HSBC
Global Research

By: HSBC FX Strategy

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Currency Outlook

No “sweet 16” for the USD

The USD rallied sharply in anticipation of the first Fed hike, and we believe the hiking cycle is fully priced in. Given we also think the ECB and BoJ have reached the limits of QE, we see USD weakness in 2016. Although EM may still struggle, we believe the bulk of the sell-off is behind us.

G10 FX: Hypersensitive to rates
G10 FX is more sensitive to interest rate expectations today than at any time over the last 15 years. The currency market is correct to be obsessed with Central Bank policy and expected policy differentials.

2016 currency outlooks
We provide summaries of our 2016 outlooks for the most traded currencies in G10, Asia, CEEMEA and LatAm.

Play video with David Bloom, Paul Mackel, Daragh Maher and Murat Toprak

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Summary

Key events

Date	Event
06 January	Federal Reserve releases minutes for December 15-16 meeting
14 January	Bank of England rate announcement
14 January	ECB releases minutes for December meeting
20 January	Bank of Canada rate announcement
21 January	ECB rate announcement
27 January	Fed rate announcement
27 January	RBNZ rate announcement

Source: HSBC

Central Bank policy rate forecasts (%)

	Last	Q2 2016(f)	Q4 2016(f)
USD	0-0.25	0.50-0.75	0.75-1.00
EUR	0.05	0.05	0.05
JPY	0-0.10	0-0.10	0-0.10
GBP	0.50	0.75	p1.00

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	1.059	1.053
JPY	124.5	124.4
GBP	1.508	1.496
CAD	1.341	1.325
AUD	0.684	0.676
NZD	0.622	0.609

Source: Consensus Economics Foreign Exchange Forecasts December 2015

Key themes for 2016

USD to weaken in 2016. We believe the USD will weaken in 2016, in contrast to a consensus that expects the USD rally to extend. History shows the USD weakens once the Fed starts to hike rates. In addition, we believe the conversation about the pace of Fed hikes will retain a very dovish tone in 2016, mirroring the experience of other central banks which have tried to raise rates after the 2008/09 financial crisis.

ECB will not be able to engineer a fresh bout of EUR weakness. The ECB faces constraints on how much it can expand QE, both in terms of the amount of bonds available to buy, and internal support for further monetary easing. Better than expected Eurozone data is also a challenge to a market still short EUR.

The JPY may strengthen as the BoJ is unlikely to expand QE further in 2016. Like the ECB, the BoJ's QE programme is reaching its limit, and we believe the central bank will move to a rates-based policy framework in 2016. In any event, the pressure for additional easing is on the wane given the BoJ's focus on the new (and higher) core inflation measure.

GBP to strengthen before succumbing to 'Brexit' fears. The market no longer expects the BoE to raise rates in 2016. We disagree, believing a rate hike in May is likely. The re-pricing of rate expectations should help push GBP higher early in the year towards 1.60 for GBP-USD. An intensification of the Brexit debate will likely raise fresh concerns about the sustainability of the UK's sizeable current account deficit causing GBP to weaken afresh.

Canada's fiscal experiment could be a game changer for the CAD. Although the currency will remain beholden to the vagaries of the oil price, other factors argue the currency could strengthen later in 2016. Chief among these is the prospect of some fiscal stimulus at a time when monetary policy and currency war gains are nearing exhaustion. We forecast USD-CAD at 1.25 by the end of 2016.

We expect the pace of EM FX weakness to ease in 2016 as the adjustments already made in currencies mean more of the risks are priced in. Commodity prices have already fallen a long way, thereby posing less of a threat going forward. Also EM FX should not fear a gradual Fed hiking cycle. Nonetheless, there is still not a convincing case for a significant EM FX recovery in 2016 given a meagre EM growth outlook, China risks, high EM leverage and local frailties.

No "sweet 16" for the USD

- Fed tightening will foster USD weakness not strength in 2016
- ECB and BoJ constrained in fighting EUR and JPY strength
- We forecast EUR-USD at 1.20 and USD-JPY at 115 for year-end 2016

We believe the USD will weaken in 2016, in contrast to a consensus that expects the USD rally to extend. In March 2015, we called the end of the USD bull run, a counter-consensus view at the time which has proven accurate. Our battle against the prevailing wisdom now extends into 2016, but rather than merely arguing the USD has stalled, we believe there are grounds to anticipate weakness.

There are three main strands to our argument for USD weakness:

1) The Fed tightening cycle will see the USD weaken not strengthen. History shows the USD weakens once the Fed starts to hike rates. In addition, we believe the conversation about the pace of Fed hikes will retain a very dovish tone in 2016, mirroring the experience of other central banks which have tried to raise rates after the 2008/09 financial crisis.

2) The ECB's power to engineer a weaker EUR is low. The ECB faces constraints on how much further it can expand QE, both in terms of the amount of bonds available to buy, and internal support for further monetary easing.

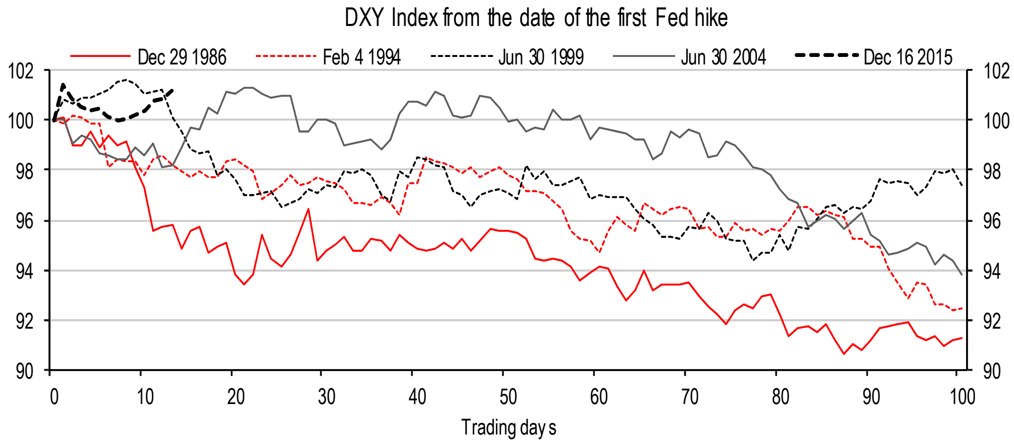
3) The BoJ is unlikely to expand QE further in 2016. Like the ECB, the BoJ's QE programme is reaching its limit, and we believe the central bank will move to a rates-based policy framework in 2016. In any event, the pressure for additional easing is on the wane given the BoJ's focus on the new (and higher) core inflation measure.

1) The Fed tightening cycle will see the USD weaken not strengthen

a) History points to a weaker USD

History offers the first point of reference for the likely path of the USD in 2016. Chart 1 shows the path of the USD over the 100 trading days following the first rate increase in each of the Fed's tightening cycles of the last 30 years. On each occasion, the USD fell even though there were additional rate increases made during the period. This suggests that some of the positive impact that the USD might derive from the Fed tightening is already in the price by the time the Fed raises rates for the first time, and that therefore the USD gives back ground once the move is made.

1. The USD has fallen after the first rate rise in previous tightening cycles



Source: Bloomberg, HSBC

The typical push back to this historical observation is “it’s different this time”. Divergence in monetary policy lies at the heart of many USD bull forecasts for 2016. The logic that the US Fed is destined to raise rates while the ECB and the BoJ continue to expand their balance sheets offers an initially comforting premise for USD bullishness.

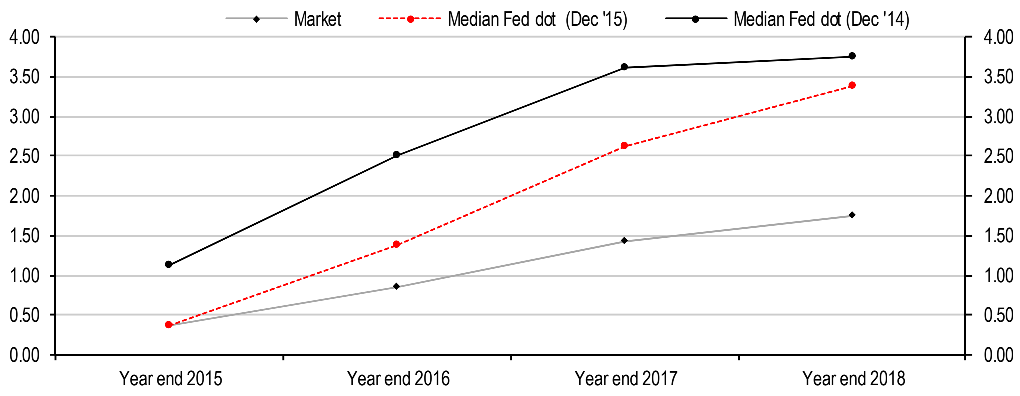
However, the historical weakness of the USD has happened irrespective of what other central banks were doing. For example, the USD weakened after the start of the Fed’s tightening cycle in 1986 even though the Bundesbank, Bank of England and the Bank of Japan continued to ease policy into 1988.

In 2015, we also saw that a divergence in monetary policy is not a sufficient reason for a persistent shift in an exchange rate. When, in March 2015, we argued the USD bull run was coming to an end, a key part of the reasoning was that a lot was already in the price in terms of monetary policy divergence. This remains the case today. The market is priced for additional hikes by the Fed in 2016. The market anticipates the BoJ and ECB will continue with their balance sheet expansion in 2016. To argue for USD strength on the basis of policy divergence requires new information which prompts expectations of accelerated Fed hikes or more aggressive policy easing elsewhere. We expect neither.

B) The ‘conversation’ about US rates will challenge the USD in 2016

The Fed’s hike in December has shifted the US rate debate from “when?” to “how high?”. This change in the nature of the conversation will be a severe challenge to US bulls. Again, there is a specious appeal for USD bulls from the current configuration of rate expectations in the US. Chart 2 shows the path for the Fed funds rate projected by the various elements of the debate. The market expects a very gradual creep up in rates. The Fed, by contrast, is projecting four 25bp hikes during 2016. The consensus among economists is in the middle. If we believe the Fed, then the USD must surely rally as market expectations for rates are revised higher.

2. Fed rate expectations are converging lower towards the market

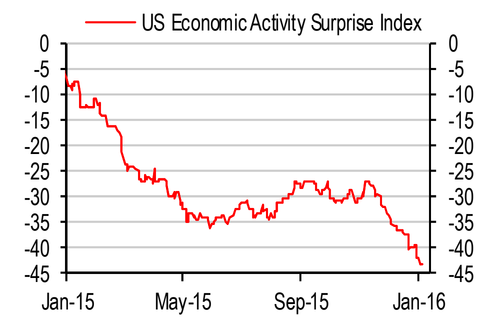


Source: Bloomberg, HSBC

The problem is that the gap is closing not via higher market rate expectations but via lower Fed projections. Look again at Chart 2. The red line shows where Fed expectations for rates lay in December 2014. The Fed's dots are still above the market, but the dovish drift is clear. Even December's hike was delivered alongside another downward revision to average projections for the Fed funds for year-end 2016 and 2017.

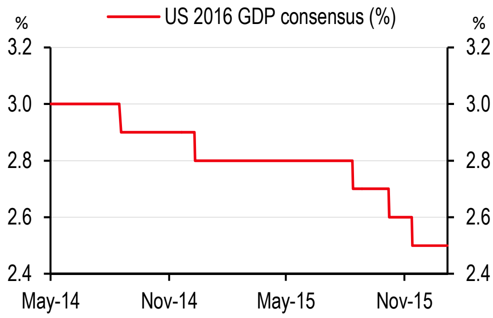
The dovish dominance is hardly surprising. We start 2016 with US economic data once again on the retreat. Chart 3 shows the US economic surprise index for activity. After a troubling start to 2015, the series stabilised in Q3 15, but resumed its downward trajectory in November and December. Simply put, there is an excess of optimism in the market relative to the reality of US activity data. The undershooting of data relative to expectations is particularly worrisome given US growth expectations are still being revised lower for 2016 (see chart 4). Data is disappointing even these lowered expectations.

3. US data is disappointing…



Source: Bloomberg, HSBC

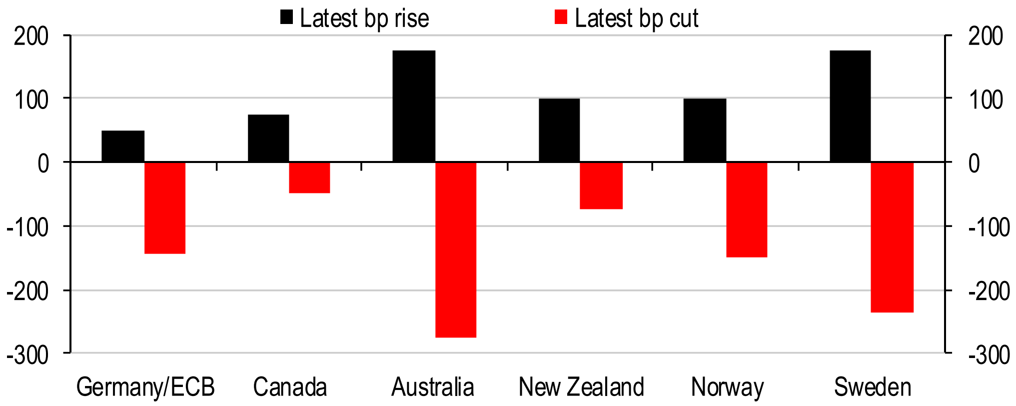
4…even though expectations are lower



Source: Bloomberg, HSCB

The underwhelming data will shift the conversation back to whether the Fed's experience with tightening will match that of other G10 central banks following the 2008/09 global financial crisis. All those which have tightened since 2008 have been forced to stop early, and then reverse the tightening, sometimes with negative rates or QE. Chart 5 shows G10 central bank tightening post-crisis, and the subsequent policy reversal.

5. Other central banks have been forced to reverse their post-crisis tightening



Source: Bloomberg, HSBC

This need not be the case for the Fed (HSBC expects two hikes in 2016), but it points to an altered conversation. For most of 2015, the only talking point was when the Fed would *hike*. For the early part of 2016, the conversation will turn to the pace of those *hikes*. But disappointing numbers will no longer just alter expectations of the pace of hikes. They will open the door to the possibility of the tightening cycle ending early, or even being reversed. It will be a very different conversation from the one held in 2015, and one which will keep the USD on the defensive.

2) The ECB's power to engineer a weaker EUR is low

Part of the USD bull argument is driven by a bearish view on the EUR. The ECB's balance sheet is destined to get ever larger as the central bank continues its bond purchases into 2017. In addition, the ECB would fight against any EUR strength that might occur as the flipside to USD weakness. We disagree on both fronts.

The fact that ECB is conducting QE is not, of itself, enough reason to assume the EUR will fall as amply demonstrated in 2015. EUR-USD reached 1.05 in March 2015 but failed to match consensus expectations for an extension to parity despite the ECB's QE programme. In fact, EUR-USD finished the year stronger, close to 1.10.

This pattern sits with our long-held narrative regarding the impact of QE on currencies. We believe there are three phases to the QE process regarding FX:

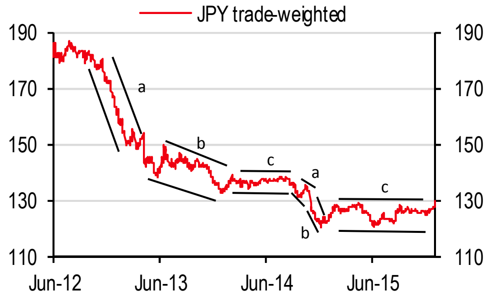
a) Promise: The central bank talks about a need for unconventional easing. The currency weakens in anticipation.

b) Delivery: The central bank delivers its policy change. Where this exceeds expectations, the currency weakens. Where it does not, the currency strengthens.

c) Autopilot: Once policy has been announced, everything is in the price and the currency drifts in a range until some new trigger is identified.

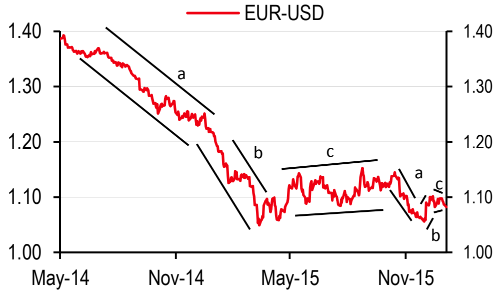
Chart 6 shows these three phases of QE in terms of the BoJ's impact on the trade-weighted JPY. Chart 7 shows the same phases for the ECB and EUR-USD. For both, there have been two sequences of "promise-delivery-autopilot". In the Eurozone, we have re-entered an autopilot phase.

6. The phases of Japanese QE



Source: Bloomberg, HSBC

7. The phases of ECB QE



Source: Bloomberg, HSBC

However, in contrast to 2015, the most likely trigger that would shift us out of the autopilot phase will not be a renewed dovish push by the ECB, but a reappraisal of future Fed hikes as outlined in section 1 above.

A stronger EUR would be an unwelcome development for the ECB given inflation is likely to remain far below target in 2016. However, in contrast to 2014 and 2015, we think the ECB's power to fight against EUR strength is limited. This is due to three key factors:

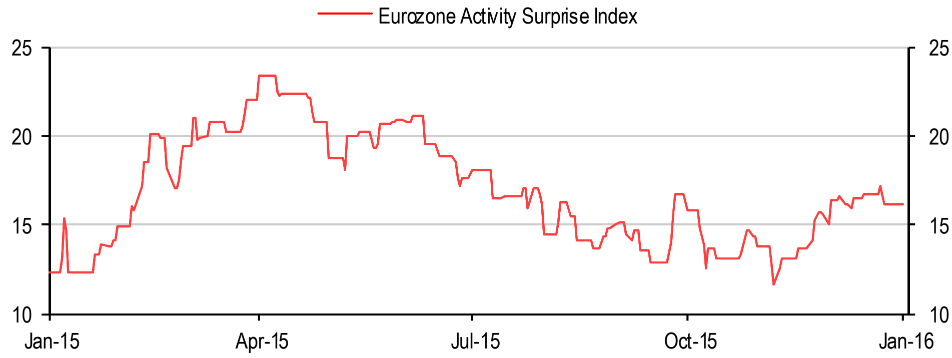
a) The scale of ECB QE is approaching its limit. The ECB has a number of restrictions on which bonds it can buy, and how many of those bonds it can buy. In previous research we have shown that these rules would mean the ECB could run out of bonds to buy around the end of 2017 (see *EUR to rise, don't be surprised*). The ECB is already committed to purchases until the end of March 2017. It does not have much room left to manoeuvre.

b) ECB hawks have regained some control over policy direction. The scale of December's ECB easing was less than the market hoped for, and some ECB speakers have argued that this was simply because the market expectations became unrealistically dovish. President Draghi explained that the December easing was decided by technical committees of all Eurozone central banks. It is possible, in our view, that some of the under-delivery relative to market expectations also reflected a renewed level of traction for ECB hawks in policy setting. This is supported by ECB 'sources' stories in the press[1]. Recent upside surprises to Eurozone activity data (see chart 8) will bolster hawks further and make aggressive ECB easing less likely in future.

c) Draghi's power over the market is diminished. The "promise" phase of the ECB's QE policy under Draghi has been the most effective at delivering EUR weakness in the past. However, given the market's disappointment around the ECB's December easing, it is likely that future dovish rhetoric by the ECB's doves, including Draghi, will be less potent in driving the EUR lower.

