



October 5, 2015

Currency Report Card

October 2015

Three month forecast returns

Most bullish	Most bearish
ARS	BRL
RUB	ILS
GBP	NZD

Source: RBC Capital Markets

12 month forecast returns

Most bullish	Most bearish
ARS	ILS
RUB	SGD
GBP	NZD

Source: RBC Capital Markets

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All values in USD unless otherwise noted.

Priced as of prior trading day's market close, ET (unless otherwise stated).

Forecast revisions include:

USD/JPY: Short-term profile revised lower. Q4 2015 now 125 (previously 128). Long-term profile unchanged.

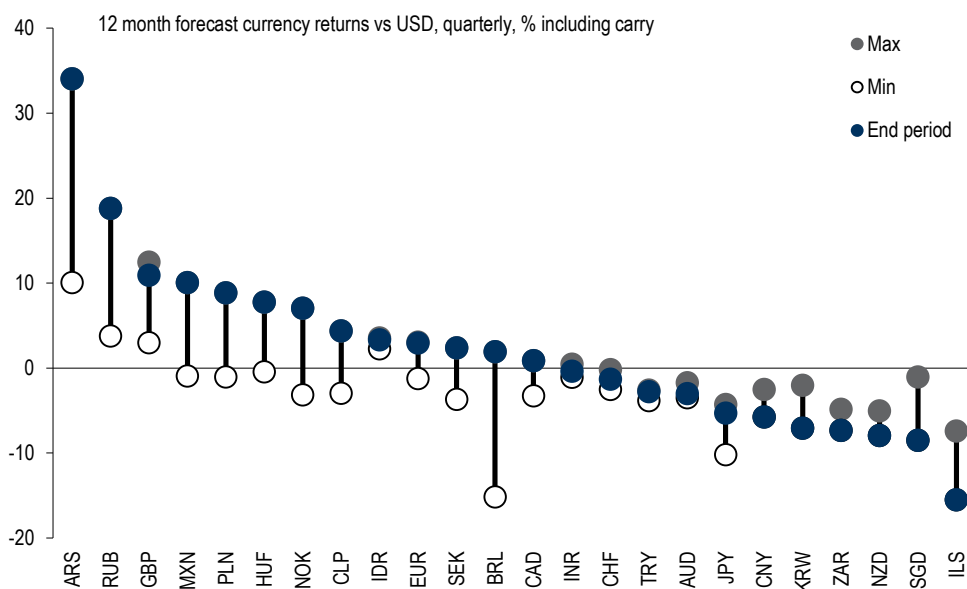
USD/ZAR: Profile revised higher. End-Q4 now 14.5 (12.9). End-Q3 2016 now 15.5 (11.0).

USD/BRL: Profile revised higher. End-Q4 now 4.50 (4.00). End-Q3 2016 now 4.40 (3.95).

USD/ILS: Long-term profile revised higher. End-Q3 2016 now 4.50 (3.90).

EUR/HUF: Profile revised higher. End-Q4 now 310 (305). End-Q3 2016 now 300 (285). Similar revision profile for EUR/PLN.

High-yield EM and GBP outperformance; NZD, JPY and SGD underperformance; USD mixed



Source: RBC Capital Markets



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US Dollar

Adam Cole

1-3 Month Outlook – Higher, but not much

USD fell steadily into the September 17 FOMC meeting, making a low after the unchanged rate decision, then spent the rest of the month recovering to end unchanged – both in DXY-terms and bilaterally against all of the major currencies. With September 17 behind us, the debate has now shifted to whether the Fed hikes at either of the two remaining meetings this year (Oct 28 or Dec 16). With insufficient new news by this month's meeting, the "live" meeting is December and the ~35% probability of a hike currently discounted is very similar to expectations for the September meeting, 2½ months prior to the event. So the start of Q4 is in many respects similar to the start of Q3 – the US domestic data are fine (notwithstanding one month's poor payrolls), economic surprises are balanced (our ESI close to zero) and the next important Fed meeting is priced as being in the balance. How USD trades for the rest of the year will largely be a reflection of how this probability evolves. Fed comments subsequent to the FOMC have consistently suggested a "default" position of a hike this year, the onus being on the news-flow to stop the Fed moving and this has continued after the disappointing September payrolls report. Our economists' central case is that the Fed does hike at that meeting, but the September experience suggests the hurdle for staying on hold is not high and the factors that could stop them are multiple – beyond soft data, the list should include a significantly stronger USD and heightened volatility. Reflecting this view, our forecasts have USD only slightly stronger into year-end (DXY +1.0%) and the uncertainty around this is high. Our trading strategy will continue to look for ideas in the crosses, avoiding directional USD exposure.

6-12 Month Outlook – Moderately bullish

There is still a widespread view that USD rallies ahead of the first Fed hike and sells off after. While this holds *on average*, the degree of dispersion suggests it would be unwise to rely on it (see [Total FX](#), 7 Aug). We remain USD positive into next year, particularly against JPY. The US is better placed than most countries to shoulder currency appreciation. We find global demand is a more important driver for US export growth than the level of USD (see [Total FX](#), 8 May). And because much of global trade is dominated in USD, the US sees lower exchange rate pass-through than other countries (a recent academic study estimates it is a quarter to a third of pass-through in EM countries). That means both on the growth and the inflation front, USD has room to rise.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.07	1.11	1.12	1.11	1.12	1.16	1.16	1.17
USD/JPY	120	123	120	125	132	129	126	123
USD/CAD	1.27	1.25	1.33	1.36	1.34	1.33	1.31	1.30

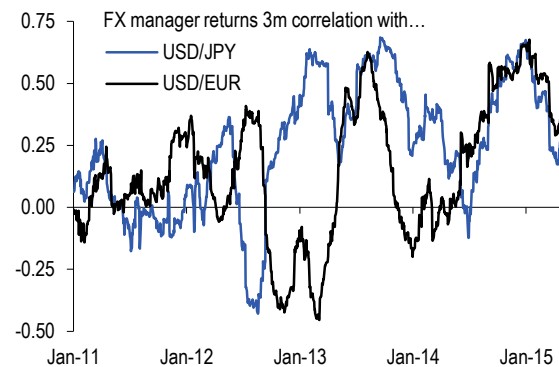
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	0.25% (0.25%)
Trend interest rates (10yr average)	1.9%
Bias in interest rate market	Flat
Core PCE Inflation %Y/Y Aug (Jul)	1.3% (1.2%)
Inflation target	Price stability
Budget balance % GDP FY13 (FY12)	-4.6% (-7.4%)
Budget balance target % GDP	-
GDP Growth % y/y Q2 (Q1)	2.7% (2.9%)
Trend GDP %y/y	2.5%
Purchasing Power Parity Value	-
Spot	-
PPP Valuation	-
Current account balance % GDP Q2 (Q1)	-2.4% (-2.3%)
Trend current account balance % GDP	-3.8%
Moody's Foreign Currency Rating	Aaa
Outlook	Stable

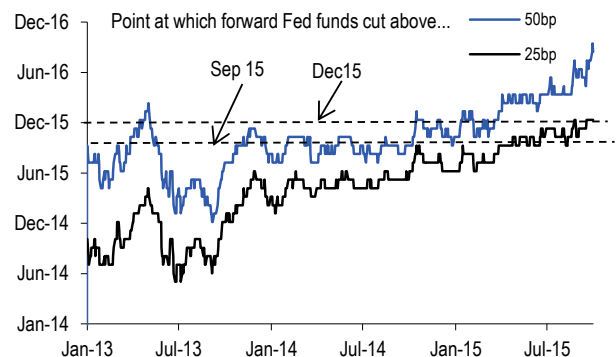
* Current is latest month, quarter or year

1. Managers short USD/JPY, neutral EUR/USD



Source: RBC Capital Markets; Bloomberg

2. Fed hike expectations still receding



Source: RBC Capital Markets; Bloomberg

Euro

Elsa Lignos

1 – 3 Month Outlook – Opposing forces into year end

As we approach year end, we are happy to say we have not changed our EUR/USD forecast since the start of the year and see no reason to change it now (RBC end-Q4: 1.11). It falls in the middle/lower half of the 1.08-1.15 range that has broadly held since May (except for the extreme illiquid/risk off conditions on August 24-25).

EUR is trapped between several opposing forces at the moment. Pushing EUR higher we have: (1) risk aversion, since EUR is trading as risk off proxy (see [Total FX: EUR as a risk off proxy](#), 7 Aug 2015), (2) weaker US data and falling US rate expectations and (3) forward-looking indicators which still point to decent domestic recovery (the aggregate Euro area PMI is still elevated around 54). Pushing EUR lower we have: (1) the prospect of further ECB QE (we look for purchases to be extended at the December 3 meeting), (2) an interest to rebuild short EUR positions since positioning has turned relatively neutral (Figure 1) and (3) any time there is a recovery in risk appetite. Since the Sept FOMC disappointment, we have been suggesting short EUR/USD vol as the best way to capture these opposing forces.

In its September meeting, the ECB opened the door for further QE and made its message clear: if things get worse it can and will act. The GovCo is particularly sensitive to an “unwarranted tightening of financing conditions”. To capture this risk, our European team has constructed a ‘real financial conditions’ indicator, based on the factors most important to the real economy (see Figure 2 and [European Directions](#), 11 Sept 2015). The October meeting is likely to be too soon for action, but we think the December meeting would be an opportune moment alongside the updated staff forecasts.

6 – 12 Month Outlook – Domestic demand still key

Our base case is that the slow pace of recovery will continue. While EM developments still pose a downside risk, the domestic picture in the Euro area is doing nicely (see [European Directions: Domestic Strong – Externals weak – how long can it last?](#) 1 Oct 2015). Domestic demand remains supported by the ECB’s easing measures. Credit growth is still edging higher and with almost half of Euro area member state trade staying within the Euro area’s borders, domestic demand is critical for the outlook. The slow pace of recovery means it will be a long time before inflationary pressures start to show which should keep EUR/USD cyclically weak near current spot over the duration of our forecast horizon.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.07	1.11	1.12	1.11	1.12	1.16	1.16	1.17
EUR/JPY	129	137	134	139	148	150	146	144
EUR/CAD	1.36	1.39	1.49	1.51	1.50	1.54	1.52	1.52

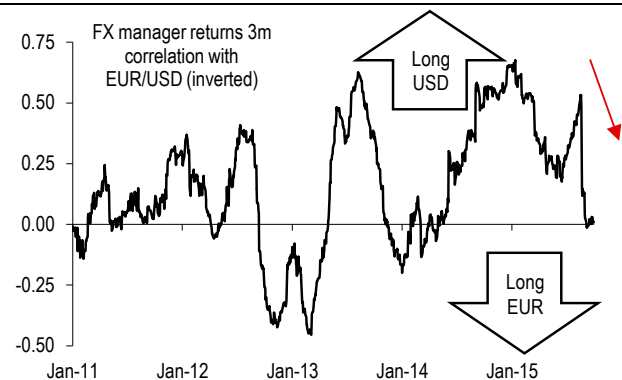
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	0.05% (0.05%)
Trend interest rates 10y average	1.9%
Bias in interest rate market	Lower
HICP core Inflation %Y/Y Sep (Aug)	0.9% (0.9%)
Inflation target	Close to but less than 2.0%
Budget balance % GDP FY14 (FY13)	-2.4% (-2.1%)
Budget balance target % GDP	3% of GDP-Unless special circumstances
GDP Growth %Y/Y Q2 (Q1)	1.5% (1.5%)
Trend GDP %y/y	1.1%
Purchasing Power Parity Value Aug	1.2703
Spot end-Sep	1.1177
PPP Valuation	EUR/USD is undervalued
Current account % GDP Q2 (Q1)	2.6% (2.3%)
Trend current account balance % GDP	0.3%
Moody's Foreign Currency Rating	Aaa (Germany)
Outlook	Stable

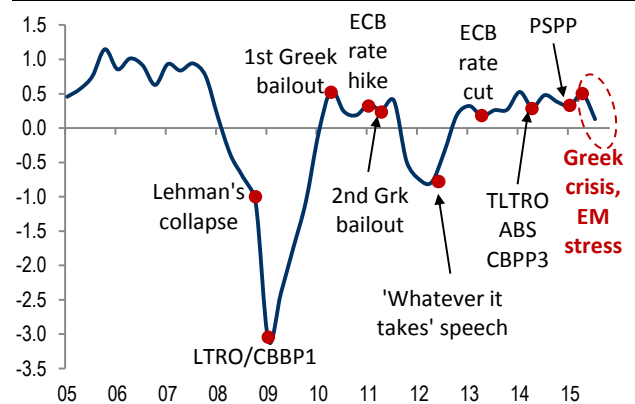
* Current is latest month, quarter or year

1. EUR/USD positioning looks neutral on some measures



Source: RBC Capital Markets; Bloomberg

2. ECB will act to prevent tightening in financial conditions



Source: RBC European economics; Bloomberg

Japanese Yen

Adam Cole

1 – 3 Month Outlook – USD/JPY reversal

As markets turned risk-averse and currencies reverted to their traditional status as safe-haven or risky asset, JPY was the star performer through Q3, rising against all G10 currencies. However, the evidence now suggests JPY is being propped up by increasingly skewed positioning and for the first time since the beginning of the Abe/Kuroda era, FX managers appear to be short USD/JPY. Figure 1 shows reported returns for the currency managers monitored by Parker Global against USD/JPY. Having previously persistently profited from USD/JPY rising, since June managers appear to be losing money when USD/JPY rallies and vice versa. On the face of it, this is compelling evidence that FX managers have a large concentration of risk in short USD/JPY positions. Other measures of JPY positioning have shown a similar pattern in recent weeks. CFTC net short JPY positions, having accounted for 70-80% of open interest for most of the last three years have slumped to just 10-20% in recent weeks. Similarly, having been consistently bid for calls, USD/JPY risk reversals have flipped to be bid for puts across the entire vol curve. Of course, just because the market appears to be short USD/JPY, it does not follow that spot has to trade higher. But the establishment of a sizeable long JPY position outside Japan helps explain why persistently [negative capital flows](#) have not weakened the currency recently. With those flows ongoing and positioning extreme, the balance of risk favours a reversal of USD/JPY losses Q4.

