

# Foreign Exchange Outlook

Intensifying stress in European peripheral credit markets, prolonged monetary policy accommodation (and liquidity injection) by systemically important central banks, renewed bullishness in high-yielding emerging markets, currency diversification dynamics, and resilient commodity markets are key factors shaping capital flows in foreign exchange markets.

The USD is adopting a defensive stance against major regional countries in the Americas, yet it will continue to gain strength versus the EUR and – modestly – the JPY. Mild improvement in US economic prospects and continuous commodity market strength bode well for CAD; however, we are more cautious on the MXN.

Heightened volatility, ongoing credit rating rebalancing and the risk of disorderly currency adjustments continue to shape the European financial landscape. We anticipate further weakening of the EUR against all major currencies while the GBP will benefit from USD and EUR weakness.

China remains committed to its managed approach of gradual appreciation. Japan stands ready to intervene to limit JPY gains versus all currencies caused by safe-haven trading dynamics. The rest of the Asian floating currencies enjoy an appreciating momentum following sharp weakening shifts in the last quarter.

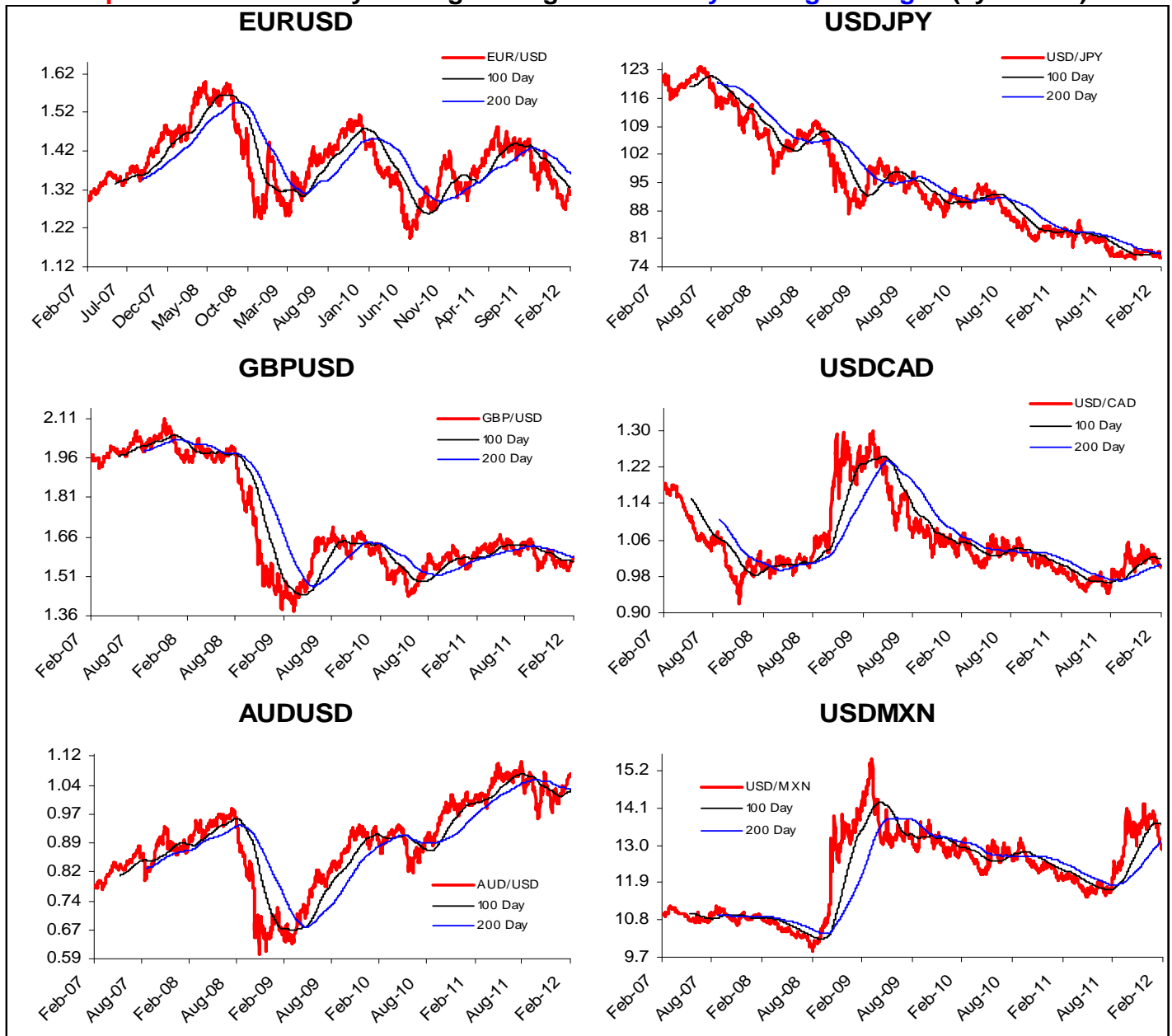
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## Global Foreign Exchange Outlook

| February 2, 2012  |            | Actual | Q3a 11 | Q4a 11 | Q1 12 | Q2 12 | Q3 12 | Q4 12 | Q1 13 | Q2 13 |
|-------------------|------------|--------|--------|--------|-------|-------|-------|-------|-------|-------|
| Euro              | EURUSD     | 1.31   | 1.34   | 1.30   | 1.29  | 1.28  | 1.27  | 1.25  | 1.25  | 1.26  |
|                   | Consensus* |        |        |        | 1.29  | 1.29  | 1.29  | 1.30  | 1.31  | 1.31  |
| Yen               | USDJPY     | 76.1   | 77     | 77     | 78    | 80    | 80    | 82    | 83    | 83    |
|                   | Consensus* |        |        |        | 77    | 77    | 78    | 78    | 79    | 80    |
| Sterling          | GBPUSD     | 1.58   | 1.56   | 1.55   | 1.56  | 1.59  | 1.62  | 1.63  | 1.65  | 1.66  |
|                   | Consensus* |        |        |        | 1.53  | 1.54  | 1.55  | 1.57  | 1.58  | 1.59  |
| Canadian Dollar   | USDCAD     | 1.00   | 1.05   | 1.02   | 1.02  | 1.01  | 0.99  | 0.98  | 0.98  | 0.97  |
|                   | Consensus* |        |        |        | 1.03  | 1.03  | 1.02  | 1.01  | 1.01  | 1.01  |
| Australian Dollar | AUDUSD     | 1.07   | 0.97   | 1.02   | 1.05  | 1.07  | 1.08  | 1.09  | 1.10  | 1.10  |
|                   | Consensus* |        |        |        | 0.99  | 0.99  | 0.99  | 1.00  | 0.99  | 0.99  |
| Mexican Peso      | USDMXN     | 12.84  | 13.90  | 13.94  | 13.52 | 13.33 | 13.17 | 13.05 | 13.16 | 13.06 |
|                   | Consensus* |        |        |        | 13.55 | 13.24 | 12.99 | 12.73 | 12.71 | 12.79 |

Spot Price vs. 100 Day Moving Average vs. 200 Day Moving Average - (5yr Trend)



(\*) Source: Consensus Economics Inc. December 2011

## MARKET TONE &amp; FUNDAMENTAL FOCUS

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European developments continue to dominate the attention of global investors and policymakers. The world's major central banks seem committed to supplying the necessary liquidity to stimulate global growth. Demand for assets in fast-growing developing economies is driving gains in equity securities markets, though the emerging-market world is not immune to the stress present in European fixed-income markets. Credit differentiation within the high yielding emerging-market economies is deepening. Downward adjustments in world (and Chinese) growth expectations have also become an issue of market focus. Nevertheless, commodity price dynamics are not reflecting such a change in global growth expectations; precious and base metals prices regained an appreciating bias. Overall, official intervention by the world's major central banks to stabilize currency and credit markets remains a useful tool to guide trends and rates.

The North American currency environment offers a promising near-term outlook. We maintain a positive view for the US dollar (USD) versus the euro (EUR) despite the presence of temporary corrective forces. The trade-weighted DXY index reached a technical resistance barrier in mid-January after a 10% gain in the previous two months. Despite an unexpected monthly decline in economic activity (November 2011) due to foreign trade factors, the Canadian dollar (CAD) remains one of the world's most stable and demanded currencies. We expect the CAD to close the year at 0.98 per USD, supported by systemically sound financial conditions, improving commodity markets and manageable leverage positions. Meanwhile, economic developments in Mexico continue to support a near-term appreciation of the Mexican peso (MXN), as interest rate differentials and modest economic acceleration fuel demand for the high-yielding NAFTA zone currency; however, the risk of an adverse shock remains of the utmost importance and have us cautious on MXN. At times, election-related policy uncertainties may influence market sentiment in both Mexico and the US as both countries elect new presidents in July and November, respectively.

The European economic landscape remains fragile. Greece and now Portugal are struggling to regain creditor confidence and face major refinancing needs in the context of adverse market conditions. We maintain a bearish view for the EUR for the remainder of the year, as the European Central Bank (ECB) intensifies its asset-purchase programme and multifaceted monetary stimulus. The multiple sovereign debt rating downgrade actions executed by Standard & Poor's in early January, which were largely anticipated, are intensifying the credit differentiation phase within the euro zone. On a positive note, European government debt securities have somewhat

recovered from the heightened stress prevailing in the last quarter of last year. Of utmost relevance is the marked decline in Italian (10-year) bond yields to 5.7% from 7.1% in the last three weeks. Given the sizable refinancing requirements faced by the Italian borrowers, policy and economic developments in this country will be key market movers in the months to come. We expect the British pound (GBP) to maintain a relatively stable trading pattern in the near term and appreciate slowly to GBPUSD 1.63 by year-end. As for the Swiss franc, we expect the EURCHF to approach the 1.24 mark by the end of the year, as the authorities remain committed to the exchange floor intervention policy.