1 see "ECB lowered stimulus ambitions after hitting opposition - sources", Reuters 5 December 2015. http://www.reuters.com/article/us-ecb-policy-draghi-exclusive-idUSKBN0TO0L520151205

8. Eurozone activity has been better than expected lately



Source: Bloomberg, HSBC

3) The BoJ is unlikely to expand QE further in 2016

Another likely mirror of USD strength would be JPY weakness. In similar fashion to the Eurozone, local currency strength may not be especially welcome, but we suspect that policymakers may be unable to prevent it. Two things, in particular, have changed:-

a) The stock of available bonds for purchase under QE is running out

b) The economic case for additional QE is weakening

We believe the sustainability of the QE programme will become an important theme in 2016 as the supply of bonds available for BoJ purchase begins to dry up. Even if we assume the BoJ merely maintains the current QE pace at JPY80tn of purchases per year, we estimate that the limits of QE will be reached by the end of 2016. Given anticipated JGB issuance of JPY38.5tn, the BoJ will need the open market to sell JPY41.5tn of JGBs just to maintain the current run-rate of QE. This will not be straightforward.

In previous research by our economics team (see *Bank of Japan: Beyond QE*, 10 November 2015), HSBC examines each of the major holders of JGBs, and identify how much they could still realistically sell under QE. The banks may have JPY30tn to sell, life insurers JPY15tn, and pension funds JPY13tn. Our calculations suggest the QE programme therefore has only roughly a year to run. In addition, the risk of undersubscribed BoJ bond auctions is likely to increase during H2 16 when portfolio rebalancing by key JGB holders will be largely complete. Such constraints pose an operational constraint on the existing QE programme, and make expanding QE in order to foster JPY weakness or counteract any JPY strength even more unlikely.

A further constraint on QE expansion is that the economic case for such an easing is also weakening. Growth and inflation may still be shy of the ambitious targets of policymakers, but things are moving in the right direction. The narrative from the BoJ emphasises that the reflationary trend is on track with policymakers taking particular comfort from the tightness in the labour market. The BoJ's new emphasis on inflation excluding food and energy suggests this metric is the focus of policy. Given it is tracking at a comparatively lofty 1.2% YoY, the imperative to ease it not evident.

In addition, the political pressure for a weaker JPY has long since abated. The threat of direct FX intervention remains should the JPY appreciate too swiftly, but our forecast of 115 on USD-JPY by the end of 2016 would not warrant action by policymakers, we suspect.

Conclusion

We believe the USD will weaken during 2016. In part, this reflects the historical tendency of the USD to depreciate in the early stages of a Fed tightening cycle, but it also reflects our belief that the debate around the Fed is likely to retain a very dovish tone. As rates are increased gradually, the conversation will turn to whether more are required, whether a pause is warranted, or even whether the Fed may have to contemplate a policy reversal in similar fashion to other G10 central banks. EUR strength is likely to be the flipside to any USD weakness but, in contrast to 2014 and 2015, we believe the ECB will be less able to engineer renewed EUR weakness. Similarly, in Japan we believe we are approaching the limits of QE, and anticipate some JPY strength as a consequence.

G10: FX hypersensitive to rates

- G10 FX is more sensitive to interest rate expectations today than at any time over the last 15 years
- This has serious implications for monetary policy
- The currency market is correct to be obsessed with Central Bank policy and expected policy differentials

Getting carried away

G10 FX prices today are far more sensitive to changes in expected interest rate differentials than at any time over the last 15 years. It is striking that the sensitivity today is much greater than it was pre-crisis – a time when the FX carry trade was often viewed as the only trade in town.

Huge macro implications

Any sizeable upward shift to interest rate expectations would come with a significant strengthening of the currency. This would lead to disinflationary pressures – in effect, part of the economic tightening would come via the currency, thus negating much of the need for the tightening cycle which caused the currency strength in the first place.

This extreme sensitivity of FX to interest rate expectations has significant implications for monetary policy since it seriously constrains the ability of central banks to raise rates more quickly than the market expects. It also makes it harder for central banks to pursue a purely independent interest rate path. A successful monetary policy normalisation may have to wait until the major economies can tighten together.

In other words, not only is FX now being driven by what happens to interest rates, but there is a feedback loop whereby currencies are constraining the plausible path of interest rates in the future.

What this means for FX

This bolsters our current view for the USD. We were dollar bulls from the first mention of tapering in 2013. The change in interest rate expectations from then to now led to substantial strengthening of the USD. A Fed hiking cycle is now firmly priced in. Indeed, given the strength of the USD, less tightening is actually needed.

HSBC forecasts, and market expectations, are for a very subdued hiking cycle in the US. As such, we think further USD gains are unlikely. Indeed, given the discrepancy between market expectations and the "Fed dots" we think the most likely scenario is that the Fed expectations are reduced so they become closer to the levels expected by the market. This would probably be accompanied by some negative USD sentiment.

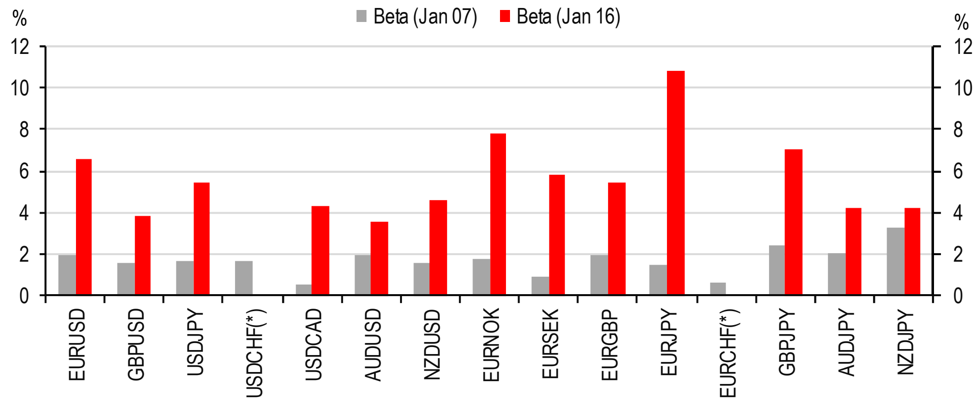
Tracking the response of FX to rates

The expected path of interest rates has always been an important consideration for the FX market. Now that we have seen the first step of the Fed hiking cycle it is a good time to investigate this relationship in some detail. We explore how the strength of this relationship has changed over time.

What, precisely, are we trying to measure?

We are trying to identify how far exchange rates shift in response to a specified move in the expected interest rate differentials (abbreviated to IRD in the rest of this piece). For those of you who don't want to wade through the details, the short story is: G10 FX is notably more responsive to changes in IRD expectations, with many currency pairs being significantly more sensitive (Chart 1).

1. FX move associated with a 100bp increase in expected IRD



Source: HSBC, Bloomberg

* = The current beta estimates from currency pairs involving CHF are polluted by the sharp moves seen in the wake of the removal of the EURCHF floor

Which data did we use?

We start with historical data on FX prices and expected IRD. Clearly, the FX data is simple. However, the historical data on interest rate expectations is a little more complicated. Since an exchange rate involves a pair of currencies, we need historical data for interest rate expectations for both currencies. Furthermore, since we need to calculate expected interest rate *differentials*, we need the chosen measure of interest rate expectations to be comparable for both currencies. For this analysis we have used 1Y1Y forward swap rates.[2]

How do we measure the sensitivity?

We investigate the relationship between changes in expected IRD and the return in the exchange rate. We perform a linear regression between the two variables to measure the reaction of the exchange rate to changes in IRD expectations. To track how this sensitivity has changed over time we perform rolling regressions with a 1-year window and plot the beta. We explain below what this beta means.

[2] *We use forward rates since they are market-clearing values for future interest rates and we use swap rates since FX markets have traditionally been more focused on money market rates than rates on other instruments. However, the choice of the 1Y1Y forward point is open for debate. For those of you who wish to see more than the 8-pages of charts in the two appendices towards the back of this document, we have repeated the analysis for a variety of other points on the forward curve matrix. These results can all be found in our* Supplemental Data appendix *but the big macro conclusion of this piece remains valid for other choices of forward rate.*

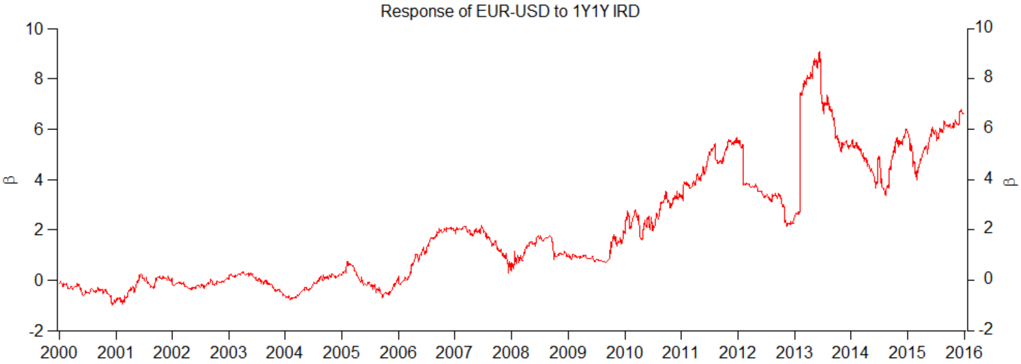
An example: EUR-USD

In Chart 2 we show the results of this rolling regression for EUR-USD. The results suggest a split into four main time periods:

From 2000-2004, the measured beta is close to zero.[3] This means that during this period there was no reliable linear relationship between the exchange rate and changes in expected IRD: The relationship was too weak, too variable, or too swamped by other factors to be picked up by the regression.

- From 2004-2007 the beta increased from close to zero, to around two. During this period the carry trade was often seen as the only trade in town for the FX market so increased sensitivity of FX to expected IRD during this time is plausible.
- From 2007-2010 there was little change in this beta.
- From 2010 the beta increased significantly. The current beta (around six) is over three times higher than the value during 2007.

2. EUR-USD vs 1Y1Y Interest Rate Differential



Source: HSBC, Bloomberg

So what does a beta of "six" mean anyway?

Let us put this result in more intuitive terms: Imagine that market expectations for the upcoming Fed hiking cycle suddenly shifted so that an extra 100 bp increase was priced in to the 1Y1Y forward swap rate (and everything else was kept constant). This current relationship suggests that EUR-USD would fall by 6.6% (see Table 1 for equivalent estimates for other USD-G10 pairs).

Table 1. FX move expected in response to 100bp shift in US rate expectations

	Response to shift in US rate expectations
EURUSD	-6.6%
USDJPY	5.4%
NZDUSD	-4.6%
USDCAD	4.3%
AUDUSD	-3.6%
GBPUSD	-3.9%

Source: HSBC estimates

More details in the full piece

In the *full document*, we show the equivalent results for other G10 FX pairs, and investigate the robustness of the results. In the *Supplemental Data appendix*, we show the regression results for other forward rates.

[3] *Indeed, this is one of the reasons why such regressions have not always been a standard part of the FX Strategy toolkit.*

Conclusion

We have identified a significant change in the sensitivity of FX to changes in expected interest rate differentials. The obvious question is: what might have caused this change? In our view, the dominant factor seems to be that a 25bp rate hike is simply a much more significant change when rates are close to zero than it is when rates are at more normal levels. Another compelling factor is that abundant liquidity and extremely low policy rates from major central banks have led to a huge weight of money desperately searching for yield.

The consequences of our results are significant:

- FX markets are likely to remain hypersensitive to rate expectations until we are past the current era of extremely accommodative monetary policy.
- This means that economic data will be an important driver for FX – particularly for data releases which we know are important to central banks.
- Policymakers are not going to be able to ignore the impact their commentary and decisions have on the currency. The currency war is unlikely to abate any time soon. Indeed, we have moved into the phase where this is becoming more of a *policy war* than a currency war.

Currency war or policy war?
We would argue that recent actions by the ECB and BoJ are consistent with a policy war. Large-scale QE programmes are ostensibly implemented for their influence on the domestic economy. However, a significant proportion of the benefit of QE for both central banks has been the associated weakening of the currency. Policymakers are clearly well aware of this fact. The risk is that we see an escalating series of policies, where at least part of the aim is to weaken the currency.

CAD: Darkest before the dawn

- Canada's government has said it will use fiscal policy in an attempt to revitalise the Canadian economy
- With FX more sensitive to rates than ever before, we see CAD strength provided this fiscal stimulus increases rate expectations
- We see USD-CAD at 1.25 by Q4 16

Diminishing returns

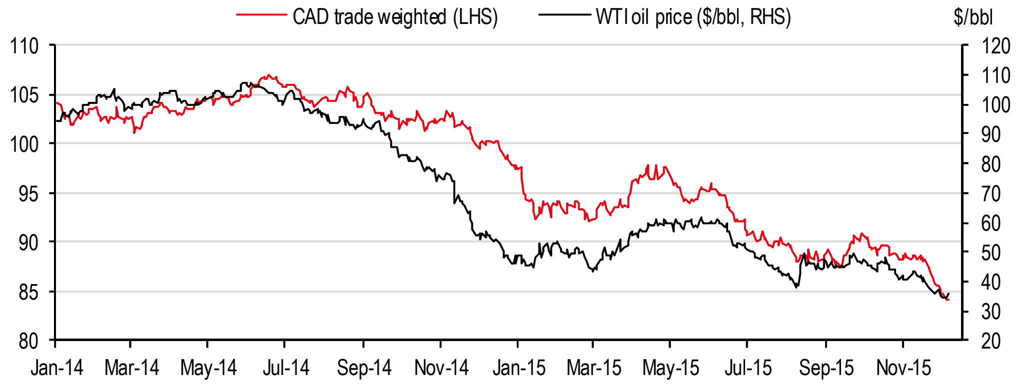
Canada's central bankers have tried. Faced with an economy struggling in the face of the sharp fall in energy prices, interest rates have been cut twice in 2015 from an already lowly 1.00% to just 0.50%. The currency has not been explicitly targeted, but the easing in policy has likely contributed to its weakness and helped to offset the economic damage of lower oil prices.

A recent speech by Bank of Canada deputy governor Lynn Patterson suggested grounds for optimism. She argued that the economy would recover on the back of faster US demand, that the oil shock had been most acute in H1 2015 and would dissipate, and that investment would help drive economic growth higher. In turn, this would ensure that any spare capacity would be used up by mid-2017.

All things are possible, but the markets and consensus are justifiably nervous. After all, the policy rate has been 1% or lower since 2009 yet GDP growth in 2015 is likely to be barely 1% and inflation looks set to be at a similar level. The decline in the oil price is at the heart of these numbers, hitting investment, affecting employment and capping inflation. Monetary policy has done what it can to provide an offset, and a weak currency has been part of the adjustment mechanism also, mirroring the path of energy prices (see chart 1). But given that the signs of the anticipated rebalancing have been irregular and tentative, there is a growing sense that more needs to be done.

Canada forms part of a wider G10 narrative where there is a growing sense that easing an already highly accommodative monetary policy is generating lacklustre and diminishing economic benefits. Consider some recent observations from the Eurozone and Japan, the two economies currently

1. CAD vs energy prices



Source: HSBC, Bloomberg

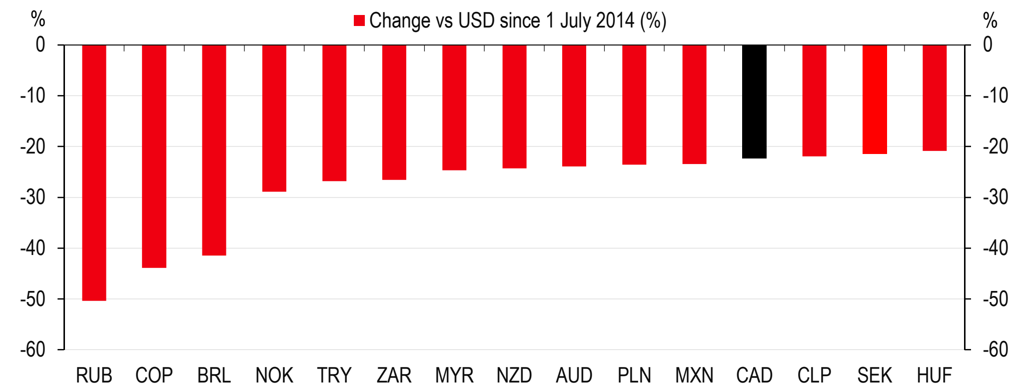
leading the way in terms of monetary expansion. In Japan, the minutes of the last BoJ meeting included the observation that the "marginal effects of QQE had been diminishing". In Europe, the ECB's Sabine Lautenschlaeger reminded markets that "one thing is crucial – there are limits to expansive monetary policy. Like any medicine, the beneficial effects of monetary policy measures decline with continued use, while the undesirable side-effects increase." For Canada, would another 25bp cut in rates really be a game changer for the economy or inflation? Most likely not.