6 – 12 Month Outlook – Weaker on capital outflows

The capital outflows referred to above have much further to run. Contrary to the widespread view that the GPIF reallocation is “close to completion” we see many more months of outflows. Although the Q2 allocation into foreign stocks (yellow bars in Figure 2) was the biggest ever, price action in Q3 more than reversed it. On our estimates, having put JPY2.5trn into foreign stocks in Q2, mark-to-market losses have cut holdings by JPY3.0trn in Q3, leaving GPIF with another JPY6trn to buy (dark blue bars in Figure 2). And this does not include other public pension funds that follow GPIF and will only start reallocating this month (JPY30trn of assets in total) or a similar reallocation by soon-to-be privatised Yucho and Kampo. And we still expect private sector investors to start selling JPY (via lower hedge ratios) as US rates start to rise. Overall, the case for USD/JPY trading much higher in the long-term remains compelling.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/JPY	120	123	120	125	132	129	126	123
EUR/JPY	129	137	134	139	148	150	146	144
CAD/JPY	95	98	90	92	99	97	96	95

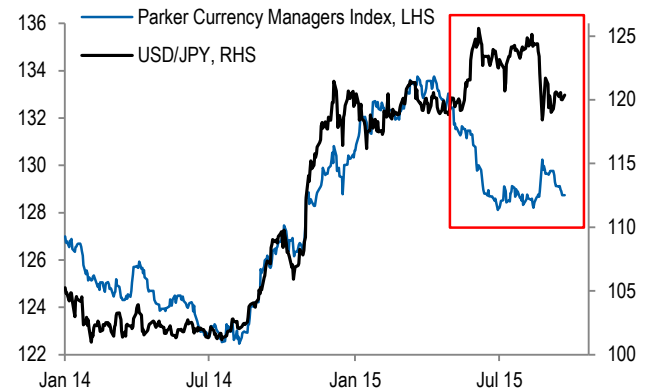
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	0.1% (0.1%)
Trend interest rates 10y average	0.15%
Bias in interest rate market	Flat
CPI Inflation %Y/Y Aug (Jul)	-0.1% (0.0%)
Inflation target	2.0%
Budget balance % GDP FY14 (FY13)	-7.0% (-7.8%)
Budget balance target % GDP	n/a
GDP Growth %Y/Y Q2 (Q1)	0.9% (-0.8%)
Trend GDP %Y/Y	1.2%
Purchasing Power Parity Value Aug	89.05
Spot end-Sep	119.88
PPP Valuation	USD/JPY is overvalued
Current a/c balance % GDP Q2 (Q1)	3.5% (3.0%)
Trend current account balance % GDP	2.8%
Moody's Foreign Currency Rating	A1
Outlook	Stable

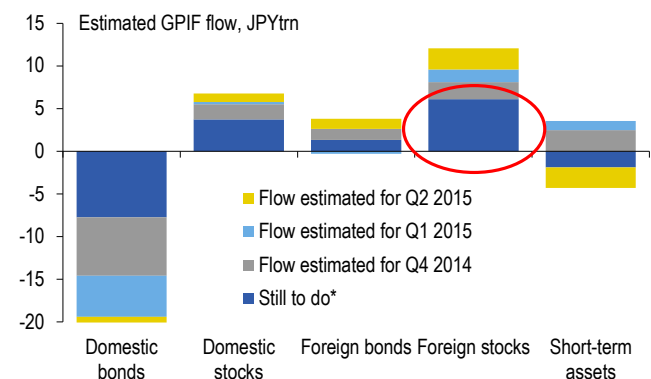
* Current is latest month, quarter or year

1. Markers now profiting from JPY strength



Source: RBC Capital Markets; Bloomberg, Parker Global

2. GPIF still has much to do



Source: RBC Capital Markets; Bloomberg, GPIF

Sterling

Adam Cole

1-3 Month Outlook – Reverting to an outperformer

Bullish GBP is a consensus view with which we agree, but it has clearly not worked in recent weeks. Only the commodity currencies underperformed GBP in Q3, and EUR/GBP is 500pts (7%) higher than the July low. Various explanations have been put forward for GBP's underperformance, including growing concern on the funding of the UK's gaping current account deficit and the rising risk of EU exit. Both are legitimate concerns, but we still see them as tail risks, rather than key drivers. In reality, GBP underperformance in Q3 was a much more "vanilla" story of rate spread dynamics (Figure 1). The greater mystery, then, is why rate spreads have moved so far against GBP, which seems completely at odds with central bank forward guidance. The reality, we think, is that the decline in UK rate spreads has been almost entirely "passive" in nature, rather than reflecting an "active" policy debate. The decline in yields since mid-July has been a global phenomenon and UK yields have declined more simply because rates (spot and more so forward) are not at the zero bound. In other words, the UK is a "high beta" market when global yields are falling in tandem (Figure 2). We put recent GBP underperformance down to a temporary decoupling from domestic fundamentals as global factors have dominated and expect a recoupling in Q4 with GBP outperformance reasserting itself.

6-12 Month Outlook – Trending higher

Longer-term, there are two key risks for GBP – the UK's unsustainable current account deficit and the EU referendum, promised for end-2017 at the latest. We think both are manageable, however, and the current account may actually strengthen the case for GBP outperformance. We have argued for some time that the UK's external deficit is largely a public sector phenomenon and this is still true, but is becoming less so as the household sector slips into deficit. As this happens, the policy prescription is slowly shifting to tighter monetary *and* fiscal policy rather than fiscal policy alone. As to the rising risk of UK EU exit, on the face of it, there are reasons to think GBP should carry a rising risk premium. This month's YouGov poll showed a small (2pt) balance in favour of voting yes to leaving the EU. In the longer term, the balance of opinion has almost always been in favour of staying in and it still is when pollsters add a qualification that the government recommends voting to stay. We maintain a moderately constructive long-term view on GBP.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
GBP/USD	1.48	1.57	1.51	1.56	1.65	1.71	1.68	1.70
EUR/GBP	0.72	0.71	0.74	0.71	0.68	0.68	0.69	0.69
GBP/JPY	178	192	181	195	217	220	212	209
GBP/CAD	1.88	1.96	2.01	2.13	2.21	2.27	2.20	2.20

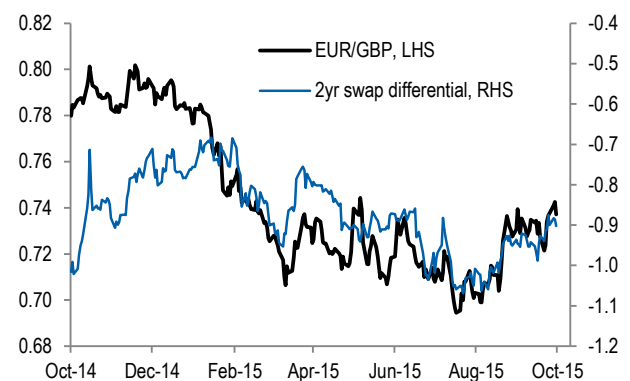
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	0.5% (0.5%)
Trend interest rates 10y average	3.3%
Bias in interest rate market	Flat
CPI Inflation %Y/Y Aug (Jul)	0.0% (0.1%)
Inflation target (HICP)	2.0%
Budget balance % GDP FY13 (FY12)	-5.8% (-6.1%)
Budget balance target % GDP	Balanced current budget over the cycle
GDP Growth %Y/Y Q2 (Q1)	2.4% (2.7%)
Trend GDP %Y/Y	2.5%
Purchasing Power Parity Value Aug	1.5225
Spot end-Sep	1.5127
PPP Valuation	GBP/USD is fairly-valued
Current a/c balance % GDP Q2 (Q1)	-5.1% (-5.3%)
Trend current account balance % GDP	-3.0%
Moody's Foreign Currency Rating	Aa1
Outlook	Stable

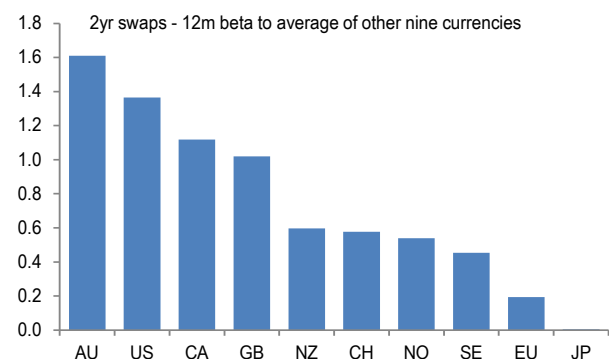
* Current is latest month, quarter or year

1. GBP underperformance is a vanilla rates story



Source: RBC Capital Markets, Bloomberg

2. GBP rates are high beta compared to EZ



Source: RBC Capital Markets, Bloomberg, GPIF

Swiss Franc

Elsa Lignos

1 – 3 Month Outlook – Positioned for long EUR/CHF

Though EUR/CHF reached a new post-floor high in mid-September (1.1050), the pace of appreciation is painfully slow. But we do not expect that to change. We have positioned for higher EUR/CHF in options with a risk reversal but the long tenor (1y at entry, expiring July 2016) shows how long we expect this process to take. Technically there is a reasonably well-defined rising trendline for EUR/CHF, dating back to the start of the current move higher in July. Support comes in at 1.0880 – that also coincides with the 40dma. A break through there may set us up for a short-term retracement. We would view that as a buying opportunity for EUR/CHF.

On a 1-3m horizon, our target is still higher though we have adjusted our Q4 forecast (now 1.10, prev 1.12). The latest quarterly SNB meeting did nothing to fundamentally change the outlook. The inflation forecast was revised lower again in the near-term (on lower energy prices) though the long-term forecast was little changed (Figure 1). Seasonally adjusted unemployment rose slightly in Q3 and the SNB calls the situation “challenging for many companies. In view of the lower margins, these companies are under pressure to raise efficiency and reduce costs”. The IMF notes that short-time work arrangements cushion the effect of slowing growth on unemployment (it is expected to increase but only modestly). But the combination of previous CHF appreciation, lower commodity prices and slack in the economy all conspire to keep inflation soft and CHF slowly trending lower.

6 – 12 Month Outlook – Nominal rates matter

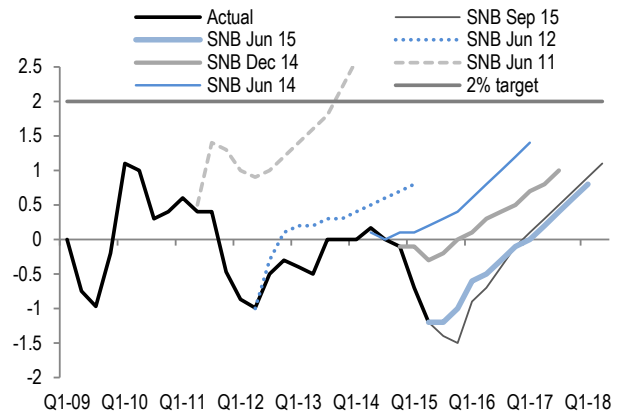
The driving factor behind our long-term CHF view is Switzerland’s inflation outlook which will allow the SNB to keep its nominal rates lowest in the world. While its real rates are amongst the highest in G10, we have shown before that nominal rates are more important in driving spot FX returns (see [Total FX](#), 2 Aug 2013). Figure 2 shows updated 1Y1Y consensus expectations (year ahead inflation, 12 months out). By 2016, Switzerland is expected to be the only G10 country with inflation still hugging zero. The SNB does not expect inflation to turn positive until early 2017 and it expects to keep rates at -0.75% throughout the forecast horizon. But our European rates team also now expects an extension to ECB QE in Sept 2016 which should flatten the path for EUR/CHF next year.

Indicators

	Current (Previous)*
Official cash rate	-0.25 to -1.25% (0.25 to -0.75%)
Trend interest rates 10y average	1.70%
Bias in interest rate market	Neutral
CPI Inflation %Y/Y Aug (Jul)	-1.4% (-1.3%)
Inflation target	less than 2.0%
Budget balance % GDP FY14 (FY13)	0.5% (0.1%)
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Y/Y Q2 (Q1)	1.2% (1.2%)
Trend GDP %Y/Y	1.80%
EUR Purchasing Power Parity Value Aug	1.2518
EUR/CHF spot end-Sep	1.0877
EUR/CHF PPP Valuation	EUR/CHF is undervalued
Current a/c balance % GDP Q1 (Q4)	7.8% (7.0%)
Trend current account balance % GDP	8.0%
Moody's Foreign Currency Rating	Aaa
Outlook	Stable

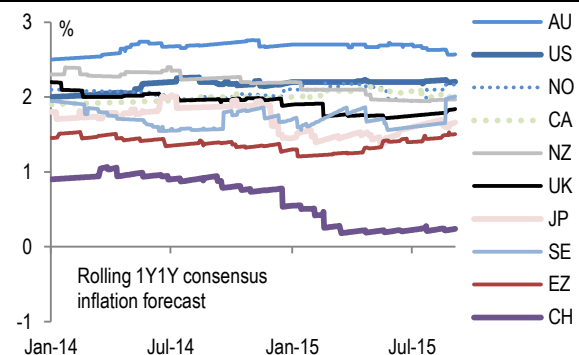
* Current is latest month, quarter or year

1. S/T inflation revised down, L/T inflation still soft



Source: RBC Capital Markets; Bloomberg; SNB

2. Expectations for Swiss inflation still stuck at zero



Source: RBC Capital Markets; Bloomberg

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CHF	0.97	0.94	0.97	0.99	0.99	0.97	0.97	0.97
EUR/CHF	1.04	1.04	1.09	1.10	1.11	1.12	1.13	1.14
CHF/JPY	124	131	123	126	133	134	129	126
CAD/CHF	0.77	0.75	0.73	0.73	0.74	0.73	0.74	0.75

Source: RBC Capital Markets estimates

Swedish Krona

Adam Cole

1-3 Month Outlook – EUR/SEK forming a base

SEK performed strongly in September, rising against all G10 currencies despite the generally negative tone for risk in the month and SEK's traditional status as a risk proxy. The apparent reversal of SEK's relationship with general risk appetite is largely a consequence of the fact it trades as a satellite of EUR, which has itself assumed the qualities of a safe-haven currency (temporarily in our view). Going forward, the dangers for SEK are that either markets turn risk-seeking, reversing gains, or much more severely risk-off, calling into question EUR's (and with it SEK's) status as a safe-haven. Moreover, EUR/SEK is now close to the levels (9.20-9.30) that have caused the Riksbank to openly talk the currency down and to ease domestic policy to reverse currency strength. At the time of the last Riksbank policy announcement (September 3), the central bank kept the main policy rate unchanged (-0.35%) and did not add to its QE programme (SEK135bn), though it continues to point to "a high level of preparedness" to do more and its forward guidance suggested a small risk of a further cut. The Riksbank's heightened sensitivity to headline inflation heading into next year's wage negotiations (see below) and recent SEK strength suggest this risk is more likely to rise than fall from current market pricing (Figure 1). We expect EUR/SEK to base around current levels (9.35) and push back to the top of the recent range around 9.60.