The Asian currency outlook remains influenced by the exchange rate policy of both Japan and China. The Japanese yen (JPY), which gained almost 7% versus the USD (12% versus the EUR) in the last 12 months, continues to be driven by the authorities' decisiveness to curb yen appreciation through large-scale intervention in the context of a decelerating global economic environment. The JPY has been immersed in a relatively narrow trading range since the second half of 2011; at present, it ranges between 76 and 78 per USD. We expect the JPY to close the year at 82 per USD. China remains stubbornly committed to maintaining a gradualist approach towards currency appreciation (4.6% stronger than the USD over the past 12 months), with no evidence that a material change to the existing exchange rate arrangement is in the works. Nevertheless, we expect the Chinese yuan, which gained 9.7% against the EUR over the past 12 months, to close the year at a rate of 6.07 per USD. The global investor community is rigorously assessing economic conditions in China, as the world economy decelerates. We estimate that the Chinese economy will expand by 8.6% this year (the IMF projects an 8.2% expansion) before accelerating to a 8.9% rate in 2013.

The universe of top-tier emerging-market currencies is in appreciating mode despite the volatile conditions affecting European markets. In the developing Americas, both the Brazilian real (BRL) and the Mexican peso (MXN) have had a positive upturn since the beginning of the year. Interest rate differentials in some cases, and commodity-linked fuel and China-led Asian demand in others, are supporting a bullish tone in the Latin American region. Beyond China and Japan, the remaining Asian floating currencies (KRW, TWD, THB, and MYR) are trading in a wide range (with an appreciating bias) after a volatile sell-off which occurred last September. A renewed bullish tone in Asian equity securities, as inflation across the region shows sign of stabilizing, is also adding fuel to a bullish trend in most developing countries.

**CANADA**

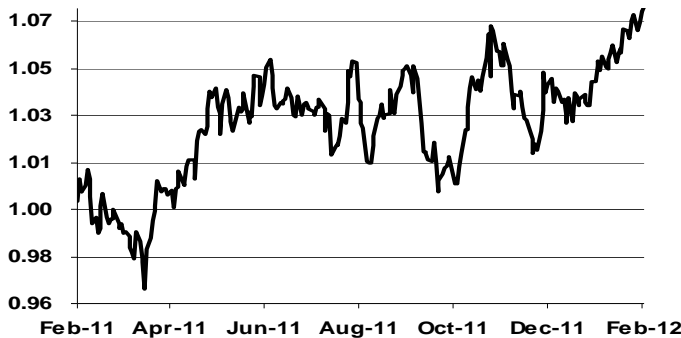
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The Canadian dollar (CAD) rallied throughout January against the USD, but underperformed the higher beta AUD and was volatile against the EUR. Moving into February the CAD was at the upper end of its four month 0.95 to 1.01 range, benefitting from a Fed-fueled broadly weaker USD. Parity continues to be an important psychological level, and one that we feel provides a reasonable sustainable level for the currency. However in the current environment there is significant risk to Europe, which dampens our otherwise bullish CAD forecast. Working in CAD's favour are several factors, including expectations for moderate but steady growth in the domestic economy, which should help improve Canada's fiscal and debt metrics. Canada remains considerably stronger than most advanced economies when compared on a relative basis (not to mention it holds an enviable Triple-A rating). As such, international investors continue to purchase Canadian securities, and we expect that CAD is a beneficiary of both that as well as foreign exchange reserve managers' ongoing efforts to diversify out of both USD and EUR-denominated investments. Given the improving outlook for the still fragile US economy, market expectations for Bank of Canada policy have shifted from a dovish outlook to one that expects an unchanged stance over the next two years. However, once the Bank of Canada does turn to tighter monetary policy it is likely to be well ahead of the US Federal Reserve. On a fundamental basis, oil prices should remain supported by a soft landing in China, with Scotia Economics forecasting a 2012 average of US\$100/bbl. Working against the currency is bearish investor sentiment, which has CAD held net short to the tune of \$1.9 billion (as reported by the CFTC). However, we note that long positions have risen since their lows from late summer 2011 while short positioning has narrowed in recent periods. In addition, any spike in risk aversion (whether stemming from Europe or elsewhere) is likely to temporarily weaken the currency. Finally, the risks posed to the global economy by Europe are material, should growth in the EMU slow more than expected, the Canadian domestic economy is also likely to be impacted. Putting the pieces together, we would expect that the bullish CAD drivers (interest rate spreads, commodity prices, relative economic performance and the ongoing decline in market volatility) offset the more bearish ones, supporting CAD close to parity, with it closing 2012 at 1.02.

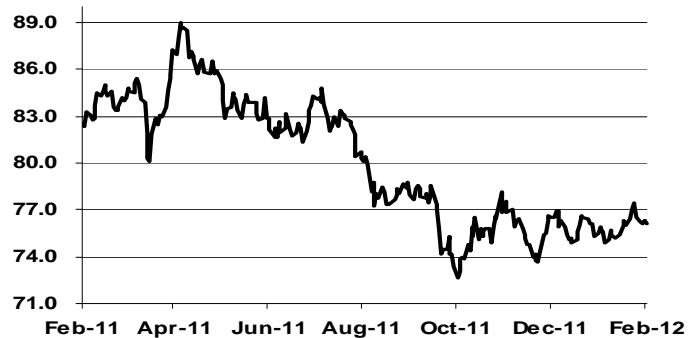
**Currency Trends**

| FX Rate | Going Back |       |       | Spot  | Outlook |       |       | FX Rate |
|---------|------------|-------|-------|-------|---------|-------|-------|---------|
|         | 12 m       | 6 m   | 3 m   |       | 2-Feb   | 3 m   | 6 m   |         |
| AUDCAD  | 0.990      | 1.047 | 1.046 | 1.070 | 1.077   | 1.073 | 1.075 | AUDCAD  |
| CADJPY  | 84.17      | 78.41 | 76.29 | 76.14 | 78.28   | 80.27 | 84.35 | CADJPY  |
| EURCAD  | 1.341      | 1.405 | 1.368 | 1.314 | 1.300   | 1.269 | 1.225 | EURCAD  |
| USDCAD  | 0.972      | 0.978 | 1.017 | 1.000 | 1.013   | 0.997 | 0.980 | USDCAD  |

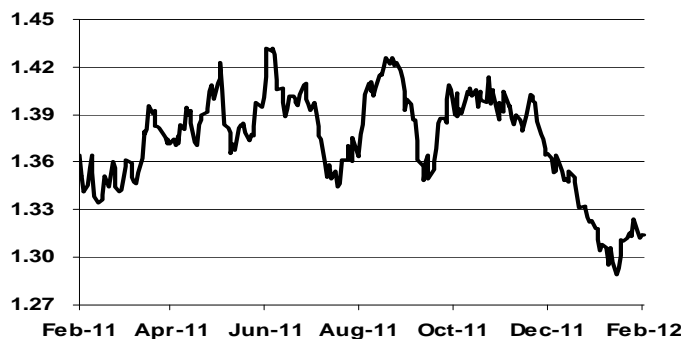
**AUDCAD**



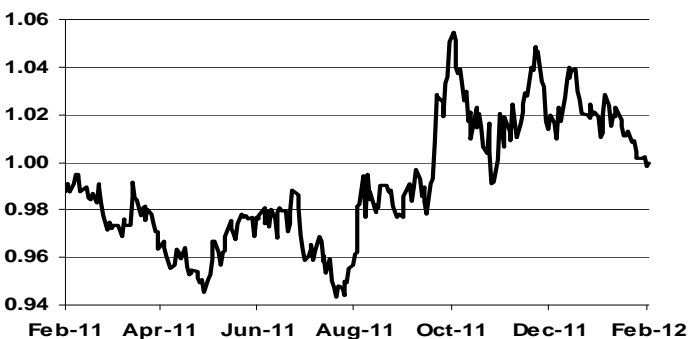
**CADJPY**



**EURCAD**



**USDCAD**



**CANADA AND UNITED STATES**  
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**UNITED STATES** - US economic data continue to outperform market forecasts, the labour market included, adding nearly 700,000 private sector jobs since September. Activity advanced at an annualized quarterly pace of 2.8% in the final months of 2011, up from 1.8% in the prior quarter, boosted by inventory rebuilding – which contributed 60% of the headline gain – and stronger consumer spending. Two straight quarters of inventory destocking subtracted a cumulative 1.5 percentage points from headline GDP growth, but the latest data revealed a full reversal. National defense spending (-12.5%) and oil & gas drilling (-19.7%) registered the sharpest declines. The recovery is expected to lose momentum in the first half of the year, pressured by spillover effects from the European credit crisis and ongoing deleveraging. With budget conscious US consumers on a moderate spending path, exports and business investment are expected to remain key growth leaders, forecast to contribute nearly two-thirds of overall GDP growth in 2012. Exports to developing markets have been expanding at a stepped-up pace, offsetting some of the demand erosion witnessed by their industrialized counterparts. These destinations – especially Mainland China – now account for nearly half of all US foreign sales, up from under a third in the 1990s. Alongside a supportive tax structure and a low interest rate environment, US business balance sheets are healthy, liquid and well capitalized, and are generating solid earnings, providing financial means to invest in productivity-enhancing technology for future growth. The fiscal card for 2012 still lacks clarity, especially the first half of the year. This is largely due to difficulty in reaching agreement over extending payroll tax cuts and unemployment benefits, beyond the most recent two-month extension. Ultimately, we believe that both programs are likely to be extended for the full year, but that there will be no additional stimulus. As a result, government will continue to act as a modest drag on economic activity.