In many instances, the anticipated channel of influence of monetary easing on growth and inflation has been through the exchange rate. But here too the potency is questionable. Japan's export volume growth is little changed despite the dramatic weakness of the JPY in the past couple of years. In fact, policymakers now point to the potential adverse consequences of additional JPY weakness. In the Eurozone, the ECB may want a weaker EUR but it will soon face constraints on its ability to engineer this (see "*EUR to rise, don't be surprised*", 28 September 2015).

As with any currency war, it is hard to find a winner. The currencies which have fallen the most since the USD bull run began in July 2014 are typically either those most exposed to lower commodity prices or high beta plays within EM FX (see chart 2). The CAD ranks 12th in the list. For commodity exporters, currency weakness has provided damage limitation. In Australia, it is helping a re-balancing away from mining, for example.

In Canada, a weaker CAD is cited by the central bank as providing support to exporters. However, our economics team has argued that the Bank has been too optimistic about the rebalancing and that the evidence of CAD-sensitive exports taking flight is unclear. Overall, signs of the anticipated rebalancing to the negative terms of trade shock are far from entrenched.

2. Currency losers since July 2014-year end 2015



Source: HSBC, Bloomberg

In the end, like other economies, Canada is faced with diminishing returns from monetary easing while the currency acts as damage limitation rather than as an active stimulus to future growth. Other macro policy levers are required.

Canada's fiscal blueprint

With questions over the potency of monetary and currency policies, fiscal policy is gathering a following as the possible answer. In Japan, plans are afoot for an emergency budget. In Norway, the government has decided to use some of its vast oil fund to finance a modest fiscal stimulus. Even in the fiscal orthodoxy of the Eurozone, governments are using the windfall gains of lower financing costs (courtesy of QE) to quietly provide a little fiscal relief without undermining their commitment to fiscal targets. The budget deal recently struck in the US also includes plans for increased spending.

But Canada looks set to be the high profile example of a country actively using fiscal policy as counter-cyclical policy tool. The newly elected Liberal party made fiscal policy a key differentiating factor in its election campaign, arguing that there was scope for stimulus before returning to balance in 2019/20. It is a measure we believe will see the CAD stronger.

A break from orthodoxy

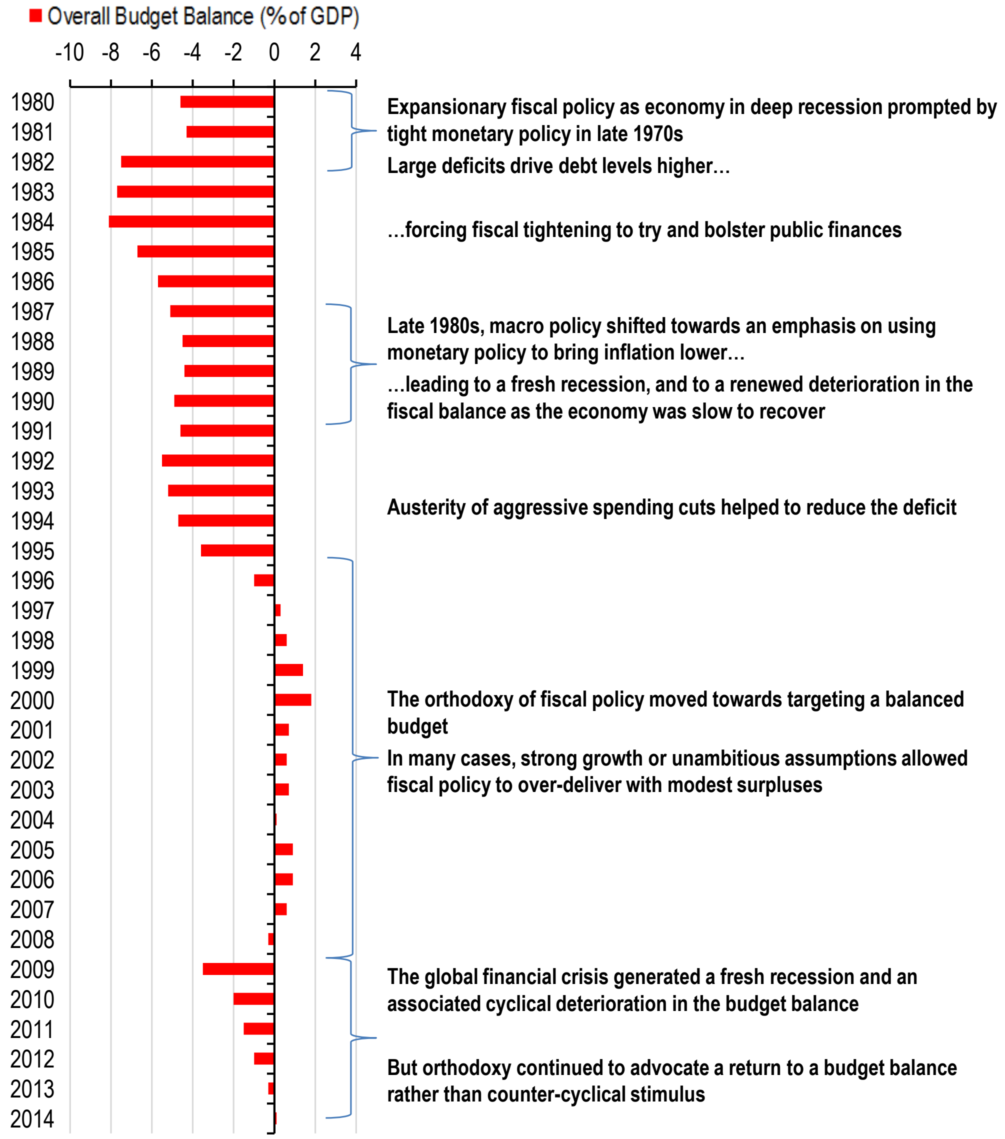
Canada's plan is significant not because it is big. In fact, the size is unclear. The pre-election plan of the Liberal government was for deficits averaging CAD8.4bn over the coming three fiscal years, a stimulus relative to pre-existing projections from the Parliamentary Budget Office for a sequence of modest surpluses. But the PBO has now revised its forecast for deficits to average CAD4.2bn over the next few years, before the government adds its fiscal stimulus. So it remains to be seen if the Liberal party will still deliver its full fiscal stimulus, or trim it to take account of the worse starting point. We will know more when the Federal budget is delivered late in Q1 2016.

Nonetheless, the significance of whatever stimulus is announced is simply that fiscal policy is being offered as a possible solution to low growth, not hidden from view as it is in the Eurozone, nor as part of a bargaining process as it was in the US. It is being sold as a tactic to spur growth.

It is also significant that Canada is taking the lead as it represents a departure from the historic narrative of its fiscal policy which has extolled the virtues of balanced budgets for the last two decades. Chart 3 overleaf shows an annotated history of Canada's budget that led policy to its love affair with balanced finances.

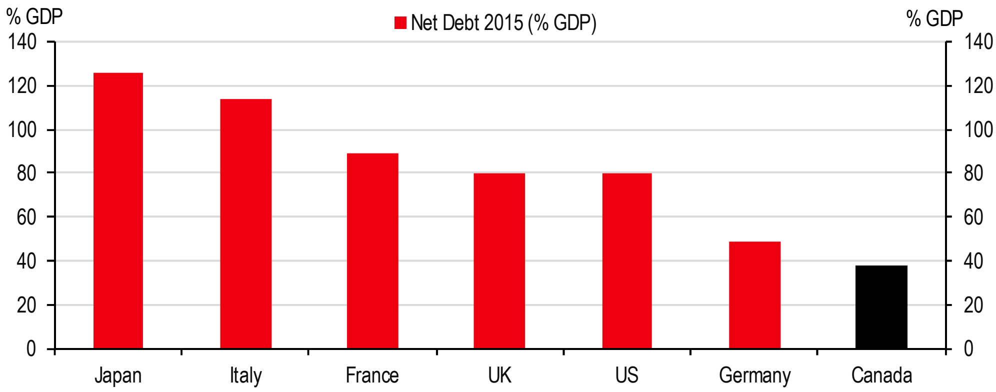
In the early 1980s, tight monetary policy caused a recession on a scale not witnessed since the 1930s, and fiscal policy remained expansionary. But by the mid-1980s, the rising debt stock forced a re-think and the deficit was reined in through higher taxes and spending cuts.

3. Canada's fiscal history



Source: IMF, HSBC

4. G7 net debt levels



Source: HSBC, Bloomberg

The early 1990s recession saw the deficit widen afresh which, together with constitutional uncertainty around the Quebec separation issue, saw Canada's credit rating downgraded by both S&P and Moody's. It was in this storm that the priority became putting federal finances back on a sustainable path, the focus moving to the merits of a balanced budget. Canada regained, over the years, its sterling credit reputation. The aspiration of fiscal policy is to contribute to low interest rates through strong government finances. This would, in turn, help support overall economic activity. It is a perspective evident still in most of G10.

So the suggestion that fiscal policy should do more is a departure from the prevailing orthodoxy both relative to that in play elsewhere in developed markets, and also to Canada's economic policy of the last two decades. That historic prudence means Canada has the wherewithal to offer a helping hand to the economy. Canada's net debt is less than 40% of GDP, the lowest in G7 (see chart 4).

CAD to capitalise

Canada's economy could do with some help, and the government has decided that fiscal policy can play its part. We believe the currency will reap the rewards and have revised our expectation for USD-CAD at the end of 2016 to 1.20 from 1.35 previously.

Economic theory suggests there are three ways in which fiscal stimulus affects a currency.

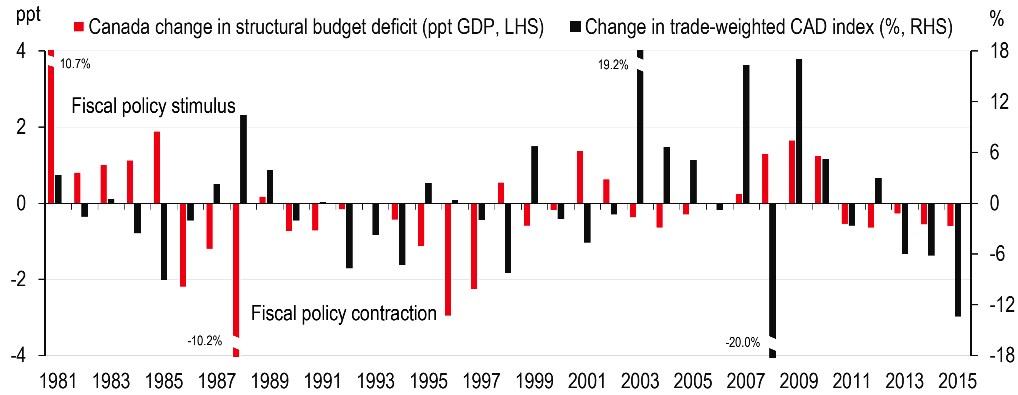
1) Income effect – CAD negative: Higher spending supports growth, but therefore boosts import demand, leading to a weaker currency

2) Price effect – CAD negative: Higher spending generates more inflation, and so the currency has to weaken in order to bring competitiveness back into equilibrium

3) Interest rates – CAD positive: Rising government borrowing and activity mean interest rates are higher than they would otherwise have been, encouraging capital inflows and causing the currency to strengthen

Unfortunately, history offers little insight into which influence will dominate. Chart 5 shows Canada's "fiscal thrust", a measure of whether fiscal policy (adjusted for the economic cycle) is expansionary or contractionary. We show this alongside the change in the currency. Historically, stimulative fiscal policy has seen the CAD strengthen as often as weaken. It has been similarly ambiguous during times of fiscal contraction.

5. Canada's fiscal thrust vs changes in the CAD



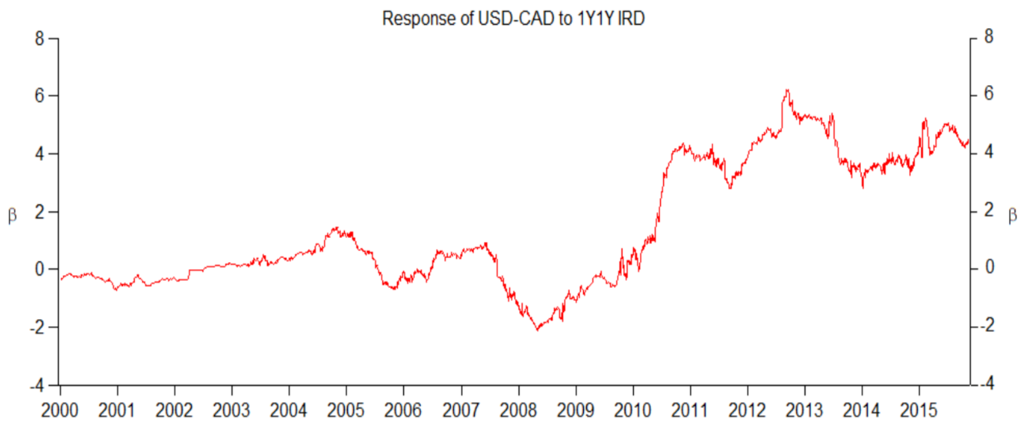
Source: IMF WEO, HSBC

The lack of a clear pattern is not surprising given currencies face so many moving parts in terms of influence. So we have to decide what today's "moving parts" suggest for the CAD's likely reaction. This fiscal stimulus will be delivered into a Canadian economy which faces a near-zero interest rate environment, with low growth, below target inflation, and at a time when this counter-cyclical strategy is not yet being widely applied elsewhere.

We believe the positives will outweigh the negatives as the capital flow factor is likely to be dominant. For most of the world, the fixation is on growth, or more accurately, the lack of it. Allied to this is a continued lack of inflation in most countries. So if economic growth and inflation are such rare commodities, the likelihood is that capital will reward those economies capable of generating it.

The idea that the interest rate impact on FX will dominate the income and price effects is supported by our analysis, which shows the sensitivity of USD-CAD to interest rate differentials is elevated compared to its historic norm. Chart 6 shows the beta of USD-CAD to the 1Y1Y interest rate differential. The current reading of roughly 4 means that for every 100bp shift in the interest rate differential, USD-CAD will move by 4%.

6. The CAD is especially sensitive to interest rate differentials currently



Source: HSBC

Canada could be rewarded for being among the first to challenge the orthodoxy arguing that balanced budgets are the way to go. It would be the first G7 economy to actively adopt a counter-cyclical fiscal policy. This is about experimenting with an approach.

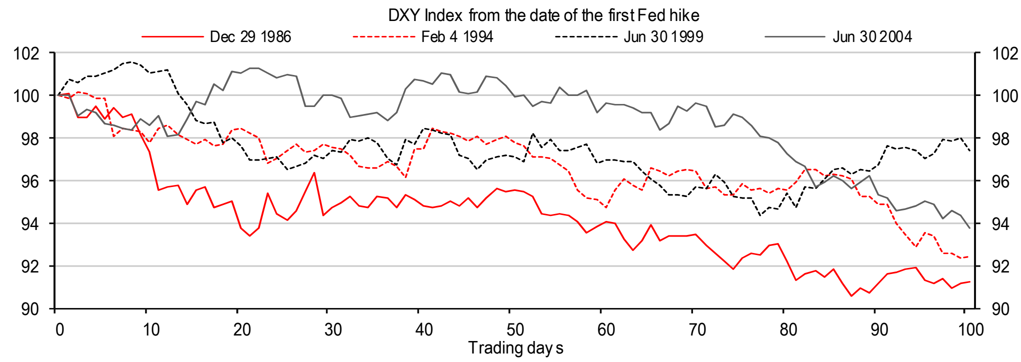
Other factors will also support the CAD

The fiscal story in Canada is a new development that we believe will drive CAD strength. But it is not the only factor that supports our forecast of USD-CAD dropping to 1.25 by the end of 2016.

A) USD to weaken once the Fed begins to tighten

On the USD side of the equation, we expect the USD to weaken. History shows that the USD weakens once the Fed begins to raise interest rates. Chart 7 shows how the DXY index has declined from the point when the Fed first raises rates (Day '0' in the chart). This has happened in each tightening cycle over the last 30 years, irrespective of whether other developed market central banks have been increasing or lowering rates.

7. USD weakens once the Fed begins to hike

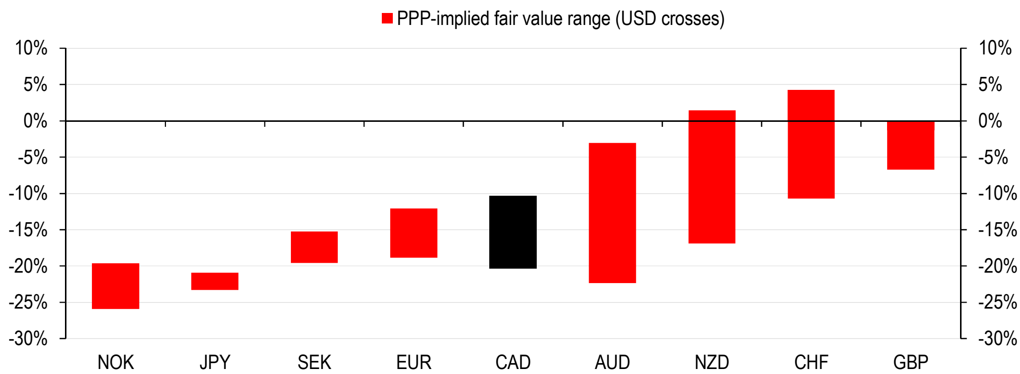


Source: Bloomberg, HSBC

B) CAD is cheap and the market is short

Our Little Mac Valuation indices place CAD in the middle of the pack in terms of valuations but it is still considerably undervalued against the USD, by close to 20% on one estimate (see chart 8). It is also more undervalued than its commodity currency peers of AUD and NZD.