6-12 Month Outlook – Eventual recovery

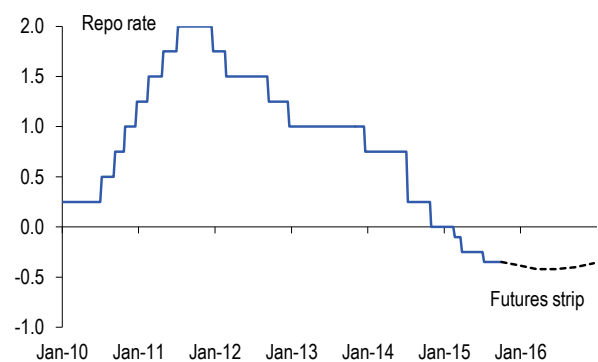
As 2016 comes into focus, so will the next major wage round scheduled next year. Agreements covering around 3 million employees (~63% of labour force) in the private and public sector will expire. Unless the Riksbank manages to engineer a material rise in headline inflation (current consensus forecast is just 1.0% in early-2016), the risk is that wage negotiations are benchmarked to very low inflation expectations and employees lock in very weak wage growth for three years. This in turn will put downward pressure on future inflation, making the task of battling low inflation even harder for the Riksbank. Assuming core inflation continues its trend acceleration, we see EUR/SEK drifting lower in the latter half of the next year once higher prices become more entrenched and the Riksbank can start to gradually raise interest rates.

Indicators

	Current (Previous)*
Official cash rate	-0.35% (-0.35%)*
Trend interest rates 10y average	3.0%
Bias in interest rate market	Flat
CPI Inflation %Y/Y Aug (Jul)	0.80% (0.9%)
Inflation target (UND1X)	2.0%
Budget balance % GDP FY14 (FY13)	-1.88% (-1.37%)
Budget balance target % GDP	Cyclical average surplus of 1%
GDP Growth %Y/Y Q2 (Q1)	3.3% (2.8%)
Trend GDP %Y/Y	2.1%
EUR Purchasing Power Parity Value Aug	8.5921
Spot end-Sep	9.3551
PPP Valuation	EUR/SEK is overvalued
Current a/c balance % GDP Q2 (Q1)	6.4% (6.2%)
Trend current account balance % GDP	7.2%
Moody's Foreign Currency Rating	Aaa
Outlook	Stable

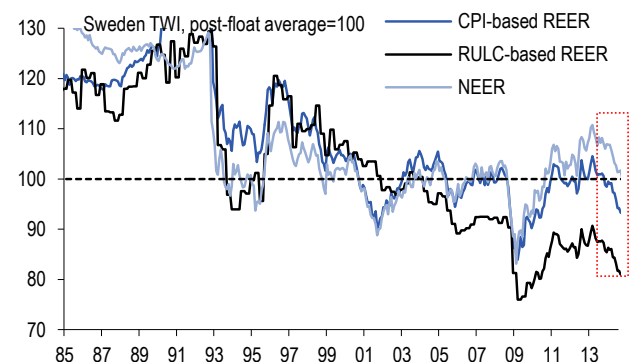
* Current is latest month, quarter or year

1. No normalisation in sight



Source: RBC Capital Markets; Bloomberg

2. SEK historically undervalued



Source: RBC Capital Markets; Bloomberg

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/SEK	8.63	8.29	8.37	8.65	8.57	8.19	8.10	7.95
EUR/SEK	9.26	9.24	9.36	9.60	9.60	9.50	9.40	9.30
NOK/SEK	1.07	1.05	0.98	1.00	1.02	1.03	1.03	1.03
CAD/SEK	6.80	6.63	6.29	6.36	6.40	6.16	6.19	6.11

Source: RBC Capital Markets estimates

Norwegian Krone

Adam Cole

1 – 3 Month Outlook – Further weakness

Norges Bank's unexpected decision to cut the deposit rate by 25bp (to 0.75%) on September 24 sealed NOK's fate as the worst performing G10 currency in the month and only AUD fared worse in the quarter as a whole. That Norges Bank chose to ease policy further, despite large and consistent upside surprises in core inflation, reasonably solid domestic activity data and a very weak NOK, highlights just how sensitive policy is to changes in crude prices. The inflation data in particular argue against further easing going forward. Core inflation rose to 2.9% y/y in August – the fourth straight upside surprise and with one exception the highest level of core inflation since 2009. Norway is one of very few G10 countries where core inflation is above the central bank's target (2.5%). Yet Norges Bank's forward guidance continues to suggest the "the key rate may be cut further in the coming year" and its forward path for rates implies a greater than 50% probability of another cut within the next year. The latter would seem to suggest Norges Bank has a "default" position of cutting rates further, and the onus is on events stopping them. This is despite inflation being projected to remain above target in 2016 and, realistically, only a material recovery in oil prices is likely to stop them cutting rates to new historic lows. While this risk overhangs, we maintain a negative stance on the currency, with EUR/NOK expected to retest the recent highs around 9.60.

6–12 Month Outlook – Cautiously constructive

While oil prices will dictate the short term moves in NOK, the longer term NOK outlook will depend on the lasting effects of lower oil prices to domestic drivers. The depreciation in NOK in H2 2014 has underpinned inflation, but slower growth and lower domestic demand will drag prices lower once the FX effect starts to wane. Providing support to domestic growth though is Norway's fiscal rule and the translational effect of a weaker NOK on Norway's sovereign oil fund, GPF, that act as an automatic stabiliser. By our calculations, this FX translational effect would have increased the government's fiscal leeway by NOK 30bn in 2014, i.e., about 1% of mainland GDP—sums which the government can use to prop up the economy. As such, we are cautiously constructive on NOK and believe EUR/NOK can drift lower once oil prices are able to find a stable floor.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/NOK	8.06	7.86	8.52	8.65	8.39	7.93	7.84	7.69
EUR/NOK	8.65	8.76	9.52	9.60	9.40	9.20	9.10	9.00
NOK/SEK	1.07	1.05	0.98	1.00	1.02	1.03	1.03	1.03
CAD/NOK	6.35	6.29	6.40	6.36	6.26	5.96	5.99	5.92

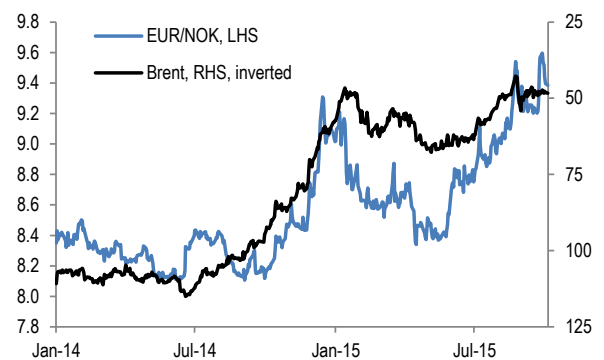
Source: RBC Capital Markets estimates

Indicators

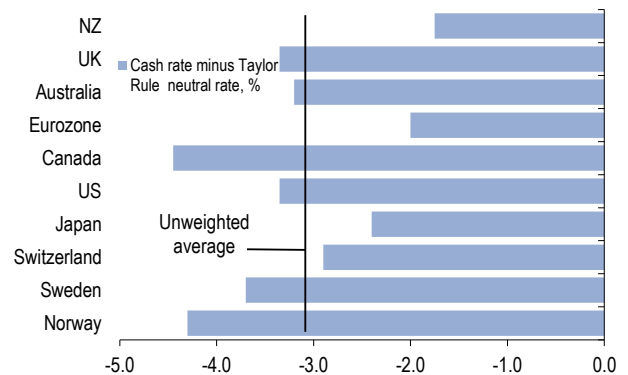
	Current (Previous)*
Official cash rate	0.75% (1.0%)
Trend interest rates 10y average	3.55%
Bias in interest rate market	Downward
CPI (ex energy and taxes) %Y/Y Aug (Jul)	2.9% (2.6%)
Inflation target %	2.5%
Budget balance % GDP FY14 (FY13)	9.1% (11.3%)
Budget balance target % GDP	Structural, non-oil deficit < 4%
GDP Mainland Growth %y/y Q2 (Q1)	1.2% (2.5%)
Trend GDP %Y/Y	2.8%
EUR Purchasing Power Parity Value Aug	8,2985
Spot end-Sep	9.5183
PPP Valuation	EUR/NOK is overvalued
Current a/c balance % GDP Q2 (Q1)	8.6% (8.3%)
Trend current account balance % GDP	13.5%
Moody's Foreign Currency Rating	Aaa
Outlook	Stable

* Current is latest month, quarter or year

1. NOK trading as an oil proxy


Source: RBC Capital Markets, Bloomberg

2. The easiest policy in G10


Source: RBC Capital Markets, Bloomberg

Canadian Dollar

George Davis

1 – 3 Month Outlook – New highs ahead

After a brief pause through mid-September, the uptrend in USD/CAD resumed as the pair moved to a new cyclical high at 1.3457 – the highest level since June 2004. We expect the catalysts for USD/CAD strength to remain in place through year-end, leading to a Q4 peak at 1.3600. First, weakness in crude oil prices - which has been the primary factor driving USD/CAD higher this year - is expected to persist. Of note, the current WTI market price of USD44.17 is well below the assumption of USD60 that was contained in the Bank of Canada's July Monetary Policy Report. With our energy analysts not expecting average annual WTI prices to return above USD60 until next year, USD/CAD should remain supported by this dynamic.

Second, although recent improvement in the Canadian economic data has RBC Economics monitoring an annualized increase of 2.5% for Q3 2015 GDP versus the BoC's forecast of 1.5%, we do not expect the BoC to raise interest rates until Q3 2016 amidst evidence of a more sustained recovery in commodity prices and growth metrics. Despite the weak September US payroll report, the Fed is expected to hike rates before the BoC (our US economics team is currently calling for a 25 bp hike in December). This dynamic should cause further widening in the 2-year US-CA rate spread and serve as another bullish factor underpinning USD/CAD into year-end (Figure 1).

The Federal Election will be taking place on October 19 and will garner more market attention as it approaches. The latest Ipsos Reid poll raises the possibility of a minority government, with the Liberals at 33%, the Conservatives at 32% and the NDP at 27% (+/-3.0%). Nonetheless, our recent work on the performance of CAD around elections dating back to the 1970s shows that CAD has not reacted in a clear, conclusive way to the outcomes (Figure 2). We therefore do not expect the election to have a pronounced impact on the currency and view it as a neutral factor.

6 – 12 Month Outlook – A very moderate decline

We look for a gradual pullback in USD/CAD in 2016, ending the year at 1.3000. Our view is driven by an expected recovery in oil, with our energy team forecasting an average price of USD62 for the year. Benefits from a weaker currency are expected to become more pronounced for exports and non-energy capital investment, causing US and Canadian monetary policy to start to converge amidst a firmer domestic growth profile.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CAD	1.27	1.25	1.33	1.36	1.34	1.33	1.31	1.30
EUR/CAD	1.36	1.39	1.49	1.51	1.50	1.54	1.52	1.52
CAD/JPY	94.7	98.0	90.0	91.9	98.5	97.0	96.2	94.6

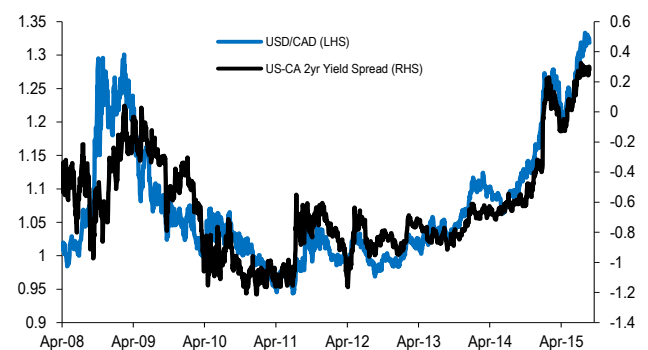
Source: RBC Capital Markets estimates

Indicators

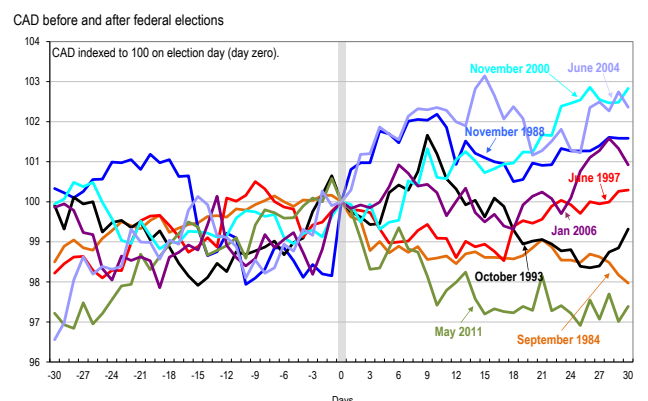
	Current (Previous)*
Official cash rate	0.50% (0.75%)
Trend interest rates 10y average	1.80%
Bias in interest rate market	Lower
Core CPI Inflation %Y/Y August (July)	2.1% (2.4%)
CPI Inflation target range %Y/Y	1-3%
Budget balance % GDP FY15E (FY14)	-2.5% (-2.8%)
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Y/Y Q2 (Q1)	1.0% (2.0%)
Trend GDP %Y/Y	1.8%
Purchasing Power Parity Value – Aug	1.2368
Spot end-Sep.	1.3313
PPP Valuation	USD/CAD is overvalued
Current account balance % GDP Q2 (Q1)	-2.9% (-2.5%)
Trend current account balance % GDP	-1.3%
Moody's Foreign Currency Rating	Aaa
Outlook	Stable

* Current is latest month, quarter or year

1. Widening interest rate spreads underpin USD/CAD


Source: Bloomberg, RBC Capital Markets

2. CAD lacks clear response to previous election results


Source: Bloomberg, RBC Capital Markets

Australian Dollar

Elsa Lignos

1 – 3 Month Outlook – Cuts postponed

In his Semi Annual Testimony on Monetary Policy last month, Governor Stevens delivered a message that was very much glass half-full in nature. He played down global developments, unlike a number of his global counterparts, expressed confidence in AU's adjustment and the current setting of monetary policy, saying "we are pretty content where we are right now". On numerous occasions, the Governor went out of his way to highlight the positives (and downplay the challenges): above average business conditions, stronger employment growth, a better than expected unemployment rate, improving non-mining activity and the rewards of a lower exchange rate. In many ways it reminds us of BoC Governor Poloz. The difference we think is that Canada is showing stronger signs of transitioning to non-commodity, non-housing driven growth while in AU, further currency weakness is needed over the long-term (see *Total FX: AUD/CAD – Waiting on Non-Commodity Exports*, 4 Sep 2015).