**CANADA** - The Canadian economy is expanding at a moderate pace. Real GDP likely increased around an annualized 2% in the final quarter of 2011, with relatively solid domestic demand tempered by soft export conditions. A number of significant headwinds, including a more uncertain global economic outlook and ongoing sovereign debt concerns in Europe, are weighing on confidence and overall activity. We expect that growth will remain in the slow lane through at least mid-2012. Exports are being constrained by weak global demand, as well as by competitive challenges associated with the persistent strength of the Canadian dollar and lacklustre productivity gains. While Canadian exporters continue to enjoy strong sales growth in faster-growing emerging markets, the slower-growing markets of the United States and Europe account for 72% and 9%, respectively, of Canada's international shipments. Fiscal stimulus is winding down, with public sector spending expected to act as a modest drag on growth in 2012-13. Consumer sentiment has deteriorated alongside a slowing in the pace of job creation and weak income gains. Nonetheless, retailers continue to report modest sales growth, aided by deep incentives and a still healthy housing market. Home sales and construction remain quite buoyant, with buyers taking advantage of historically low interest rates. Business investment also remains a bright spot. While sentiment surveys suggest businesses have become more concerned about the economic outlook, they nonetheless continue to signal strong capital investment intentions, supported by heightened competitive pressures, solid corporate balance sheets and favourable financing conditions. Prices of key commodities, while easing back from their early-2011 highs, remain at profitable levels and continue to attract sizeable long-term investments in the mining and oil & gas sectors.

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**UNITED STATES** - We now expect the Federal Reserve to hold the Federal Funds rate between 0-0.25% at least into 2014. We see meaningful risk that the Fed will undertake additional quantitative easing during the second half of 2012. On January 22<sup>nd</sup> the FOMC released an updated economic forecast for 2012. The central tendency of its GDP forecast is 2.2-2.7%; the central tendency of its unemployment forecast is 8.2-8.5%; and the central tendency of its inflation forecast is 1.4-1.8%. It also released an official inflation target of 2% and voiced the view that unemployment is currently too high and that GDP growth is below long-run expectations. Unemployment rates in the upper half of the central tendency or higher, GDP growth rates in lower range of the projection or worse, or inflation rates that are within these projections or lower will materially increase the likelihood of additional QE.

**CANADA** - We now expect the Bank of Canada (BoC) to hold its overnight rate at 1.00% through the first half of 2013 at least. We do not think that further rate cuts are at all likely in the interim absent a global financial shock, while risks of rate hikes are mitigated by the Fed Funds Rate being held at its current levels. In its recent Monetary Policy Reports the BoC has consistently listed two downside risks to its inflation outlook: a) high household debt levels and b) instability emanating from a financial crisis in Europe. These are the two key metrics by which to assess the likelihood of additional BoC action. We would add that a very low interest rate environment in the US continues to pass through to Canadian interest rates and has eased credit conditions substantially over the past number of months, thereby offering de facto monetary stimulus.

**EUROPE**  
Currency Outlook

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**EURO ZONE** - The euro (EUR) managed to climb off its January lows as the combination of loose Fed policy, an aggressive ECB, including a successful LTRO, and a better than expected outcome from S&P European downgrades supported the currency. Looking out to February, we expect some downside EUR pressure to re-emerge as the market is aggressively short EUR (-\$28bn as of January 24). In addition, uncertainty looms, leaving investor flows expected to remain negative. Finally, technicals which turned bullish in mid-January are entering February with an uneven pattern. We hold a EURUSD Q1 2012 target of 1.29 and a Q4 2012 target of 1.25.

**UNITED KINGDOM** - The British pound (GBP) entered February on stronger footing, even as another round of asset purchases looms and sentiment remains negative (CFTC reported a short position of \$3.0bn on January 22). However, the UK's Triple-A rating and clearer path ahead leave it as a more favourable inter-European play than EUR. We expect GBPUSD to close Q1 2012 at 1.56 and Q4 2012 at 1.63.

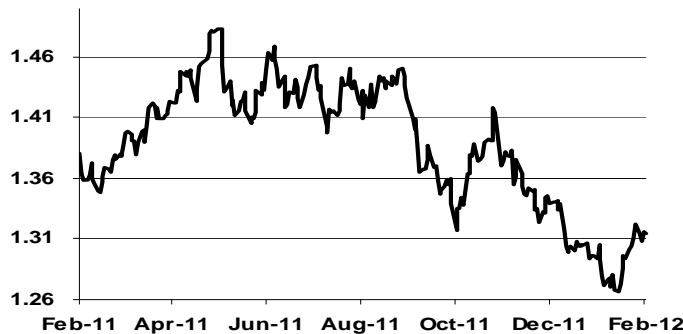
**SWITZERLAND** - The Swiss franc (CHF) has seen a considerable amount of stability in January, as the credible EURCHF floor remains unbroken. The incremental narrowing of the gap between EURCHF and the floor suggests that market participants are becoming less concerned about the potential for an increase in the floor in the near term (prior to SNB President's sudden resignation the market had expected an increase to 1.25). We hold a Q1 2012 EURCHF target of 1.24.

**NORWAY** - The Norwegian krone (NOK) has benefited from risk appetite, a relatively strong domestic backdrop and its Triple-A status. As such, NOK retraced nearly 50% of its Q411 losses in January. Looking out to the end of Q1, technicals are providing little direction, but fundamentals suggest that, barring a significant spike in risk aversion, NOK is well positioned to appreciate. We expect USDNOK to close Q1 2012 at 5.53 and Q4 2012 at 5.30.

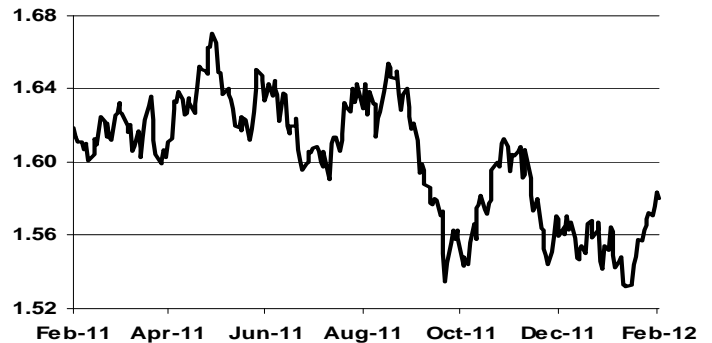
**Currency Trends**

| FX Rate | Going Back |      |      | Spot<br>2-Feb | Outlook |      |      | FX Rate |
|---------|------------|------|------|---------------|---------|------|------|---------|
|         | 12 m       | 6 m  | 3 m  |               | 3 m     | 6 m  | 12 m |         |
| EURUSD  | 1.38       | 1.44 | 1.34 | 1.31          | 1.28    | 1.27 | 1.25 | EURUSD  |
| GBPUSD  | 1.63       | 1.63 | 1.57 | 1.58          | 1.58    | 1.61 | 1.64 | GBPUSD  |
| EURCHF  | 1.28       | 1.16 | 1.23 | 1.21          | 1.24    | 1.24 | 1.25 | EURCHF  |
| USDNOK  | 5.60       | 5.37 | 5.77 | 5.83          | 5.65    | 5.50 | 5.25 | USDNOK  |

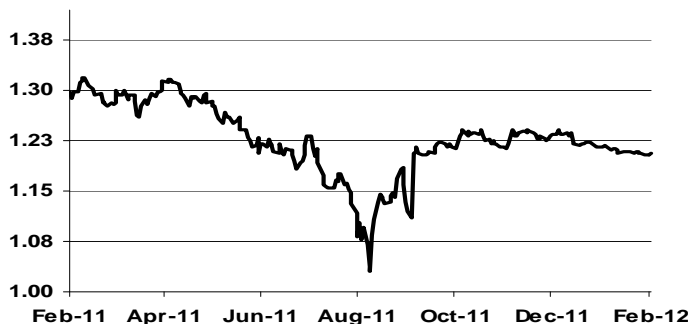
**EURUSD**



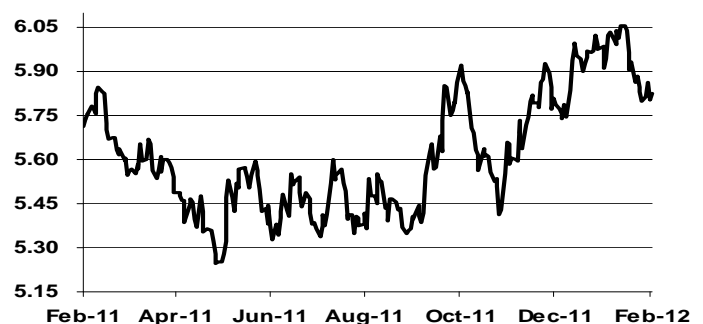
**GBPUSD**



**EURCHF**



**USDNOK**



## EUROPE

## Fundamental Commentary

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**EURO ZONE** - Volatility in euro area debt markets persists following the latest wave of credit rating downgrades, with financial market participants still waiting on a satisfactory policy response to the fiscal and economic crisis – including measures to address not only the budget fiscal deficits, but also the structural deficiencies of struggling member states. Portugal is the latest sovereign credit to come under renewed pressure, with 10-year bond yields reaching 16.5% at the end of January and 2-year yields touching above 19% as the risk of a disorderly debt restructuring increased. In contrast, funding costs for Italy and Spain have recently eased, with Italy's 10-year yield moving off a 7.5%-high in late-November to 5.7% in early February. Meanwhile, the risk of a deeper recession persists; although the PMI surveys improved again in January (the composite and services indexes moved back above the 50-mark for the first time since August), the euro area unemployment rate reached a currency union high of 10.4% in late-2011. We expect that GDP will contract by 0.5% this year, and that the succeeding recovery period will be fragile, with growth of less than 1% in 2013. This scenario is largely conditional on a marked outperformance by Germany, but if conditions there deteriorate, the aggregate outcome will be much worse. In this still uncertain environment, we continue to expect further monetary easing by the European Central Bank in the near term, with a further 25 basis point cut to bring the policy rate to 0.75%.