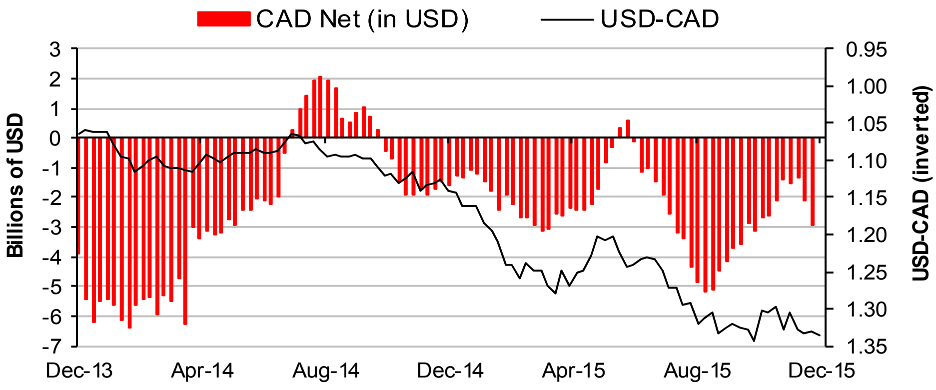
8. The CAD may be close to 20% undervalued against the USD



Source: Bloomberg, HSBC

Turning to positioning, the latest IMM data shows that CAD shorts are being rebuilt again (see chart 9). Although they are not to the extremes seen in the middle of 2015, they are back to the levels seen in March 2015 when the USD-CAD rally last stalled.

9. CAD shorts have been rebuilt

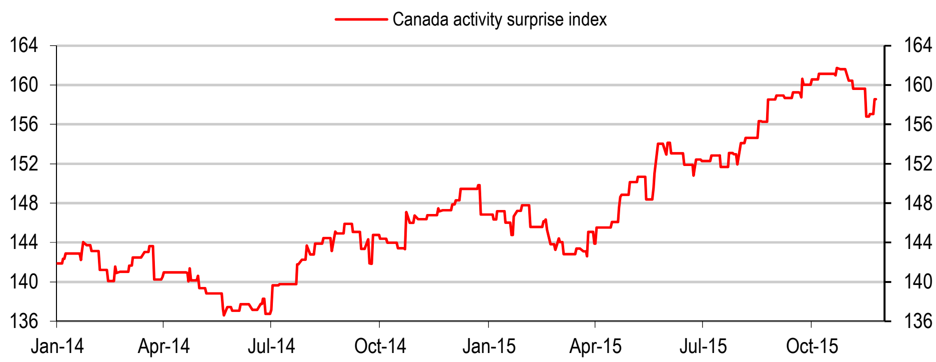


Source: Bloomberg, HSBC

C) There has been an excess of pessimism regarding Canadian data

A degree of pessimism regarding Canada is understandable given the economy's sensitivity to the collapse in the oil price. However, the reality is that Canadian data has been generally better than expected for the last nine months. This is reflected in the upward trajectory in HSBC's economic surprise index for Canadian activity (chart 10).

10. Canadian activity has been better than expected for many months



Source: HSBC, Bloomberg

We continue to be cautious on Canadian growth prospects going forward, and we expect the adverse impact of oil on the economy to be long lasting. However, the data suggests the extent of pessimism regarding some of the higher frequency measures of activity has been overdone. After-the-fact explanations can be offered as to why these upside surprises occurred, but it does not change the fact that their forecasts have been too downbeat.

Conclusion

Canada's plans for a counter-cyclical stimulus may not be large but they could still prove significant for the currency. Monetary policy globally is running out of steam and, while currency weakness has helped offset the impact of lower commodity prices on commodity producers, FX depreciation may also be witnessing diminishing potency. New answers are required, and Canada's flirtation with fiscal spending may be the new test bed. Fiscal largesse typically has mixed implications for a currency. In Canada's case, we expect the positives will win out, not least because the CAD is an undervalued currency, where the market is already short, and where the downward revisions to GDP may have largely run their course. With the USD likely to retreat once the Fed begins to hike, we forecast USD-CAD to fall to 1.25 by the end of 2016.

HSBC

2016 Currency Views

G10

USD

The dollar Bull Run is over

We have called for USD strength since Bernanke's comments about tapering in May 2013, and the DXY has climbed a further 20% since then. In March 2015, we called the end of the dollar "bull run", forecasting a range bound USD. For 2016, we now look for USD weakness against G10 currencies. For example, we see EUR-USD strengthening to 1.20, USD-JPY falling to 115, and USD-CAD dropping to 1.25 by the end of 2016.

In 2015, the market was 'now-casting': obsessed with *when* the Fed would hike rates for the first time in this cycle. As the magical date came closer and closer, the USD strengthened further and further. Now that the Fed has commenced the tightening process, the debate has changed, and the tables have turned. The market will now be forced to consider how high rates will go and *how quickly* they will get there. We think this debate is USD-negative.

History is on our side here. After the first hike in each of the last four major Fed tightening cycles, the most recent of which being in 2004, the USD has weakened by between 2-9% in the following 100 trading days.

The Fed faces a 'rough ride' if other post-crisis tighteners' are anything to go by. A number of G10 countries have tried to hike rates since 2008, but all have ultimately failed. The ECB hiked 50bp in 2011, and has since cut into negative territory and adopted QE. Similarly, Sweden hiked significantly in 2011, and is also now using negative rates and QE. Even in New Zealand, the "rock star" economy of years gone by, rate hikes in 2014 have now been completely reversed. And the list goes on. What's clear is that tightening post-crisis is a momentous task – all who have tried have so far have failed.

The key unknown in this cycle is the effect that hikes will have on already-low inflation. This is the notable difference between this tightening cycle and the last – in June 2004 CPI inflation was running at 3.0% YoY. In 2015 that figure is just 0.5%. The oil price has been a key contributor, and base effects should help support inflation, but the gap remains significant. If, as in the case of Sweden, inflation goes south very quickly now that the Fed has hiked, a loosening of monetary policy will have to be considered, which will likely see the USD fall sharply.

In anticipation of Fed tightening we have had a USD bull-run. Going forward, if rates move a little higher than expected then the USD will go up a little. However, if at any time in 2016 the market thinks the Fed may need to loosen in 2017, then the USD will plummet. The risk-reward in 2016 is for a weaker USD. Fed rate hikes are in the price.

HSBC

G10

EUR

EUR to rise, don't be surprised

We expect EUR strength in 2016, in contrast to most of the market, and see EUR-USD ending the year at 1.20. Though the ECB will try to fight this, we think that constraints on further Quantitative Easing are too binding, and will hamper the ECB in its efforts to engineer EUR weakness.

Mario Draghi was able to orchestrate significant EUR strength in 2015, but his challenge will be far greater this year. EUR weakness was catalysed by bold monetary policy; with the start of a QE programme and a further cut into negative deposit rate territory. These significant measures helped push the EUR down 10.3% over 2015, but such daring announcements will be much more difficult in 2016. We do forecast one further deposit rate cut in 2016, to -40bp, and an end to the reference date for the end of QE, but we see no increase in the monthly purchases. It remains to be seen whether this will be sufficient for the market, who, in December, deemed the 10bp cut and lengthening of QE as inadequate, causing EUR-USD to rally 3% on the day: the biggest move of the year.

QE expansion will be an uphill battle. If the experience of the Bank of Japan is anything to go by, further rounds of QE will need to come with size and surprise. However, this former objective is the sticking point; due to numerous self-imposed constraints. One of the most restrictive is the capital key: which means the central bank must allocate 25.6% of its monthly purchases to the Bund market. The limited supply of German government bonds means bonds available for the ECB to buy are also limited.

Furthermore, now that there is a recovery in growth, the opposition to aggressive action, most obviously from the Bundesbank, has more credibility. Draghi's ability to talk the EUR lower will also be less in 2016 given his perceived failure to deliver fully on the dovish promises of 2015. So the ECB may not prove quite so forthcoming with stimulus as it did in 2015, and a minor cut in the deposit rate and further QE horizon extensions are all that we have pencilled in, despite our expectations for weak inflation.

Essentially, we have two moving parts when it comes to EUR-USD: the Fed on one side and the ECB on the other. We argued as early as March 2015 in "*USD bull run: the beginning of the end*" that this policy differential had already played out; which is what drove EUR-USD from 1.40 to 1.05. Now we believe the reverse to be true: that the Fed will not live up to its hawkish dots and that the US rate cycle will be shallow and short. The ECB on the other side will not be able to be super dovish; due to the constraints it faces regarding the bonds it can buy.

We believe once the market comes to terms with the lower and shorter cycle in the US coupled with the constraints on the ECB, EUR-USD will head upwards. Hence we are now looking for EUR-USD to hit 1.20 by end 2016.

HSBC

G10

JPY

Beyond QE

Given that we disagree with the market's staunch view that the BoJ will further expand easing, we see 2016 as a year of strength for the JPY. We think QE is rapidly losing potency, which will cause USD-JPY to fall to 115 by the end of next year.

We stand by our view that further easing from the BoJ is unlikely, barring significant deflationary shocks. Although growth and inflation have fallen short of the central bank's optimistic forecasts, the BoJ is encouraged by the continued strength in labour markets and sees the underlying reflationary trend as intact. Beyond these macroeconomic factors, the Bank of Japan's reluctance to ease is compounded by technical constraints around large scale JGB purchases. We think the sustainability of the current QE programme will become an important theme in 2016, as the risk of undersubscribed BoJ bond auctions is likely to increase in the second half of the year, when portfolio rebalancing by key institutional JGB investors will likely be largely complete.

The government's desire for a stable currency also means there is little political pressure on the BoJ currently to ease policy. Our base case is that the central bank will refrain from taking additional easing action. Instead, we expect the next move from the Bank of Japan to be a change in the monetary policy framework in Q4 CY16, back to a rates-based policy regime. However, investors should be prepared for the risk of a regime shift any time in FY2016.

The consensus within the government at the moment seems to be that another bout of USD-JPY exchange rate weakness – for example beyond 125 – would do more harm than good for the economic recovery by accelerating cost push inflation, pushing down real wages, and suppressing household consumption. With Upper House elections looming in July 2016, the government is increasingly focused on raising household purchasing power.

The JPY will also benefit from its safe-haven allure. During the equity falls of August 2015, the market turned to the JPY for shelter. It was the best-performing currency over that period: with USD-JPY reaching a low of just over 116 on 24 August. Crucially though, it held onto many of the gains, stabilising around 3.5% above the 19 August (pre-crash) rate over the following two months. Should 2016 bring about any nasty widespread shocks, the JPY is likely to profit.

We believe that excessive JPY appreciation will be prevented by the market's continued faith in the "Kuroda put" of 115 – the level at which additional BoJ stimulus would likely be triggered in order to reverse JPY strength. But ultimately, the BoJ's lack of policy options alongside our outlook for a weaker USD on an underwhelming Fed tightening cycle will see the JPY strengthen in 2016. We changed our USD-JPY forecast in November 2015, and now see it at 115 by the end of 2016, from our previous forecast of 125.

G10

GBP

The rise before the fall

We see GBP having 'a year of two halves' in 2016, initially moving higher on cyclical factors, before falling towards the end of the year, due in part to political uncertainty. We see GBP-USD peaking at 1.58 by the end of Q2, and falling thereafter to 1.50 by the end of 2016.

The Fed's tightening on 16 December raised as many questions as it answered, the main one being "who is next?" Historically, the UK's 'special relationship' with the US has extended to monetary policy, meaning tightening from the Bank of England was never far behind the Fed in a tightening cycle. We see monetary policy considerations dominating GBP's fortunes above all else in early 2016, allowing it to strengthen as the market contemplates a tightening of UK monetary policy.

We look at two cyclical drivers that point to near-term support for GBP-USD:

1) Rate expectations point to GBP-USD upside – consistent with 1.57

2) GBP rises when the BoE begins to tighten

The market has not fully priced in a Bank of England rate hike until 2017 – hikes in 2016 would come as a shock. We, on the other hand, forecast two hikes next year, bringing the policy rate up to 1.00%. With FX more sensitive to rate expectations than ever, GBP will strengthen significantly should the market's view begin to shift towards our own. Again, we have history on our side here; while GBP has tended to strengthen on BoE hikes, the USD has tended to depreciate in the months following the first Fed hike in the cycle.

The latter half of the year we believe will be different: marred by structural and political difficulties. The market's current fixation on the monetary policy side means that the UK's twin deficits have largely been ignored. Add to this the political and economic risks of "Brexit", and it becomes clear that overlooking these problems is unsustainable in the medium term. In particular, the prominence of the referendum on EU membership is likely to rise during 2016.

Following on from this, the future of the UK itself could once again be called into question. If the regional breakdown of the referendum vote showed a majority of Scottish people had voted differently to the rest of the UK, calls for a second Scottish independence referendum would intensify. As we saw in 2014, this can only be GBP-negative.

The strong GBP is undermining efforts to rebalance the UK economy and curtail a current account deficit which is more than 5% of GDP. We believe the cyclically-induced strength in GBP will give way to renewed weakness next year, reversing the gains of 2015.

G10

CHF

Grinding strength

We look for relatively modest moves in EUR-CHF during 2016, with the rate expected to finish the year at 1.02. This would bring it back to the levels seen as recently as Q2 15. Nonetheless, given this appreciation of the CHF is against a EUR which, we believe, will in turn be appreciating against the USD, the trade-weighted CHF will likely remain strong. This will keep alive the threat of additional SNB action, although our central case is that the reaction will be confined to dovish rhetoric and the repeated threat of direct FX intervention.

On the face of it, the CHF should be much weaker. Growth is struggling, inflation is deeply negative, the policy rate has been cut below zero and the SNB has been actively talking the currency lower. However, in the end, the CHF remains nearly 10% stronger than a year ago when the EUR-CHF floor was in place. It suggests that these domestic factors are not a sufficient reason to anticipate ongoing CHF depreciation. It is also worth remembering that the real policy rate in Switzerland is the highest within G10 FX.

In addition, while Swiss economic growth stagnated once again in Q3 15, the blame cannot be placed only on the stronger currency. In fact, export growth has held up remarkably well despite the hit to competitiveness from the stronger CHF. Margins have been hit as export prices have been cut, and investment has been weaker as a consequence of lower profits. But this is not an economy reeling from the adverse impact of a strong currency, and it seems unlikely that local economic conditions will warrant a medicinal weakening of the CHF.

Indeed, the external balance is one of the chief reasons behind our assumption of a grind lower in EUR-CHF. We forecast a current account surplus of around 8% of GDP in 2016, more than three times the equivalent size in the Eurozone. In better times, the demand this surplus creates for CHF would be offset by outward investment flows. But these remain difficult times, and so the imbalance will be reflected in a mix of higher FX reserves and a stronger CHF.

The failure of the CHF to weaken in the way the SNB would like will keep inflation similarly constrained, although our economists look for CPI to gravitate back upwards towards zero over the course of 2016. We disagree with the SNB that the CHF is ‘significantly overvalued’. Our metrics suggest it is current within its plausible fair value range. But the SNB will likely maintain the threat of policy easing and FX intervention, but such comments have long since lost their traction in the FX market.

G10

NOK & SEK

Contrasting fortunes

We expect both the NOK and SEK to appreciate against the USD in 2016, but the extent of their gains will differ by virtue of the different economic challenges which they face. We expect the NOK to outperform the SEK. Sweden's economy is likely to grow swiftly, boosted by the influx of migrants and the associated increase in government spending. Inflation, however, will remain far below target. Norway's economic activity, by contrast, may continue to struggle with the effects of a low oil price, even with a fiscal boost. Yet inflation, unusually in G10, is in line with central bank targets.

For the SEK, growth is strong enough to make another rate cut unnecessary and we believe the Riksbank should be done. But low inflation will keep the threat of easing and FX intervention to the fore. In fact, the central bank finished 2015 by issuing an official warning that were SEK strength to continue, policy would react in order to ensure inflation moved towards target. The threat of FX intervention in 2016, or additional monetary easing, will cap growth-related SEK gains.

Other risks will also act as a constraint on the SEK. The migrant influx is prompting upward revisions to GDP growth expectations for 2016, but it also raises political uncertainty. Support for the Swedish Democrats, who oppose mass immigration, is already on the rise. The possibility of a snap election looms larger following the breakdown of political cooperation under the "December agreement". A further risk to the Swedish economy is the booming housing sector.

Overall, therefore, the SEK is likely to be the 'middle man' in the EUR-USD context. We expect it to weaken against a strengthening EUR as any marked decline in EUR-SEK under these conditions would most likely force a policy easing or direct intervention from the Riksbank. However, it will appreciate somewhat against a declining USD, a middle ground that will not trigger Riksbank concerns from a trade-weighted basis.

The NOK will continue to be buffeted by oil, and our GDP forecasts echo some concern that adverse impact on the oil-sector may filter into the mainland economy. We believe the Norges Bank will cut rates one more time during Q1 16 as insurance against the downside risks to growth Thankfully, Norway has the luxury of a considerable fiscal buffer to help support growth and orchestrate a rebalancing of the economy away from oil. The current budget already provides an impulse equivalent to 0.7% of GDP, and more could be available if required. From a structural perspective, the sizeable current account and fiscal surpluses should also act as a support for the currency.

Inflation may slow but it is high by G10 standards, and this is not a currency that policymakers will be trying to push lower to offset a deflation threat. In addition, we believe the earlier weakness in the currency has been overdone, with the extent of selling reflecting a rather illiquid market during periods of falling oil prices. We assume that oil prices will be stable in 2016, and believe the NOK will be able to reverse some of the overshoot, with our valuation metric suggesting the currency could be close to 27% undervalued against the USD.

HSBC

G10

CAD

The darkness before the dawn

Faced with an economy struggling in the face of the fall in energy prices, interest rates in Canada were cut twice in 2015 to just 0.50%. The currency has not been explicitly targeted, but the easing in policy has likely contributed to its weakness and helped offset the economic damage of lower oil prices.

Instead Canada is turning to fiscal policy to stimulate growth and inflation. The newly elected Liberal party made fiscal policy a key differentiating factor in its election campaign, arguing that there is scope for stimulus before returning to balance in 2019/20. Though historically expansionary fiscal spending has had mixed effects on the currency, we believe in this case CAD will see strength on the back of the increased spending.

Economic theory suggests there are three ways in which fiscal stimulus affects a currency. Higher spending and growth will boost import demand, which is FX-negative, and higher spending will also generate inflation, leading to FX weakness to bring competitiveness back into equilibrium.

The third impact is through the interest rate channel. Rising government borrowing and activity mean interest rates are higher than they would otherwise have been, encouraging capital inflows and causing the currency to strengthen. This is especially significant given that FX is more sensitive to rates than ever. We therefore believe that the interest rate impact on FX will dominate the two theoretical negative income and price effects.

