicators have recently shown net outflows



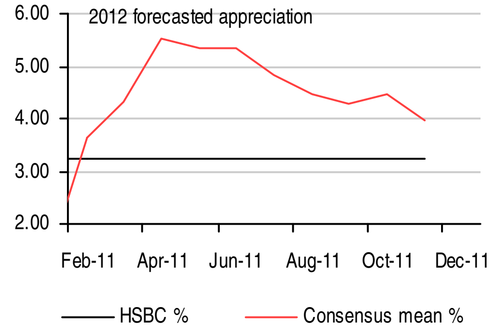
Source: Bloomberg, HSBC

4. The FX regime dynamics have changed under capital outflows



Source: HSBC estimates based on data from Bloomberg, Reuters, CEIC

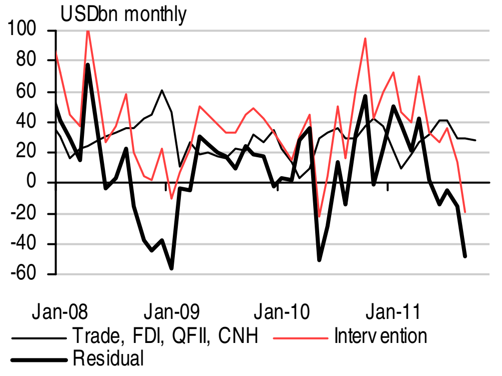
5. Consensus has scaled back appreciation expectations for 2012



Source: Bloomberg, HSBC; Note: Consensus mean is the % change from the consensus mean forecast for 2011 to the consensus mean forecast for 2012.

Rather than a particular source of flow to explain the persistence of USD demand, we believe it is a broad-based phenomenon. In chart 6, we present a common method used to gauge short-term FX flows – basically calculating the difference between FX market intervention, and explained fundamental flows.

6. Hot money outflows are not new



Source: HSBC estimates based on data from Bloomberg, Reuters, CEIC,

While often termed "hot-money" flows, this residual can come from a variety of sources, including changes in hedging behaviour on foreign trade, choice of funding currency decisions, as well as the oft cited speculative in- or outflows.

One area where these changes have been particularly visible and flagged in the press has been in net FX settlement from current account transactions as reported by banks, which had fallen sharply recently. Chart 7 shows this net FX settlement compared to the monthly trade balance[1]. The difference could be considered a net shift in hedging behaviour (we explain this analysis in more detail in the "Appendix B: Gauging the size of recent outflows" in the *full version* of this report).

We believe even a modest adjustment of RMB expectations can cause enough of a shift in behaviour and position adjustment to produce a sizable outflow for a limited period of time. **This presence of outflows does not necessarily indicate that participants are now expecting currency depreciation; simply that they are expecting less appreciation.**

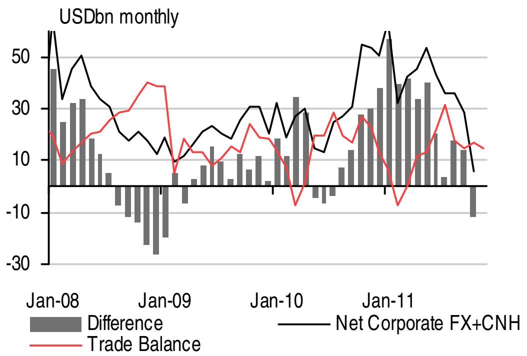
…against smaller trade surpluses create more volatility in net flows

However, the size and the magnitude of recent "unexplained" outflows are not new: the period between May-08 and Aug-09 saw nearly USD80bn of cumulative unexplained outflows, for example.

What is new, however, is that, as discussed earlier, today's fundamental surpluses are much smaller, and are unable to offset the outflows, as had happened in earlier episodes. This is why outflows have had such a more visible impact on the actual net balance of flows, and therefore the spot exchange rate.

[1] *Note that the Corporate FX series are for current account items, which will include a net services balance which this analysis does not take into account. We also add offshore CNH accumulation, as an explained and visible source of foregone USD demand from trade.*

7. Hedging decisions can mean that corporate FX flows diverge significantly from underlying activity



Source: HSBC, CEIC

This increased volatility is likely to continue throughout 2012. As the fundamental surplus continues to decline, not only could this cause further reduction of appreciation expectations and position adjustments, but these adjustments will be increasingly reflected in net flows and the spot rate.

Expect international currency politics to be hot this year

Put all together, 2012 will likely be a year where international currency politics becomes much more contentious. With a current account-to-GDP surplus falling well below 4% – the upper threshold proposed by the US Treasury Secretary last year during G20 negotiations – and especially with at least a temporary fall in FX reserves in 2012, the Chinese will find that the key indicators of currency misalignment commonly cited by the US Treasury no longer hold. Our read of the latest US Treasury semi-annual report on currencies released on December 27 suggests recognition that arguing RMB undervaluation is more nuanced than in the past. Especially in a year where China's exports will face greater challenges, we should expect to see the typical surge of RMB appreciation leading into international political events become a much more muted phenomenon in 2012.

With less obvious and persistent signs of RMB appreciation in a US election year, congressional noise is likely, whether the intention to actually pass legislation is real or not. Meanwhile, trade friction will likely also escalate throughout the year.

Eurozone talk is not cheap

Two other key topics stand out as we consider the RMB in 2012. First, the outlook for the Eurozone and how this could impact China and the RMB. Second, the internationalization of the RMB was more in focus than during previous trips.

Both of these topics reinforce our thinking that RMB appreciation will be slower next year whilst internationalization of the currency will become a more important feature. We maintain that the development of the offshore RMB will continue, despite the volatility seen by the CNH in September and early October 2011.

The Eurozone syndrome

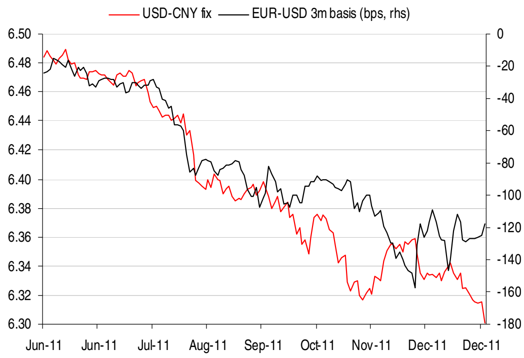
Our sense is that, unlike in previous episodes, in particular in May 2010 (see "*RMB… game change*", 4 June 2010), there is currently less blatant concern by policymakers about what the intensifying nature of the Eurozone's sovereign risk could mean for the RMB. Back then, the concern was that the unfolding Eurozone debt crisis could hurt exports materially and pressure the existing exchange rate regime.

This time, however, it appears that, like market participants, Chinese policymakers are already very aware of the deteriorating outlook for the Eurozone and what the potential implications could be should its sovereign risk issues turn even worse. So, a key difference between more recent challenges surrounding the EUR and the Eurozone and May 2010 is that many have had much more time to think about the implications now than previously.

This does not mean policymakers in China are relaxed about the negative impact on the country's exports from a weakening Eurozone economy but rather a general acceptance that it is severe and the implications for the RMB are not constructive. But again, this supports our thinking of a lower trade surplus and slower RMB appreciation in 2012.

One notably absent feature of the most recent financial market stress which stands out is the seeming lack of focus on USD liquidity pressures. So, although USD liquidity pressures have been intensifying in recent months, this did not appear to be playing a material role in RMB policy. This should make sense if we consider how the trend lower in USD-CNY fixes continued at a time when there has been a significant widening of USD basis, for example (chart 8). That is, policy allowed slow and steady CNY appreciation as reflected in the fix despite USD funding pressures turning more difficult.

8. USD-CNY continued to fix lower when USD liquidity pressures were intensifying



Source: HSBC, Bloomberg

If not appreciation, then internationalization

While currency policy is moving away from appreciation, the greater focus will be on internationalization. While earlier in 2011 we had already noted a large-scale acknowledgement of RMB internationalization as core policy, we believe there is now a high level of buy-in to the initiative across policymakers in Beijing.

While there has been a healthy debate on the merits and risks of internationalization onshore with some vocal critics[2], all indications are that opponents to the policy are very much in the minority. Thus, there appears to be minimal risk of a roll-back of internationalization, even with negative developments in the global and domestic macroeconomic environment, although progress would likely slow if the Eurozone situation got much worse.

We have already extensively covered the RMB internationalization developments to-date, and what we expect next year (see *Offshore renminbi – an updated primer*, 20 September 2011 and *Offshore RMB Q&A*, 02 December 2011).

Conclusion – RMB in 2012

We reiterate our long-held forecast of 3% appreciation over 2012. However, appreciation will be less gradual and instead more volatile, both because of a likely increase in the variability of the fixings, as well as more volatility in net flows. RMB depreciation is highly unlikely, but not impossible, should the USD suddenly be much stronger.

FX reserves are likely to show periods of decline and together with a declining trade surplus will make international currency politics more

[2] *WSJ: Ex-PBOC Adviser: Should Hold Off on New Yuan Internationalization Policies, 4 December 2011*

contentious, especially during a year of political transition on both sides of the Pacific. Trade tensions could also rise.

However, RMB internationalization will continue both in terms of organic market growth offshore as well as further opening and widening of cross-border channels.

We believe the RMB will be a favoured Asian currency to hold in 2012, and even if we expect it to be more volatile next year, it should be relatively less volatile than other currencies in the region. Thus, we recommend long RMB positions in the short end of the NDF curve either against the USD, or as the long side of a regional relative value trade.

Best and worst of 2012

- G10 – best: NOK and CAD, worst: AUD
- Asia – best: MYR, SGD and RMB, worst: INR and IDR
- Latam – best: COP and BRL, worst: ARS and CLP
- EMEA – best: TRY and HUF, worst: CZK

Our top picks

We present our most and least favoured currencies from the different regions for 2012. We also give our views on the precious metals market.