In the short-term, an on-hold RBA, some boost to sentiment on the back of a new Prime Minister and any recovery in global risk appetite will provide some support for AUD. Offsetting that is the risk of a big El Nino event (see *Total FX: Hedging El Nino risk*, 17 Sept 2015), along with continued soft investment/manufacturing data out of China and the inability of commodity prices to recover. Added to that list is the risk of a bigger drawdown in China's reserves. In *Total FX: Deep dive into Chinese reserves* (2 Oct 2015) we broke apart Q2 data to find it is likely China is a much larger holder of AUD assets than the average reserve manager. If Chinese reserve drawdown accelerates, we would look for AUD to trade lower. But under our base case, we look for AUD/USD to end Q4 not far from current spot in Q4 (end-Q4 target 0.69).

6 – 12 Month Outlook – Trend lower

As we head into 2016, we look for some further AUD weakness backed by two further cuts from the RBA. That is currently only partially discounted by the market (OIS is priced for -37bps in the year ahead). In an environment of slowing global trade, countries most dependent on the external sector/least able to rely on domestic demand are likely to underperform. AU is a risk in that regard (see *Total FX: Slow global trade – Winners and Losers*, 24 Sep 2015). We look for CNY depreciation to extend to 6.95 and AUD should be a relative underperformer if we are right.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
AUD/USD	0.76	0.77	0.70	0.69	0.68	0.67	0.67	0.67
EUR/AUD	1.41	1.45	1.59	1.61	1.65	1.73	1.73	1.75
AUD/NZD	1.02	1.14	1.10	1.13	1.13	1.14	1.16	1.18
AUD/CAD	0.97	0.96	0.93	0.94	0.91	0.89	0.88	0.87

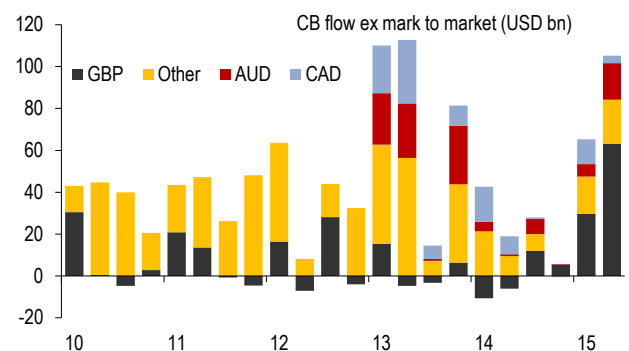
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	2.00% (2.00%)
Trend interest rates 10y average	4.4%
Bias in interest rate market	Downward
CPI Inflation %Y/Y Q2 (Q1)	1.5% (1.3%)
CPI Inflation target range %Y/Y	2.0-3.0%
Budget balance % GDP FY15E/14	-2.7%/-3.2%
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Y/Y Q2 (Q1)	2.0% (2.5%)
Trend GDP %Y/Y	2.8%
Purchasing Power Parity Value Q2	0.7301
Spot end-Sep	0.7048
PPP Valuation	AUD/USD is undervalued
Current account balance % GDP Q1 (Q4)	-4.7% (-3.3%)
Trend current account balance % GDP	-4.4%
Moody's Foreign Currency Rating	Aaa
Outlook	Stable

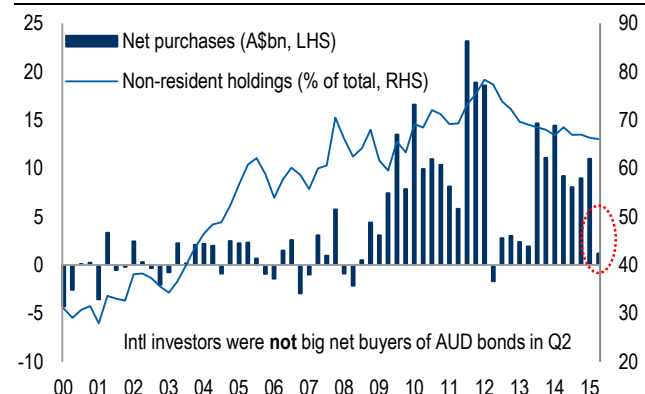
* Current is latest month, quarter or year

1. Central banks appeared to be big AUD buyers in Q2...



Source: IMF, Bloomberg, RBC Capital Markets

2. ...But ABS data shows that is unlikely to be the case



Source: ABS, RBC Capital Markets

New Zealand Dollar

Elsa Lignos

1-3 Month Outlook – One more cut?

When the RBNZ cut rates last month, it stuck to its easing bias, using the same line as the July statement “at this stage, some further easing in the OCR seems likely” adding “this will depend on the emerging flow of economic data”. So what has happened since the last rate cut and how does that set up the RBNZ for its decision later this month? (1) NZD is up 1-3% against its major trading partners (AUD, CNY, USD). The Fed surprised with no hike/a dovish statement and now a weak payrolls report has pushed back expectations of a hike further into 2016. (2) domestic data have been mixed – sentiment surveys remain weak (3) market concerns over China remain high but (4) dairy prices saw the largest jump in five years at the last auction (Sep 15), though it was on diminishing supply and (5) the RBNZ released a staff paper estimating the nominal neutral 90 day bank bill rate to be 3.8-4.9% (the RBNZ’s current estimate of neutral 90d rates is 4.5%). The paper is seen by some as a signal that the RBNZ may be at or near the end of this cutting cycle. Rates are already ~150bps below neutral. Our NZ economists think the news flow will be enough for the RBNZ to cut one more time in October. The discussion on the exchange rate in the Sept MPS seems to back that view: “The medium-term inflationary impacts [of higher NZD] would depend on the factors driving the move...One potential cause...would be a rebound in export prices. In such a scenario the medium-term outlook would be for stronger incomes, growth and inflationary pressure.” But NZD “could be higher than assumed if the Federal Reserve or other central banks were to delay interest rate increases because of concerns about a weaker or more uncertain economic outlook. In that case, the implication for New Zealand would be both lower near-term inflation and weaker medium- term growth.” We seem to be in the latter scenario, raising the risk that the RBNZ cuts in Oct. But if we are right in thinking it would be the last cut in this cycle, the fallout for NZD should be limited.

6-12 Month Outlook – Waiting for ToT recovery

Over the longer horizon we still expect NZD/USD to weaken as NZ/US monetary policy diverges. While the RBNZ is particularly sensitive to NZD now, a recovery in export prices (and the terms of trade) would reduce the central bank’s sensitivity to the currency. Until then the risks are skewed towards further NZD weakness.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
NZD/USD	0.75	0.68	0.64	0.61	0.60	0.59	0.58	0.57
EUR/NZD	1.44	1.65	1.75	1.82	1.87	1.97	2.00	2.05
AUD/NZD	1.02	1.14	1.10	1.13	1.13	1.14	1.16	1.18
NZD/CAD	0.95	0.85	0.85	0.83	0.80	0.78	0.76	0.74

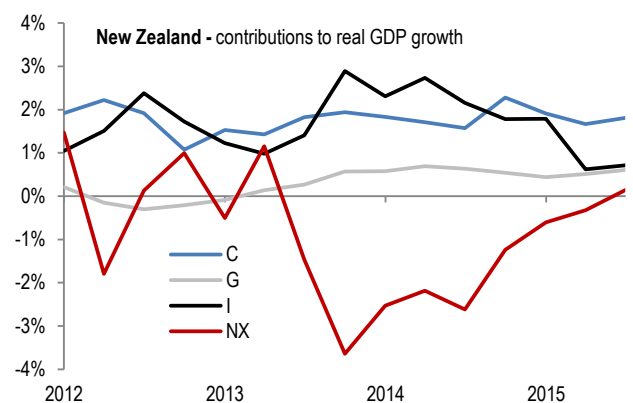
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	3.00% (3.25%)
Trend interest rates 10yr average	5.40%
Bias in interest rate market	Downward
CPI Inflation %Y/Y Q2 (Q1)	0.3% (0.1%)
Inflation target	1.0-3.0%
Budget balance % GDP FY15E/FY14	-0.1%/-0.45%
Budget balance target % GDP	Balanced over business cycle
GDP Growth %Y/Y Q1 (Q4)	2.6% (3.5%)
Trend GDP %Y/Y	3.1%
Purchasing Power Parity Value Q2	0.6527
NZD/USD end-Sep	0.6447
Valuation	NZD/USD is fairly valued
Current account balance % GDP Q1 (Q4)	-3.6% (-3.3%)
Trend current account balance % GDP	-4.8%
Moody's Foreign Currency Rating	Aaa
Outlook	Stable

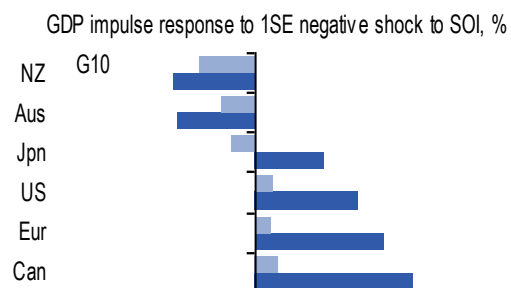
* Current is latest month, quarter or year

1. NZ has been less reliant on external demand



Source: RBC Capital Markets; Haver

2. El Nino a risk to NZ economic outlook



Source: Cashin, Mohales and Raissi, RBC Capital markets

Chinese Yuan

Sue Trinh

1-3 Month Outlook – Further easing is needed

Volatility has eased back from the initial spike seen following the devaluation, but is still some way from returning to pre-devaluation levels, which we attribute to the general elevation in global risk aversion indicators. Most activity indicators in September continue to highlight the challenging economic backdrop. Although the trade surplus was wider than expected at USD60.2bn (cons: USD48.0bn), it was thanks to a 13.8% contraction in annual import growth (cons: -7.9%/y), which far outweighed the marginally better than expected contraction in annual export growth (-5.5%, cons: -6.6%). Annual PPI deflation is at a pace last seen in 2011. Flash manufacturing PMI came in at 47 (cons: 47.5, previous: 47.3), which was the lowest reading on record and seventh straight month in contractionary territory. We have grown increasingly worried by increasing evidence that the labour market is coming under increasing stress. Labor demand continues to outstrip supply, but the Q2 reading of 1.06 represented a sharp drop from the 1.15 reading in Q4, and is the lowest level since Q3 2012. The Manpower Employment Outlook, which measures the difference between the percentage of firms planning to add headcount versus the percentage of firms planning to reduce headcount, fell to 5% in Q4, down from 13% in Q3 and the lowest level since Q1 2009. As the Chinese government has a stated priority for unemployment, further stimulus in the next 1-3 months is expected. We look for further stimulus in the next 1-3 months – a 25bps cut to the 1 year lending rate and at least 50bps in cuts to the RRR.