The fiscal story is not the only factor that supports our forecast of USD-CAD dropping to 1.25 by the end of 2016. We have long-since argued for USD weakness in 2016. Historically, each tightening cycle over the last 30 years has led to subsequent USD weakness, irrespective of whether other developed market central banks have been increasing or lowering rates. Furthermore, our Little Mac Valuation indices place CAD in the middle of the pack in terms of valuations. Crucially, though, it is still considerably undervalued against the USD, by close to 20% on one estimate.

Finally, there has been excess pessimism on the Canadian economy for some time now. This is somewhat understandable given Canada's sensitivity to the collapse in the oil price. However, the HSBC's economic surprise index for Canadian activity shows that data has exceeded market expectations for some time now. .

Fiscal largesse typically has mixed implications for a currency. In Canada's case, we expect the positives will win out, not least because the CAD is an undervalued currency, where the market is already short, and where the downward revisions to GDP may have largely run their course. With the USD likely to retreat once the Fed begins to hike, we forecast USD-CAD to fall to 1.25 by the end of 2016.

G10

AUD & NZD

Opposing forces

We expect limited movement for both the AUD & NZD next year. Both remain at the mercy of commodity prices, which have been on a downward trend since mid-2014. However, growth in both countries is strong, and we are looking for broad USD weakness next year. We see the AUD depreciating very slightly over the year, with AUD-USD finishing at 0.70, and have NZD-USD flat in each quarter, at 0.68.

With iron ore down around 32% in 2015 and dairy prices down 14%, it is no surprise that commodities dragged the two currencies down in 2015. However, these relationships are weakening. As Australia shifts its economy away from mining, into services, and New Zealand looks towards tourism instead of dairy products, a shift is clearly underway. 2016 will likely see commodities' grip on the AUD & NZD weaken even further, which we see as a good thing for the currencies. The market's obsession with commodities has driven down the AUD and NZD considerably, whilst ignoring other considerations: the fact that growth has remained robust in both countries, for example.

Next year, we see monetary policy going then same way for Australia and New Zealand: expecting a cut in Q1 for both, down to 1.75% and 2.25% respectively. The RBA, we think, will be forced to act with inflation lying unnervingly near the bottom of the 2-3% target band. But it is unlikely to be an easy decision. With record-low interest rates already having boosted asset prices significantly, further cuts could threaten financial stability.

New Zealand's inflation worries are considerably more severe. 2015 saw CPI inflation fall to its lowest level this century, and the RBNZ will be desperate to rectify this. They too, must consider house price inflation – the median house price in Auckland prices is now around 80% higher than four years ago.

Another key factor for the two countries is the prosperity of the Chinese economy. China is the biggest net importer of Australian goods, and the second largest of New Zealand's, cementing its place as a key cog in the Australasian machine. Our economists have recently downgraded their China growth forecasts, from 7.2% in 2016 to 6.7%, which, if correct, will have negative consequences for the two southern-hemisphere economies. China's November trade balance data showed that imports were down 18.8% YoY, which paints a worrying picture for Australia and New Zealand should it continue.

Despite this, we still see little movement in the AUD and NZD next year. Yes there will likely be rate cuts, yes commodities are still driving the currencies and yes the outlook for China is uncertain. But the evidence that both economies are moving away from commodities, coupled with our prediction for broad USD weakness next year, means we see AUD-USD and NZD-USD moving largely sideways until the end of 2016.

HSBC

Asia

RMB

Prepare for greater volatility

The Chinese renminbi (RMB) should weaken in 2016. On the cyclical side, **a slowing Chinese economy and diverging US-China monetary policies should result in the reduction of FX liabilities and exposures by Chinese corporates and multinationals.**

Structurally, **there is pent-up demand from locals for foreign assets as China proceeds with its capital account liberalisation**. Enterprises' outward direct investments (ODIs) have been on the rise and are expected to exceed the size of foreign direct investments (FDIs) inflows soon. These ODIs are likely to accelerate in 2016 under the "One Belt, One Road" programme, with help of initiation of the Asia Infrastructural Investment Bank (AIIB). Meanwhile, households' demand for foreign assets will also increase, especially given the RMB's elevated valuation. The currency's strength makes such asset diversification attractive. Such private sector FX outflows would be consistent with historical observations, for example, Japan in early 80s. China's outward investments will increase the nation's private sector foreign assets and reduce the need to hold an excessive amount of official FX reserves.

However, this is not the start of a prolonged depreciation by the RMB. Long-term confidence in the yuan is rooted in China's high domestic saving and the tendency to run a current account surplus, as well as its relatively higher growth rate. Demand for RMB assets from foreigners, can also quicken, with a potential inclusion of China's A shares into MSCI indices, alongside the effectiveness of the RMB in the IMF's new SDR basket. The RMB's rising influence may also draw more focus at the G20 summit which is hosted by China on 4-5 September 2016.

We view **the current diverging US-China rate cycle as the much needed window for China to open up capital account without worrying about excessive inflows**. It also makes it easier for China to export capital abroad and promote the RMB as a financing currency. As China gradually moves towards a "clean floating" FX regime, we expect the RMB to trade with greater independence. The recent unveiling of the CFETS RMB effective exchange rate index underscores how China's authorities are increasingly looking at the currency in a much broader context, moving away from a focus on the USD.

We forecast USD-RMB to end the year at 6.70 in 2016, but this is consistent with China refraining from purposely weakening its currency. In addition, HSBC's forecast for the EUR and JPY to strengthen against the USD in 2016 reinforces our view that the broad CNY effective exchange rate should moderate further. RMB's depreciation will be accompanied by greater two way volatility, allowed by the likelihood of more relaxed FX policy, including a flexible reference rate and a wider daily trading band. Over time, as China continues to pursue capital account liberalization, greater arbitrage avenues between the onshore and offshore markets will ensure that the CNY and CNH exchange rates naturally converge.

Rising RMB volatility may trigger concerns initially, but over time these should diminish as the markets realise that this is a natural part of the process whereby the currency is maturing into a more global one. With China's low currency mismatch and high savings, and hence its potential to borrow largely in its own currency, the risk of financial instability stemming from currency depreciation and volatility is low and falling.

Asia

KRW

A capital exporter

In 2015, the Korean won (KRW) had its worst annual performance versus the USD since the 2008-09 crisis. This happened despite a record wide current account surplus (~8% of GDP; 2008: 0.4%). The weakness in the KRW is largely due to outflows by residents - both the private sector and the official sector (i.e. building FX reserves).

Korean companies have been steadily increasing their outward direct investments and accumulating FX deposits over the past few years. **The more notable development recently is in portfolio diversification.** Residents' investments in overseas equities and bonds surged to an average of USD10bn per quarter in Q1-Q3 2015, similar to 2014.

Domestic policies have been partly responsible for such strong outflows. **Besides Bank of Korea (BoK) rate cuts that have significantly narrowed Korea-US rates since 2014, Korea also announced regulatory measures to encourage FX outflows in June 2015. The bulk of such policies will be implemented from 2016 onwards.** These include granting tax incentives for foreign equity funds, relaxing foreign investment and hedging regulations to encourage insurance and pensions to invest abroad, and supporting Korean companies' overseas direct investment. The National Pension Service (NPS), for example, announced on 24 December 2015 that it would reduce its FX hedging target rate for overseas bonds to 50% by end of 2017 and 0% by end of 2018.

There is ample scope for overseas asset diversification. Local portfolio outflows in 2016 could thus possibly exceed the levels reached in 2006-2007 when Korea - US interest rates differentials were negative. **Korea's foreign assets scaled by GDP are low compared to other high savings countries. Moreover, Korea's growth has fallen due to lower demographic potential and other structural headwinds.** While credit growth appears strong, it partly reflects rising loans for jeonse payments (rental deposit). Consumption remains capped by a high stock of household debt (84% of GDP). The ongoing restructuring of large unprofitable corporates could also have a short-term negative impact on investments and growth.

Additionally, it was announced in December 2015 that Korea's president has nominated Yoo Il Ho as the new Finance Minister. It is widely expected Mr Yoo's policies will not be too different from those under the previous Minister Choi Jyung Hwan, even though the incoming Finance Minister did hint at plans to scale back exchange rate intervention (Bloomberg, 22 December 2015). While the government has announced it will review the current macro-prudential measures, implemented after 2008, it has stated that it will not consider easing withholding tax on foreign bond investments (Bloomberg, 21 December 2015).

In 2016, **Korea's monetary and FX policy should remain focused on promoting growth and ensuring export competitiveness, especially in light of the weaker RMB**. This should prevent the KRW from outperforming despite its strong underlying BoP metrics.

Asia

INR

Still looking good

The Indian rupee (INR) was the best performing Asian currency on a total return basis in 2015 and its resilience should continue in 2016, in our view. India's external accounts are relatively strong due to favourable terms of trade and an acceleration of FDI inflows. **A key challenge for the Reserve Bank of India (RBI) could be shifting from improving FX reserve cover to encouraging corporates to borrow more in local currency.**

Good things first. India's BoP is largely in balance. The trade deficit declined to USD9.8bn in November 2015, down from USD16.2bn in the same period in 2014, thanks to a slowing of non-oil-non-gold imports. Prime Minister Modi's three new gold schemes, including the sovereign gold bond scheme, should further reduce India's dependence on gold imports. **Helped by stable remittances and sluggish commodity prices, our economists expect the current account deficit to come in at 1% of GDP in FY16. This shortfall will be fully funded by FDI alone,** which has registered two record net inflows of USD9.6bn and USD10.2bn in Q1 and Q2. A spate of measures – from relaxing FDI limits in 15 sectors in November to FPI limits in September – should continue to attract long term inflows and build RBI's FX reserves. The central bank has moved into a much better position to guard against any quick capital reversal; a policy strongly adhered to by the RBI since early 2014.

In our view, increasing FX reserves should be a less urgent task for the RBI now. Capital inflows in the form of equity, debt and FDI have broadly been persistent given India has been a relatively brighter spot within EM. A large chunk of the USD34bn FX inflows attracted under RBI's FCNR (Foreign Currency Non-repatriable deposits) window will be maturing in 2016. But the RBI seems to have started to prepare for this, as it has been increasing its holdings of long USD-INR forwards as early as July/August in 2015 (*8 October 2015, The Financial Express*). FX reserve cover remains relatively comfortable.

It is noticeable that there have been strong inflows under the 'other investments' component within the BoP over past a couple of years. This could suggest less stable FX inflows, which include Non Resident Indian deposits and under-hedged corporate borrowings. These flows, incentivised by high yields and short term stability in the INR, could increase India's medium and long term FX liabilities. **The RBI's decision to encourage companies to issue rupee denominated bonds abroad is a step in addressing this issue of unhedged external debt.**

In 2016, we also need to **monitor the progress made on the reforms side, including the passing of the 'big-bang' bills on GST, land acquisition and labour laws.** Also, four Indian states go into assembly polls in 2016. It will be important for sentiment as to whether Modi's BJP party will manage to increase their voting share in these non-BJP ruling states. Uncertainty could also materialise for the INR should RBI Governor Rajan depart at the end of his current tenure in September 2016.

Asia

IDR

Forward optimism

The Indonesian rupiah (IDR) had a rough ride in 2015 but it is not the same rupiah as seen in 1997. The transition from a quasi-peg to a more flexible regime has limited abrupt exchange rate movements. Moreover, relatively weak corporate external balance sheets are compensated by a stronger banking system and government balance sheet. As such, **the IDR's weakness this time around has been a shock absorber for the economy, a distinct difference compared to 1997**. USD-IDR’s FX forwards are too high, especially for the longer-dated tenors such as the 1-year or 2-year. Now the Fed has started tightening and if the market welcomes Bank Indonesia (BI) easing in 2016, then USD-IDR’s forward curve will be under pressure to flatten.

Recently, **Indonesia’s policy makers have rolled out many measures aimed at stimulating economic growth and stabilising the currency.** The government’s policies have been focused on tax incentives and deregulations that target solving supply side bottlenecks. Bank Indonesia's (BI) measures have ranged from committing to necessary market intervention, tightening IDR liquidity, and strengthening FX supply and demand. These, together with the central bank's previous measures to encourage corporates to conduct FX hedging should continue to strengthen confidence in the local FX market.

Nevertheless, **the currency remains highly sensitive to external sentiment given its relatively large FX funding gap**. The IDR needs to reflect the deterioration of Indonesia's terms-of-trade and stay competitive to help the economy rebalance away from its over-reliance on resources.

In 2016, it will be important to monitor if the policymakers can:

1) Maintain fiscal prudence while implementing its infrastructure investments and other plans to stimulate growth

2) Fund its budget deficit smoothly with domestic and external debt

3) Further improve its investment policies to attract FDI (note: its 2016 investment list is due around mid-year)

4) Effectively implement tax incentives and other measures to encourage foreigners to reinvest in Indonesia so as to reduce the large income deficit; and

5) Ease monetary policy prudently without affecting FX policy credibility. **We see a good chance that Indonesia can pass most of these important policy tests, which should support the IDR, especially given the elevated levels of the FX forwards.**

Indeed, Indonesia has already made some progress in passing reforms and implementing prudent macro policies. The recent proposal on tax amnesty, BI FX bill issuance, discussion of relaxation of FDI ownership in mining, hotels and restaurants, and BI's decision to keep policy rates unchanged in December for example, suggest policies remain on the right track and should be viewed as positive for the currency. Although we expect USD-IDR to reach 14,500 by the end of 2016 we believe it will be an outperformer in Asia on a total return basis.

CEEMEA

PLN

Unanchored

We remain of the view that the PLN is vulnerable to the loosening of two historically strong anchors, namely the fiscal and monetary orthodoxy. PLN strength over recent years was largely due to a disciplined fiscal approach and a relatively tight monetary policy. In 2016, we believe that looser and less orthodox policies are likely.

The new PiS (Law & Justice) led government's economic programme raises risks for FX from many angles. They are looking to increases spending significantly (more generous social benefits, lower retirement age, etc.) with little clarity of the financing. Meanwhile, the conversion of households' FX-denominated loans into PLN and the wish to reduce the share of foreign investors in the local government debt market are all likely to weigh on the PLN in 2016. Higher borrowing requirements need to be financed by already constrained local investors (mainly banks), whilst the bill on FX mortgage conversion presented to local banks could create the conditions for a weaker PLN even with further ECB QE.

Monetary policy may also become more pro-cyclical and less orthodox to complement fiscal policy. This would be facilitated by the renewal of the MPC with eight members out of ten due to be replaced in Jan-Feb 2016. The changes on monetary policy may take two aspects:

1. **Looser monetary policy via a lower real policy rate:** The NBP's historical orthodoxy, ensuring a high real policy rate, has been a strong support for PLN. This might change with possible rate cuts while inflation is gradually picking up.

2. **A reshuffle of the monetary policy framework:** The new government's objectives remind us of Hungary's policies. Several options such as LTRO, the funding for growth programme to support corporates or some sort 'self-financing' programme to reduce foreign participation in the local government debt market have been mentioned. Such policies would imply – as in Hungary – the reform of monetary policy and the introduction of new instruments. We are not convinced that Poland needs such policies as economic growth is robust and the external debt is lower than in Hungary (73% vs 110% of GDP). It is also worth noting that reduced foreign participation in Hungary has had less impact on the HUF thanks to its large current account surplus. Poland's current account is largely neutral, meaning that net outflows from the bond market would have a more significant negative impact on the PLN.

CEEMEA

RUB

From Russia without love

The RUB is likely to face another challenging year in 2016. Although we do not expect the scale of last year's decline to be repeated, it is very difficult to see notable positive catalysts that can put the RUB onto a stronger path. Volatility is likely to remain elevated, especially if onshore trading volumes stay subdued, and geopolitical risks are still clearly visible. We now see USD-RUB at 72 by the end of 2016.

We see four key areas which will likely contribute to ongoing RUB depreciation in 2016:

Capital flow dynamics likely to remain challenging…
Russia saw significant capital outflows in 2015 but could face more in 2016. The pace is likely to be slower this year given the prior reduction in net portfolio liabilities, and because locals have built up larger FX deposits already. However, these flows, as well as the maturity of external debt in early 2016 should not be ignored. Russia's challenging macro-economic outlook (we see another contraction in growth and 7% inflation) is unlikely to spur inflows.

…and downside risks remain for the current account
Oil remains a key variable for the current account balance, but looking past this, non-oil trade has been deteriorating too. Soft external growth makes it hard to see a robust export recovery, suggesting some downside risks remain for the current account.

Persistently high inflation sees the RUB act as an adjustment mechanism
Since the central bank (CBR) allowed the currency to float more freely, the RUB has acted as an adjustment mechanism for the rest of the economy. In our view, the still elevated level of Russia's inflation versus its trade partners will necessitate a further gradual weakening of the currency in order to maintain competitiveness. Using HSBC's FX and inflation forecasts we find that a move into the low 70s in the coming year will keep the RUB REER towards the cheaper end of its "equilibrium" range, which in our view is justified by the challenging macro picture.

The CBR has less ammunition to curb RUB weakness
We believe the CBR will be biased to rebuild FX reserves which will curb USD-RUB downside. The CBR also has a significant portion of FX repos to roll over in early 2016 and although it has signalled it will do this, demand may depend on the rates at which the foreign currency is offered. If deemed too high by the market, there could be greater demand in spot. Interest rates may also be less RUB supportive as the CBR looks to cut despite already negative real rates.

CEEMEA

TRY

Less vulnerable

The TRY remains vulnerable to a challenging global environment (Fed, China, geopolitical situation, etc.) because of its well-known macro and financial weaknesses. We continue to see USD-TRY rising in 2016. However, we think it is now less vulnerable to bouts of acute weakness. Positioning has gone through a sharp adjustment and FX valuation raises fewer concerns. The CBRT's expected monetary policy simplification and normalisation will be pivotal.

A sharp positioning adjustment reduces the risk of acute TRY weakness
Foreign investors reduced their exposure to local assets in 2015. There were over USD6bn of outflows from bond and equity markets. This exit is quite striking in comparison to 2013 and 2014, which saw net inflows despite the very challenging global and local context. It is worth emphasising the ratio of foreign holding of local bonds as a percentage of total debt declined to 22% from a peak of 28% in mid-2013. But it is not just foreigners who were selling the TRY. Local holdings of foreign currency ramped up in 2015. In fact, households' FX deposits have increased by over USD10bn. Overall, we believe that the positioning adjustment has been significant; suggesting that the peak in FX demand may have passed.