These recommendations are based on our belief that the euro will not break up, nor will any country leave the euro. Eventually the Eurozone news flow will stabilise. Once we start focusing on the 2012 US presidential election and the US budgetary position, the USD is likely to come under pressure in H2 2012.

G10

Best: NOK

- In a league of its own with a large current account surplus, a low sovereign risk profile, and a budgetary position which is second to none.
- Based on macro metrics, it is not difficult to argue that the NOK is the best currency in the world, and it possesses all the key attributes of a true safe haven.
- However, the NOK does not have the liquidity structure to absorb large flows, and rapid appreciation would likely trigger a policy fight back from the authorities in the form of lower rates.

Best: CAD

- Considering the issues facing the "ugly" G4 currencies, we see CAD as the best option when taking liquidity constraints into consideration.
- Although the case for it is not overwhelming as it is trading near fair value, it has a strong fiscal position and a stable financial system.
- It has twice the turnover of SEK, and is much less overvalued than the AUD.
- However, we believe some of these favourable attributes are already priced into the CAD, which should constrain its upside.

Worst: AUD

- The currency has been one of the most strongly correlated with the "risk on-risk off" factor for some time.
- The Eurozone news flow will eventually stabilise, and at some point, the market's focus will also have to turn to the unsustainable fiscal situation in the US.
- We therefore expect the "risk off" dynamics to push AUD lower.
- Global risks and slowing growth in Australia's Asian trading partners recently

caused the RBA to start easing policy, and further rate cuts look likely in our view.

- We see AUD as strongly overvalued, and expect it to average well below parity against the USD in 2012.

Asia

Best: MYR

- Large domestic demand and the strong trade surplus are fundamental reasons to be bullish MYR, particularly if commodity prices remain elevated.
- Political issues are holding back economic reforms at present, but we see these being overcome in 2012, with more FDI and privatisations offering further support on a flow basis.

Best: SGD

- Capital flows, particularly FDI into Singapore, are likely to persist into 2012, especially in the petro-chemical and biotechnology sectors.
- With inflation still well above MAS's forecast of 3-4% and a long-term average of 2%, MAS is likely to maintain an appreciation stance.
- With S$NEER now trading on the weak side of the policy band, the upside risk on USD-SGD is limited. In addition, any resolution in Europe should push S$NEER quickly towards the strong side of the band since this is a proxy of Asia and China.

Best: RMB

- See pages 26-31

Worst: INR

- Sizeable current account deficit will continue to make India over-reliant on external funding.
- Despite an aggressive rise in domestic nominal policy rates, higher and more persistent inflation has kept INR real interest rates very negative.
- Ongoing concern with the NPLs and reversal of FDI policy would encourage further portfolio outflows and limited FDI inflows.

Worst: IDR

- The medium-term risks for the IDR have risen, particularly with Bank Indonesia's (BI) dovish signals.
- Authorities need to remain mindful of the inflation threat in 2012.
- An expected increase in regulations will be a theme for the IDR in 2012 but the currency is at risk of weakening.

Latam

Best: COP

- Improving commodities output in Colombia.
- Central bank still in tightening mode, while most others are cutting.
- Less chance of funding squeezes after new government measures (volatility control options and reduction of pension funds trading limits).
- Improving economic activity.
- Strong FDI (aided by recent FTA with US).
- Main risk comes via lower oil prices.

Best: BRL (total return)

- We expect the currency to remain in a broad 1.70-1.90 range with the BCB intervening around these levels to both buy and sell USDs.
- Authorities will want to avoid too much BRL strength (hurts exporters) and weakness (could exacerbate inflation, although as

inflation pressures ease we may see more tolerance for BRL weakness).

- Lower volatility supports carry trades.
- We do not see signs of a structural shift for investors to shy away from Brazil, despite declining rates and previous measures to avoid BRL strength.
- Main risk comes via commodity prices (China).

Worst: ARS

- Stronger capital outflow pressures are being seen.
- Argentina has high dependence on grain prices (this will be relevant for the timing of more accelerated ARS weakness).
- Real appreciation of ARS in recent months suggests a faster pace of ARS depreciation will need to come.
- Recent measures to increase USD supply will not have a lasting effect.
- Extremely high forward points mean total USD returns of long ARS positions could still be positive, but this would be a high-risk trade and we maintain a negative outlook on nominal ARS returns

Worst: CLP

- Chile's dependence on copper exports makes it highly exposed to a global slowdown.
- Domestic growth is also declining and our economists expect the central bank to start cutting rates as early as this month (more than most EM currencies, the CLP tends to respond to widening/narrowing interest rate differentials).
- The current account has already turned negative, on the back of lower copper exports in 2011, and we expect a widening of the deficit for 2012.

EMEA

Best: TRY

- The Turkish lira is no longer an overvalued currency. It has massively underperformed the rest of EM FX.
- The forthcoming economic deceleration (partly via weaker credit growth) will reduce the external imbalances.
- Some sort of monetary policy normalisation would be TRY-supportive.
- The tolerance of the central bank for a weaker currency is very small.

Best: HUF

- The HUF is oversold, while the macro situation vs. 2008-09 is very different.
- The maintenance of a current account surplus will be rewarded, particularly with a government still committed to achieve a fiscal deficit of 3.5-3.0% of GDP in 2012.
- The government has no choice but to find an agreement with the IMF/EU. Such a deal would eliminate the tail risk.
- A cautious central bank policy, offering a decent carry.

Worst: CZK

- The Czech currency appears expensive, particularly on a relative basis.
- The CZK has not entirely priced-in the Eurozone recession and will be affected via exports. A mitigating factor is the financial sector is in better shape than its peers.
- In a very open economy with very weak domestic demand/low inflation, the only channel of adjustment is FX.

Precious Metals in 2012

Gold to trend higher

The gold market is likely to trend higher in 2012 based in part on positive underlying supply/demand fundamentals. Recent price declines should stimulate price-sensitive emerging market demand, notably for jewellery from China and India, which together account for around 55% of global jewellery consumption. Additionally, scrap supplies, while ample, are unlikely to rise at current price levels. Mine supply is slated to grow moderately in 2012 but we do not believe the marginal increase in output will be sufficient to deter a rally.

Accommodative monetary policies are historically gold-friendly. The possibility that government remedies for debt problems will indirectly lead to higher gold prices through inflation is likely to encourage gold investment in 2012. The Federal Reserve's stated commitment to keeping fed funds at near zero levels until mid-2013 is evidence of ongoing monetary easing and provides a bullish backdrop for gold prices. As central bankers and other policymakers run out of options, investor disquiet is increasing and paper markets look increasingly uncertain. In the near term, however, gold prices may be impacted by swings in investor risk sentiment. In a departure from its usual trading patterns, gold prices have become more correlated with risk assets, including equities. This can largely be explained by the ongoing Eurozone sovereign risk crisis, which is weighing heavily on the EUR and boosting the USD. As a surrogate currency, gold is inversely correlated to the USD and positively correlated to the EUR. Therefore, for as long as the Eurozone sovereign debt crisis is the main focus of the financial markets gold prices may be constrained. A remedy to the Eurozone crisis or a shift in focus to the US and its fiscal problems in 2012 would likely be highly supportive of gold.

An encouraging sign for gold is the steadfastness of the gold exchange-traded-funds, which despite periodic losses saw relatively little investor liquidation in 2011. A recovery in gold ETF demand in 2012, along with buoyant small bar and coin demand could propel gold higher in 2012. Furthermore, we do not attribute the steep losses in gold prices in Q4 2011 to a fundamental change in market sentiment towards bullion. Rather, we believe the sales were trigged by a need to raise cash by investors facing margin-related losses in the equity markets. We expect official sector buying to play a significant role in the gold market in 2012. The reluctance of gold-rich western central banks to dispose of their gold

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1. Updated precious metals forecasts (year average, USD/oz)

	2012	2013	2014	Long-term (2015-2019 average)
Gold	1850	1800	1750	1500
Silver	34	32	28	25
Platinum	1775	1825	1800	1800
Palladium	785	825	835	850

Source: HSBC

reserves combined with a growing appetite for gold from emerging central banks as a way to diversify their foreign exchange reserves promises to support prices.

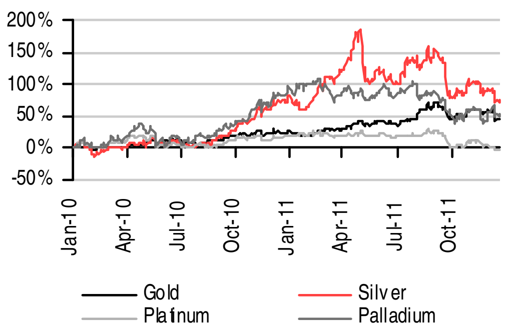
PGMs

The PGM markets are likely to rally in 2012. The auto sector accounts for more than half of platinum and palladium's annual production. Auto production is slated to recover after disruptions in production due to the Japanese tragedy early in 2011. Auto demand should provide a firm foundation for both platinum and palladium prices. Although growth in industrial demand for PGMs may be not be as robust in 2012 as envisaged earlier in 2011, industrial consumption is still likely to grow. Platinum stands to win market share in the crucial jewellery market from gold, due to its lower price and perceived higher quality status. Palladium prices will be sensitive to any evidence of diminished Russian exports. Although there is no public information on the subject, Russian stockpiles are perceived to be dwindling. Both platinum and palladium will be supported by limited mine supply growth in 2012. In the case of platinum, mine supply growth will be limited by electricity, manpower and other shortages in South Africa. In the case of palladium, output will be constricted by falling ore grades and limited nickel output in Russia, from which palladium is derived as a by-product. Palladium ETFs registered steep losses in 2011 and any recovery in investor demand in 2012 may serve to tighten underlying supply/demand balances.