6 – 12 Month Outlook – USD/RMB higher, but RMB a regional outperformer

By the end of 2016, we expect USD/CNY to be testing 7.0 due to a mix of cyclical USD strength as well as domestic factors. Since the devaluation, we believe PBC have been intervening to maintain the RMB's stability. This intervention cannot continue indefinitely. At the current rate of reserves depletion, we estimate that China has approximately six months before running up against the upper bound of reserve adequacy. Narrowing GDP growth and interest rate differentials also argues for a higher USD/CNY. By the end of 2016, we expect the benchmark 1-year lending rate to be at 4.10% and the RRR (for major banks) to be at 15.5%. Inclusion in the IMF's SDR basket next year should help RMB outperform within the region however.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CNY	6.20	6.21	6.36	6.56	6.70	6.80	6.90	6.95
EUR/CNY	6.65	6.92	7.10	7.28	7.50	7.89	8.00	8.13
CNY/JPY	19.4	19.7	18.9	19.1	19.7	19.0	18.3	17.7
CAD/CNY	4.89	4.97	4.77	4.82	5.00	5.11	5.27	5.35

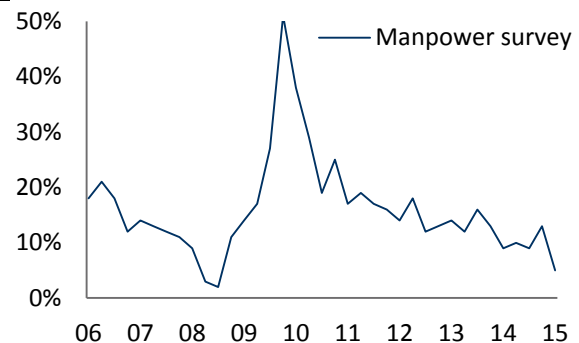
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	1.75% - 4.60% (2.0% - 4.85%)
Trend interest rates (10yr average)	2.85%-6.07%
Bias in interest rate market	Lower
CPI Inflation %Y/Y last (prev)	1.6% (1.4%)
Inflation target	3.0%
Budget balance % GDP last (prev)	-1.78% (-1.80%)
Budget balance trend % GDP	-1.21
GDP Growth % y/y last (prev)	7.0% (7.0%)
Trend GDP %y/y	9.0
RBC-POLAR misalignment	15.6
Spot end-September	6.3560
FX Valuation	Overvalued
Current account balance % GDP last (prev)	2.71% (2.76%)
Trend current account balance % GDP	4.1
Moody's Foreign Currency Rating	Aa3
Outlook	Stable

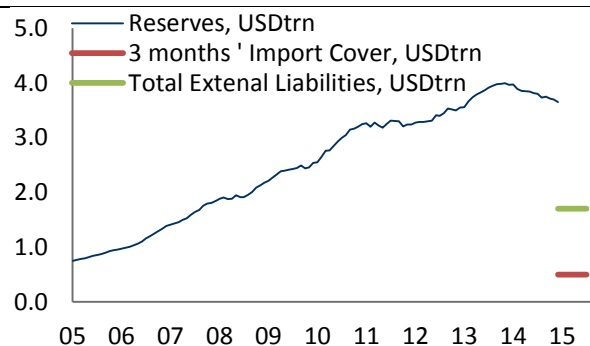
* Current is latest month, quarter or year

1. Labour market stress



Source: RBC Capital Markets; Manpower, Bloomberg

2. Reserve adequacy



Source: RBC Capital Markets; CEIC, IMF, Bloomberg

Indian Rupee

Sue Trinh

1-3 Month Outlook – Limited scope for underperformance

With Finance Minister Jaitley stating on 21 September that he wanted “rates to come down”, we, along with consensus, expected RBI to cut rates by 25bps on 29 September. As it turned out, RBI cut rates by a more aggressive 50bps, taking the policy repo rate to 6.75%. Alongside the rate cut, RBI cut its growth forecast for the fiscal year from 7.6% to 7.4% and set a new inflation target of around 5% by March 2017. With the government constrained by its fiscal targets, the onus was on the RBI to do the heavy lifting and we were impressed with this pre-emptive policy action, which places the RBI ahead of the curve. The RBI will maintain an accommodative stance, but the front loaded rate cut in September has reduced the odds of further easing in the next 1-3 months.

6 – 12 Month Outlook –INR a relative outperformer, implementation of the reform agenda crucial

We expect INR to be one of the outperformers in the region. India is among the best positioned in Asia to benefit from lower oil prices and it is also relatively insulated from China’s economic growth slowdown (from a trade perspective) with exports to China accounting for just ~5% of India’s total exports in 2014. We think the bigger issue for INR watchers is the progress of structural reform or lack thereof. India has an historically disappointing investment cycle related to land, labour and tax issues. Since late August, key reform bills have suffered major setbacks. Modi allowed the temporary executive order on land acquisition to lapse after failing to secure enough support. He also abandoned the plan to call a special session of parliament to secure approval for implementing GST, which means likely delay to the April 2016 “deadline” for rolling out the GST. Finally, major strikes and protesting took place against Modi’s Labour reform plans in early September. Reforms on tax, labour and land are all crucial if India is to attract FDI. Again, RBI is doing its part to help, announcing a range of measures to liberalise financial markets. For example, it increased the current USD30bn limit for foreign investment in govt bonds by USD18bn (by March 2018 in stages; currently fully utilized and up to 5% of outstanding). Meantime, the coming Pay Commission Report, where employee salaries are linked to performance, could help in lifting domestic demand and productivity meaningfully.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/INR	62.3	63.6	65.6	67.0	67.0	68.5	69.5	71.0
EUR/INR	66.9	70.9	73.3	74.4	75.0	79.5	80.6	83.1
INR/JPY	1.93	1.93	1.83	1.87	1.97	1.88	1.81	1.73
CAD/INR	49	51	49	49	50	52	53	55

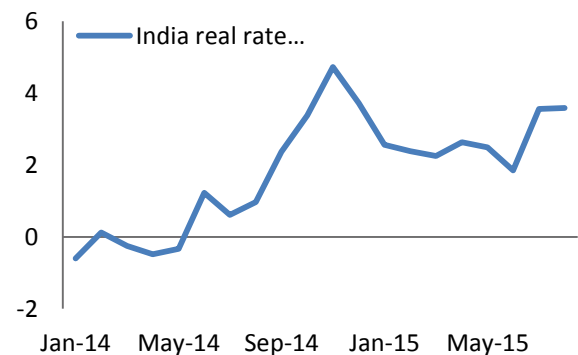
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate (Repurchase Rate)	6.75% (7.25%)
Trend interest rates (10yr average)	6.75%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	3.66% (3.69%)
Inflation target	5% by FY-end 2016/17
Budget balance % GDP last (prev)	-4.82% (-5.00%)
Budget balance trend % GDP	-5.15
GDP Growth % y/y last (prev)	7.0% (7.5%)
Trend GDP %y/y	6.4
RBC-POLAR misalignment	-7.1
Spot end-September	65.59
FX Valuation	Undervalued
Current account balance % GDP last (prev)	-1.27% (-1.36%)
Trend current account balance % GDP	-1.35%
Moody's Foreign Currency Rating	Baa3
Outlook	Positive

* Current is latest month, quarter or year

1. India real interest rates



Source: RBC Capital Markets; Bloomberg

2. Historical difficulty doing business in India

Ease of Doing Business Ranking - World Bank	
Singapore	1
HK	2
Malaysia	18
Taiwan	19
Thailand	26
Vietnam	78
China	90
Philippines	95
Indonesia	114
India	142/189

Source: RBC Capital Markets; Bloomberg

South Korean Won

Sue Trinh

1-3 Month Outlook – More signs the June cut was BoK’s last, consolidation in KRW playing out

The Bank of Korea kept its benchmark rate steady on 11 September, as widely expected. Alongside the decision, BoK Governor Lee said growth is still likely to hit the Bank’s 2.8% target this year. His comments that the current benchmark interest rate hasn’t reached the “lower limit” fuelled expectations of further rate cuts, but we note the BoK’s subsequent clarification that those comments were “(not) a rate cut signal” was important.

Fundamentally, we have been encouraged by signs CPI inflation is basing (August: 0.2%*m/m*, 0.7%*y/y*). But inflation remains low and well below the BoK’s target band of 2.5 to 3.5%, which will be revised shortly.

The BoK’s Monetary Policy Committee last lowered the Base Rate by 25bps, from 1.75% to 1.50% in June. We think this should be the last in the cycle. With inflation basing, the supplementary budget (KRW12trn, 0.8% of GDP) to counter the economic fallout from the MERS outbreak and sharp decline in the KRW REER, we think it is enough to keep BoK on hold through the rest of 2015. The September Business Survey showed continued recovery in confidence. Manufacturing confidence rose from a 3.5 year low of 67 in July to 71, while non-manufacturing confidence also increased from an 11-month low of 66 to 73.

6 – 12 Month Outlook –Grinding weakness in KRW

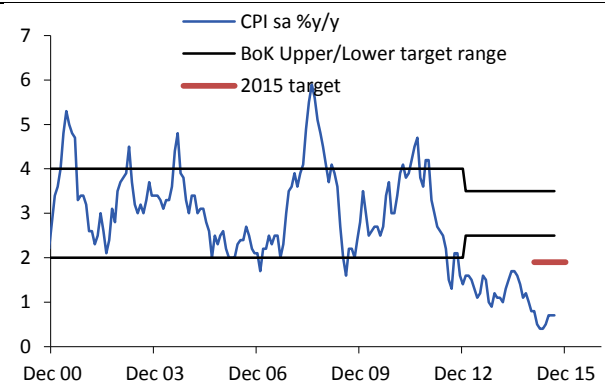
KRW is one of the biggest potential losers from continued JPY and CNY weakness, which we expect. South Korea has the highest export correlation and lowest export complementarity with Japan and China. BoK forecasts inflation of 0.9% this year and 1.8% in 2016. We see downside risk to the 2016 projections. In early September, Finance Minister Choi Kyung-hwan announced the government had cut its forecast for growth in 2016 from 3.5% to 3.3% due to risks from China’s slowdown. We anticipate grinding weakness for KRW after a period of consolidation in the shorter-term.

Indicators

	Current (Previous)*
Official cash rate	1.50% (1.5%)
Trend interest rates (10yr average)	3.45%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	0.6% (0.7%)
Inflation target	0.9% in 2015, 1.8% in 2016
Budget balance % GDP last (prev)	-0.62% (-0.40%)
Budget balance trend % GDP	2.18
GDP Growth % y/y last (prev)	2.2% (2.5%)
Trend GDP %y/y	4.1
RBC-POLAR misalignment	-5.1%
Spot end-September	1,185.29
FX Valuation	Undervalued
Current account balance % GDP last (prev)	7.31% (6.92%)
Trend current account balance % GDP	2.51%
Moody’s Foreign Currency Rating	Aa3
Outlook	Positive

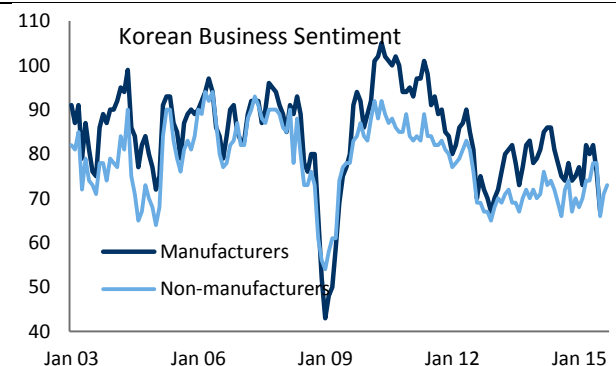
* Current is latest month, quarter or year

1. CPI inflation basing



Source: RBC Capital Markets, BoK, Bloomberg

2. Business confidence basing



Source: RBC Capital Markets; BoK, Bloomberg

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/KRW	1109	1120	1185	1200	1210	1240	1270	1310
EUR/KRW	1190	1249	1325	1332	1355	1438	1473	1533
JPY/KRW	9.2	9.1	9.9	9.6	9.2	9.6	10.1	10.7
CAD/KRW	874	896	890	882	903	932	969	1008

Source: RBC Capital Markets estimates

Singaporean Dollar

Sue Trinh

1-3 Month Outlook – MAS easing in October

Singapore's CPI fell in August for the tenth consecutive month (-0.8%, cons: -0.6%/y, previous:-0.4%) to the lowest since 2009. We think there is a non-negligible risk of Singapore slipping into technical recession following the weaker than expected industrial production numbers in July (-6.1%/y). Singapore's key electronics and pharmaceuticals sectors are buckling under the combined weight of weak demand, both domestically and externally.

We continue to think there are significant downside risks to MAS's inflation and growth forecasts. MAS's 2015 GDP growth forecast of 2–4% appears a little too optimistic. SME business confidence underscores our concerns. Confidence is at the lowest level since 2013 with an uncompetitive exchange rate and waning external growth momentum.

MAS decided to maintain its policy of a modest and gradual appreciation of the S\$NEER policy band in April with no change to the slope and width of the policy band, and the level at which it is centred. But we think there remains a significant risk the MAS will be forced to ease monetary policy, on or before the next scheduled Monetary Policy Statement in October.

6 – 12 Month Outlook – Underperformance entrenched

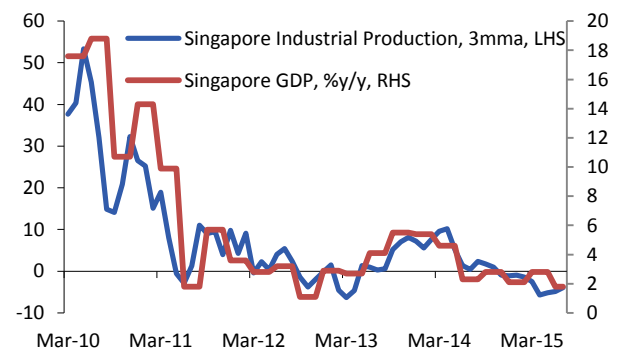
We maintain an underweight SGD view. The combination of low implied volatility and low yield renders SGD as a very attractive funding currency for high yielding Asian FX and we expect SGD underperformance to become more entrenched in the longer term, particularly if the Fed begins its tightening cycle in December, as our US Strategists expect.

Indicators

	Current (Previous)*
Official S\$NEER Target	Modest & gradual appreciation
Trend interest rates (10yr average)	1.20%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	-0.4% (-0.3%)
Inflation target	Price stability (-0.5-0.5%/y)
Budget balance % GDP last (prev)	1.07% (1.33%)
Budget balance trend % GDP	0.69
GDP Growth % y/y last (prev)	1.8% (2.8%)
Trend GDP %y/y	5.4
RBC-POLAR misalignment	3.9%
Spot end-September	1.4240
FX Valuation	Overvalued
Current account balance % GDP last (prev)	23.13% (21.89%)
Trend current account balance % GDP	23.13
Moody's Foreign Currency Rating	Aaa
Outlook	Stable

* Current is latest month, quarter or year

1. Technical recession looming?



Source: RBC Capital Markets; Bloomberg

2. Headline CPI inflation below MAS target



Source: RBC Capital Markets; MAS, Bloomberg

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/SGD	1.37	1.35	1.42	1.45	1.48	1.53	1.57	1.60
EUR/SGD	1.47	1.50	1.59	1.61	1.66	1.77	1.82	1.87
SGD/JPY	87.5	90.9	84.3	86.2	89.2	84.3	80.3	76.9
CAD/SGD	1.08	1.08	1.07	1.07	1.10	1.15	1.20	1.23

Source: RBC Capital Markets estimates

Indonesian Rupiah

Sue Trinh

1-3 Month Outlook – Upside risk to interest rate expectations

Consensus expects BI to cut its benchmark interest rates by 50bps to 7% in 2016. However, we think BI Governor Martowardojo was explicit in August in saying BI expects the benchmark rate at 7.5% for next year, that IDR was undervalued and a joint policy effort from both BI and the government was required to stabilize the economy and the IDR.