FX valuation does not suggest a need for further acute TRY weakness
While TRY depreciation in 2015 was largely justified in our eyes, we should not ignore that some fundamental progress has occurred. The current account has narrowed, even if it is because of a sharper contraction of imports than exports, while the terms of trade have risen. Hence, the extremely low level of the REER, which should also be taken into account when assessing the TRY's degree of vulnerability going forward, appears to be in undervaluation territory.

CBRT's monetary policy simplification is pivotal for TRY in 2016
The CBRT has not responded to TRY depreciation in as aggressive a manner as it would traditionally do – via interest rate hikes. However it has taken on a key role in supplying FX to the market. The central bank has sold over USD10bn in 2015 and has directly provided around USD9.4bn to the state energy company, Botas. The CBRT is likely to continue to mitigate the effects of the FX demand and supply mismatch. But the TRY outlook in 2016 will largely depend on the expected monetary policy simplification and normalisation of interest rates. The narrowing of the interest rate corridor and making the one-week repo the main policy instrument will be crucial. A successful implementation ensuring greater transparency and delivering some tightening in liquidity would constitute an important buffer to the TRY in a globally challenging context.

CEEMEA

ZAR

Walking on one leg

Higher political risk premium and weakening fiscal anchor…
Our new USD-ZAR forecast of 16.20 by end-2016 vs 14.70 previously reflects the pricing of a higher political risk premium and the consequences of weaker fiscal anchor. We believe that the political turmoil that occurred at the end of 2015 will leave its mark.

President Zuma's sudden decision to replace Nhlanhla Nene, a respected finance minister, with a little-known member of parliament in mid-December cannot be overlooked. It has two types of negative consequence, in our view. First, it creates concerns about the risk of arbitrary political decisions, at a time when the President appears weaker and political manoeuvres within the ANC have started ahead of the elective conference at the end of 2017. Second, market confidence in the National Treasury has likely been eroded. The appointment of Pravin Gordhan as the new finance minister is a positive development to help calm the market's concerns. However, it will take time to re-convince the market that the Treasury is still a solid institution and fiscal discipline is still a priority. The presentation of the budget in February will be pivotal.

The risk of negative bond-FX circularity
The ZAR faces the risk of a negative feedback loop between bonds and FX in 2016. As the recent political events have now concentrated the risks on the fiscal side, the key question is whether the fear of a fiscal deterioration would lead to foreigners further reducing their participation in the local bond market. It is worth noting that the foreign participation has been declining but remains at a high level of 34% of total debt. Maintaining foreigners' appetite for local bonds is all the more challenging since the macro picture will remain poor in 2016. Our economists believe growth will struggle to reach 1%, whilst inflation is likely to remain at elevated levels. Some form of stagflation increases the fiscal challenges and puts the crucial investment grade status at risk. The re-widening of the current account deficit in 2016 (4.8% of GDP vs 4.2% in 2015) amid weak commodity prices will add another layer of vulnerability.

SARB is a robust anchor but may face more acute challenges
The South African Reserve Bank (SARB) remains a credible institution but its task could be even more complicated in 2016. The weakening of the National Treasury leaves the SARB with more vulnerable financial and FX markets. The central bank's approach so far has been that the SARB cannot really prevent currency depreciation but can try to mitigate the effects of a weak ZAR on inflation. This is one of the reasons why the SARB hiked its policy rate in both 2014 and 2015. The downside pressure on the ZAR clearly increases the pressure on the SARB to tighten further. However, we believe that the SARB is unlikely to intervene directly in the FX market to stop ZAR depreciation as FX reserves are only just over USD40bn.

Ignore the appeal of attractive valuation
The ZAR has become the most undervalued currency in EM that we cover. The HSBC Little Mac Valuation Ranges suggest that the ZAR is now 29-34% undervalued relative to the USD. However, we choose to ignore the appeal of value as the factors described above are likely to override the valuation factor in 2016.

LatAm

BRL

The storm continues

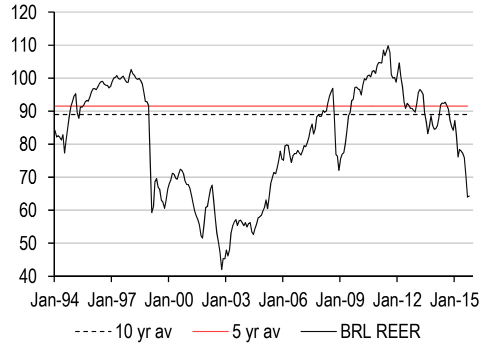
We forecast USD-BRL to rise to 4.20 by mid-2016, and remain steady at that level into year end. The deterioration of Brazil's fiscal accounts is continuing, with little sign of a turnaround as the government's recent minimum wage increases add to fiscal woes. The country's deep recession is hurting revenues while the government's efforts to pass legislation such as the proposed CPMF financial transactions tax that would help achieve even a small primary fiscal surplus in 2016, are struggling to find traction in congress.

Tighter monetary policy has so far been relatively ineffective in bringing down inflation, in part due to the excessive weakness of the BRL in recent months. Further rate hikes now appear more likely, with HSBC economists calling for two 50bp hikes in 1Q. However, with the economy mired in a deep recession, higher interest rates will likely further dent fiscal revenues. Deeper reforms are needed, but the contentious political atmosphere has meant that meaningful reforms will likely remain elusive.

The result is a probable increase in the country's debt-to-GDP ratio and the potential for further ratings downgrades in 2016. S&P and Fitch already have Brazil one notch below the investment grade threshold and Moody's may follow soon. The recent loss of investment grade status was taken well by the market, implying that it had already been priced in, but further downgrades in 2016 could have a more negative effect. As Chart 2 below shows, the behaviour of Brazil's CDS spreads can have a strong relationship with the BRL and is arguably a more important factor than external account dynamics at the moment.

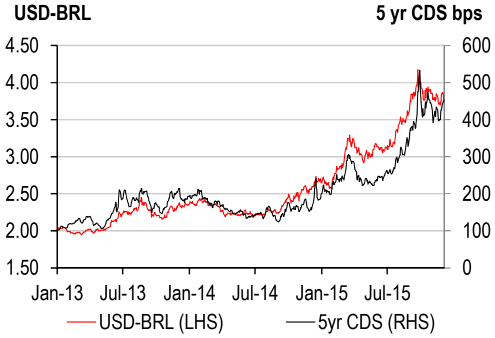
Brazil's current account deficit is shrinking thanks to lower imports and fewer outward dividend and tourism related payments, i.e. from negative growth drivers. Meanwhile FDI inflows are expected to hold up reasonably well around USD60bn in 2016, implying few stresses on the overall balance of payments. However, despite this, we still see downside risks for the BRL in 2016 based on the economy's weakness, deteriorating fiscal accounts, political "gridlock" and a weak external environment.

1. BRL REER is 30% weaker than the 10-year average, but can cheapen further



Source: BIS, HSBC

2. BRL has been closely tracking CDS spreads



Source: Bloomberg, HSBC

LatAm

MXN

Outperformer

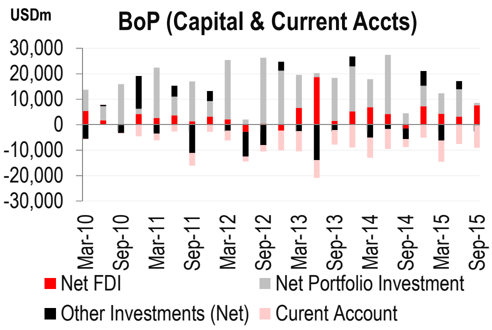
We expect USD-MXN to finish 2016 at 16.50, suggesting the MXN will be one of the best performers in LatAm. A number of forces are likely to be in play during 2016, including the US tightening cycle, oil prices, and fiscal developments.

The MXN is expected to cope well with the US tightening cycle. Mexico's central bank (Banxico) remains mindful of likely Fed moves and will tend to mirror these as it did in December. However, if EM FX remains untroubled by the Fed, the market may pare back how much Banxico has to hike, generating a bullish backdrop for Mexican bonds and, by extension, for the currency. The MXN should be supported by Mexico's efforts to retain a strong fiscal anchor. Spending cuts equivalent to 1.1% of GDP are planned for 2016 on top of the 0.7% of cuts introduced in 2015.

Our forecast of 16.50 for year-end 2016 reflects optimism around the Fed reaction and efforts towards a credible fiscal policy, but the currency faces some challenges. Growth remains relatively weak and, while our economists look for improvement in 2016, the output gap is not likely to close until end-2016. The spending cuts, so desirable from a fiscal standpoint, will continue to act as a drag on the economy. Our economists believe services will lead growth and the weak level of the MXN will help tourism; however, with US manufacturing expected to remain lacklustre, there is not an obvious catalyst for a big upswing in activity. Things are getting better, just not in a sufficiently dramatic way to get MXN bulls energised.

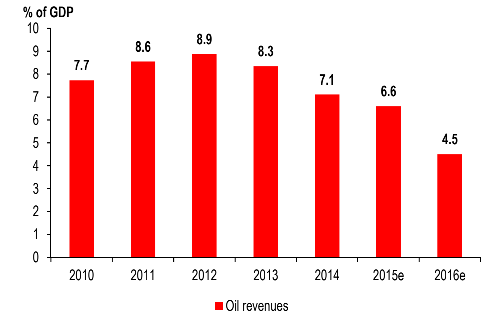
The economy, and currency, will continue to be sensitive to portfolio flows (Chart 1 below) and oil prices. The government's assumption on the Mexico mix oil price of USD50/bbl is optimistic, though not outrageously so, and oil price hedges will dampen the pain for 2016. But the persistence of very low oil prices would be challenging for the budget and the currency as 30% of fiscal revenues rely on oil (Chart 2). Of course, the opposite is also the case in the event of a spontaneous rally in energy prices. Our MXN forecasts assume a modest recovery in oil prices in 2016.

1. Mexico reliant on portfolio flows



Source: Bloomberg, HSBC

2. Lower oil revenues trigger spending cuts



Source: Ministry of Finance, HSBC

Precious metals

Gold builds a base to go higher

Gold prices recently fell again to five-year lows, largely on the back of renewed USD strength. We are mildly bullish on gold prices going forward, but our anticipated bounce may not materialise until further into 2016. Our average price forecast for 2016 is unchanged at 1,205/oz, including a year-end forecast of USD1,255/oz and we anticipate a broad trading range of USD1,025/oz-1,275/oz for the year. Our 2017 and longer-term average price forecasts are also unchanged at USD1,300/oz and USD1,325/oz respectively.

Gold has a traditional inverse correlation to the USD, and this was a key driver behind weak gold prices in 2015. Expectations of a Fed rate hike and persistently weak commodity prices, notably but not exclusively oil, took gold to five-year lows in July, with these lows revisited again in November and December.

A triad of reasons

There are three main drivers for our mildly bullish stance: demand from India and China, expectations for EUR-USD strength, and renewed – albeit tepid – investment demand. In addition, we expect central bank buying to keep rising and, with supply largely unchanged, this creates a favourable demand/supply backdrop.

While investor flows dominate gold prices in the near to medium term, the locus of physical demand has shifted from West to East. Nearly two-thirds of all the physical bullion purchased is consumed by India and China, who trade the number one and two spots for greatest consumer and importer between them. Indeed, since 2013, Western investor liquidation has weighed on gold prices, but price downswings have been met by increased EM demand. While economic growth in China and other EMs may be slowing, it is still strong by historical standards and we expect incomes to keep rising enough to support growing gold purchases. EM demand is highly price sensitive and increased with gold's decline below USD1,100/oz. This demand may increase further should prices drop to near USD1,000/oz. While this price sensitive nature of EM demand may not foment a rally, it will help establish a floor on prices, we believe.

The case for the inverse relationship between the USD and gold prices rests largely, though not exclusively, on gold being traded primarily in US dollars. Gold is especially sensitive to EUR-USD movements. We expect a higher EUR-USD in 2016 in the aftermath of the Fed rate hike and expect EURUSD to reach 1.20 by year end. This would further support gold and push it above USD1,200/oz, we estimate. The long awaited Fed rate hike may have finally "cleared the deck" and allow gold to rally. A US rate rise may, in itself, also be supportive of gold. During the last four Fed tightening cycles, gold prices tended to weaken going into a rate rise and rally for the next 120 days afterwards.

Gold has been weighed down by a negative investment climate. Gold ETFs have liquidated considerable amounts of bullion since 2013. The pace of liquidation in the ETFs in 2015 was more moderate than in 2014 but was still sufficient to weigh on prices. We believe the bulk of ETF sales have occurred. Many remaining ETF holders appear to have adopted buy-and-hold strategies that should keep the bulk of remaining holdings largely intact. Indeed, we look for a recovery in demand leading to a modest build in holdings in 2016. At the same time, short positions on the Comex are historically high and net long positions are very low. The Comex has not been net short since 2001. This holds out the possibility of short covering rally.

The official sector has become an important source of gold demand in the past three years, as reserve managers in emerging market central banks diversify FX reserves away from the USD, and we expect this to continue, this year. On the supply side mine supply is likely topping out, although we see only modest decline in 2016. Low prices will help keep supply tight in part by discouraging scrap supplies from the recycling markets, and hedging should have little impact on the market.

Silver to glimmer

We look for prices to rise from current levels but have recently lowered our 2016, 2017 and long-term forecasts to 15.90/oz, 18.00/oz and 20.50/oz, respectively. We forecast a trading range of USD13.25/oz-USD16.75/oz for 2016.

Our positive price outlook is based on a likely easing in mine production after a decade of significant output increases. Further to the supply-side, low prices are constricting scrap supplies. Industrial demand, which comprises half of total silver consumption, weakened in 2015 due mostly to lower China offtake. This component of demand should recover modestly in 2016. Low prices are stimulating coin and small bar demand and may support jewellery offtake. Holdings in silver ETFs have been far steadier than in gold ETFs and we look for gains this year. Like gold, silver is inversely correlated to the USD, and USD strength has been a prime reason for ongoing investor selling of silver. A weaker USD would likely buoy silver. Positions on the Comex are still net long, but gross short positions are high, creating a possible short covering rally.

PGMs have positive catalysts

We are positive on the PGMs from current levels but have recently lowered our average our 2016, 2017 and long-term forecast for average prices for platinum to USD1,005/oz, 1,195/oz and USD1,450/oz, respectively. We look for a trading range in 2016 of USD815/oz to USD1,105/oz. For palladium we also recently lowered our forecast for 2016, 2017 and long term, to USD655/oz, USD760/oz, and USD900/oz, respectively. We anticipate a wide USD555/oz to 720/oz trading range for 2016.

We attribute much of platinum's poor price performance in 2015 to USD strength, sinking commodity prices, concerns over future diesel vehicle demand, and weak jewellery offtake from China. On the demand side prices reacted negatively to a better-than-expected rebound in mine production after the 2014 South African strike and steady recycling levels. This led to investor ETF liquidation and increased short positions on the Comex. Low prices have led to restructuring programs and cost cutting across the mining industry, which, over time, should constrain mine supply growth, tighten supply/demand balances, and eventually support prices. The impact on prices of the emissions scandal appears overdone and tighter regulations should support platinum auto demand. Low prices and restocking may elicit greater jewellery demand in China. These factors and a weaker USD are likely to lead to a recovery in investment demand.

Many of the same factors weighed on palladium prices. A more vigorous increase in auto demand coupled with limited scope for mine production increases in most producing nations, sets the stage for higher prices in 2016. A key factor will be ETF demand which saw substantial liquidation in 2015. Even modest investor accumulation would likely have a pronounced impact on prices. Both PGMs face the likelihood of substantial production/consumption deficits in 2016, which should support prices.

HSBC Volume-Weighted REERs

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.

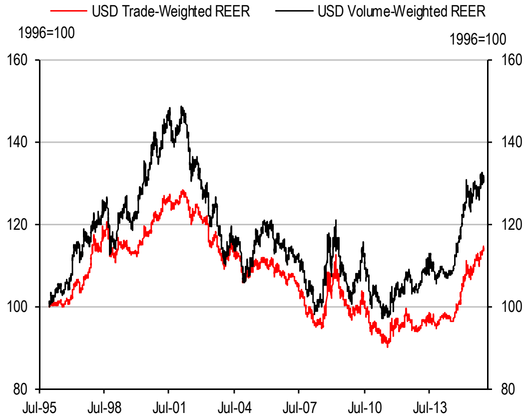
We would argue that if you are a financial market investor, the effective value of a currency you would be exposed to is more accurately represented by the HSBC volume-weighted index rather than the trade-weighted index.

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.