Silver: good but not great

Although we are bullish on silver in 2012 we believe there is less upside scope for price appreciation than for the other precious metals. Unlike gold and the PGMs, silver will see considerable increases in mine supply next year based on significant investment made earlier in the mining cycle. Growth in industrial demand, while likely to be good, may not be as robust as forecast earlier in 2011. Also silver recycling is adding to supply as jewellery and photographic demand appear sluggish. Notably, the appetite for silver in the key solar power sector is moderating after initial stellar growth. Price direction in 2012 will depend heavily on investor sentiment. Retail demand for coins and small bars is likely to continue to be robust but demand for silver EFTs, which are significant holders of silver, fell in 2011.

2. Precious Metals Return



Source: HSBC, Bloomberg

Long-term forecasts

Long-term planning assumptions

We normally publish FX forecasts with about an 18-24 month time horizon. The purpose of these forecasts is to give customers a very short-hand way of identifying where we see the principal risks in the FX market over the next year. As always, we would caution against taking our point forecasts too seriously. They are only designed to show whether we see the principal risk as being that a currency goes up or down, a little or a lot over the coming year. Long experience has shown us that when we are basically right on market direction, the market moves further and more quickly than we dare forecast, and one-year targets can be reached very quickly. When we have the direction wrong, we can be wrong for a very long time.

Given the problems of forecasting out one year, many are understandably reluctant to venture a view for further out. However, we are aware that a number of our customers have a need for some indication of the likely FX market direction over a longer-term horizon for planning purposes. So again, with some trepidation, we publish our longer-term forecasts. If our one-year forecasts need to be treated with caution, it goes without saying that the longer-term numbers are even less to be relied upon. Nevertheless, we are aware that decisions and plans have to be made, and that a defensible and internally consistent set of forecasts may be of some value.

Methodology

The forecasts presented on the following two pages are based on the following methodology:

1. Short-term forecasts to the end of 2013 are taken from our existing numbers.
2. We estimate long-term 'fair value' exchange rates based on a rate that would be consistent with long-term external balance sustainability. These are sometimes called fundamental equilibrium exchange rates (FEERs) (see *Peterson Institute for International Economics, Policy Brief, June 2010 for* a discussion on FEERs).
3. We assume a gradual convergence to the long-term 'equilibrium' levels over the five years beyond our short-term forecast horizon.

Over the next two years, we see the dollar remaining relatively weak, as the US continues to struggle with its fiscal deficit and the overhang of debt. We see the euro remaining relatively strong, despite the sovereign debt issue, partly because of the Eurozone's strong external position, and partly as the sovereign debt problems are gradually addressed. Upward pressures on many EM currencies may intensify, but official resistance to appreciation will be strong. Once US economic recovery is better established, we would expect the dollar to move back towards long-term fair value. We expect JPY and CHF to remain relatively strong longer term for structural reasons.

HSBC

Long term forecasts versus USD

average year		2014f	2015f	2016f	2017f	2018f
Americas						
	Canada (CAD)	0.95	1.00	1.03	1.07	1.10
	Mexico (MXN)	13.50	13.80	14.00	14.20	14.20
	Brazil (BRL)	1.85	1.90	1.95	2.00	2.00
	Argentina (ARS)	5.00	5.25	5.50	5.75	5.75
	Venezuela (VEF)	4.00	4.00	4.00	4.00	4.00
	Chile (CLP)	530	530	530	530	530
	Colombia (COP)	2100	2100	2200	2200	2200
Western Europe						
	Eurozone (EUR*)	1.40	1.35	1.30	1.25	1.25
Other Western Europe						
	UK (GBP*)	1.55	1.54	1.52	1.50	1.50
	Sweden (SEK)	6.29	6.67	7.08	7.48	7.60
	Norway (NOK)	5.14	5.33	5.54	5.76	5.76
Emerging Europe	Russia (RUB)	40.4	40.8	41.1	41.5	41.5
	Hungary (HUF)	186	193	200	208	208
	Turkey (TRY)	1.60	1.60	1.60	1.60	1.60
Asia/Pacific						
	Japan (JPY)	72	75	80	85	90
	India (INR)	48.7	51.8	55.0	55.0	55.0
	Australia (AUD*)	0.90	0.85	0.80	0.75	0.75
	New Zealand (NZD*)	0.70	0.68	0.66	0.62	0.60
North Asia						
	China (CNY)	5.77	5.60	5.43	5.27	5.11
	Hong Kong (HKD)	7.80	7.80	7.80	7.80	7.80
	Taiwan (TWD)	27.9	28.9	30.0	30.0	30.0
	South Korea (KRW)	1087	1143	1200	1200	1200
ASEAN 5						
	Thailand (THB)	29.2	31.3	33.5	33.5	33.5
	Malaysia (MYR)	2.98	3.21	3.45	3.45	3.45
	Indonesia (IDR)	9067	10133	11200	11200	11200
	Philippines (PHP)	43.3	46.7	50.0	50.0	50.0
Africa						
	South Africa (ZAR)	7.30	7.30	7.30	7.30	7.30

source HSBC

Long term forecasts versus EUR and GBP

average year		2014f	2015f	2016f	2017f	2018f
Vs euro						
Americas						
	US (USD)	1.40	1.35	1.30	1.25	1.25
	Canada (CAD)	1.33	1.35	1.34	1.34	1.38
Europe						
	UK (GBP)	0.90	0.88	0.86	0.83	0.83
	Sweden (SEK)	8.80	9.00	9.20	9.35	9.50
	Norway (NOK)	7.20	7.20	7.20	7.20	7.20
	Switzerland (CHF)	1.20	1.25	1.30	1.35	1.40
	Russia (RUB)	56.6	55.1	53.4	57.5	57.5
	Poland (PLN)	3.50	3.50	3.50	3.50	3.50
	Hungary (HUF)	260	260	260	260	260
	Czech Republic (CZK)	23.0	23.0	23.0	23.0	23.0
Asia/Pacific						
	Japan (JPY)	101	101	104	106	113
	Australia (AUD)	1.56	1.59	1.63	1.67	1.67
	New Zealand (NZD)	2.00	1.99	1.97	2.02	2.08
Vs sterling						
Americas						
	US (USD)	1.55	1.54	1.52	1.50	1.50
	Canada (CAD)	1.47	1.54	1.57	1.61	1.65
Europe						
	Eurozone (EUR)	0.90	0.88	0.86	0.83	0.83
	Sweden (SEK)	9.7	10.3	10.8	11.2	11.4
	Norway (NOK)	8.0	8.2	8.4	8.6	8.6
	Switzerland (CHF)	1.33	1.43	1.52	1.62	1.68
Asia/Pacific						
	Japan (JPY)	112	116	122	128	135
	Australia (AUD)	1.72	1.81	1.90	2.00	2.00
	New Zealand (NZD)	2.21	2.26	2.30	2.42	2.50

source HSBC

Dollar Bloc

AUD – global contagion

After a highly volatile period in the second half of 2011, AUD-USD stabilised somewhat towards the very end of the year (chart 1). We believe the backdrop for the currency has weakened, and with "risk on-risk off" dynamics being the main driver of price action, we retain our bearish bias on the AUD.

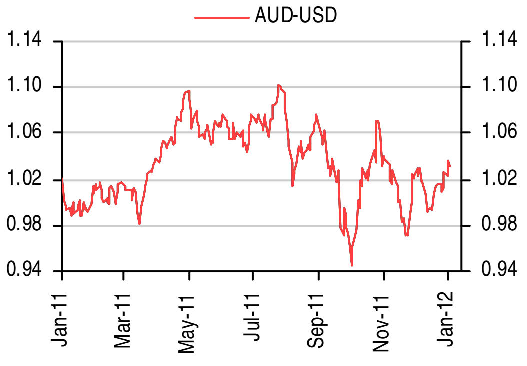
The growth prospects for Australia look relatively good purely on domestic grounds. Growth in 2011 was held back by natural disasters, and the mining investment boom is likely to pick up this year. However, growth has become uneven: those sectors directly linked to mining (around 20% of the economy) are doing very well, while growth in the sectors which constitute the remaining 80% is weak. Exchange rate sensitive sectors, such as tourism, manufacturing and education exporters, have slowed.

There is also little doubt that the external backdrop has weakened, and this will adversely affect the Australian economy. Growth is slowing in Australia's Asian trading partners, and the global risks have a large impact on sentiment and financial markets. This has caused the RBA to start easing policy as an insurance against further global slowdown. With the RBA now comfortable with its outlook for inflation, and given the global scene looks ever more worrisome, we expect a further 50bps of rate cuts in this quarter. The market is also pricing in further easing by the RBA (chart 2).

The AUD has, along with its antipodean smaller cousin NZD, been one of the most "risk on" currencies for some time. The Eurozone crisis is still the market's main focus, and even if the Eurozone news flow were to stabilise, we expect that attention will turn to the US presidential election and the unsustainable budgetary position, in which case the dynamics of the "risk on-risk off" paradigm would push AUD lower.

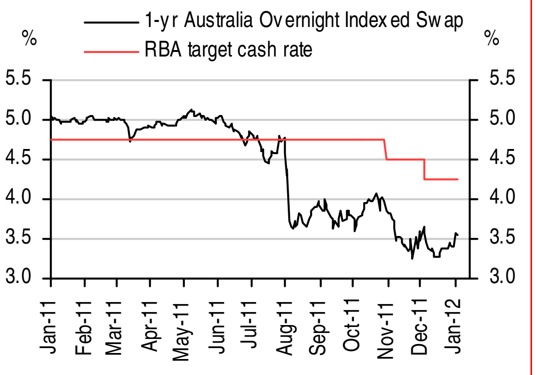
We remain bearish of the AUD and expect it to average well below parity against the USD in 2012.