**UNITED KINGDOM** - The UK will continue to grow at a below-trend pace in 2012, with a probable, though mild, recession through the first quarter of the year. The advance GDP estimate showed a 0.2% q/q contraction in the final three months of 2011, implying a 0.8% y/y growth rate for the quarter and a 0.9% outturn for the year overall. The improvement in the PMI surveys in December, if maintained in January, could indicate that a second output contraction in the first quarter is less likely. However, given that the business expectations component of the services PMI deteriorated sharply in recent months, we consider a temporary dip into recession a more probable scenario. We thus anticipate a deceleration to around 0.7% in 2012, accompanied by an increase in unemployment (already at a multi-year high) and a substantial fall in inflation (from 4.2% y/y in December to 2.1% by end-2012). The drag on growth from fiscal tightening should be less pronounced this year, with the government frontloading many austerity measures in 2011. The economy should embark on a steady recovery path in the third quarter, picking up to an average 1.8% growth rate in 2013 – an outperformance relative to euro zone peers, which will support the sterling (GBP) relative to the euro and the US dollar. We continue to expect another monetary injection in the form of additional bond purchases by the Bank of England at the next meeting of the Monetary Policy Committee on February 9th, to the tune of at least GBP 50 billion.

**SWITZERLAND** - Switzerland's position as a regional safe haven in Europe will continue to test the Swiss National Bank's (SNB) exchange rate floor of 1.20 francs (CHF) per euro. Seeing little progress toward a comprehensive solution to the crisis by EU policymakers, market participants have pushed the EURCHF gradually lower since the SNB's last policy meeting in mid-December, from almost 1.24 to its current level of just below 1.21, unperturbed by the resignation of the central bank's chairman over a currency trading scandal early last month. With the strong currency – roughly 25% above its pre-global recession level – acting to depress exports and deter business investment and hiring, and compounding the effects of the Europe-wide collapse in confidence, we expect output performance this year to be limited to near ¼%. While the manufacturing PMI slid deeper into contractionary territory in January, and the KOF leading indicator turned negative, the ZEW economic expectations survey improved significantly (though it remains negative on balance). Growth should rebound next year to around 1¾%, supported by the gradual recovery in Switzerland's trading partners, accommodative fiscal and monetary conditions, and strong fundamentals, including low unemployment and sound public accounts (roughly balanced fiscal position and low debt relative to peers). With deflation accelerating on a yearly basis (the CPI fell 0.7% y/y in December), it is possible that the SNB will consider raising the exchange rate floor at its next meeting in March.

**NORWAY** - Norway's growth prospects remain comparatively robust. Though the nation will not escape entirely the effects of the debt crisis and recession in the euro area, the domestic economy will continue to be well-supported by accommodative policy conditions, expanding energy investment and strong fundamentals. We expect that overall real GDP growth will rise from around 1¼% in 2011 to 2% on average in 2012-13 (though, we note that mainland activity excluding oil will likely decelerate). While exports are beginning to suffer from reduced demand from the rest of Europe, certain sectors, namely petroleum-related industries and housing construction, continue to show resilience as illustrated by the Norges Bank's most recent regional network report (a business expectations survey). The central bank judges that capacity utilization is currently close to normal while unemployment is relatively low (at 3.4%). Nonetheless, the benchmark deposit rate was lowered by 50 basis points in December in a precautionary move to shield the economy from potential negative spillovers, including tighter funding conditions for banks. The rate cut will also help to limit deflationary pressures. The inflation rate dropped to 0.2% y/y in December from 1.2% in the prior month, though this was largely on base effects, with the underlying rate staying steady at 1.0%. The Norwegian government, aiming to lessen the impact of the crisis on exporters, has offered a loan of NOK 55 billion (US \$9.4 billion) to the IMF in order to support lending to the ailing euro zone economies.

**ASIA/OCEANIA**  
Currency Outlook

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**JAPAN** - The Japanese yen (USDJPY) broke out of its tight 76.33 to 78.98 4-month range on February 1st. The January upside test was driven by deteriorating trade figures and risk appetite, but once the Fed opened the door to still looser policy for longer, USDJPY collapsed back to post-intervention lows. The drop below 76 is likely to frustrate Japanese officials and exporters. However, investors remain undeterred by the possibility of intervention and as of January 24 held a net long JPY position of US\$7.1 billion (CFTC). We hold a Q1 2012 USDJPY target of 78.

**CHINA** - The Chinese yuan (CNY) resumed its trend of steady appreciation in January, as risk appetite returned to markets and policymakers remain committed to rebalancing the world's second largest economy. We expect the downtrend in USDCNY to continue in 2012, with a Q1 2012 target of 6.26.

**AUSTRALIA** - As we enter February, the Australian dollar (AUD) is near the top of its five month range as signs of a soft Chinese landing support demand for Australian commodity exports, the carry trade is once again a market darling and AUD benefits on positive flows based on its Triple-A status. We expect more of the same in 2012, interrupted by temporary bouts of risk aversion. Investors' bullish sentiment is also reflected in a US\$7.3 billion (CFTC) net long. However, we are approaching overbought levels, which could pressure the currency lower in the near-term. We hold a Q112 AUDUSD forecast of 1.02 and a more bullish Q4 target of 1.08.

**NEW ZEALAND** - The New Zealand dollar (NZD) is the best-performing major currency of 2012, with a 7% gain to February 1st. The outperformance has pushed NZDUSD to levels not seen since Q3 2011, supported by risk sentiment and investors' net long position of \$1.1bn (CFTC). Technicals suggest further upward movement; however the currency is flirting with overbought levels, leaving us cautious in the near-term. We hold a 0.79 Q1 2012 target.

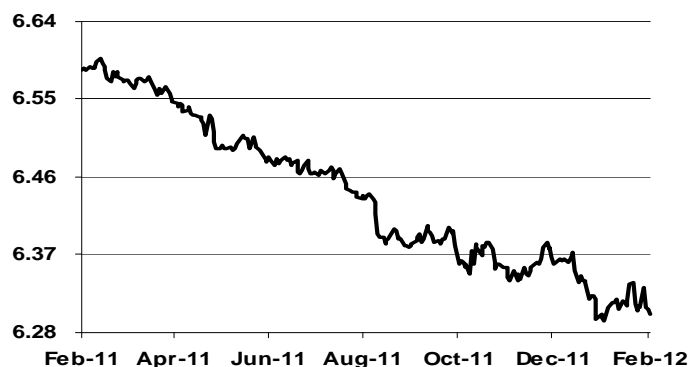
**Currency Trends**

| FX Rate | Going Back |      |      | Spot | Outlook |      |      | FX Rate |
|---------|------------|------|------|------|---------|------|------|---------|
|         | 12 m       | 6 m  | 3 m  |      | 2-Feb   | 3 m  | 6 m  |         |
| USDJPY  | 81.8       | 76.7 | 77.6 | 76.1 | 79.3    | 80.0 | 82.7 | USDJPY  |
| USDCNY  | 6.57       | 6.38 | 6.38 | 6.30 | 6.22    | 6.16 | 6.03 | USDCNY  |
| AUDUSD  | 1.02       | 1.07 | 1.03 | 1.07 | 1.06    | 1.08 | 1.10 | AUDUSD  |
| NZDUSD  | 0.75       | 0.85 | 0.78 | 0.83 | 0.80    | 0.80 | 0.82 | NZDUSD  |

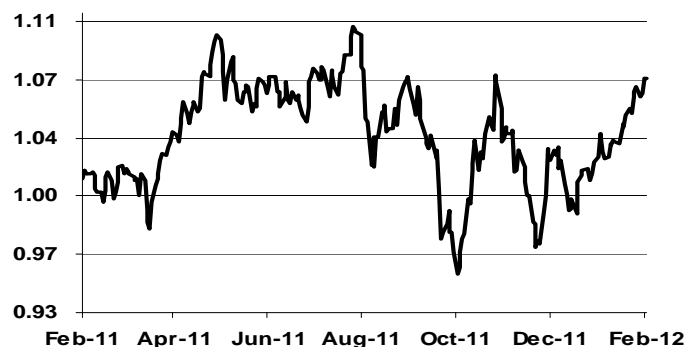
**USDJPY**



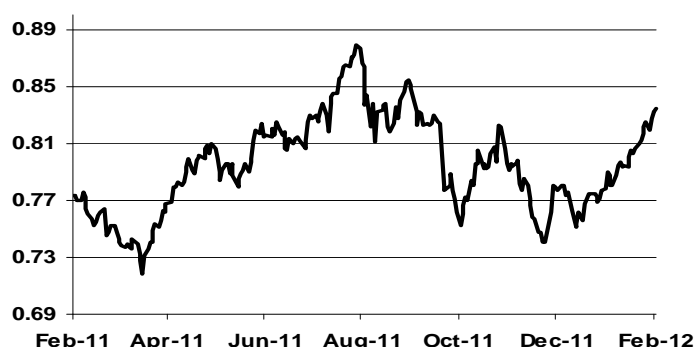
**USDCNY**



**AUDUSD**



**NZDUSD**



## ASIA/OCEANIA

## Fundamental Commentary

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**JAPAN** - The Japanese yen (JPY) will display a weakening profile over the forecast horizon. While still elevated global uncertainty continues to result in a strongly supported JPY, exchange rate strengthening forces will be countered by uncertainty regarding the country's industrial sector recovery and the Bank of Japan's (BoJ) persistent battle with excessive appreciation. The BoJ is expected to maintain a loose monetary policy stance, backed by sporadic expansions of its domestic bond buying program. After a slight sequential acceleration in inflation, deflationary forces settled again during the final three months of 2011, with an annual 0.2% contraction in consumer prices. Given the background of a near-zero benchmark interest rate, extended quantitative easing by the BoJ will continue to be a key support at a time when large manufacturing firms are suffering from the impact of a strong yen. While latest export figures display renewed setbacks due to scarcities in the supply of parts from flood-affected Thailand, accelerating foreign sales to China and the US coincided with a 4% m/m advance in industrial output in December, the largest in seven months. According to BoJ figures, exports in real terms contracted by a meager 0.5% y/y in 2011 after inking an over 27% expansion in 2010. This advance constituted the basis for an extraordinary 4.5% y/y output gain, which we estimate will be followed by a 0.4% contraction in 2011. Subsequently, we expect Japan's GDP to advance at an average 2% y/y rate in 2012-13.