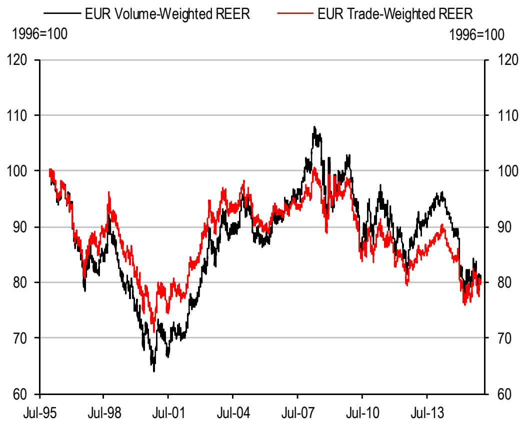
HSBC Volume – Weighted REERs

USD REER index



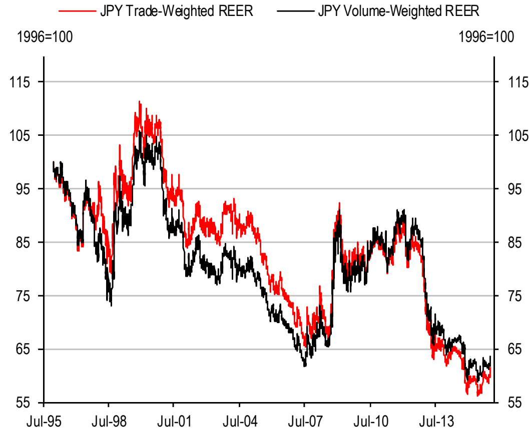
Source: HSBC

EUR REER index



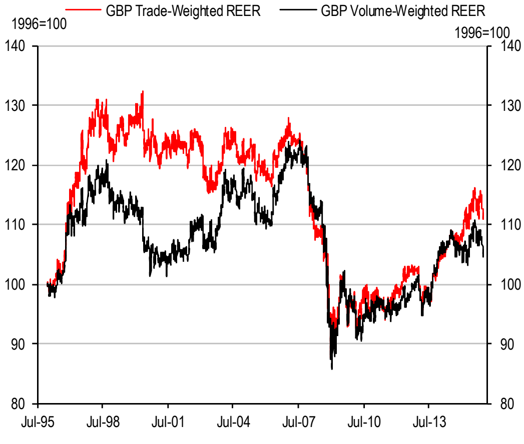
Source: HSBC

JPY REER index



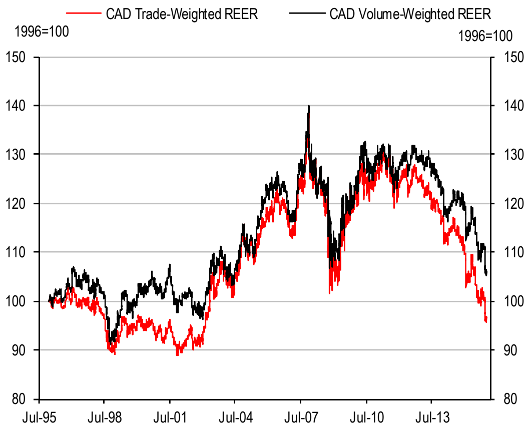
Source: HSBC

GBP REER index



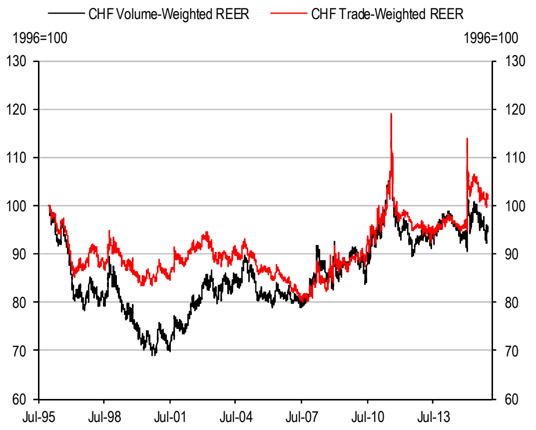
Source: HSBC

CAD REER index



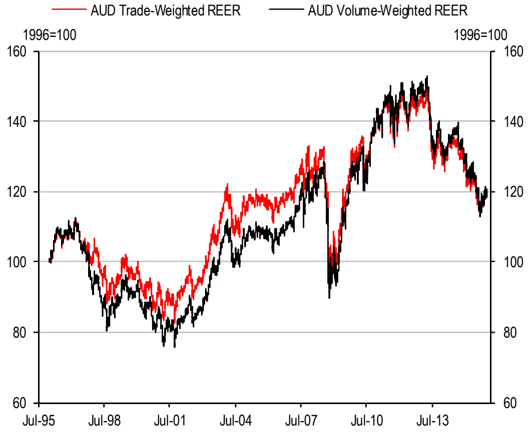
Source: HSBC

CHF REER index



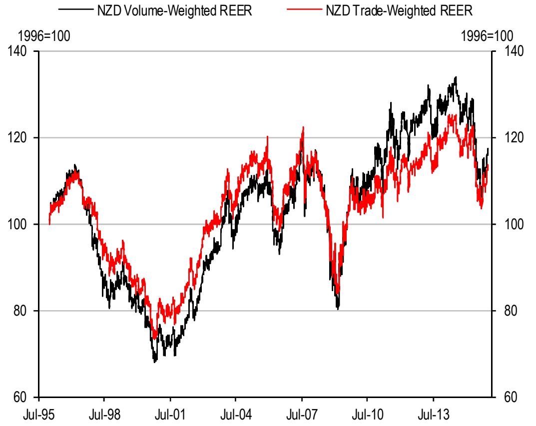
Source: HSBC

AUD REER index



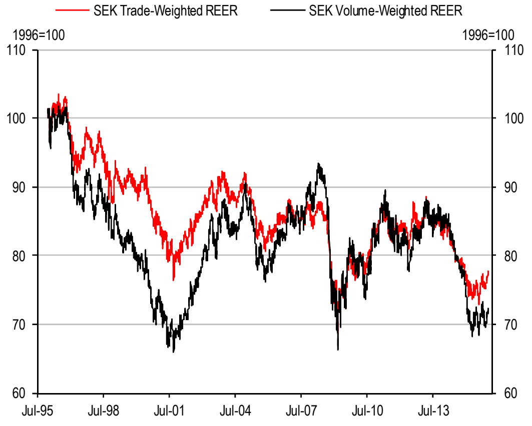
Source: HSBC

NZD REER index



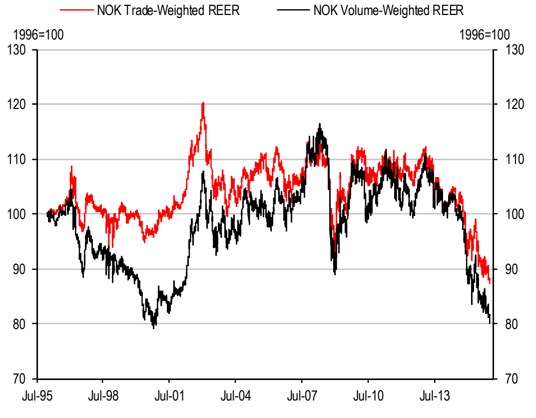
Source: HSBC

SEK REER index



Source: HSBC

NOK REER index



Source: HSBC

HSBC Little Mac Valuation Ranges

When using a REER to measure whether a currency is over/under valued, it is necessary to compare the current value of the REER to some reference value. Calculating REERs is a simple task – the difficulty in using them for FX valuation is deciding on which reference value to choose.

A common approach is to use a moving average value of the REER as the reference. However, this requires an arbitrary choice of window length to use for the moving average. One person might believe that a five-year window was an appropriate choice whereas someone else might choose 10 years. These choices will regularly give contradictory valuations and there is no principled way to choose between them.

Our methodology circumvents this problem by using all possible window lengths of five years and more. Each window choice gives a different valuation and we use the entire range of these valuations. If they **all** give a consistent valuation signal then this gives us some confidence of the direction of valuation.

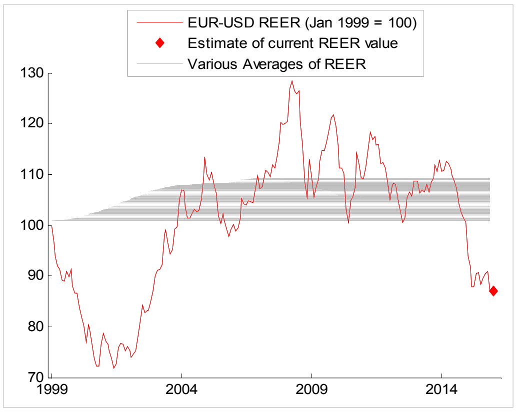
Procedure to calculate the HSBC Little Mac Valuation Ranges

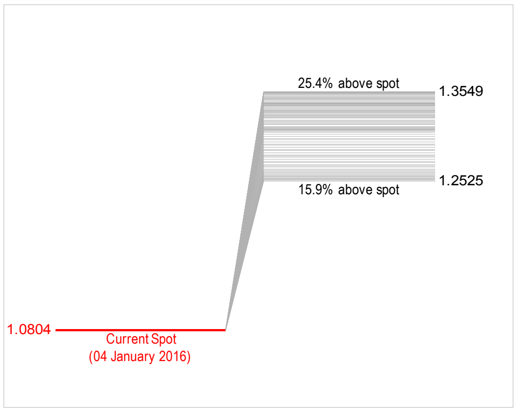
1. We create single currency pair REERs, beginning at 100 in January 1999.
2. We calculate average values of the REER for all recent time windows which are at least five years in length.
3. We use the spot moves since the most recently available inflation data to estimate the value of the REER today[2].
4. For each average value of the REER calculated in step 2, we calculate what value of the exchange rate would move ou[4]r estimated value of the REER today (step 3) to the average. We use this value as one of our estimated PPP values.
5. The range of the entire set of the estimated PPP values (step 4) constitutes our HSBC Little Mac Valuation Range for this currency pair.

For full details of the construction methodology, please see "*HSBC Little Mac Valuation Ranges*", September 2015.

[4] *The maximum window length over which we calculate an average value is from January 1999 to today.*
[2] *We make the assumption that the most recently observed YoY change in CPI will also be the YoY change observed for this month in estimating this REER value.*

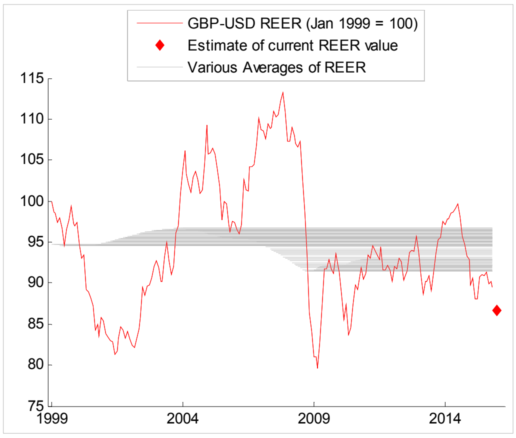
EUR-USD HSBC Little Mac Valuation Range

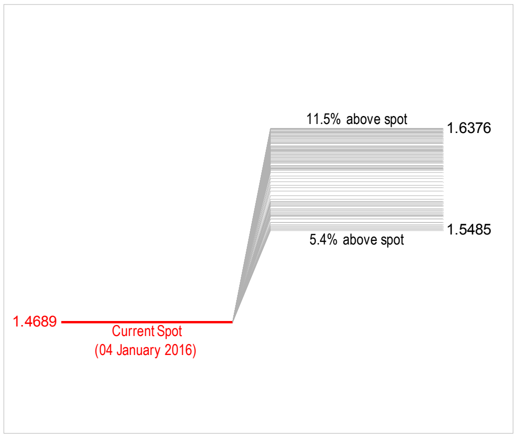




Source: HSBC, Thomson Reuters Datastream

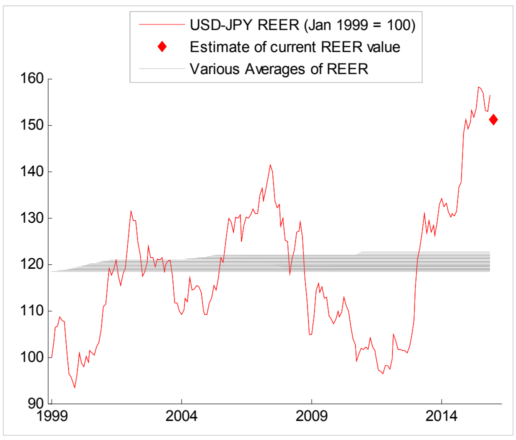
GBP-USD HSBC Little Mac Valuation Range

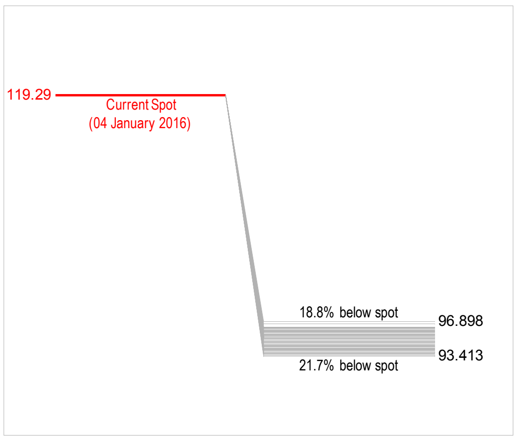




Source: HSBC, Thomson Reuters Datastream

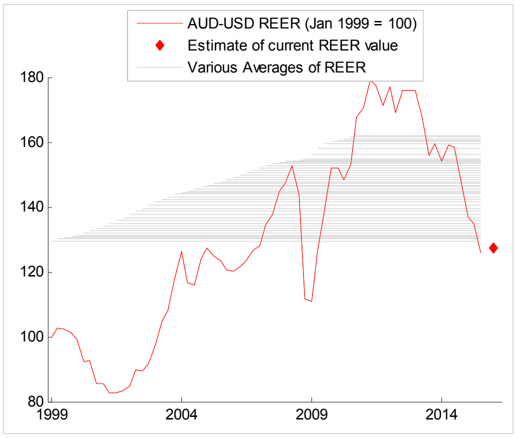
USD-JPY HSBC Little Mac Valuation Range

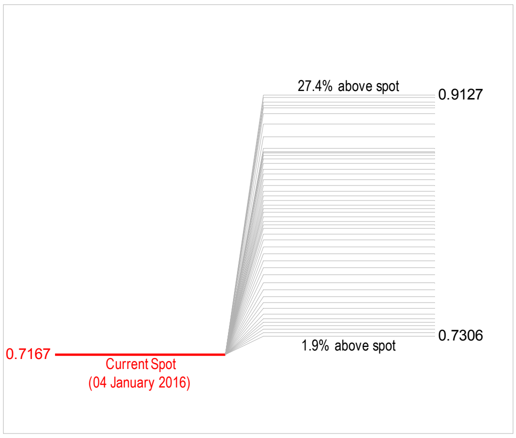




Source: HSBC, Thomson Reuters Datastream

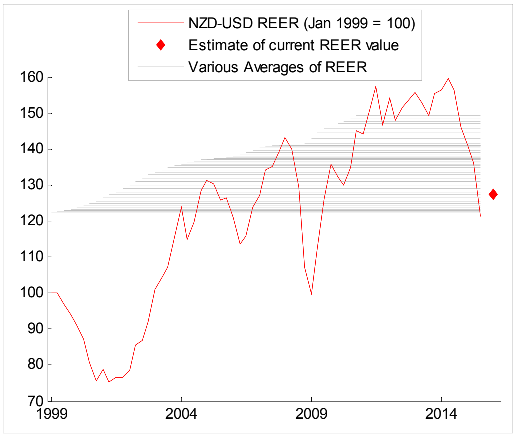
AUD-USD HSBC Little Mac Valuation Range

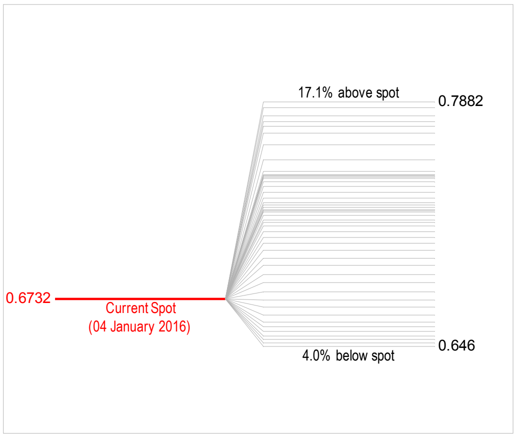




Source: HSBC, Thomson Reuters Datastream

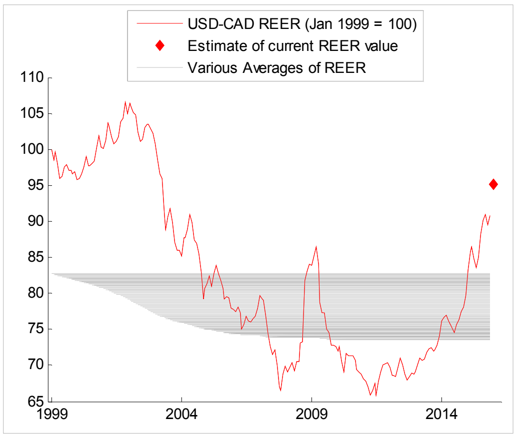
NZD-USD HSBC Little Mac Valuation Range

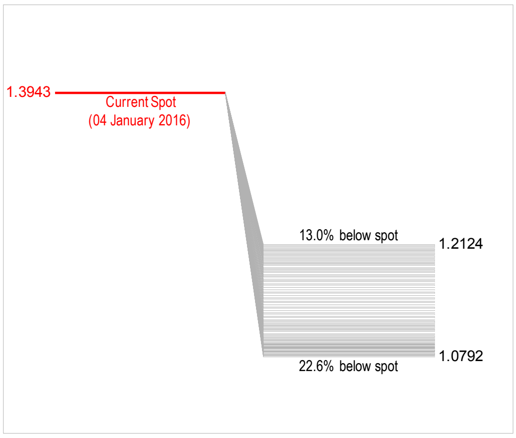




Source: HSBC, Thomson Reuters Datastream

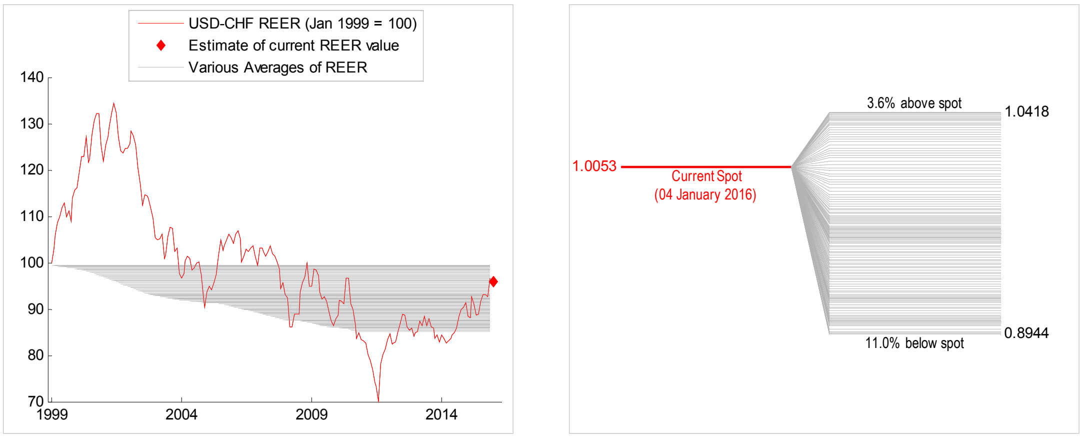
USD-CAD HSBC Little Mac Valuation Range





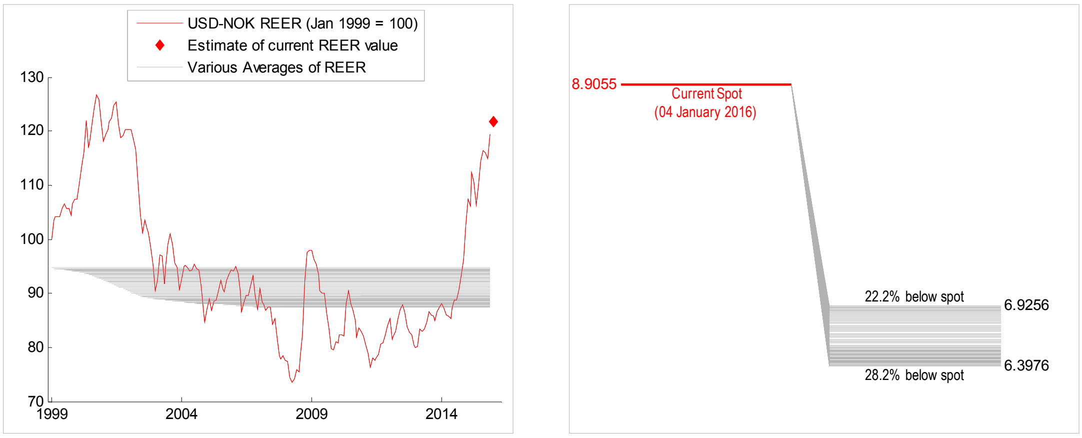
Source: HSBC, Thomson Reuters Datastream