1. AUD-USD was very volatile in H2 2011



Source: HSBC, Bloomberg

2. The market is pricing in further easing by the RBA



Source: HSBC, Bloomberg

NZD – can't escape RORO

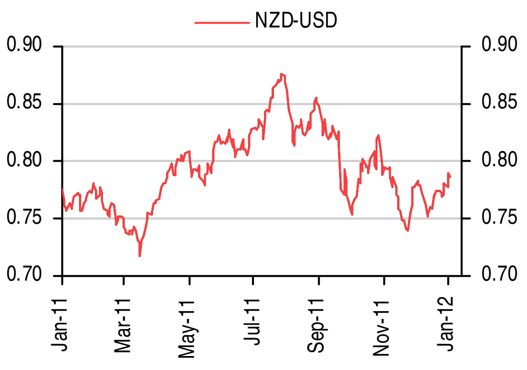
Considering the high volatility in NZD-USD observed in recent months, December was a relatively stable month for the pair (chart 1). The NZD continues to be one of the currencies most strongly correlated with the "risk on-risk off" (RORO) factor, leaving economic fundamentals playing second fiddle. When the market's view is positive, the NZD performs well, and when the news flow turns negative, it sells off.

The economic outlook for New Zealand looks relatively solid in comparison with other developed economies. Growth was solid in Q3, up 0.8% q-o-q, strongly supported by the 80,000 extra visitors who came to New Zealand for the Rugby World Cup. Business confidence appears to have stabilised at moderately positive levels (chart 2), which supports the view that recovery is continuing even as global concerns increase. The rebuilding of Canterbury has not yet hit full stride, and should support growth going forward. However, slowing growth in New Zealand's main trading partners, lower commodity prices as a result of the weakening global situation, and higher local bank funding costs putting pressure on borrowing rates, are all factors which could dampen growth.

As expected, the RBNZ kept rates on hold at 2.50% in its December meeting. The central bank has been unable to lift rates from what they were referring to as "emergency levels" put in place after the Canterbury earthquake in February. The RBNZ has now dropped the phrasing "emergency levels", implying that these low rates may be held for some time yet. We believe that the strong global risks and the Eurozone crisis' impact on growth in Asia will keep the RBNZ on hold for longer than previously expected. Our Australia and New Zealand economist, Paul Bloxham, suggests that we might seamlessly have moved from one emergency to the next, and that these historic lows may be the "new normal", at least for a while.

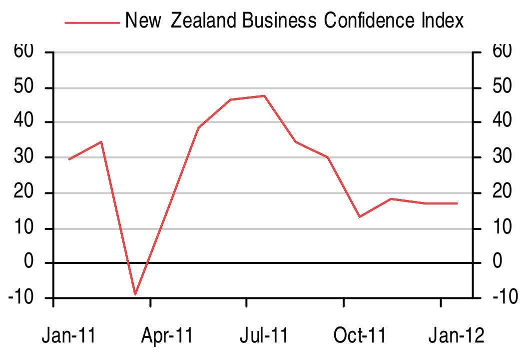
In summary, the outlook for New Zealand economy looks relatively good, but as long as the RORO paradigm remains the dominant force in the market, global stresses will push the NZD lower.

1. NZD-USD stabilised somewhat in the last month of 2011



Source: HSBC, Bloomberg

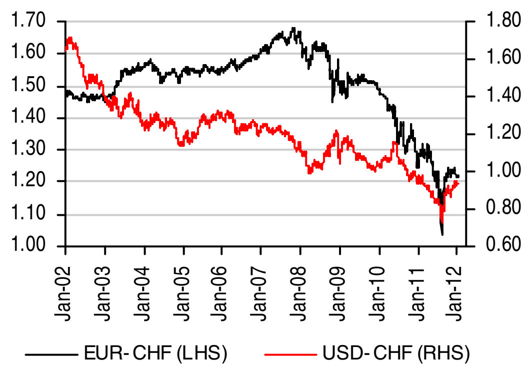
2. Business confidence appears to have steadied down



Source: HSBC, Bloomberg

Europe at a glance

CHF



Source: Bloomberg

Switzerland: Expect the floor to stay put

- The success of the SNB's intervention policy is such that the market debate still largely centres not on whether the floor on EUR-CHF will hold, but whether it may be raised to further ease the currency-induced headwinds the economy is facing.
- There are grounds for a higher floor as many Swiss economic indicators are succumbing to the adverse impact of CHF strength, including the recent descent in the KOF index to a 2-year low. Although the 1.20 floor has held, the CHF remains strong by historical standards.
- Nonetheless, we continue to believe that the current strategy will not be modified. The SNB has built up considerable credibility through its stable approach, resisting the temptation to alter the floor at the December meeting. A substantial adjustment would be required to have a big impact on economic fortunes, and a much higher floor might simply encourage the market to test the SNB's resolve.

EUR-NOK

Source: Bloomberg

Norway: Our favourite pick in 2012

- See page 32

EUR-SEK

Source: Bloomberg

Sweden: At the mercy of Europe

- GDP rebounded more strongly than expected in Q3 11 (1.6% q-o-q), mainly driven by net exports. However, Sweden's trade reliance on the Eurozone will likely cause external demand for Sweden's main exports to wane going in to 2012, and domestic demand was anaemic in Q3.
- Nevertheless, its budget surplus and low public debt mean that Sweden will not be forced into austerity, and thus looks a lot less vulnerable than others.
- We are more cautions on the SEK than the NOK as it is generally more correlated with equities than NOK, and is thus likely to be hit harder if there is a large risk-off equity sell-off.
- The SEK can thus not be treated as a true safe haven, although it does possess many attractive qualities.

Asia – regional overview

Difficult start to 2012

The road ahead will be difficult for Asian currencies, with widespread uncertainty likely to persist in coming months. The combination of slower global growth, ongoing European sovereign difficulties and uncertain FX policy from G10 authorities will all combine to create a tentative environment for Asian FX. However, further out, we think the trend of Asian currency appreciation will broadly return. Asian economic growth is on a much sounder footing structurally than the G10 world. Also, Asian authorities will be able to introduce counter-cyclical measures in order to ensure growth does not weaken too notably.

USD funding may impact trade

One key area of concern has been USD liquidity, as investors have scrambled to get their hands on the greenback. The 12m US Libor rate has moved from a low of 0.72% to 1.13% while EUR-USD basis swaps continue to imply heavy pressure on US funding. One way in which this could hit Asian FX is through lower trade financing. Using Letters of Credit data for Korea and Taiwan as a proxy for trade finance, we can see that there have already been signs of a decline, which could be a pre-cursor of exports weakening further. Part of the slowdown in this data could be due to a reduction in developed world demand. However, as we have noted for some time, the rise of intra-regional trade should keep underlying demand robust. Also, despite the decline in credit conditions, overall things look better than in 2008 so outright Asian currency weakness seems unlikely in the medium term.

Be wary of further position reduction

Another concern is the potential for ongoing positioning adjustment out of Asia and back towards "safe havens" and the USD. Foreigners in the Asian equity markets which we track have re-trenched around 25% of their positions since May 2011. There is still quite high ownership in some Asian equity markets. However, we think that an equally large further withdrawal seems unlikely, and that those countries with bond exposures could be more at risk. So far, adjustments in Asian fixed income positions have been lacking and foreign ownership as a percentage of total issuance remains sizeable. Some countries even saw renewed interest in their government bond markets in late 2011. These could come under renewed pressure if markets continue to look shaky in early 2012.

Policy and politics starting to matter more

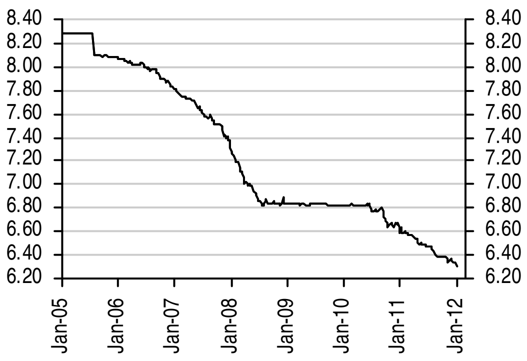
On the plus side, Asian authorities are well placed to stabilise excessive weakness in both their economies and their currencies. The fiscal situation is better than in 2008, which will allow stimulus measures to be enacted. Meanwhile, as we have written previously, FX reserves provide an important large buffer to currency declines. If global uncertainty starts to clear up, then Asian currencies will be well place to outperform.

Favour intra- over inter- regional positions

With the near-term picture mixed for Asia versus G10, we prefer to look for regional crosses and continue to favour the robust stories in RMB and SGD over the likes of TWD, which stands out as a funding currency in Asia.

Asia at a glance

USD-CNY

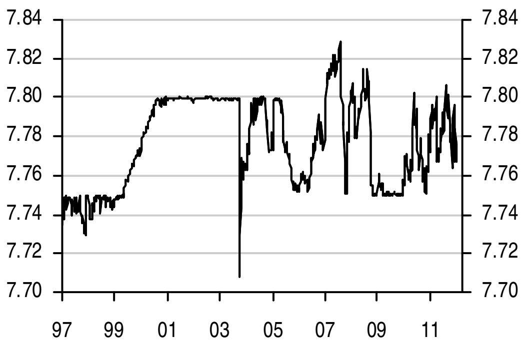


Source: Bloomberg

China: Internationalization, less appreciation

- We believe that the RMB will see less appreciation – around 3% in 2012 versus 5% last year – and more volatility in 2012. We had been factoring a slower amount of RMB appreciation in 2012 for some time. The shifting policy focus from inflation to growth means a slowdown in RMB appreciation. Meanwhile, the weakening of RMB appreciation expectations is causing volatility in flows.
- With less RMB appreciation being built in, we will likely see more frequent occurrences of outflows, which coupled with the smaller external trade balance, will add to the currency's volatility.
- A final takeaway is that the policy focus will shift towards further internationalization, a policy which found broad support onshore. We think that any roll back is unlikely.