**CHINA** - Gradual Chinese yuan (CNY) appreciation will continue, although at a slower pace. While CNY strengthening remains a primary component of a concerted policy to promote domestic market development, slowing exports to Europe and a downtrend in inflation have opened the door to more limited currency gains. Headline yearly inflation ended 2011 at 4.1% y/y, down from a 6.5% mid-year peak. We expect it to close 2012 at 4.5%. While elevated food price gains still loom in the background, the accelerated headline fall prompted the People's Bank of China (PBoC) to switch its monetary policy stance to growth promotion. Such a move was made explicit with the decision to lower the bank reserve requirement ratio (RRR) by 50 basis points last November. The PBoC resorts to RRR calibration as the main tool to manage liquidity, while interest rate increases are aimed mainly at redirecting expectations of asset overvaluation. Subdued export growth will likely intensify during the first quarter of 2012, with the sequential slowdown prompting fiscal and monetary policy support. In the midst of stabilizing inflationary trends, steady gains in household consumption combined with infrastructure developments will likely reaffirm China's role as the global growth pace setter. We expect the Chinese economy to expand at a still solid 8.75% y/y average rate during 2012-13. With no material structural change in the currency regime foreseen, year-end rates of CNY6.07 per USD for 2012 and CNY5.84 for 2013 are anticipated.

**AUSTRALIA** - The Australian dollar (AUD) will remain well supported over the forecast horizon. Firm external and improving fiscal account fundamentals, strong Asian ties and exposure to highly bid commodities all work in favour of the AUD. Headline inflation at 3.1% y/y finally converged towards the Reserve Bank of Australia's (RBA) 2-3% target, as core goods price gains have been contained on the back of a strong AUD. Core services items, however, continue to advance at the strongest pace since the final quarter of 2008. The latter fact points to persistent local pressures, as implied by favourable conditions within the mining sector where investment spending propels ahead. While labour markets are less strained in non-mining activities, there is no evidence of slack, with unemployment steady at slightly over 5%. The country's terms of trade have peaked, but remain elevated, enticing further investment in the resource sector, which ultimately trickles down to underlying services industries. The downtrend in inflation and an uncertain global outlook, combined with evidence of cooling in the local residential market, opened the door for looser monetary conditions. After lowering the cash rate twice for a total of 50 basis points to 4.25%, the RBA left the benchmark rate unchanged at its last monetary policy meeting. RBA authorities judge current conditions favouring economic expansion at a pace broadly in line with trend. On the back of still steady demand throughout Asia, we expect Australian GDP to advance 3.5% y/y on average in 2012-13.

**NEW ZEALAND** - The stellar run by the New Zealand dollar (NZD) so far in 2012 is bound to lose momentum in the coming months as the Reserve Bank of New Zealand (RBNZ) further supports the country's economic recovery. While the RBNZ decided to leave the official cash rate unchanged at 2.5% after the latest monetary policy meeting, inflationary trends placed now at the bottom of the 1-3% comfort zone imply that further economic support is likely. Headline inflation came down significantly to 1.8% y/y in the fourth quarter of 2011, with both tradable goods and non-tradable items displaying flailing pressures. NZD strength underpinned dwindling costs in externally exposed sectors, with the situation in locally oriented industries seemingly pointing towards excess capacity conditions. While limited signs of reinvigorated household spending have paired with reconstruction efforts in the Canterbury region, the country's unemployment rate increased to 6.6% at the last reading given an expanded participation rate. On the external front, export values rebounded in the final three months of 2011 as foreign shipments to Australia improved in the context of falling European sales. We expect New Zealand's GDP to expand at a 3% y/y rate in 2012-13 on the back of persistent Asian growth. Positioning in NZD has been less volatile in comparison to the Australian dollar, remaining net-long for most of 2011. We forecast the NZD to close the year 2012 at 0.81 per US dollar.

**DEVELOPING ASIA**  
Currency Outlook

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**INDIA** - The Indian rupee's (INR) rebound has come on the back of sharply falling inflation and improved production indicators. This has provided for a stabilization in sentiment towards the rupee, and enhanced fund inflows particularly in the bond market as the market prices in the RBI's rate cutting cycle. However, until we see sustained production stabilization and a drop in inflation expectations, we don't expect INR to be very well insulated from risk aversion that may come down the road.

**KOREA** - In January Korean won (KRW) broke below support at 1120, removing a strong technical barrier for the pair, helped by the easing in global risk aversion. Given the challenges facing the Korean economy on the external front, the central bank should continue to resist too great an appreciation in KRW, as the currency has been an outperformer since the mid-January risk rally ensued. As a result, reserve accumulation and modest KRW strength would be expected so long as euro zone related uncertainty remains on the backburner.

**THAILAND** - The Thai baht's (THB) long march lower has been reversed with the mid-January market turnaround in global risk sentiment. This has helped to stabilize financial flows as foreign investors returned to Thai risk assets and were net buyers of equities through the month of January, stabilizing the financial account. The relatively solid performance of THB leaves it with further upside on normalization in the global macro environment, despite any temporary rate cuts that are now being executed by the Bank of Thailand to offset the impact of last year's flooding .

**HONG KONG** - The Hong Kong dollar (HKD) has strengthened to its highest level since late 2010. The removal of the USD bid during the second half of January has helped. Talk of a "conversion play" between HKD and RMB has essentially faded away.

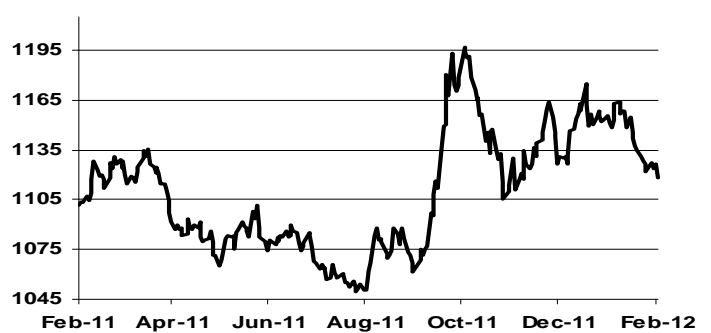
**Currency Trends**

| FX Rate | Going Back |       |       | Spot  | Outlook |       |       | FX Rate |
|---------|------------|-------|-------|-------|---------|-------|-------|---------|
|         | 12 m       | 6 m   | 3 m   |       | 3 m     | 6 m   | 12 m  |         |
| USDINR  | 45.27      | 46.10 | 52.21 | 49.16 | 49.54   | 49.61 | 49.41 | USDINR  |
| USDKRW  | 1129       | 1067  | 1143  | 1118  | 1107    | 1096  | 1071  | USDKRW  |
| USDTHB  | 30.60      | 29.93 | 30.87 | 30.90 | 30.63   | 30.36 | 29.84 | USDTHB  |
| USDHKD  | 7.79       | 7.79  | 7.77  | 7.76  | 7.75    | 7.75  | 7.75  | USDHKD  |

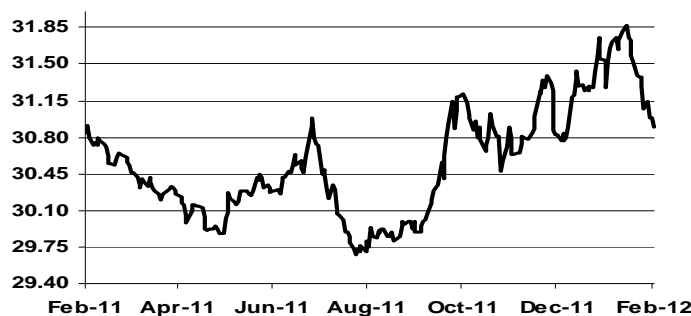
**USDINR**



**USDKRW**



**USDTHB**



**USDHKD**



**DEVELOPING ASIA**  
Fundamental Commentary

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**INDIA** - The Indian rupee (INR) will remain well bid as interest and growth differentials favour the Asian giant. Inflationary trends finally moderated with the headline wholesale cost index advancing at 7.5% y/y in December, a significant drop from the 9.5% average of the previous three months. Ebbing food costs underpinned the fall in inflation, with fuel price gains still the main force behind upward price pressure, as the withdrawal of state-backed fuel subsidies combines with elevated global oil prices. INR appreciation has been a favourable development that is likely to ease the fuel cost tally. An accentuated downtrend in bank loan growth from 25% y/y in early 2011, to about 15% now, has also been behind the disinflationary spree. The Reserve Bank of India (RBI) switched tactics to a growth supporting monetary policy stance, as it cut the cash reserve ratio (CRR) by 50 basis points to 5.5% in January. Moderating inflationary expectations are likely to lead to further CRR cuts and eventually to benchmark interest rate reductions. India's GDP is currently expanding at a 7% y/y rate, the weakest pace of advance in over two years. The economy's prospects hinge on price pressure containment, as deteriorating purchasing power and shrinking profit margins condition domestic demand gains. A build up in momentum is anticipated from here on, as loose monetary policy meets a rebound in private spending on the back of cost containment. We expect India's economic expansion to average 7.5% y/y in 2012-13.

**KOREA** - The Korean won (KRW) will retain an appreciatory trend in the coming months. Notwithstanding the economic slowdown on the back of slipping European exports, South Korean growth and interest rate spreads are bound to continue to support the KRW. The country's output expanded at a sluggish 0.4% q/q rate (3.4% y/y) in the final quarter of 2011, the slowest sequential gain in two years. The deceleration came on the back of dwindling exports to some euro zone countries together with a slippage in local private spending as both investment and consumption outlays as the year progressed. South Korean exports to the UK, Italy and Spain went into reverse towards the final months of last year, while sales to Germany and the US also displayed a slowdown. Demand from neighboring Asian countries improved for the most part, however, as sales to Japan, Thailand, Hong Kong, Singapore and Indonesia all accelerated through year-end. We expect these trends to continue, leading South Korea's output to expand at a 3.6% y/y rate in 2012. The Bank of Korea (BoK) will likely soon be able to support a rebound in local demand as signs of lowering price pressures continue to emerge. Headline inflation at 3.4% y/y in January lies well within the BoK's 3 +/- 1% target, supporting evidence of the central bank's effectiveness in averting a wage/price spiral in a context of low unemployment. Downshifting demand conditions and a relatively strong KRW will likely continue to support disinflation in coming quarters.