We see upside risk to market expectations of further BI easing since CPI Inflation remains well above target. In addition, foreign investors' share of outstanding Indonesian government bonds increased to a record 39.6% in June, one of the highest shares in the region and real interest rates are barely positive. BI must remain vigilant against inflation and a renewed widening of the current account deficit. While BI cut its forecast for 2016 economic growth to 5.2-5.6% from 5.3-5.7% previously, we don't think this is significant enough to alter our view on BI rates.

6 – 12 Month Outlook – Reform progress key to IDR, Widodo has bought some time

President Widodo continues to struggle within Parliament, not least because of his coalition's lack of a majority and underperforming ministers, despite a Cabinet reshuffle. This is preventing meaningful progress with reforms and infrastructure spending. But he has bought himself some time with the government announcing a comprehensive stimulus plan in August, aimed at increasing foreign investment, lifting exports, growth and IDR. So far, the government has announced tax holidays of between 5 and 15 years to new companies investing at least IDR1trn across a wide range of industries. Ministers are currently assessing regulations that are impeding investment before a policy package is issued on that front. BI expects GDP growth to increase from 4.9% in 2015 to 5.54% in 2016.

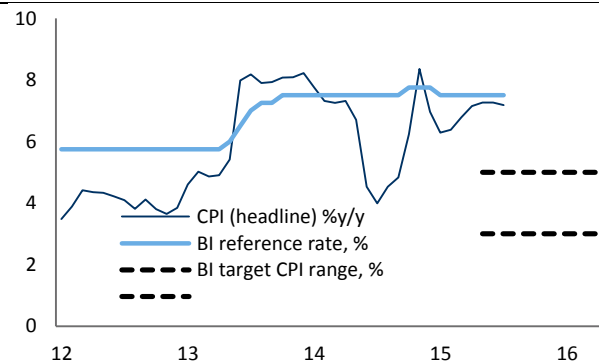
There is an expectation is that infrastructure spending will pick up in H2 and we will be monitoring this closely, along with developments in local politics and whether the President is able to move forward with key infrastructure projects as the key to our IDR outlook.

Indicators

	Current (Previous)*
Official cash rate (Repurchase Rate)	7.50% (7.50%)
Trend interest rates (10yr average)	7.63
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	6.83% (7.18%)
Inflation target	4%+/-1.0%
Budget balance % GDP last (prev)	2.2% (1.9%)
Budget balance trend % GDP	-1.39
GDP Growth % y/y last (prev)	4.67% (4.72%)
Trend GDP %y/y	5.5
RBC-POLAR misalignment	1.4%
Spot end-September	14,653
FX Valuation	Neutral
Current account balance % GDP last (prev)	-2.48% (-3.03%)
Trend current account balance % GDP	1.33
Moody's Foreign Currency Rating	Baa3
Outlook	Stable

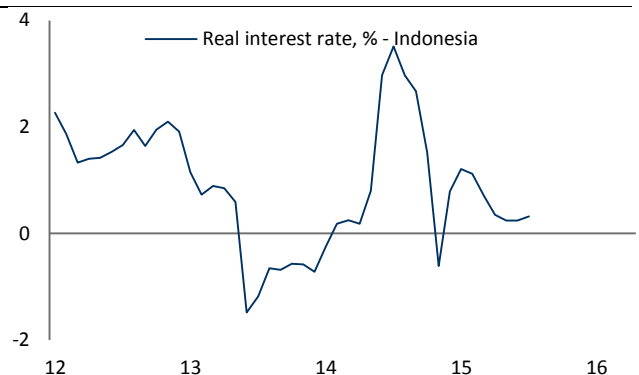
* Current is latest month, quarter or year

1. Foreign investors have piled into IDR debt



Source: RBC Capital Markets; BI, Bloomberg

2. Real interest rates barely positive



Source: RBC Capital Markets; BI, Bloomberg

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/IDR	13071	13351	14603	14500	14600	14900	15200	15600
EUR/IDR	14026	14882	16322	16095	16352	17284	17632	18252
JPY/IDR	108.8	109.0	121.8	116.0	110.6	115.5	120.6	126.8
CAD/IDR	10303	10686	10969	10662	10896	11203	11603	12000

Source: RBC Capital Markets estimates

Turkish Lira

1-3 Month Outlook – Another election

On November 1, Turkey will be heading for another round of parliamentary elections. The latest batch of Konda polls indicates results will not be meaningfully different from the last round of general elections in the summer. The incumbent AKP should reach 41.7% of the vote, social democrat CHP 24.8%, nationalistic movement MHP 16.4% and pro-Kurd party HDP at 12.3%. Thus, the most likely outcome is a hung parliament without a clear majority.

We are working with three possible scenarios: AKP reaches a simple majority, AKP-CHP and AKP-MHP coalitions. A simple AKP majority might be positive in the near term because markets might feel reassured by continuity. Nevertheless, in the medium term, we would be concerned about President Erdogan legacy. Erdogan has been looking for ways to perpetrate his dominance in Turkish politics. Following the elections, we are unsure whether a combination of Erdogan and PM Davutoglu at the helm of the coalition will be sustainable. Moreover, Erdogan may resume CBT bashing, pushing the central bank to ease while inflation remains a concern.

AKP-CHP coalition might be a concern in the near future because many investors fear it will not be sustainable. Many think CHP will try to prosecute Erdogan's close allies, which may break the alliance fairly soon. We disagree - this might be the most realistic outcome. AKP-MHP coalition is most concerning as it could drive escalation higher within the region given the uncertainty in relation to the peace process with the Kurds. Just like the CHP, MHP members may also strive to prosecute Erdogan's allies for corruption relatively soon, which may also break the coalition apart.

6-12 Month Outlook – Overshooting

Using our POLAR valuation framework, we estimated the extent of undershooting to take place across EMFX. For the TRY, we find that it may bottom at 33% undervaluation. This leaves an additional 26% of potential devaluation. The bottom of this cycle could be reached shortly, within the next 3-6 months with a recovery thereafter. We estimate USD/TRY to peak at 3.40 around next summer and appreciate thereafter. The backdrop for this outcome should be high external debt accumulated over the past five years of large current account deficits. The ratio of external debt to FX reserves in Turkey is one of the most concerning across all EM. Furthermore, CBT continues to run a policy mix of low real interest rates, which undermines the inflation targeting regime.

Forecasts

	2015				2016			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/TRY	2.60	2.68	3.03	3.15	3.25	3.35	3.40	3.10
EUR/TRY	2.79	2.99	3.38	3.50	3.64	3.89	3.94	3.63
TRY/JPY	46.3	45.7	39.6	39.7	40.6	38.5	37.1	39.7

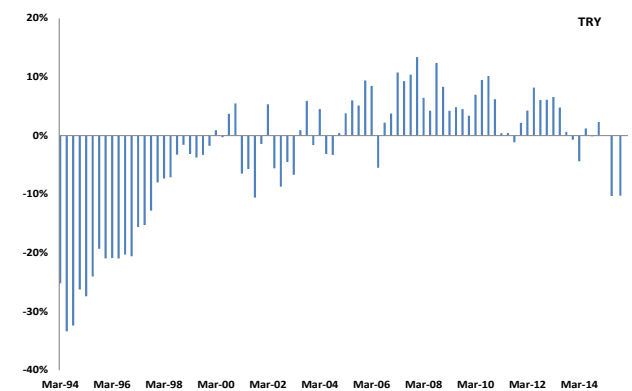
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	7.5 (7.5)
Trend interest rates (10yr average)	6.25
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	7.14 (6.81)
Inflation target	5.00%
Budget balance % GDP last (prev)	-1.06 (-1.55)
Budget balance trend % GDP	-2.16
GDP Growth % y/y last (prev)	3.78 (2.49)
Trend GDP %y/y	4.56
RBC-POLAR misalignment	-10.25%
Spot	2.99
FX Valuation	Undervalued
Current account balance % GDP last	-5.86 (-5.84)
Trend current account balance % GDP	-5.83
Moody's Foreign Currency Rating	Baa3
Outlook	Negative

* Current is latest month, quarter or year

1. RBC-POLAR: TRY



Source: RBC Capital Markets estimates, Bloomberg

2. EMEA valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
RUB	-15.2%	-19.5%	Oct-16	13	-5%
TRY	-10.2%	-33.4%	Oct-15	1	-26%
PLN	-5.1%	-16.9%	Apr-16	7	-12%
ZAR	-18.8%	-29.6%	Jul-17	22	-13%
ILS	6.2%	-10.0%	Jan-17	16	-15%
HUF	-6.2%	-16.6%	Jan-17	16	-11%
CZK	-5.2%	-34.5%	Apr-16	7	-31%

Source: RBC Capital Markets estimates

Russian Ruble

Daniel Tenengauzer and Daria Parkhomenko

1-3 Month Outlook – CBR to err on the side of caution

We believe CBR will remain on hold at its October 30 meeting if headline inflation y/y continues to rise and USD/RUB remains above 65. The key rate is at 11.0%, while August inflation came in at 15.8% y/y. CBR expects headline to decline to 12-13% y/y in December. Meanwhile, USD/RUB has averaged ~66 in the past two months. In our opinion, CBR would not want to cut rates and then have to hike again. Therefore, we expect CBR to err on the side of caution and resume its rate cuts if USD/RUB stays above 65.

Real wages y/y have continued to deteriorate, reaching -9.8% in August. Inflation remains high and wage indexation is frozen for public employees in 2015. Thus, it is not likely real wages growth will experience significant improvement if any for the rest of this year. This may strain consumer confidence and exert downward pressure on household consumption. This is likely to mitigate inflationary pressures.

However, this will come at the expense of economic growth. The breakdown for Q2 GDP y/y is not yet available. Based on the breakdown for Q1 GDP, the only positive contribution came from net exports while consumption had a negative contribution. Given that retail sales y/y (Aug. = -9.1%) have been contracting since January, consumer confidence remains negative, and real wages are contracting, domestic demand is not likely to pick up either.

Thus, economic growth will continue to depend on net exports. The trade balance is in surplus. Yet, it has been shrinking as both imports and exports y/y are contracting. Unlike previous months of contraction, exports y/y contraction of 40.2% was almost in line with the contraction of imports y/y of 41.9% in July. This is despite the ruble weakening in July. Given Russia's reliance on net exports, this is worrisome. A reliance on external demand makes it even more vulnerable to external conditions.

6-12 Month Outlook – USD/RUB lower

In the long-term, we expect USD/RUB to experience a gradual move lower. We are expecting CBR to resume cutting to ease financing, which will support investment and economic growth. As of September, CBR is expecting GDP to contract 3.9-4.4% y/y in 2015 and 0.5-1.0% y/y in 2016.

Our RBC-POLAR model shows the trade weighted ruble currently undervalued at 15%. According to our overshooting framework, the ruble is close to the bottom of its undervaluation, supporting our view for USD/RUB lower.

Forecasts

	2015				2016			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/RUB	58.2	55.3	65.5	65.0	63.0	61.0	61.0	61.0
EUR/RUB	62.5	61.7	73.2	72.2	70.6	70.8	70.8	71.4
RUB/JPY	2.06	2.21	1.83	1.92	2.10	2.11	2.07	2.02

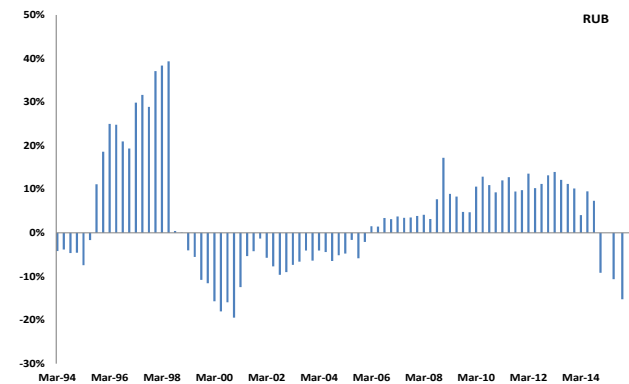
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	11 (11)
Trend interest rates (10yr average)	9.63
Bias in interest rate market	easing
CPI Inflation %Y/Y last (prev)	15.8 (15.6)
Inflation target	4.0%
Budget balance % GDP last (prev)	-2.91 (-1.99)
Budget balance trend % GDP	1.85
GDP Growth % y/y last (prev)	-4.6 (-2.2)
Trend GDP %y/y	3.40
RBC-POLAR misalignment	-15.22%
Spot	66.39
FX Valuation	Undervalued
Current account balance % GDP last	5.43 (4.53)
Trend current account balance % GDP	5.79
Moody's Foreign Currency Rating	Ba1
Outlook	Negative

* Current is latest month, quarter or year

1. RBC-POLAR: RUB



Source: RBC Capital Markets estimates, Bloomberg

2. EMEA valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
RUB	-15.2%	-19.5%	Oct-16	13	-5%
TRY	-10.2%	-33.4%	Oct-15	1	-26%
PLN	-5.1%	-16.9%	Apr-16	7	-12%
ZAR	-18.8%	-29.6%	Jul-17	22	-13%
ILS	6.2%	-10.0%	Jan-17	16	-15%
HUF	-6.2%	-16.6%	Jan-17	16	-11%
CZK	-5.2%	-34.5%	Apr-16	7	-31%

Source: RBC Capital Markets estimates

South African Rand

Daniel Tenengauzer

1-3 Month Outlook – Low inflation for now

The source of lower than expected inflationary pressures remains unclear. Exchange rate depreciation and a significantly undervalued rand should be pulling inflation back above 5%. Nevertheless, the latest reading for August was below expectations at 4.6% y/y against 4.8% y/y for consensus. The slack in the job market could be partially to blame. Power consumption is also declining, which should be a boon given the ESKOM debacle and its constraints.

Core inflation remains at 5.3% y/y, suggesting the impact of lower commodity prices on headline could be transitory. We believed SARB would follow up with an additional hike at its September meeting after the surprising decision to hike in the previous gathering. We did not expect that inflation data out the day of the decision would be released as low as it was. We believe that exchange rate pass-through may raise inflation later this year. SARB will likely therefore tighten an additional 25bp at the November 19 monetary policy meeting. Currency volatility will likely be to blame on the decision. SARB's FX reserves holdings remain insufficient to stave off excessive positioning at extreme daily trading behavior. The key critical factor tilting the SARB either way will be Q3 preliminary activity data. There is a high probability of negative growth as a result of weak external and domestic demand.