USD-HKD

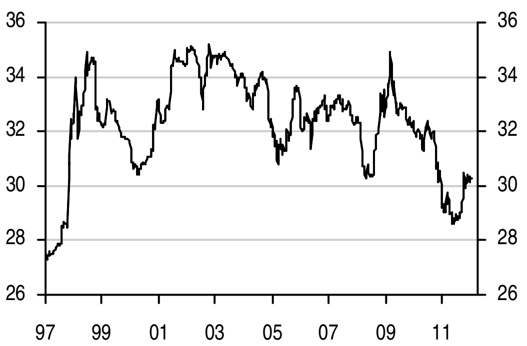


Source: Bloomberg

Hong Kong: Offshore RMB QFII launched

- Chinese authorities issued rules for a pilot programme from Renminbi Qualified Foreign Institutional Investors (RQFII) on 19 December. The initial size of the channel is small, RMB20bn, and so the immediate impact is also limited. However, the trend of opening and widening cross-border RMB flow channels will continue to improve the consistency of liquidity of the CNH market. The take-up of the RMB FDI programme has been swift, and this has probably contributed to the re-convergence of the onshore and offshore spot rates. Increased cross-border channels mean that CNH deposit base changes will be better able to respond to supply-demand imbalances, which should help to reduce CNH FX volatility. Over time this process will provide a better anchor of price and volatility to onshore spot, though we reiterate that, for now, risk managers need to continue to treat CNH as a separate and deliverable currency.

USD-TWD



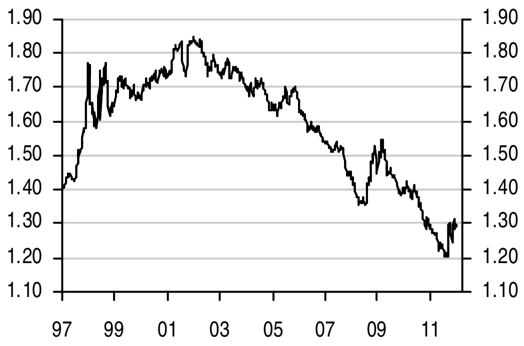
Source: Bloomberg

Taiwan: Risk of weakness from tight presidential race

- We believe the risk for USD-TWD is to the upside ahead of Taiwan's elections on 14 Jan. The recent polls have hinted that while incumbent President Ma Ying-Jeou is in the lead, the margin is considerably smaller than in 2008. Then he won 58.5% of the votes and was leading by around 25% in the polls prior to the election. This year, his margin stands at just 6-7%. Around 15% of voters remain undecided which leaves a big swing factor. If the current opposition DPP was to win the election, it could create some uncertainty. The DPP's historical relationship with China may make further gains in the cross strait relationship more difficult, and this could lead to potential portfolio outflows. While 2011 did see around USD30bn of equity outflows, this only accounts for around half of the inflows since 2009 and further retracement is possible. If KMT were to retain power, TWD strength would likely be resisted by CBC.

Asia at a glance continued

USD-SGD



Source: Bloomberg

Singapore: Selling USD despite NEER far from band bottom

- The recent release of the MAS's reserves data and forward book showed that Singapore's FX reserves declined during October. This is of particular interest, as Singapore is the only country in Asia that explicitly uses FX policy in a defined manner – to keep the S$NEER in a "modest and gradual" upward trend. Normally we would therefore only expect to see sustained USD selling when the NEER is at the bottom of the band. In October, the S$NEER was trading in the lower half of the band, but it did not get particularly close to the estimated band bottom. One possible explanation may be that ongoing concerns about USD funding and liquidity caused the MAS to provide dollars to keep the financial system well oiled. While it is hard to corroborate, we think it is worth keeping an eye on. If MAS is willing to act more decisively away from the band limits, it may make trying to trade the NEER even less transparent.

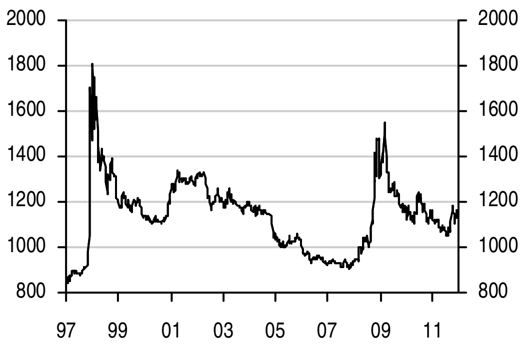
USD-INR

Source: Bloomberg

India: RBI fighting back

- The RBI has moved to fight the sharp slide in INR. Corporates will have to do the majority of their hedging on actually transacted trade exposures. This should reduce the average tenor of these hedges and constrain the speculative activities that have been adding to pressure on the INR in recent months. However, these sorts of measures alone are unlikely to resolve INR depreciation pressures in the very long-run. Currency depreciation pressures stem from the fundamental vulnerability from: (a) a sizable external funding requirement (b) a growth-inflation mix that makes attracting this funding difficult domestically, and (c) still stressed global USD funding markets. We believe the INR has not overshot significantly. In other words, the INR still faces strong headwinds despite a steady stream of regulations announced to stem the slide. We remain committed USD bears and believe that will play a stronger role in putting downward pressure on USD-INR further out.

USD-KRW



Source: Bloomberg

South Korea: Implications of Kim Jong Il's demise

- North Asian geopolitical risks have been known for some time, and while the recent passing away of North Korea's leader may put them into greater focus in the near term, the impact on the global market, and the KRW, should be limited. Although we are fundamentally bullish on most Asian currencies in the medium term, we have always stated that KRW is one of the most reactive currencies in the region to changes in risk sentiment. Therefore, we have preferred to remain relatively neutral on the currency, due to its higher volatility. Given the heightened uncertainty north of the border and the ongoing deterioration in global conditions, the KRW is likely to remain volatile. The BoK would need to be more aggressive in the FX market to limit upside risk on USD-KRW. That said, the BoK has sufficient USD ammunition to do this, especially given the recent signing of USD30bn swap lines with Japan. Further signing of USD swap lines, such as with the Fed (their previous swap line expired in February 2010) would also be helpful.

Latin America at a glance

USD-BRL

Source: Bloomberg

Brazil: Partially insulated, but not immune

- In December our economists revised down their 2012 GDP growth projections for Brazil from 4.0% to 3.7%. This would still not be a bad result given the conditions being felt in Europe and the US. Brazil benefits from having a relatively closed economy and will continue to ease monetary policy through the first half of the year. Some fiscal easing seems likely too. But despite this, the BRL is still exposed to external events, including the performance of commodities, which themselves are highly dependent on China's economic growth. That we envisage a soft landing for China (above 8% growth this year) is positive, and should help to support the BRL. Broader risk sentiment will remain crucial, however, with USD-BRL likely to oscillate within a broad 1.70-1.90 range. We favour buying the BRL towards the top side of this range, expecting the BCB to step back into the market with USD sales should this level be breached.

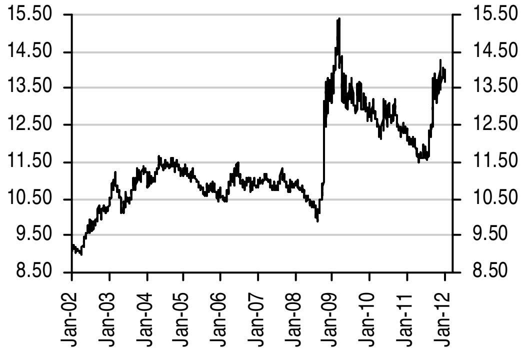
USD-CLP

Source: Bloomberg

Chile: Facing headwinds

- We have turned much less constructive on the CLP for 2012. In particular, as an open and small economy that is largely dependent on one commodity product, copper, Chile looks highly exposed to a global slowdown. In that sense, Chile is one of the countries most exposed to the softening of growth in China via the commodities channel. Domestic growth is also declining and our economists expect the central bank to start cutting rates as early as this month. More than other currencies in the region, the CLP tends to respond to changes in interest rate differentials. Additional pressures on the currency will come from the deterioration of external accounts. The current account has already turned negative, on the back of lower copper exports, and we expect a widening of the deficit for 2012. To the extent that the central bank has suspended its reserve accumulation program, the overall impact on flows may be felt less starkly though.

USD-MXN



Source: Bloomberg

Mexico: Recovery dependent on US data

- The Mexican economy is set to perform relatively well in 2012, with our economists forecasting 3.4% GDP growth. Exports have been showing good traction, domestic consumption and consumer confidence is firm, fiscal balances are in good shape and the cheapness of the exchange rate supports Mexico's competitiveness. Auto production and exports are set to grow strongly with a number of major car manufacturers recently announcing plans for new plants. Overall, therefore, we remain broadly constructive on the MXN, not least thanks to the central bank's recent decision in late November to introduce a volatility control system should the peso weaken more than 2% from the previous day. The peso will remain closely aligned to US economic data, and given the recent improvements being seen for the latter, this bodes well. However, global uncertainty will keep investors cautious, likely tempering MXN gains.

EMEA at a glance

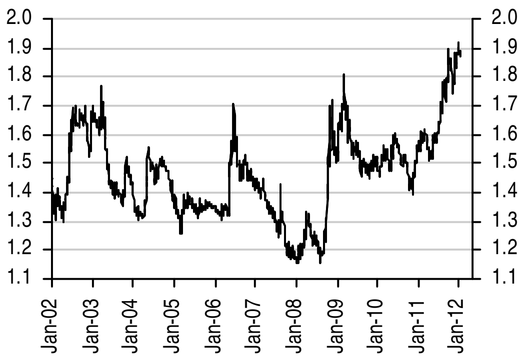
USD-RUB

Source: Bloomberg

Russia: RUB supported in Q1 but...