**THAILAND** - Thai baht (THB) appreciation will continue in the coming quarters as the country regains its footing from the effects of the recent flooding disaster. Evidence of easing in the export slump emerged in December as customs data revealed a pickup in industrial and agricultural foreign sales. On the local demand side, the government's post-flood rehabilitation program (worth US\$11.3 billion) is bound to propel the economy forward as reconstruction spending is added to novel water-management infrastructure designed to avoid extreme flooding effects in the future. Headline inflation has continued to trend down, reaching 3.4% y/y in January, as food costs stabilized back from double-digit yearly gains. However, the core measure (which is the main objective of the central bank's inflation target) failed to follow the downtrend, remaining elevated at 2.75% y/y. The Bank of Thailand (BoT) cut its policy interest rate for the second straight month in January, signaling a pause in monetary policy easing as it judges the current level as appropriate for the growth and inflation outlook. We anticipate one further benchmark interest rate reduction during the second quarter of 2012, with price pressures firming consequently on the back of a rebound in activity in the manufacturing sector and fiscally propelled domestic demand. After a calamitous six months that likely limit GDP growth to just 1.8% y/y in 2011, we expect the Thai economy to pickup pace and display a brisk 4% gain in 2012, followed by a 3.6% advance in 2013.

**HONG KONG** - The Hong-Kong dollar (HKD) will continue to fluctuate within a tight range against the USD. While Hong Kong authorities reiterate the intention to maintain the USD peg, deposits in Chinese yuan (CNY) are likely to continue rising driven predominantly by trade flows. Inflation remains a concern in Hong-Kong as headline consumer prices rose 5.7% y/y in December, while the underlying measure inked an elevated 6.4% gain. Rents associated with private housing increased 0.5% m/m, the quickest pace in three years, highlighting persistency of the asset bubble threat. Still robust consumer spending backed by resilient employment conditions and the persistent pickup in dwelling costs are expected to keep inflation elevated in the near term. Loose monetary conditions in the US and a procyclical local fiscal stance point to inflationary resillience, with negative real interest rates underpinning asset price gains further supporting domestic demand. Hong Kong's GDP expanded at a 5% y/y rate in 2011, as a 0.3% q/q (3% y/y) gain was recorded in the final three months of the year, a sequential acceleration. While export values peaked in the third quarter, they remained steady in the fourth with shipments to China and Japan recovering. While a slowdown in foreign sales is anticipated as a result of the travails in Europe, compensating Asian trade flows, and domestic demand propulsion on the back of a US\$10 billion growth-support government package, lead us to expect GDP to expand at a 4.3% y/y rate in 2012-13.

**DEVELOPING AMERICAS**  
Currency Outlook

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**BRAZIL** - The Brazilian real (BRL) will continue to trade in a relatively stable range over the next few months, strongly supported by massive foreign capital inflows, ongoing demand for Latin American investment-grade rated debt securities and persistent Chinese resilience to the European financial shocks. Accelerating growth and declining inflation coupled with sustained accumulation of central bank reserves also support a relative positive scenario for the Brazilian economy.

**MEXICO** - The Mexican peso (MXN) came under intense pressure at the end of last year; however, it has now entered a strengthening phase, posting one of the biggest monthly gains in January since the second quarter of 2009. With this, the MXN recovered more than half of the losses observed in October of 2011. Higher risk appetite in financial markets boosted positions in MXN-denominated assets, in line with the rest of the region's currencies. We now expect the Mexican currency to close 2012 at 13.05 per US dollar (USD).

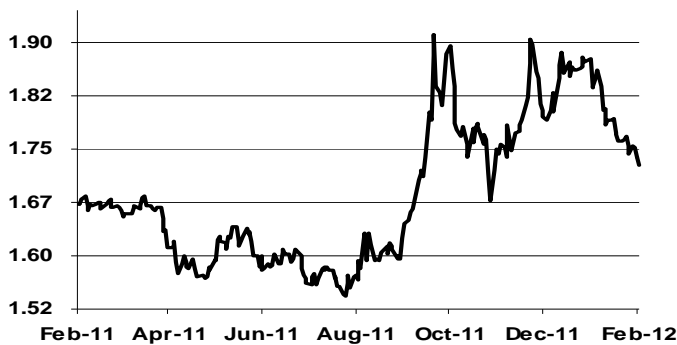
**CHILE** - The Chilean peso (CLP) has been in steady recovery mode since the beginning of the year in line with the positive market tone present in all emerging-market economies of Asia and Latin America. As a commodity-linked currency, the CLP is benefitting from a surge in relevant commodity prices and strong demand for investment grade rated assets in Latin America. We expect the CLP to close the year at 495 per USD.

**COLOMBIA** - The Colombian peso (COP) posted one of the biggest monthly gain against the US dollar in the region in January, and looks set to trade below the 1,800 mark. Strong consumer credit expansion, a tighter monetary policy and positive momentum for emerging markets have been the key drivers supporting the COP. We expect the Colombian currency to close the year at 1870 per USD.

**Currency Trends**

| FX Rate | Going Back |       |       | Spot<br>2-Feb | Outlook |       |       | FX Rate |
|---------|------------|-------|-------|---------------|---------|-------|-------|---------|
|         | 12 m       | 6 m   | 3 m   |               | 3 m     | 6 m   | 12 m  |         |
| USDBRL  | 1.66       | 1.59  | 1.81  | 1.72          | 1.75    | 1.75  | 1.77  | USDBRL  |
| USDMXN  | 12.10      | 12.33 | 13.63 | 12.84         | 13.39   | 13.22 | 13.12 | USDMXN  |
| USDCLP  | 476        | 461   | 516   | 480           | 504     | 499   | 496   | USDCLP  |
| USDCOP  | 1908       | 1778  | 1951  | 1794          | 1832    | 1848  | 1875  | USDCOP  |

**USDBRL**



**USDMXN**



**USDCLP**



**USDCOP**



**DEVELOPING AMERICAS**  
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**BRAZIL** - The Brazilian currency environment regained a bullish tone on the back of foreign capital inflows linked to international debt issuance activity and renewed evidence of a gradual economic recovery. The Brazilian government is taking advantage of the excess global liquidity generated by the US and European commitment to keep interest rates near zero for a prolonged period of time. The state-controlled integrated oil firm (Petrobras) quickly announced a large-scale issuance plan totalling US\$7 billion in debt assets. The extra yield paid by Petrobras is highly attractive to high yield seekers around the world. Moreover, the Brazilian economy is experiencing a slight rebound as industrial production and monthly activity indicators show a modest uptick. On another positive note, inflationary pressures seem to be subsiding, as expectations show a declining trend for the next 12 months. A shift in price pressures, coupled with persistently low international administered interest rates, has permitted the Brazilian central bank to continue with its monetary easing phase without causing any material damage to the value of the local currency. In fact, the BRL has been trading in a relatively wide range between 1.70 and 1.90 over the past four months. We expect the USDBRL rate to close the year at 1.75. In addition, we have revised our projection for the benchmark rate, and now expect that the administered SELIC rate will be cut to 9.5% by the end of the second quarter of the year.

**MEXICO** - The Mexican Peso (MXN) has recovered 6.7% vis-à-vis the US dollar since the beginning of the year as a result of higher risk appetite in financial markets, US economic data showing a better –though still slow- economic recovery, and strong local economic fundamentals that anticipate a solid economic performance in the last quarter of 2011. An increase of flows in favour of the Mexican peso have been rebuilt after December's peak; taking the MXN below the 13.0 pesos mark, a level not seen since the beginning of November. The central bank maintains a neutral monetary policy stance and despite an increase in inflation at the end of last year, it remains within the authority's tolerance range. Still, with this neutral bias, which we expect to be maintained through 2012, the spread between the Mexican and US 10-year bond yields still favours assets denominated in pesos by around 400 basis points. However, the MXN remains vulnerable to the international environment and the delay in the resolution of the European debts crisis, as well as any turnaround in US economic performance. So far, there has not been any evidence that local presidential elections are affecting markets; however, this will gain more attention as we get closer to the presidential ballot in early July. The central bank has an ample stock of foreign reserves (US\$147 billion) that can be utilized, if necessary, to smooth exchange rate volatility and currently maintains the US\$400 million daily auction.

**CHILE** - The Chilean macroeconomic environment continues to be strongly influenced by external demand conditions, in particular Asian demand for Chilean exports. Taking a relatively bearish view, the central bank opted to lower its monetary policy rate by 25 basis points to 5% in January. The central bank estimates that the Chilean economy will expand by between 3.75% and 4.75% in 2012, down from 6.2% in 2011. The monetary policy decision arrived as domestic demand conditions and tight labour markets are exerting wage-adjustment price pressures on the economy. However, the monetary authorities opted to shrug off the increase in inflation (4.4% y/y in December 2011) and focus instead on responding to an adverse external context by stimulating economic activity through traditional monetary means. Despite the apparent official concerns about the global growth scenario, metal prices continue to ascend in response to strong Asia-led demand. We do expect, however, that the authorities will be tempted to further ease monetary conditions and reduce the monetary policy interest rate once more at the next meeting. Beyond domestic growth factors, the CLP is receiving a boost from a renewed rally in emerging-market securities and a positive environment for Latin America as a whole. A positive regional economic and financial market environment allows the central bank to accumulate international reserves, which reached almost US\$42 billion at the end of 2011, representing a yearly increase of 50%.