6-12 Month Outlook – Still far from stability

We performed an empirical exercise to better understand peaks and troughs across POLAR valuation cycles. We collected half-cycle data across a sample of 33 currencies in the past 22 years using quarterly data. Even though we find that the rand is one of the most undervalued currencies across our EMFX sample, it may weaken further. According to the model, it is currently undervalued by 18%.

The model history shows that it may undershoot to as much as -30%, suggesting additional 10-12% devaluation. The model shows that this weakness may carry on throughout 2016 and into 2017. We have internalized these findings into our forecasts and now expect a peak of 15.50 by the middle of next year and a recovery thereafter. SARB's hawkish stance may help cushion some of this weakness. We believe it may opt to tighten more aggressively once the rand breaks 15.00.

Forecasts

	2015				2016			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/ZAR	12.1	12.2	13.9	14.5	14.8	15.0	15.5	14.5
EUR/ZAR	13.0	13.6	15.5	16.1	16.5	17.4	18.0	17.0
ZAR/JPY	9.90	10.07	8.65	8.62	8.95	8.60	8.13	8.48

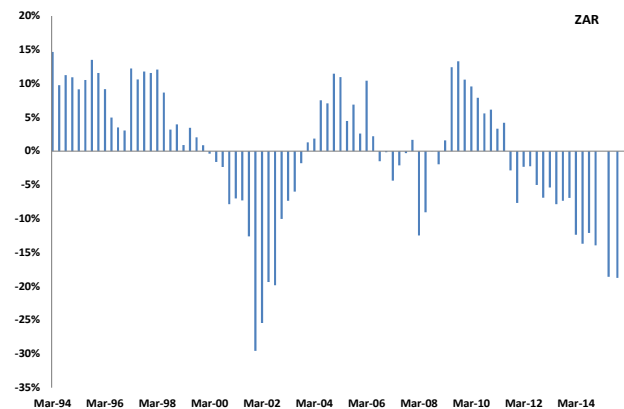
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	6 (6)
Trend interest rates (10yr average)	7.13
Bias in interest rate market	flat
CPI Inflation %Y/Y last (prev)	4.6 (5)
Inflation target	3.0%-6.0%
Budget balance % GDP last (prev)	-4.09 (-4.12)
Budget balance trend % GDP	-2.79
GDP Growth % y/y last (prev)	1.2 (2.1)
Trend GDP %y/y	3.00
RBC-POLAR misalignment	-18.77%
Spot	13.73
FX Valuation	Undervalued
Current account balance % GDP last	-3.1 (-4.7)
Trend current account balance % GDP	-4.84
Moody's Foreign Currency Rating	Baa2
Outlook	Stable

* Current is latest month, quarter or year

1. RBC-POLAR: ZAR



Source: RBC Capital Markets estimates, Bloomberg

2. EMEA valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
RUB	-15.2%	-19.5%	Oct-16	13	-5%
TRY	-10.2%	-33.4%	Oct-15	1	-26%
PLN	-5.1%	-16.9%	Apr-16	7	-12%
ZAR	-18.8%	-29.6%	Jul-17	22	-13%
ILS	6.2%	-10.0%	Jan-17	16	-15%
HUF	-6.2%	-16.6%	Jan-17	16	-11%
CZK	-5.2%	-34.5%	Apr-16	7	-31%

Source: RBC Capital Markets estimates

Polish Zloty

1-3 Month Outlook – Volatility

We expect NBP to remain on hold in the short-term on the back of EUR/PLN staying well above 4.00. We believe this is the case despite inflation surprising to the downside. In fact, NBP stated in its Minutes from [September 2](#) – “in the coming months it could be justified to consider raising interest rates.”

Headline inflation has deteriorated with preliminary Sept. inflation at -0.8% y/y. This was below expectations and inflation has remained negative since July 2014.

Meanwhile, EUR/PLN has stayed well above 4.18 the past month, which may help increase inflationary pressures. According to NBP Governor Belka, inflation is likely to turn positive in November/December. This is close to our inflation seasonality model’s estimates.

Additionally, 12-month consumer inflation expectations have risen, currently at 0.23% y/y. Prior to this figure, expectations were on average at 0.18% year-to-date.

Assuming NBP remains neutral in the short-term and ECB announces an extension of its QE program (our European economists are forecasting an extension announcement in December), interest rate differentials between EU and Poland local fixed income interest rates may widen. This may attract investor interest in Polish assets, supporting our view for EUR/PLN lower.

In July, Poland experienced an inflow of capital, but this was a result of residents bringing their capital back home whereas foreign investment fell. Given that foreign ownership of Poland’s banking industry remains high, we are tracking the status of potential taxes on banks that may be approved after parliamentary elections as this may negatively impact foreign investment.

6-12 Month Outlook – Gradual appreciation

According to RBC-POLAR, PLN is close to fair value, currently at -3%. Market consensus is forecasting growth at 3.50% for both 2015 and 2016 and headline inflation to increase in 2016. The unemployment rate has continued to show improvement, declining to 10.0%.

Meanwhile, Poland approved a budget deficit for 2016 at PLN 55bn. This is above the deficit level of PLN 46bn planned for this year.

Lastly, the majority of the MPC board is leaving in early 2016. This may affect monetary policy decisions in the long-term. Although we do not have a strong opinion yet on stance, we do believe the MPC will first aim to establish credibility upfront.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/PLN	4.07	4.19	4.25	4.25	4.20	4.10	4.05	4.00
USD/PLN	3.80	3.76	3.80	3.83	3.75	3.53	3.49	3.42
PLN/HUF	73.7	75.3	73.8	72.9	73.8	74.4	74.1	73.8

Source: RBC Capital Markets estimates

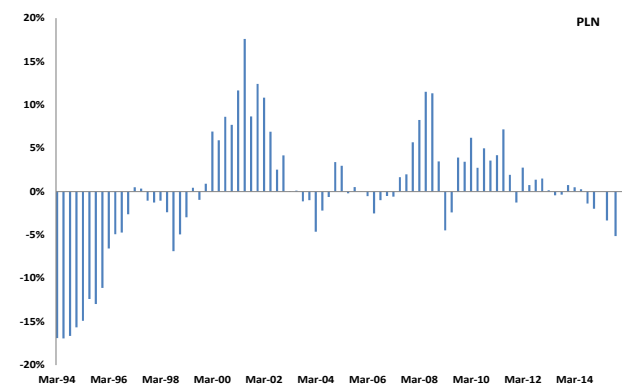
Daniel Tenengauzer and Daria Parkhomenko

Indicators

	Current (Previous)*
Official cash rate	1.5 (1.5)
Trend interest rates (10yr average)	4.05
Bias in interest rate market	flat
CPI Inflation %Y/Y last (prev)	-0.8 (-0.6)
Inflation target	2.5% (+/-1%)
Budget balance % GDP last (prev)	-4.3 (-3.9)
Budget balance trend % GDP	-4.92
GDP Growth % y/y last (prev)	3.3 (3.6)
Trend GDP %y/y	3.79
RBC-POLAR misalignment	-5.13%
Spot (EUR/PLN)	4.25
FX Valuation	Undervalued
Current account balance % GDP last	1.05 (0.9)
Trend current account balance % GDP	-3.58
Moody's Foreign Currency Rating	A2
Outlook	Stable

* Current is latest month, quarter or year

1. RBC-POLAR: PLN



Source: RBC Capital Markets estimates, Bloomberg

2. EMEA valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
RUB	-15.2%	-19.5%	Oct-16	13	-5%
TRY	-10.2%	-33.4%	Oct-15	1	-26%
PLN	-5.1%	-16.9%	Apr-16	7	-12%
ZAR	-18.8%	-29.6%	Jul-17	22	-13%
ILS	6.2%	-10.0%	Jan-17	16	-15%
HUF	-6.2%	-16.6%	Jan-17	16	-11%
CZK	-5.2%	-34.5%	Apr-16	7	-31%

Source: RBC Capital Markets estimates

Hungarian Forint

1-3 Month Outlook – On hold above EUR/HUF 300

We believe NBH will remain on hold at its next policy rate meeting if EUR/HUF remains well above 300. Below this, we expect NBH to cut as deflationary pressures may rise from a stronger HUF and negatively impact terms of trade.

It seems NBH is rather open to a higher EUR/HUF – “the weaker real exchange rate may also support a further increase in Hungary’s export market share” ([Inflation Report](#)). Terms of trade have improved since mid-2014. Net exports growth was a significant share of Q2 GDP. Its contribution had declined compared to Q1, but it was still 2pp to Q2 real GDP growth of 2.7% y/y. NBH estimates exports and imports to grow this year at 7.9% y/y and 7.6% y/y. Thus a weaker HUF is favorable to Hungary.

However, we expect the probability of NBH cutting its policy rate to increase if (1) inflation continues to deteriorate, (2) GDP growth surprises to the downside, and (3) ECB extends its QE program.

Headline inflation y/y has continued to trend lower, reaching 0.0% y/y in August. NBH has revised its inflation forecast, increasing the amount of time it will take inflation to reach its target level of 3% by two quarters. Meanwhile, NBH expects real GDP y/y to remain robust at 3.2% and 2.5% in 2015 and 2016. However, Hungary’s dependence on net exports for growth makes it more vulnerable to deterioration in the external environment.

Additionally, NBH cites that household consumption may help drive growth going forward. With inflation non-existent and expectations for reduction in income tax, consumers’ purchasing power should increase. Household FX loans have declined by HUF 3.687trn from Q4 2014 to Q2 2015, reducing household vulnerability to FX risks. However, a further decline in total (FX and local) consumer credit outstanding (declined by HUF 680bn from Q4 2014 to Q2) and a [lack of decline in the savings rate](#) may pose downside risks to domestic demand and push NBH to cut.

Lastly, our European economists are expecting an extension to ECB’s QE program. This may widen the spread between HUF and EU local fixed income rates, driving EUR/HUF lower and potentially pushing NBH to cut.

6-12 Month Outlook – EUR/HUF lower

We still forecast EUR/HUF lower on the back of improving fundamentals, but the probability of a more gradual HUF appreciation against the EUR has risen. According to Mihály Varga, Minister for National Economy, the VW scandal may decrease GDP growth by 0.3% to 0.6% of GDP. He has also cited that Hungary may need to change its estimates for the budget deficit to account for migration costs.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/HUF	300	315	313	310	310	305	300	295
USD/HUF	280	283	280	279	277	263	259	252
PLN/HUF	73.7	75.3	73.8	72.9	73.8	74.4	74.1	73.8

Source: RBC Capital Markets estimates

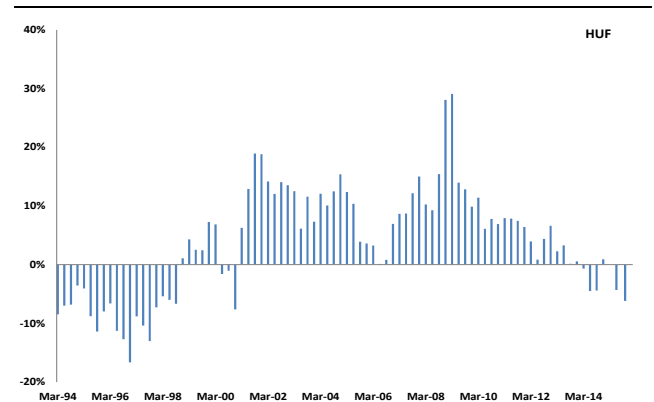
Daniel Tenengauzer and Daria Parkhomenko

Indicators

	Current (Previous)*
Official cash rate	1.35 (1.35)
Trend interest rates (10yr average)	6.07
Bias in interest rate market	flat
CPI Inflation %Y/Y last (prev)	0 (0.4)
Inflation target	3% (+/- 1%)
Budget balance % GDP last (prev)	-2.2 (-2.1)
Budget balance trend % GDP	-4.66
GDP Growth % y/y last (prev)	2.7 (3.5)
Trend GDP %y/y	0.90
RBC-POLAR misalignment	-6.18%
Spot (EUR/HUF)	313
FX Valuation	Undervalued
Current account balance % GDP last	2.94 (2.26)
Trend current account balance % GDP	-4.42
Moody's Foreign Currency Rating	Ba1
Outlook	Stable

* Current is latest month, quarter or year

1. RBC-POLAR: HUF



Source: RBC Capital Markets estimates, Bloomberg

2. EMEA valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
RUB	-15.2%	-19.5%	Oct-16	13	-5%
TRY	-10.2%	-33.4%	Oct-15	1	-26%
PLN	-5.1%	-16.9%	Apr-16	7	-12%
ZAR	-18.8%	-29.6%	Jul-17	22	-13%
ILS	6.2%	-10.0%	Jan-17	16	-15%
HUF	-6.2%	-16.6%	Jan-17	16	-11%
CZK	-5.2%	-34.5%	Apr-16	7	-31%

Source: RBC Capital Markets estimates

Czech Koruna

1-3 Month Outlook – Commitment to EUR/CZK floor

We expect CNB to remain committed to its EUR/CZK floor of 27.00. At the beginning of September, EUR/CZK was close to 27.0, but then mid-month, it reversed its decline.

Inflation has continued to deteriorate in August, reaching 0.3% y/y (prior 0.5% y/y). This was slightly below consensus of 0.4% y/y and well below the central bank's lower-bound inflation target range. According to CNB, August inflation continued to deteriorate mostly on the back of lower food prices and partly due to lower energy prices. Our inflation seasonality model shows headline inflation reaching the lower-bound of 1% y/y in Jan'16.

Meanwhile, 2Q F GDP y/y came in at 4.6% y/y. This was slightly above the preliminary estimate of 4.4% y/y. Consensus is forecasting growth to decelerate but to remain robust at 3.7% and 2.7% y/y in 2015 and 2016.

Any deterioration in inflation and economic growth in the Euro area, especially Germany, may pose downside risks to Czech Republic's real GDP growth and headline inflation. Our European economists are forecasting ECB to announce an extension of its QE program in December due to underlying inflation and international developments.