- The current account balance tends to improve in Q1 as imports underperform exports. This is the key macro factor behind our constructive view on the rouble for Q1. However, the growing political clouds put our forecast at risk. The uncertainties surrounding the Presidential elections due to be held in March may trigger more capital outflows and weigh on the currency. The outflows may still be lower than the current account surplus, limiting depreciation pressures.
- Beyond Q1, we continue to see a weaker RUB in 2012. The current account surplus will narrow from Q2, while net capital outflows are likely to continue. High inflation should be also another RUB-negative factor and the currency depreciation the main way to improve the balance of payments. Finally, the uncertainties about oil prices because of a slowing global economy will be a risk factor.

USD-TRY

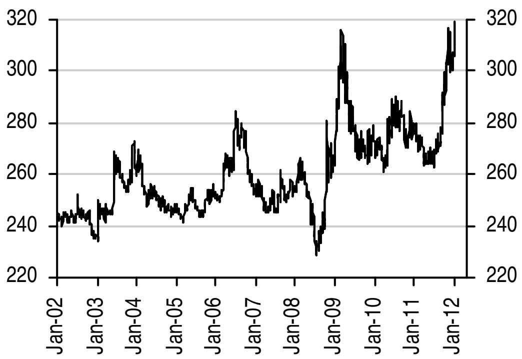


Source: Bloomberg

Turkey: Uncertainty weighs on the lira

- Although the aim was to increase the predictability of the monetary policy, the recent set of measures announced by the central bank has created even more confusion for the markets. The FX interventions (via auction or direct) and lira funding will continue to vary depending on what the central bank defines as "normal days" and "exceptional days". The market does not like uncertainty, particularly in a context of high inflation and wide current account deficit, and the lira pays the price.
- Yet, from a valuation standpoint the currency is undervalued. The currency has depreciated sharply in 2011, being one the worst performing currencies in the EM space. This fall has created some misalignment with the valuation metrics .The likely narrowing of the current account deficit in coming months and some sort of normalisation in the monetary policy would be TRY-positive.

EUR-HUF



Source: Bloomberg

Hungary: The HUF is still vulnerable

- The HUF remains vulnerable. The formal negotiations with the IMF due to start at the beginning of January have been delayed. The adoption of law potentially reducing the central bank's independence has been criticised by the IMF and European institutions and triggered an unexpected S&P's rating downgrade. Hungary's credit rating is now below investment grade with both S&P's and Moody's.
- The IMF deal is pivotal for the HUF outlook as the market sees the high level of private and public debt as a threat to the financial stability in the context of a Eurozone crisis. A financial insurance would reduce considerably the tail risk weighing on the HUF. Combined with a current account surplus and a central bank maintaining high level of interest rates, IMF support would actually offer significant appreciation potential to the HUF.

HSBC Volume-Weighted REERs

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For full details of the construction methodology of the HSBC REERs, please see *"HSBC's New Volume-Weighted REERs" Currency Outlook April 2009*.

The value of a currency

Since FX prices are always given as the amount of one currency that can be bought with another, the inherent value of a currency is not defined. For example, if EUR-USD goes up, this could be because the EUR has increased in value, the USD has decreased in value, or a combination of both. One possible method for getting some insight into changes in the value of a currency is to look at movements in the value of a basket of other currencies against the currency of interest. For example, if EUR-USD increased over some time period, one could see how EUR had performed against a range of other currencies to determine whether EUR has become generally more valuable or whether this was simply a USD-based move. An effective exchange rate is an attempt to do this and to represent the moves in index form.

There are two main approaches to building an effective exchange rate: Nominal Effective Exchange Rates (NEERs) and Real Effective Exchange Rates (REERs). NEERs simply track the weighted average returns of a basket of other currencies against the currency being investigated; REERs deflate the returns in an attempt to compensate for the differing rates of inflation in different countries. The reason for doing this is that, particularly over long time frames, inflation can have a large impact on the purchasing power of a currency.

How should we weight the basket?

If we are trying to create an index for the change in value of a currency against a basket of other currencies, we now need to decide on how to weight our basket. One possible solution would be to simply have an equally-weighted basket. The rationale for this would be that there is no *a priori* reason for choosing to put more emphasis on any one exchange rate. However, this could clearly lead to the situation where a large move in a relatively small currency can strongly influence the REERs and NEERs for all other currencies. To avoid this, the indices are generally weighted so that more "important" currencies get higher weighting. This, of course, begs the question of how "importance" is defined.

Trade Weights

Weighting the basket by bilateral trade-weights is the most common weighting procedure for creating an effective exchange rate index. This is because the indices are often used to measure the likely impact of exchange rate moves on a country's international trade performance.

Volume Weights

The daily volume traded in the FX market dwarves the global volume of physical trade. From this it is possible to make a convincing argument that the weighting which would be really important would be to weight the currency basket by financial market flows, rather than bilateral trade.

To do this properly would require us to have accurate FX volumes for all currency pairs considered in the index. However, these are not available. The BIS triennial survey of FX volumes only gives data for a small number of bilateral exchange rates. However, the volumes are split by currency for over 30 currencies. From these volumes we can estimate financial weightings for each currency. We believe that this gives another plausible definition for "importance", and one which may be more relevant for financial investors than trade weights. We call this procedure volume weighting and the indices produced through this procedure we call the HSBC volume-weighted REERs.

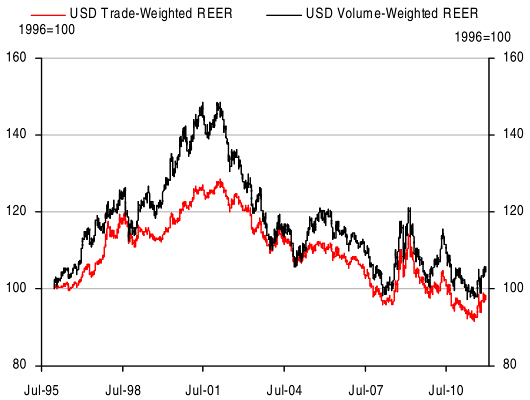
We would argue that if you are a financial market investor, the effective value of a currency you would be exposed to is more accurately represented by the HSBC volume-weighted index rather than the trade-weighted index.

Data Frequency

This is something which is rarely considered when constructing REERs – inflation data is generally released at monthly frequency at best so the usual procedure is to simply create monthly indices by default. However, some countries release their inflation data only quarterly. The usual procedure for these countries is to simply *pro-rata* the change over the period. Here there is an implicit assumption that the rate of inflation changes slowly. We take this assumption one step further and assume that it is valid to spread the inflation out equally over every day in the month.