**COLOMBIA** - After maintaining a stable trading range during the last quarter of 2011, the Colombian peso (COP) embarked on a strengthening path at the beginning of the year, posting its biggest monthly gain vis-à-vis the US dollar (USD) since the second quarter of 2009 (7%). Risk-on mode has helped emerging currencies in the last month; however, the COP has also been benefited from strong local fundamentals and a tightened monetary stance. In late January, the central bank unexpectedly hiked the reference rate by 25 basis points (bps) to 5.0%, as a result of strong local demand, consumer credit expansion and inflation close to the upper limit of the central bank's tolerance range. This action signals another decoupling phase in monetary policies in the Americas: while Chilean and Brazilian central banks recently cut their reference rates and the Fed announced a low interest rate environment for a longer period, the Colombian authorities increased the interest rate spreads due to strong local credit. More increases are in store; however we do not foresee an aggressive monetary cycle as many risks remain, especially those related to the European debt crisis and the possible spillover effects on financial markets. With the COP trading close to the 1,800 per USD mark, the authorities could come under pressure (exports will loose competitiveness) to increase their presence in the market, limiting but not changing the currency direction by re-establishing the USD daily purchase.

**DEVELOPING EUROPE/AFRICA**  
Currency Outlook

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**RUSSIA** - The Russian ruble (RUB) will trend sideways through 2012, interrupted by periods of volatility driven by domestic political instability as well as ongoing euro-centred unrest in global financial markets. Investor concern is largely focused on Putin's return to the presidency in March (from his temporary post as prime minister), and potential setbacks in privatization and economic diversification programs. We expect the RUB to close the year around 30.5 per USD.

**TURKEY** - The Turkish lira (TRY) will continue to gradually retrace its late-2011 losses versus the US dollar. However, the still-wide current account deficit and unconventional policymaking continue to generate concerns for financial market participants, suggesting that the lira's appreciatory trend will likely be interrupted by periodic bouts of volatility, including capital outflows, in 2012. We expect a USDTRY rate of around 1.77 at end-2012 and 1.73 at end-2013.

**POLAND** - Over the next several months the Polish zloty (PLN) will remain vulnerable to fluctuations in global risk aversion, with downside potential tied to events in the euro zone. Over the medium term we expect a gradual appreciation of the PLN against the EUR on the back of robust economic performance (the currency has already recovered roughly half of its losses in the second half of 2011), with year-end targets of 4.15 and 3.95 in 2012 and 2013, respectively.

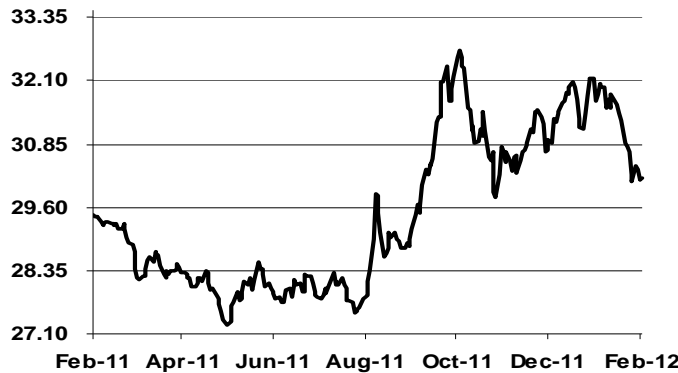
**SOUTH AFRICA** - The South African rand (ZAR) will continue to mirror global shifts in risk appetite, as well as developments in commodity markets. We expect the rand to close 2012 little changed from its end-2011 level versus the US dollar, at around 8.00. Thereafter, our forecast calls for a gradual weakening on the back of ample twin deficits in the current and fiscal accounts, with an end-2013 target of 8.25.

**Currency Trends**

| FX Rate | Going Back |      |      | Spot<br>2-Feb | Outlook |      |      | FX Rate |
|---------|------------|------|------|---------------|---------|------|------|---------|
|         | 12 m       | 6 m  | 3 m  |               | 3 m     | 6 m  | 12 m |         |
| USDRUB  | 28.9       | 28.8 | 30.7 | 30.2          | 30.4    | 30.4 | 30.6 | USDRUB  |
| USDTRY  | 1.60       | 1.72 | 1.83 | 1.76          | 1.77    | 1.77 | 1.76 | USDTRY  |
| EURPLN  | 3.96       | 4.14 | 4.50 | 4.19          | 4.19    | 4.18 | 4.12 | EURPLN  |
| USDZAR  | 6.97       | 6.99 | 8.11 | 7.64          | 7.88    | 7.93 | 8.04 | USDZAR  |

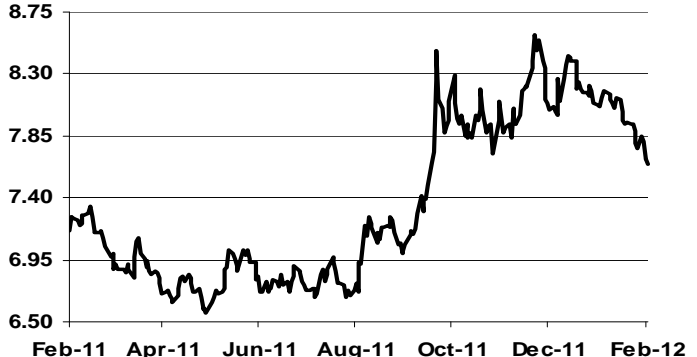
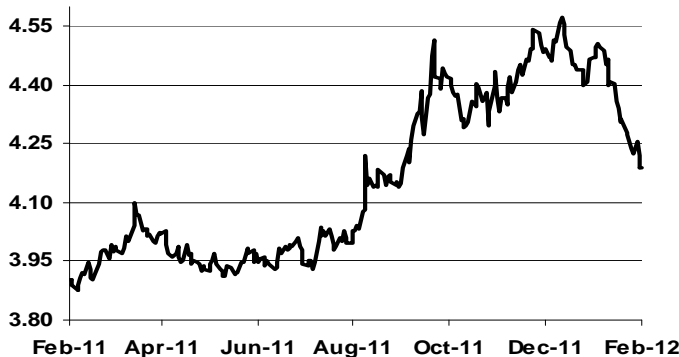
**USDRUB**

**USDTRY**



**EURPLN**

**USDZAR**



**DEVELOPING EUROPE/AFRICA**  
Fundamental Commentary

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**RUSSIA** - Global economic and domestic political uncertainty continue to cloud the outlook for the Russian economy. Several depreciatory factors will exert pressure on the ruble this year, including the ongoing public backlash to what is viewed by many as an irregular electoral process (following December's elections, in which the ruling United Russia party lost a considerable share of votes and parliamentary seats), investor unease about Vladimir Putin's return to the presidential office and a possible deterioration in both the business climate and US-Russian relations, and persistent risk aversion in global financial markets tied to the crisis in Europe. We expect the Russian economy to mirror the slowing global trend, decelerating from around 4¼% in 2011 to roughly 3¼% this year (in line with the recently updated IMF forecast). Amid easing price pressures (the annual rate of inflation fell to 6.1% y/y in December from 6.8% in the prior month), the Russian central bank responded late last year to fading economic momentum by reducing the benchmark refinancing rate from 8.25% to 8.00%. Given that the downturn in inflation is expected to be temporary and that the rate will likely re-accelerate later in the year (surpassing the central bank's 6% 2012 target before year-end), we do not anticipate any further monetary easing in the near term. However, should growth prospects deteriorate materially – if the euro zone self-destructs, for instance, causing a collapse in commodity prices – then the central bank will respond in kind.

**TURKEY** - The Turkish economy is expected to slow markedly this year as policymakers promote an economic rebalancing between an overheating domestic sector and muted external demand. Indeed, the current account deficit (on a 12-month basis) has already begun to moderate, easing slightly from a record-high US\$78.7 billion in October to US\$77.8 billion in November. However, the shortfall remains more than double the average level of the previous five years, implying a ratio of about 10% relative to GDP, which makes the economy – and the lira – particularly vulnerable to the heightened volatility and sudden capital outflows threatening financial markets globally. To ensure preparedness for such shocks, and in light of an imminent economic deceleration, the IMF has advised the Turkish authorities to adjust the current policy mix by frontloading fiscal consolidation and implementing other structural reforms in order to allow monetary policy to focus solely on price stability. Although inflation accelerated throughout 2011 (reaching a three-year high of 10.4% y/y in December), the benchmark interest rate has been kept at a record-low 5.75% since last August, with the central bank attempting to implement monetary tightening through alternative policy measures (judged by the IMF to be ineffective). With inflation to remain elevated on higher administered prices and a weakened currency, and the pace of GDP growth set to slow from 7½% in 2011 to around 2% in 2012, we do not expect any policy changes in the near term.

**POLAND** - Poland will outperform many of its emerging European peers through the global deceleration and euro zone recession in 2012. The IMF has recently noted that Poland relies less heavily on external demand (with a 40% share of exports in GDP, versus the 65% average for other new EU members), and that its banking sector remains adequately capitalized and profitable, offering a cushion to the economy against a trade slowdown and/or credit squeeze. The zloty is judged to be largely consistent with fundamentals, with recent central bank interventions in support of the currency deemed appropriate. Poland enjoys stable access to international lending, with the 10-year sovereign bond yield around 5.6% (little changed from six months ago), and a flexible credit line with the IMF maintained for precautionary purposes. The nation's well-developed and liquid capital markets offer an adjustment mechanism for asset prices (including the zloty), while also presenting a risk, given a high exposure to core euro zone banks and susceptibility to swings in investor sentiment. Our forecast suggests that following a 4% expansion in 2011, the pace of growth will slow to 2¼% in 2012 – still robust within the EU – though an intensification of the euro zone crisis could worsen the scenario significantly. The central bank will likely maintain a neutral policy stance over the medium term, with currently elevated inflation (4.6% y/y in December) projected to eventually moderate toward the 2.5% target amid softer domestic and external demand and fiscal consolidation.