USD-CHF HSBC Little Mac Valuation Range



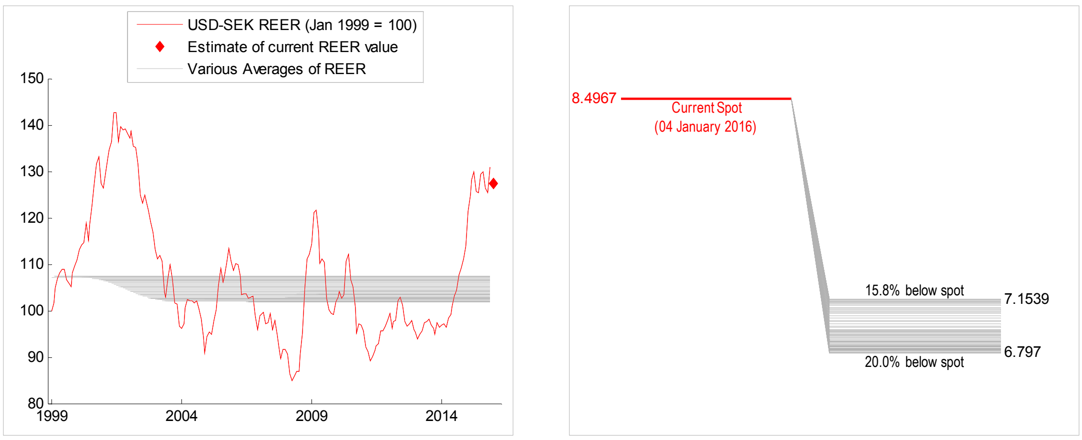
Source: HSBC, Thomson Reuters Datastream

USD-NOK HSBC Little Mac Valuation Range



Source: HSBC, Thomson Reuters Datastream

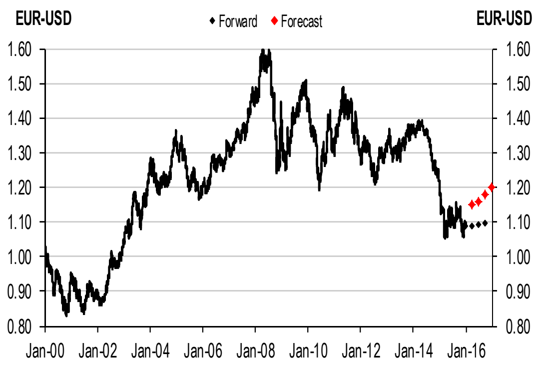
USD-SEK HSBC Little Mac Valuation Range



Source: HSBC, Thomson Reuters Datastream

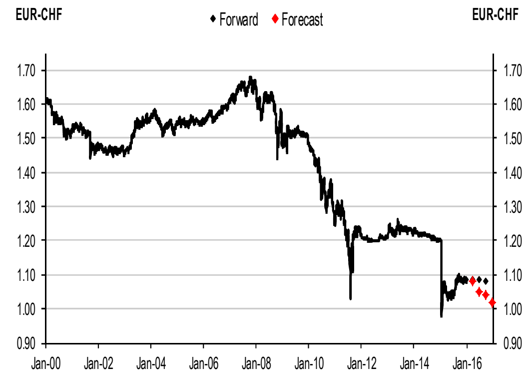
HSBC forecasts vs forwards

EUR-USD vs forwards



Source: Thomson Reuters Datastream, Reuters, HSBC

EUR-CHF vs forwards



Source: Thomson Reuters Datastream, Reuters, HSBC

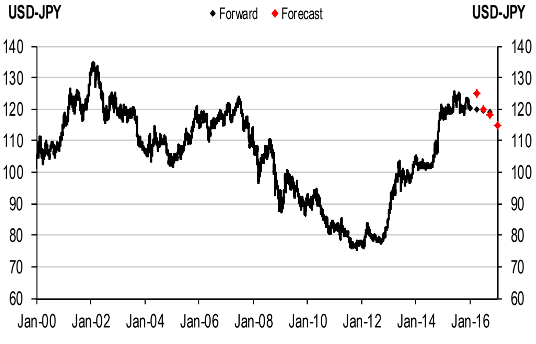
GBP-USD vs forwards

Source: Thomson Reuters Datastream, Reuters, HSBC

EUR-GBP vs forwards

Source: Thomson Reuters Datastream, Reuters, HSBC

USD-JPY vs forwards



Source: Thomson Reuters Datastream, Reuters, HSBC

EUR-JPY vs forwards

Source: Thomson Reuters Datastream, Reuters, HSBC

Short Rates

3 Month Money

end period		Q3	Q4	2015 Q1	Q2	Q3	Q4	2016 Q1	Q2	Q3f	Q4f
North America											
	US (USD)	0.2	0.3	0.3	0.3	0.3	0.5	0.6	0.8	0.8	1.0
	Canada (CAD)	1.2	1.2	1.0	1.0	0.8	0.5	0.5	0.5	0.5	0.5
Latin America											
	Mexico (MXN)	3.0	3.0	3.0	3.0	3.0	3.2	3.5	3.8	3.9	3.9
	Brazil (BRL)	10.9	12.2	13.0	14.0	14.3	14.3	15.3	15.3	15.3	14.8
	Chile (CLP)	3.9	3.2	3.0	3.1	3.1	3.3	3.8	4.1	4.1	4.1
Western Europe											
Eurozone		0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other Western Europe											
	UK (GBP)	0.6	0.6	0.6	0.6	0.6	0.6	0.8	1.0	1.2	1.4
	Norway (NOK)	1.7	1.5	1.5	1.3	1.1	1.0	1.0	1.0	1.0	1.0
	Sweden (SEK)	0.5	0.3	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4
	Switzerland (CHF)	0.0	-0.1	-0.8	-0.8	-0.7	-0.8	-0.8	-0.8	-0.8	-0.8
EMEA											
	Hungary (HUF)	-	-	1.8	1.6	1.4	1.4	1.4	1.4	1.6	1.9
	Poland (PLN)	-	-	-	-	1.7	1.7	1.4	1.4	1.4	1.4
	Russia (RUB)*	10.5	23.8	15.7	12.5	12.0	11.9	10.9	10.4	9.9	9.7
	Turkey (TRY)	9.3	9.8	9.2	9.3	11.0	11.0	10.0	10.0	10.0	10.0
	South Africa (ZAR)	6.1	6.1	6.1	6.1	6.3	6.6	6.8	7.1	7.3	7.3
Asia/Pacific											
	Japan (JPY)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
	Australia (AUD)	2.7	2.8	2.2	2.0	2.1	2.1	2.1	2.1	2.1	2.1
	New Zealand (NZD)	3.7	3.7	3.7	3.3	2.9	2.6	2.6	2.6	2.6	2.6
North Asia											
	China (CNY)	4.5	4.2	4.9	2.9	3.0	3.0	2.8	2.5	2.4	2.3
	Hong Kong (HKD)	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5
	Taiwan (TWD)	0.9	0.9	0.9	0.9	0.9	0.8	0.7	0.7	0.7	0.7
	South Korea (KRW)	2.4	2.1	2.0	1.7	1.6	1.6	1.6	1.6	1.6	1.6
South Asia											
	India (INR)	8.5	8.3	8.3	7.7	7.1	7.8	7.5	7.5	7.5	7.5
	Indonesia (IDR)	8.1	7.2	6.9	7.0	8.2	8.3	8.0	7.7	7.5	7.2
	Malaysia (MYR)	3.7	3.9	3.7	3.7	3.7	3.8	3.7	3.6	3.6	3.6
	Philippines (PHP)	1.5	1.9	2.1	2.3	0.0	2.4	2.4	2.2	2.2	2.2
	Singapore (SGD)	1.5	1.5	1.5	1.5	1.5	1.4	2.0	2.1	2.2	2.3
	Thailand (THB)	2.2	2.2	2.0	1.7	1.6	1.4	1.2	1.2	1.4	1.5
	South Africa (ZAR)	6.1	6.1	6.1	6.1	6.3	6.6	6.8	7.1	7.3	7.3

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

Emerging markets forecast table

	5-Jan-16	2015		2016				2017	
	last	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f
Latin America vs USD									
Argentina (ARS)	13.18	9.43	12.94	14.50	15.00	16.25	16.75	17.50	18.25
Brazil (BRL)	4.02	3.97	3.90	4.10	4.20	4.20	4.20	4.25	4.30
Chile (CLP)	717	696	709	705	710	710	710	715	720
Mexico (MXN)	17.32	16.93	17.21	16.75	16.50	16.50	16.50	16.50	16.50
Colombia (COP)	3220	3088	3175	3300	3350	3400	3400	3425	3450
Peru (PEN)	3.41	3.23	3.28	3.39	3.43	3.46	3.50	3.53	3.55
Eastern Europe vs EUR									
Czech Republic (CZK)	27.0	27.2	27.0	27.0	27.0	27.0	27.0	26.5	26.5
Hungary (HUF)	315	314	316	310	315	315	320	320	320
Poland (PLN)	4.31	4.25	4.27	4.25	4.30	4.35	4.40	4.40	4.40
Romania (RON)	4.53	4.41	4.41	4.41	4.41	4.41	4.41	4.41	4.41
Russia vs USD (RUB)	73.4	66.2	72.9	70.0	70.0	72.0	72.0	72.0	72.0
Turkey vs USD (TRY)	2.98	3.03	2.92	2.90	2.95	3.00	3.00	3.00	3.00
Middle East vs USD									
Egypt (EGP)	7.82	7.83	7.82	8.50	9.00	9.00	9.00	9.00	9.00
Israel (ILS)	3.93	3.92	3.89	3.85	3.80	3.80	3.75	3.75	3.75
Africa vs USD									
South Africa (ZAR)	15.63	13.86	15.49	15.80	16.00	16.20	16.20	16.20	16.20

Source HSBC

HSBC

Exchange rates vs USD

end period		2014 Q4	2015 Q1	Q2	Q3	Q4	2016 Q1f	Q2f	Q3f	Q4f	2017 Q1f	Q2f
Americas												
	Canada (CAD)	1.16	1.27	1.25	1.34	1.38	1.40	1.35	1.28	1.25	1.25	1.25
	Mexico (MXN)	14.75	15.26	15.69	16.93	17.21	16.75	16.50	16.50	16.50	16.50	16.50
	Brazil (BRL)	2.66	3.21	3.10	3.97	3.90	4.10	4.20	4.20	4.20	4.25	4.30
	Argentina (ARS)	8.46	8.82	9.10	9.43	12.94	14.50	15.00	16.25	16.75	17.50	18.25
Western Europe												
	Eurozone (EUR*)	1.21	1.07	1.12	1.12	1.09	1.15	1.16	1.18	1.20	1.20	1.20
Other Western Europe												
	UK (GBP*)	1.56	1.48	1.57	1.51	1.47	1.55	1.58	1.55	1.50	1.50	1.50
	Sweden (SEK)	7.80	8.63	8.29	8.38	8.46	8.17	8.19	8.14	8.00	8.00	8.00
	Norway (NOK)	7.49	8.06	7.84	8.54	8.85	8.09	7.84	7.54	7.25	7.25	7.25
	Switzerland (CHF)	0.99	0.97	0.94	0.97	1.00	0.94	0.91	0.88	0.85	0.85	0.85
Emerging Europe												
	Russia (RUB)	56.3	58.5	55.5	66.2	72.9	70.0	70.0	72.0	72.0	72.0	72.0
	Poland (PLN)	3.54	3.80	3.76	3.80	3.93	3.70	3.71	3.69	3.67	3.67	3.67
	Hungary (HUF)	261	280	283	281	291	270	272	267	267	267	267
	Czech Republic (CZK)	22.9	25.7	24.5	24.3	24.9	23.5	23.3	22.9	22.5	22.1	22.1
Asia/Pacific												
	Japan (JPY)	120	120	122	120	120	125	120	118	115	115	115
	Australia (AUD*)	0.82	0.76	0.77	0.70	0.73	0.71	0.71	0.70	0.70	0.70	0.70
	New Zealand (NZD*)	0.78	0.75	0.68	0.64	0.68	0.68	0.68	0.68	0.68	0.68	0.68
North Asia												
	China (CNY)	6.14	6.21	6.20	6.20	6.36	6.55	6.60	6.65	6.70	6.70	6.70
	Hong Kong (HKD)	7.76	7.75	7.75	7.75	7.75	7.80	7.80	7.80	7.80	7.80	7.80
	Taiwan (TWD)	30.4	31.6	31.3	30.9	32.8	33.2	33.4	33.6	33.8	33.8	33.8
	South Korea (KRW)	1063	1092	1098	1125	1179	1180	1190	1200	1200	1200	1200
South Asia												
	India (INR)	63.0	62.3	63.6	65.5	66.2	67.5	68.0	68.5	69.0	69.0	69.0
	Indonesia (IDR)	12128	12385	13043	13326	14670	14200	14300	14400	14500	14500	14500
	Malaysia (MYR)	3.27	3.50	3.70	3.75	4.41	4.30	4.35	4.40	4.40	4.40	4.40
	Philippines (PHP)	44.8	44.8	44.6	45.2	46.7	47.4	47.8	48.2	48.5	48.5	48.5
	Singapore (SGD)	1.27	1.32	1.36	1.35	1.43	1.42	1.43	1.43	1.43	1.43	1.43
	Thailand (THB)	32.4	32.9	32.5	33.7	36.3	36.2	36.4	36.6	36.8	36.8	36.8
	Vietnam (VND)	21380	21480	21725	22478	22485	22500	22800	23000	23000	23000	23000
Africa												
	South Africa (ZAR)	11.55	12.14	12.15	13.86	15.49	15.80	16.00	16.20	16.20	16.20	16.20

Source HSBC *pairs denoted XXX-USD

Exchange rates vs EUR & GBP

end period		2015				2016				2017	
	Q4	Q1	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f
Vs euro											
Americas											
US (USD)	1.21	1.07	1.12	1.12	1.09	1.15	1.16	1.18	1.20	1.20	1.20
Canada (CAD)	1.41	1.36	1.39	1.50	1.50	1.61	1.57	1.51	1.50	1.50	1.50
Europe											
UK (GBP)	0.78	0.72	0.71	0.74	0.74	0.74	0.73	0.76	0.80	0.80	0.80
Sweden (SEK)	9.44	9.26	9.25	9.38	9.19	9.40	9.50	9.60	9.60	9.60	9.60
Norway (NOK)	9.06	8.65	8.74	9.54	9.62	9.30	9.10	8.90	8.70	8.70	8.70
Switzerland (CHF)	1.20	1.04	1.04	1.09	1.09	1.08	1.05	1.04	1.02	1.02	1.02
Russia (RUB)	68.1	62.7	61.9	74.1	79.2	80.5	81.2	85.0	86.4	86.4	86.4
Poland (PLN)	4.28	4.07	4.19	4.25	4.27	4.25	4.30	4.35	4.40	4.40	4.40
Hungary (HUF)	316	300	315	314	316	310	315	315	320	320	320
Czech Republic (CZK)	27.7	27.6	27.4	27.2	27.0	27.0	27.0	27.0	27.0	26.5	26.5
Asia/Pacific											
Japan (JPY)	145	129	136	134	131	144	139	139	138	138	138
Australia (AUD)	1.48	1.41	1.45	1.59	1.49	1.62	1.63	1.69	1.71	1.71	1.71
New Zealand (NZD)	1.55	1.44	1.65	1.75	1.59	1.69	1.71	1.74	1.76	1.76	1.76
Vs sterling											
Americas											
US (USD)	1.56	1.48	1.57	1.51	1.47	1.55	1.58	1.55	1.50	1.50	1.50
Canada (CAD)	1.81	1.88	1.96	2.03	2.04	2.17	2.14	1.98	1.88	1.88	1.88
Europe											
Eurozone (EUR*)	0.78	0.72	0.71	0.74	0.74	0.74	0.73	0.76	0.80	0.80	0.80
Sweden (SEK)	12.15	12.81	13.04	12.69	12.46	12.69	12.97	12.61	12.03	12.03	12.03
Norway (NOK)	11.66	11.96	12.32	12.92	13.04	12.55	12.42	11.69	10.90	10.90	10.90
Switzerland (CHF)	1.55	1.44	1.47	1.48	1.47	1.46	1.43	1.37	1.28	1.28	1.28
Asia/Pacific											
Japan (JPY)	187	178	192	181	177	194	190	183	173	173	173
Australia (AUD)	1.91	1.95	2.04	2.16	2.02	2.19	2.23	2.22	2.15	2.15	2.15
New Zealand (NZD)	2.00	1.99	2.32	2.37	2.15	2.28	2.33	2.28	2.21	2.21	2.21

Source HSBC *denoted EUR-GBP

Source: HSBC

Notes

Notes

Disclosure appendix

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1 This report is dated as at 06 January 2016.

2 All market data included in this report are dated as at close 04 January 2016, unless otherwise indicated in the report.

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