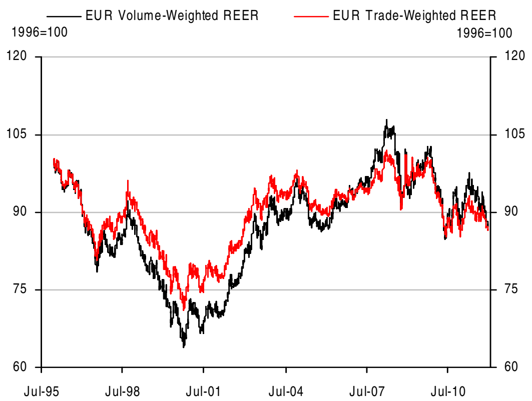
HSBC Volume – Weighted REERs

USD REER index



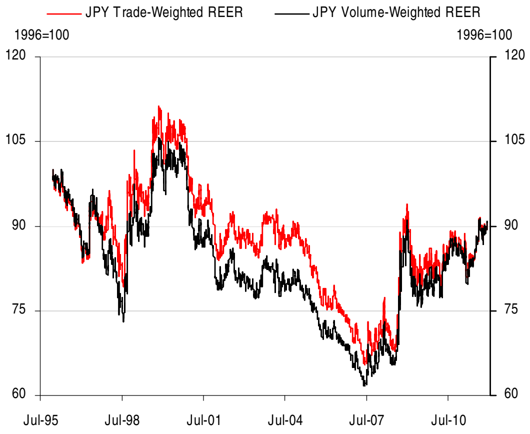
Source: HSBC

EUR REER index



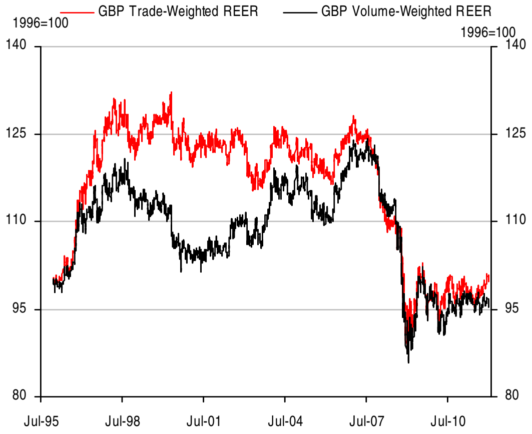
Source: HSBC

JPY REER index



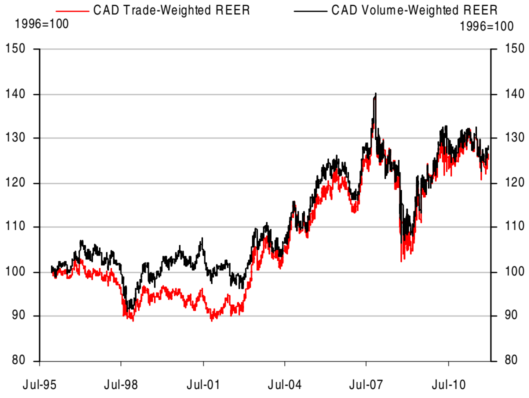
Source: HSBC

GBP REER index



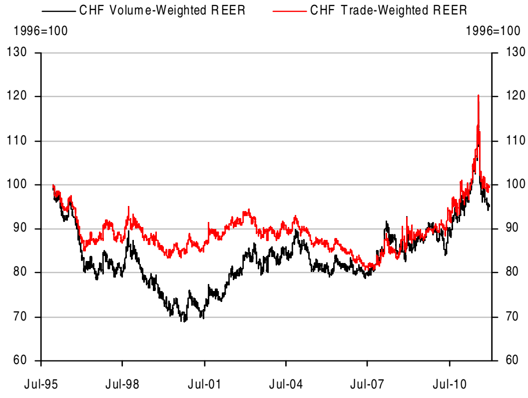
Source: HSBC

CAD REER index



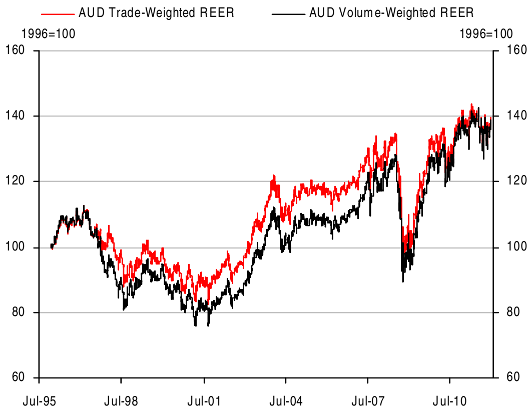
Source: HSBC

CHF REER index



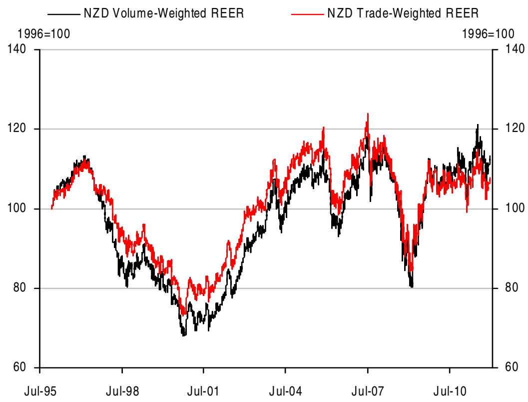
Source: HSBC

AUD REER index



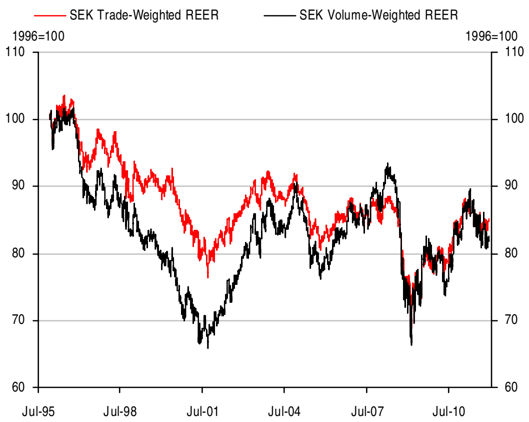
Source: HSBC

NZD REER index



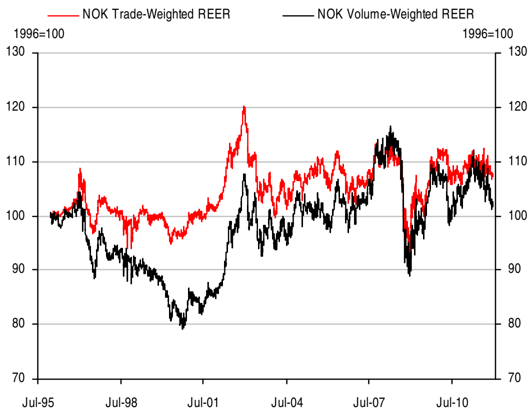
Source: HSBC

SEK REER index



Source: HSBC

NOK REER index



Source: HSBC

HSBC forecasts vs forwards

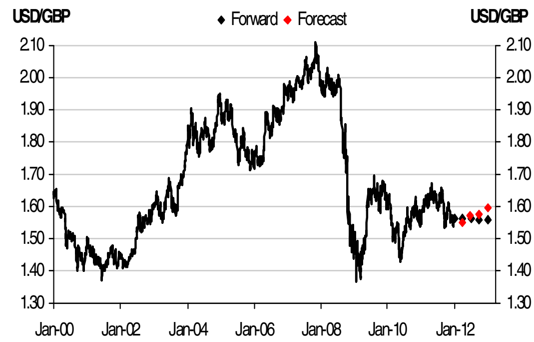
EUR-USD vs forwards

Source: Thomson Financial Datastream, Reuters, HSBC

EUR-CHF vs forwards

Source: Thomson Financial Datastream, Reuters, HSBC

GBP-USD vs forwards



Source: Thomson Financial Datastream, Reuters, HSBC

EUR-GBP vs forwards

Source: Thomson Financial Datastream, Reuters, HSBC

USD-JPY vs forwards

Source: Thomson Financial Datastream, Reuters, HSBC

EUR-JPY vs forwards

Source: Thomson Financial Datastream, Reuters, HSBC

Short rates

3 Month Money

end period		2007 Q4	2008 Q4	2009 Q4	2010 Q4	2011 Q3	Q4	2012 Q1f	Q2f	Q3f	Q4f
North America											
	US (USD)	4.7	1.4	0.3	0.3	0.4	0.5	0.6	0.5	0.5	0.5
	Canada (CAD)	4.5	1.9	0.5	1.2	1.2	1.4	1.5	1.4	1.4	1.4
Latin America											
	Mexico (MXN)	7.3	8.2	4.6	4.6	4.3	4.3	4.3	4.4	4.4	4.5
	Brazil (BRL)	11.2	13.0	8.7	11.1	12.0	11.0	10.0	9.0	9.0	9.0
	Argentina (ARS)*	13.6	19.8	10.0	11.3	14.0	18.0	17.0	16.0	15.0	16.0
	Chile (CLP)	6.2	7.9	0.5	3.3	5.3	5.3	4.6	4.6	4.6	4.6
Western Europe											
Eurozone		4.6	2.9	0.7	0.9	1.5	1.4	1.2	1.1	1.1	1.0
Other Western Europe											
	UK (GBP)	5.9	2.8	0.6	0.8	1.0	1.1	1.0	0.9	0.9	0.9
	Norway (NOK)	5.9	4.0	2.2	2.6	3.0	2.9	2.0	1.9	1.9	1.8
	Sweden (SEK)	4.7	2.5	0.5	1.8	2.5	2.7	2.2	2.2	2.2	2.3
	Switzerland (CHF)	2.6	0.6	0.3	0.2	0.0	0.1	0.1	0.1	0.1	0.1
EMEA											
	Hungary (HUF)	7.6	10.0	6.0	5.9	6.1	7.0	7.0	7.0	7.0	6.9
	Poland (PLN)	5.1	5.8	4.2	4.0	4.8	5.0	5.0	4.8	4.7	4.7
	Russia (RUB)*	6.3	20.6	6.6	3.8	6.2	6.0	6.3	6.5	6.7	6.5
	Turkey (TRY)	16.0	15.5	7.5	6.7	8.0	9.7	9.5	9.3	9.3	9.0
	Ukraine (UAH)	6.6	20.0	16.1	9.1	12.0	20.0	17.0	17.0	17.0	10.0
Asia/Pacific											
	Japan (JPY)	0.6	0.6	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
	Australia (AUD)	7.3	4.1	4.0	4.9	4.8	4.7	4.1	4.1	4.1	4.1
	New Zealand (NZD)	8.9	6.0	2.8	3.3	2.8	2.9	2.8	3.1	3.3	3.6
North Asia											
	China (CNY)	3.3	1.7	1.7	2.3	3.1	3.1	3.1	3.1	2.9	2.9
	Hong Kong (HKD)	3.5	1.0	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3
	Taiwan (TWD)	2.2	1.0	0.5	0.7	0.9	0.8	0.6	0.8	1.0	1.1
	South Korea (KRW)	5.7	4.7	2.8	2.8	3.6	3.5	3.3	3.3	3.3	3.3
South Asia											
	India (INR)	8.3	9.2	3.7	7.2	8.4	8.4	8.2	8.0	7.8	7.8
	Indonesia (IDR)	7.8	12.0	6.6	6.4	6.4	5.3	5.1	4.9	4.9	4.9
	Malaysia (MYR)	3.6	3.4	2.3	3.0	3.3	3.2	2.9	2.7	2.7	2.8
	Philippines (PHP)	3.7	6.1	3.9	0.8	0.7	4.5	4.2	4.2	4.2	4.2
	Singapore (SGD)	2.5	1.4	0.7	0.4	0.4	0.4	0.4	0.4	0.4	0.4
	Thailand (THB)	3.7	3.6	1.4	2.2	3.6	3.6	3.6	3.6	3.6	3.8
Africa											
	South Africa (ZAR)	11.3	11.4	7.1	5.6	5.6	5.5	5.2	5.2	5.1	5.1

*Notes: * 1-month money. Source: HSBC*

Important note

This table represents three month money rates. Due to the dislocation in the three month money markets, these rates may not give a good indication of policy rates.