**SOUTH AFRICA** - The slowdown in South Africa in 2012 will be moderated by the nation's expanding trade relations with emerging markets in Asia and Latin America, and lessening reliance on export markets in Europe. However, domestic conditions remain challenging; the general unemployment rate is a staggering 25%, widespread industrial action devastated mining production for much of 2011 (and looks set to continue into 2012), and deficits on both the fiscal and current accounts are notable – at around 5% and 4%, respectively. We expect the modest output performance of 2011 – a growth rate of roughly 3% – to be followed by a slower pace of slightly under 2½% in 2012. The Kagiso PMI rebounded in January to 53.2 after dipping below the neutral threshold in December. The South African Reserve Bank (SARB) has revised upwards the projected inflation profile, noting that the CPI continues to grow despite a lack of demand-side pressures. The central bank now expects the inflation rate (at 6.1% y/y in December) to remain above the upper bound of the 3-6% target range for all of 2012 on the back of administered price increases, a weakened currency and buoyant food prices, before gradually settling back below 6% in 2013. Though the IMF has cautioned policymakers to maintain supportive monetary conditions in light of the nation's increasing exposure to euro-centred volatility, the medium term outlook for accelerating growth and persistent inflationary pressures suggest that the SARB will likely begin to tighten rates before year-end.

| <b>GLOBAL CURRENCY FORECAST (end of period)</b> |                     |        |       |       |       |       |       |       |       |       |       |       |       |       |
|---|---------------------|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|   |                     | 2010   | 2011  | 2012f | 2013f | 2012f |       |       |       | 2013f |       |       |       |       |
|   |                     |        |       |       |       | Q1    | Q2    | Q3    | Q4    | Q1    | Q2    | Q3    | Q4    |       |
| <b>MAJOR CURRENCIES</b>                         |                     |        |       |       |       |       |       |       |       |       |       |       |       |       |
|   | <b>Japan</b>        | USDJPY | 81    | 77    | 82    | 84    | 78    | 80    | 80    | 82    | 83    | 83    | 84    | 84    |
|   | <b>Euro zone</b>    | EURUSD | 1.34  | 1.30  | 1.25  | 1.29  | 1.29  | 1.28  | 1.27  | 1.25  | 1.25  | 1.26  | 1.28  | 1.29  |
|   |                     | EURJPY | 109   | 100   | 103   | 108   | 101   | 102   | 102   | 103   | 104   | 105   | 108   | 108   |
|   | <b>UK</b>           | GBPUSD | 1.56  | 1.55  | 1.63  | 1.68  | 1.56  | 1.59  | 1.62  | 1.63  | 1.65  | 1.66  | 1.67  | 1.68  |
|   |                     | EURGBP | 0.86  | 0.83  | 0.77  | 0.77  | 0.83  | 0.81  | 0.78  | 0.77  | 0.76  | 0.76  | 0.77  | 0.77  |
|   | <b>Switzerland</b>  | USDCHF | 0.93  | 0.94  | 0.99  | 0.97  | 0.96  | 0.97  | 0.98  | 0.99  | 1.00  | 0.99  | 0.98  | 0.97  |
|   |                     | EURCHF | 1.25  | 1.22  | 1.24  | 1.25  | 1.24  | 1.24  | 1.24  | 1.24  | 1.25  | 1.25  | 1.25  | 1.25  |
| <b>AMERICAS</b>                                 |                     |        |       |       |       |       |       |       |       |       |       |       |       |       |
| <b>North</b>                                    | <b>Canada</b>       | USDCAD | 1.00  | 1.02  | 0.98  | 0.96  | 1.02  | 1.01  | 0.99  | 0.98  | 0.98  | 0.97  | 0.97  | 0.96  |
|   |                     | CADUSD | 1.00  | 0.98  | 1.02  | 1.04  | 0.98  | 0.99  | 1.01  | 1.02  | 1.02  | 1.03  | 1.03  | 1.04  |
|   | <b>Mexico</b>       | USDMXN | 12.34 | 13.94 | 13.05 | 13.35 | 13.52 | 13.33 | 13.17 | 13.05 | 13.16 | 13.06 | 13.17 | 13.35 |
|   |                     | CADMXN | 12.36 | 13.65 | 13.32 | 13.91 | 13.25 | 13.20 | 13.30 | 13.32 | 13.43 | 13.46 | 13.58 | 13.91 |
| <b>South</b>                                    | <b>Argentina</b>    | USDARS | 3.98  | 4.30  | 5.50  | 6.00  | 4.53  | 4.83  | 5.15  | 5.50  | 5.62  | 5.74  | 5.87  | 6.00  |
|   | <b>Brazil</b>       | USDBRL | 1.66  | 1.87  | 1.75  | 1.85  | 1.75  | 1.75  | 1.75  | 1.75  | 1.77  | 1.80  | 1.82  | 1.85  |
|   | <b>Chile</b>        | USDCLP | 468   | 520   | 495   | 505   | 507   | 502   | 498   | 495   | 496   | 499   | 502   | 505   |
|   | <b>Colombia</b>     | USDCOP | 1908  | 1939  | 1870  | 1900  | 1821  | 1837  | 1854  | 1870  | 1877  | 1885  | 1892  | 1900  |
|   | <b>Peru</b>         | USDPEN | 2.81  | 2.70  | 2.63  | 2.57  | 2.70  | 2.66  | 2.66  | 2.63  | 2.64  | 2.60  | 2.60  | 2.57  |
|   | <b>Venezuela</b>    | USDVEF | 4.29  | 4.29  | 5.15  | 5.15  | 4.44  | 4.66  | 4.90  | 5.15  | 5.15  | 5.15  | 5.15  | 5.15  |
| <b>ASIA / OCEANIA</b>                           |                     |        |       |       |       |       |       |       |       |       |       |       |       |       |
|   | <b>Australia</b>    | AUDUSD | 1.02  | 1.02  | 1.09  | 1.12  | 1.05  | 1.07  | 1.08  | 1.09  | 1.10  | 1.10  | 1.11  | 1.12  |
|   | <b>China</b>        | USDCNY | 6.61  | 6.30  | 6.07  | 5.84  | 6.26  | 6.20  | 6.13  | 6.07  | 6.01  | 5.95  | 5.90  | 5.84  |
|   | <b>Hong Kong</b>    | USDHKD | 7.77  | 7.77  | 7.75  | 7.75  | 7.75  | 7.75  | 7.75  | 7.75  | 7.75  | 7.75  | 7.75  | 7.75  |
|   | <b>India</b>        | USDINR | 44.7  | 53.1  | 49.7  | 48.0  | 49.5  | 49.6  | 49.6  | 49.7  | 49.3  | 48.8  | 48.4  | 48.0  |
|   | <b>Indonesia 1/</b> | USDIDR | 9.00  | 9.07  | 8.75  | 8.35  | 8.95  | 8.88  | 8.82  | 8.75  | 8.65  | 8.55  | 8.45  | 8.35  |
|   | <b>Malaysia</b>     | USDMYR | 3.06  | 3.17  | 3.00  | 2.98  | 3.03  | 3.02  | 3.01  | 3.00  | 2.99  | 2.99  | 2.98  | 2.98  |
|   | <b>New Zealand</b>  | NZDUSD | 0.78  | 0.78  | 0.81  | 0.85  | 0.79  | 0.80  | 0.80  | 0.81  | 0.82  | 0.83  | 0.84  | 0.85  |
|   | <b>Philippines</b>  | USDPHP | 43.8  | 43.8  | 41.5  | 39.7  | 42.5  | 42.2  | 41.8  | 41.5  | 41.0  | 40.6  | 40.1  | 39.7  |
|   | <b>Singapore</b>    | USDSGD | 1.28  | 1.30  | 1.24  | 1.21  | 1.25  | 1.25  | 1.24  | 1.24  | 1.23  | 1.22  | 1.22  | 1.21  |
|   | <b>South Korea</b>  | USDKRW | 1126  | 1152  | 1080  | 1025  | 1115  | 1103  | 1092  | 1080  | 1066  | 1052  | 1038  | 1025  |
|   | <b>Thailand</b>     | USDTHB | 30.1  | 31.6  | 30.0  | 29.1  | 30.8  | 30.5  | 30.3  | 30.0  | 29.8  | 29.5  | 29.3  | 29.1  |
|   | <b>Taiwan</b>       | USDTWD | 29.3  | 30.3  | 29.0  | 27.9  | 29.5  | 29.3  | 29.2  | 29.0  | 28.7  | 28.4  | 28.1  | 27.9  |
| <b>EUROPE / AFRICA</b>                          |                     |        |       |       |       |       |       |       |       |       |       |       |       |       |
|   | <b>Czech Rep.</b>   | EURCZK | 25.0  | 25.6  | 24.8  | 24.2  | 25.2  | 25.1  | 24.9  | 24.8  | 24.6  | 24.5  | 24.3  | 24.2  |
|   | <b>Iceland</b>      | USDISK | 115   | 123   | 118   | 116   | 123   | 121   | 119   | 118   | 117   | 117   | 116   | 116   |
|   | <b>Hungary</b>      | EURHUF | 279   | 315   | 290   | 280   | 294   | 293   | 291   | 290   | 287   | 285   | 282   | 280   |
|   | <b>Norway</b>       | USDNOK | 5.82  | 5.98  | 5.30  | 5.00  | 5.76  | 5.60  | 5.45  | 5.30  | 5.22  | 5.15  | 5.07  | 5.00  |
|   | <b>Poland</b>       | EURPLN | 3.96  | 4.47  | 4.15  | 3.95  | 4.21  | 4.19  | 4.17  | 4.15  | 4.10  | 4.05  | 4.00  | 3.95  |
|   | <b>Russia</b>       | USDRUB | 30.5  | 32.1  | 30.5  | 31.0  | 30.4  | 30.4  | 30.5  | 30.5  | 30.6  | 30.7  | 30.9  | 31.0  |
|   | <b>South Africa</b> | USDZAR | 6.63  | 8.09  | 8.00  | 8.25  | 7.84  | 7.90  | 7.95  | 8.00  | 8.06  | 8.12  | 8.19  | 8.25  |
|   | <b>Sweden</b>       | EURSEK | 8.98  | 8.93  | 8.80  | 8.50  | 9.00  | 8.85  | 8.80  | 8.80  | 8.66  | 8.58  | 8.57  | 8.50  |
|   | <b>Turkey</b>       | USDTRY | 1.54  | 1.89  | 1.77  | 1.73  | 1.78  | 1.77  | 1.77  | 1.77  | 1.76  | 1.75  | 1.74  | 1.73  |

f: forecast; 1/ in thousands

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