HSBC

Emerging markets forecast table

	5-Jan-12	2011		2012				2013			
	last	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Latin America vs USD											
Argentina (ARS)	4.30	4.21	4.30	4.40	4.53	4.66	5.00	5.20	5.40	5.50	5.65
Brazil (BRL)	1.83	1.85	1.88	1.90	1.90	1.85	1.80	1.83	1.85	1.88	1.90
Chile (CLP)	510	521	520	525	530	530	530	530	530	530	530
Mexico (MXN)	13.70	13.88	13.97	13.60	13.50	13.40	13.20	13.28	13.35	13.43	13.50
Columbia (COP)	1885	1930	1939	1875	1875	1850	1800	1800	1800	1800	1800
Peru (PEN)	2.69	2.73	2.71	2.71	2.70	2.69	2.68	2.68	2.69	2.70	2.70
Venezuala (VEF)	4.29	4.30	4.30	4.30	4.30	4.30	4.30	5.60	5.60	5.60	5.60
Eastern Europe vs EUR											
Czech Republic (CZK)	25.92	24.71	25.50	26.00	26.00	24.50	24.30	24.00	23.80	23.70	23.70
Hungary (HUF)	323	293	315	300	295	290	285	275	270	270	270
Russia vs USD (RUB)	31.78	31.88	32.02	29.40	31.70	32.70	32.60	30.70	32.10	32.50	32.80
Romanian (RON)	4.34	4.31	4.31	4.35	4.30	4.20	4.20	4.10	4.05	4.00	4.00
Turkey vs USD (TRY)	1.88	1.86	1.89	1.85	1.80	1.75	1.65	1.65	1.60	1.60	1.55
Poland (PLN)	4.51	4.42	4.46	4.50	4.40	4.20	4.10	4.00	3.90	3.80	3.80
Middle East vs USD											
Egypt (EGP)	6.03	6.00	6.00	6.30	6.50	6.80	7.00	7.10	7.20	7.20	7.20
Israel (ILS)	3.85	3.70	3.80	3.75	3.70	3.65	3.60	3.50	3.50	3.50	3.40
Africa vs USD											
South Africa (ZAR)	8.17	8.04	8.07	8.50	8.00	7.50	7.30	7.00	6.80	6.80	6.80

Source: HSBC

Exchange rates vs USD

end period		2009	2010	2011			2012				2013			
		Q4	Q4	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Americas														
	Canada (CAD)	1.05	0.99	0.97	1.04	1.02	1.00	1.00	0.98	0.97	0.95	0.95	0.95	0.95
	Mexico (MXN)	13.08	12.36	11.71	13.88	13.97	13.60	13.50	13.40	13.20	13.28	13.35	13.43	13.50
	Brazil (BRL)	1.74	1.67	1.56	1.85	1.88	1.90	1.90	1.85	1.80	1.83	1.85	1.88	1.90
	Argentina (ARS)	3.80	3.97	4.11	4.21	4.30	4.40	4.53	4.66	5.00	5.20	5.40	5.50	5.65
Western Europe														
	Eurozone (EUR*)	1.43	1.34	1.45	1.34	1.30	1.34	1.37	1.40	1.44	1.45	1.45	1.45	1.45
Other Western Europe														
	UK (GBP*)	1.61	1.57	1.61	1.56	1.55	1.55	1.57	1.57	1.60	1.60	1.62	1.62	1.62
	Sweden (SEK)	7.14	6.72	6.31	6.87	6.86	6.64	6.50	6.29	6.11	6.03	6.00	5.97	5.93
	Norway (NOK)	5.78	5.81	5.37	5.87	5.97	5.71	5.51	5.32	5.14	5.07	5.03	5.00	4.97
	Switzerland (CHF)	1.03	0.93	0.84	0.91	0.94	0.90	0.88	0.86	0.83	0.83	0.83	0.83	0.83
Emerging Europe														
	Russia (RUB)	30.2	30.5	28.1	31.9	32.0	29.4	31.7	32.7	32.6	30.7	32.1	32.5	32.8
	Poland (PLN)	2.86	2.95	2.75	3.29	3.43	3.36	3.21	3.00	2.85	2.76	2.69	2.62	2.62
	Hungary (HUF)	188	207	183	219	242	224	215	207	198	190	186	186	186
	Czech Republic (CZK)	18.4	18.7	16.8	18.4	19.6	19.4	19.0	17.5	16.9	16.6	16.4	16.3	16.3
Asia/Pacific														
	Japan (JPY)	93	81	81	77	77	78	77	75	74	72	72	72	72
	Australia (AUD*)	0.90	1.03	1.07	0.97	1.03	0.98	0.97	0.96	0.95	0.95	0.95	0.95	0.95
	New Zealand (NZD*)	0.73	0.78	0.83	0.76	0.78	0.76	0.75	0.73	0.73	0.72	0.72	0.72	0.72
North Asia														
	China (CNY)	6.83	6.59	6.46	6.38	6.29	6.30	6.25	6.20	6.15	6.10	6.05	6.00	5.95
	Hong Kong (HKD)	7.75	7.77	7.78	7.78	7.77	7.80	7.80	7.80	7.80	7.80	7.80	7.80	7.80
	Taiwan (TWD)	32.1	30.4	28.7	30.5	30.3	29.5	29.0	28.5	28.0	27.7	27.4	27.1	26.8
	South Korea (KRW)	1166	1121	1067	1181	1159	1130	1110	1090	1070	1060	1050	1040	1030
South Asia														
	India (INR)	46.4	44.7	44.7	49.0	53.0	49.0	48.5	48.0	47.5	47.0	46.5	46.0	45.5
	Indonesia (IDR)	9425	9010	8577	8790	9068	8700	8550	8400	8300	8200	8100	8000	8000
	Malaysia (MYR)	3.42	3.08	3.02	3.19	3.17	3.05	3.00	2.95	2.88	2.85	2.82	2.79	2.74
	Philippines (PHP)	46.5	43.6	43.3	43.7	43.8	43.0	42.5	42.0	41.0	40.5	40.0	40.0	40.0
	Singapore (SGD)	1.41	1.28	1.23	1.31	1.30	1.25	1.23	1.21	1.19	1.18	1.17	1.16	1.15
	Thailand (THB)	33.3	30.1	30.7	31.1	31.6	30.2	29.7	29.2	28.8	28.5	28.0	27.5	27.0
	Vietnam (VND)	18200	19498	20515	20830	21037	21500	21500	21500	21500	21500	21500	21500	21500
Africa														
	South Africa (ZAR)	7.36	6.62	6.78	8.04	8.07	8.50	8.00	7.50	7.30	7.00	6.80	6.80	6.80

Source: HSBC

Exchange rates vs EUR & GBP

end period		2009	2010	2011			2012				2013			
		Q4	Q4	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Vs euro														
Americas														
	US (USD)	1.43	1.34	1.45	1.34	1.30	1.34	1.37	1.40	1.44	1.45	1.45	1.45	1.45
	Canada (CAD)	1.50	1.33	1.40	1.40	1.32	1.34	1.37	1.37	1.40	1.38	1.38	1.38	1.38
Europe														
	UK (GBP)	0.89	0.86	0.90	0.86	0.84	0.87	0.87	0.89	0.90	0.91	0.89	0.89	0.89
	Sweden (SEK)	10.24	9.02	9.15	9.21	8.90	8.90	8.90	8.80	8.80	8.75	8.70	8.65	8.60
	Norway (NOK)	8.29	7.80	7.78	7.88	7.75	7.65	7.55	7.45	7.40	7.35	7.30	7.25	7.20
	Switzerland (CHF)	1.48	1.25	1.22	1.22	1.21	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
	Russia (RUB)	43.4	40.9	40.7	42.8	41.6	39.4	43.4	45.8	46.9	44.5	46.5	47.1	47.6
	Poland (PLN)	4.11	3.96	3.98	4.42	4.46	4.50	4.40	4.20	4.10	4.00	3.90	3.80	3.80
	Hungary (HUF)	270	278	266	293	315	300	295	290	285	275	270	270	270
	Czech Republic (CZK)	26.4	25.1	24.3	24.7	25.5	26.0	26.0	24.5	24.3	24.0	23.8	23.7	23.7
Asia/Pacific														
	Japan (JPY)	134	109	117	103	100	105	105	105	107	104	104	104	104
	Australia (AUD)	1.60	1.31	1.35	1.38	1.27	1.37	1.41	1.46	1.52	1.53	1.53	1.53	1.53
	New Zealand (NZD)	1.97	1.72	1.76	1.76	1.66	1.76	1.83	1.92	1.97	2.01	2.01	2.01	2.01
Vs sterling														
Americas														
	US (USD)	1.61	1.57	1.61	1.56	1.55	1.55	1.57	1.57	1.60	1.60	1.62	1.62	1.62
	Canada (CAD)	1.69	1.56	1.55	1.62	1.58	1.55	1.57	1.54	1.55	1.52	1.54	1.54	1.54
Europe														
	Eurozone (EUR)	0.89	0.86	0.90	0.86	0.84	0.87	0.87	0.89	0.90	0.91	0.89	0.89	0.89
	Sweden (SEK)	11.53	10.53	10.13	10.70	10.65	10.28	10.19	9.90	9.76	9.66	9.74	9.69	9.63
	Norway (NOK)	9.33	9.10	8.61	9.15	9.27	8.84	8.64	8.38	8.21	8.12	8.17	8.12	8.06
	Switzerland (CHF)	1.67	1.46	1.35	1.41	1.45	1.39	1.37	1.35	1.33	1.33	1.34	1.34	1.34
Asia/Pacific														
	Japan (JPY)	150	127	130	120	120	121	121	118	118	115	117	117	117
	Australia (AUD)	1.80	1.53	1.50	1.60	1.52	1.58	1.62	1.64	1.68	1.69	1.71	1.71	1.71
	New Zealand (NZD)	2.22	2.00	1.94	2.04	1.99	2.04	2.09	2.16	2.19	2.22	2.26	2.26	2.26

Source: HSBC

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