Given that this may drive EUR/CZK lower, we do not rule out CNB building up its FX reserves to weaken the koruna. As we have previously argued, it is in Czech Republic's favor to build up its reserves to cushion its total external debt levels. Based on ST external debt as of Q2 and international reserves as of August 31, ST debt stood at 81% of reserves.

Another risk we will be watching is the developments surrounding the VW scandal given that [Skoda Auto is fully owned](#) by VW (*Skoda Annual Report 2014*, p. 165). This scandal may have a negative impact on Czech Republic's labor markets and foreign direct investment.

6-12 Month Outlook – Testing the floor

In the long-term, we remain bullish on CZK. We expect it to continue testing the EUR/CZK floor of 27.0 on the back of robust fundamentals relative to the euro area. CNB forecasts the government budget deficit to decline from 2.0% in 2014 to 1.4% and 0.6% of GDP in 2015 and 2016, respectively. It also expects government debt to decline from 42.6% in 2014 to 40.7% and 39.3% of GDP in 2015 and 2016.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/CZK	27.55	27.28	27.19	27.30	27.15	27.00	27.00	27.00
USD/CZK	25.68	24.47	24.33	24.59	24.24	23.28	23.28	23.08
PLN/CZK	6.76	6.51	6.40	6.42	6.46	6.59	6.67	6.75

Source: RBC Capital Markets estimates

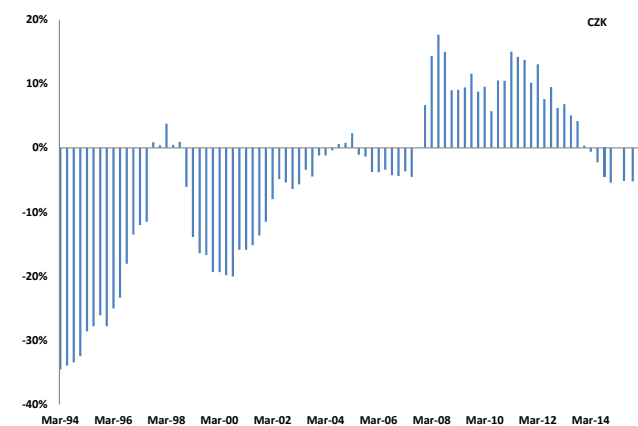
Daniel Tenengauzer and Daria Parkhomenko

Indicators

	Current (Previous)*
Official cash rate	0.05 (0.05)
Trend interest rates (10yr average)	1.41
Bias in interest rate market	flat
CPI Inflation %Y/Y last (prev)	0.3 (0.5)
Inflation target	1%-3%
Budget balance % GDP last (prev)	-1.5 (-4.2)
Budget balance trend % GDP	-3.59
GDP Growth % y/y last (prev)	0.3 (0.7)
Trend GDP %y/y	2.30
RBC-POLAR misalignment	-5.21%
Spot (EUR/CZK)	27.15
FX Valuation	Undervalued
Current account balance % GDP last	1.54 (0.81)
Trend current account balance % GDP	-2.04
Moody's Foreign Currency Rating	A1
Outlook	Stable

* Current is latest month, quarter or year

1. RBC-POLAR: CZK



Source: RBC Capital Markets estimates, Bloomberg

2. EMEA valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
RUB	-15.2%	-19.5%	Oct-16	13	-5%
TRY	-10.2%	-33.4%	Oct-15	1	-26%
PLN	-5.1%	-16.9%	Apr-16	7	-12%
ZAR	-18.8%	-29.6%	Jul-17	22	-13%
ILS	6.2%	-10.0%	Jan-17	16	-15%
HUF	-6.2%	-16.6%	Jan-17	16	-11%
CZK	-5.2%	-34.5%	Apr-16	7	-31%

Source: RBC Capital Markets estimates

Israeli Shekel

1-3 Month Outlook – Neutral policy

The market has been expecting BoI to ease policies on the back of low inflation. Headline inflation dropped to -0.4% y/y in August against -0.2% for consensus and -0.3% for July. The market forecasts inflation to rise to 0.4% in the coming year, which is well below the target range. The 'S' index, the main activity indicator watched by BoI has been gradually improving since bottoming in the summer of 2014. The war in the south pulled activity to its lowest level since the European sovereign debt crisis. Domestic demand has been gradually catching up since then. Meanwhile, commodity prices are keeping headline inflation extremely well behaved.

Despite this low inflation environment, we do not believe BoI will change its policy stance anytime soon. This is because domestic demand seems stable and fiscal policies may ease into next year. The USD/ILS weakened from 3.50 to close to 4.00. The currency has largely outperformed the vast majority of the EM currencies, mainly because of Israel's higher value added exports. Next, BoI policy makers seem to imply expectations for a likely imminent lift-off in the US. BoI reference rate is only 0.1%, which may trigger USD demand even if there is just a one notch rate hike in the United States.

6-12 Month Outlook – Above 4.00

We performed an empirical exercise to better understand possible overshooting levels across EMFX. For the ILS, we find that it remains one of the more overvalued currencies in EM. This might be largely because it has outperformed mostly Asia currencies and the EUR. Our exercise points to a potential 16% depreciation in the real effective exchange rate, from a current 6% overvaluation, well into the beginning of 2017. We have therefore lifted our forecast path into 2016 to as high as 4.50 by next summer.

We also believe that this overshooting may coincide with a neutral stance at the BoI while the Fed raises its key rate to as much as 0.75% to 1%. Shekel weakness will take place as a combination of both fiscal and monetary easing. Some of the measures proposed recently by the MinFin should enhance productivity and competitiveness significantly. Nevertheless, tax breaks and lower import barriers for agricultural products may raise imports demand. Moreover, lower food prices may keep headline inflation lower for longer, supporting a dovish BoI for quite a while.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/ILS	3.98	3.77	3.92	4.20	4.30	4.50	4.50	4.30
EUR/ILS	4.27	4.21	4.38	4.66	4.82	5.22	5.22	5.03
ILS/JPY	30.2	32.5	30.6	29.8	30.7	28.7	28.0	28.6

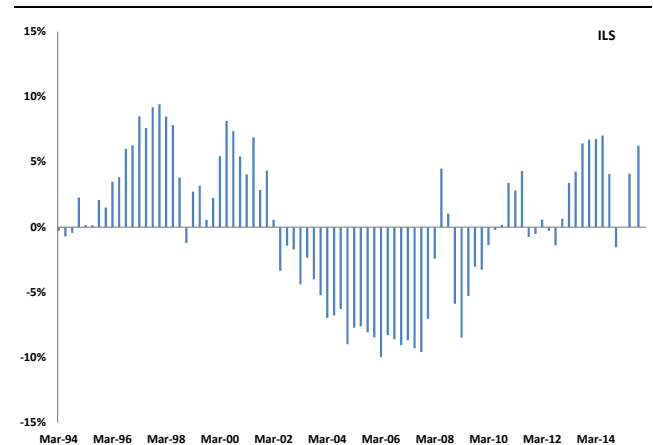
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	0.1 (0.1)
Trend interest rates (10yr average)	2.65
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	-0.4 (-0.3)
Inflation target	1.0% - 3.0%
Budget balance % GDP last (prev)	-3.2 (-3.9)
Budget balance trend % GDP	-2.90
GDP Growth % y/y last (prev)	1.8 (2.9)
Trend GDP %y/y	4.20
RBC-POLAR misalignment	6.25%
Spot	3.909
FX Valuation	Overvalued
Current account balance % GDP last	3.44 (3.87)
Trend current account balance % GDP	3.39
Moody's Foreign Currency Rating	A1
Outlook	Stable

* Current is latest month, quarter or year

1. RBC-POLAR: ILS



Source: RBC Capital Markets estimates, Bloomberg

2. EMEA valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
RUB	-15.2%	-19.5%	Oct-16	13	-5%
TRY	-10.2%	-33.4%	Oct-15	1	-26%
PLN	-5.1%	-16.9%	Apr-16	7	-12%
ZAR	-18.8%	-29.6%	Jul-17	22	-13%
ILS	6.2%	-10.0%	Jan-17	16	-15%
HUF	-6.2%	-16.6%	Jan-17	16	-11%
CZK	-5.2%	-34.5%	Apr-16	7	-31%

Source: RBC Capital Markets estimates

Mexican Peso

1-3 Month Outlook – Neutral Banxico

Inflation has been consistently well behaved. We believe seasonality will eventually catch up between October and November. Data usually shows a catch up into the start of the school year and ahead of the year-end shopping season. Meanwhile, we estimate that the one-off impact of the reforms implemented earlier this year may have had a lasting downward effect at a tune of 50-75bp on the headline. Still, even after reducing this rebate, headline remains below 3.5%. Benign price behavior should keep Banxico from tightening at least until early next year.

Governor Carstens was confirmed by an overwhelming support to stay for an additional six year term until 2021. We were unsure about this outcome as Carstens did express interest in the top job at the IMF and perhaps alternative careers thereafter. The main implication of the re-appointment might be additional support for the ongoing stance. The policy mix is currently of low real interest rates and a weaker peso. Meanwhile, the government is seeking to tighten fiscal policy to offset large oil revenue shortfalls. This was again emphasized in the outline of the 2016 budget. This far in 2015, it appears that exports and consumer spending have been the main growth engines. A weaker peso, low interest rates, and a recovery in the US are helping offset the negative impact of low oil revenues and consequently fiscal tightening.

6-12 Month Outlook – Appreciation

The beginning of the tightening cycle early next year will likely, in our view, help support the peso. We run an overshooting exercise on our POLAR FX valuation model. We sought to better understand peaks / troughs in currency valuations and the extent of half-lives. We find that, on average, currencies would take 32 months from peak overvaluation to bottom undervaluation. We find that the peso is close to its bottom undervaluation.

Assuming the overvaluation peaked in the early part of 2013, it would place the bottom right around the last quarter of this year. In line with our findings, we forecast 17-17.25 to be the peak in USD/MXN and a gradual appreciation next year. The main trigger for this turnaround will likely be the initiation of a tightening cycle, most likely a couple of months after the Fed lift-off in March next year. We expect the policy mix to turn somewhat by then towards tighter money but easier fiscal.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/MXN	15.27	15.74	16.91	17.00	16.50	15.80	15.50	16.00
EUR/MXN	16.38	17.54	18.91	18.87	18.48	18.33	17.98	18.72
MXN/JPY	7.87	7.78	7.09	7.35	8.00	8.16	8.13	7.69
CAD/MXN	12.033	12.596	12.705	12.500	12.313	11.880	11.832	12.308

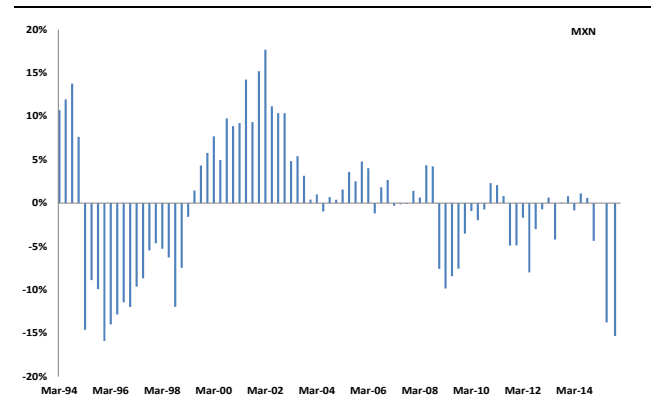
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	3 (3)
Trend interest rates (10yr average)	4.71
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	2.59 (2.74)
Inflation target	3.0 (+/-1%)
Budget balance % GDP last (prev)	-3.68 (-3.38)
Budget balance trend % GDP	-1.43
GDP Growth % y/y last (prev)	2.2 (2.6)
Trend GDP %y/y	2.40
RBC-POLAR misalignment	-15.32%
Spot	16.76
FX Valuation	Undervalued
Current account balance % GDP last	-1.7 (-1.79)
Trend current account balance % GDP	-1.27
Moody's Foreign Currency Rating	A3
Outlook	Stable

* Current is latest month, quarter or year

1. RBC-POLAR: MXN



Source: RBC Capital Markets estimates, Bloomberg

2. LatAm valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
BRL	5.3%	-23.8%	Apr-17	19	-28%
COP	-18.1%	-18.1%	Jul-19	46	0%
MXN	-15.3%	-15.9%	Apr-16	7	-1%
CLP	-10.1%	-12.9%	Jan-16	4	-3%
ARS	-24.6%	-28.6%	Apr-16	7	-5%
PEN	-0.1%	-10.7%	Apr-18	31	-11%

Source: RBC Capital Markets estimates

Brazilian Real

Daniel Tenengauzer

1-3 Month Outlook – Overshooting

Brazil's fiscal situation must be resolved in the coming weeks. In August, the consolidated public sector accounts posted a BRL7.3bn deficit. The central government imbalance reached BRL6.9bn deficit. Moreover, the state owned enterprises added BRL 0.2bn to the deficit. So far this year, the primary deficit has reached BRL15bn, an unprecedented result in Brazilian fiscal data. Over the past year, the primary deficit reached -0.8% of GDP. This is well below the already concerning 0.15% of GDP primary surplus target for 2015. Extremely high real interest rates and an ever increasing debt to GDP ratio add up to very concerning fiscal accounts' result. The nominal fiscal deficit is now over 9% of GDP against 6% last December.

The latest cabinet reshuffle will likely do little to improve the fiscal situation. President Dilma focused on providing enough sweeteners to PMDB coalition party as to avoid an approval of an impeachment motion through Congress. Meanwhile, motions to introduce spending cuts and tax rises remain highly unlikely to pass through the lower house. The key to fiscal consolidation is a much awaited reduction in cabinet seats from 39 to 29 as well as the re-introduction of the financial transactions tax (CPMF). Both of these have been placed in the backseat to avoid congressional support for an impeachment motion.

6-12 Month Outlook – The new normal

Our POLAR valuation framework continues to point towards an overvalued BRL. This has mainly led to higher than expected inflation, a collapse in productivity/investment, and a persisting current account deficit. The model shows that the BRL may still depreciate by more than 25% before reaching the bottom of the cycle. We believe that ahead of a full downgrade to sub-investment grade by Fitch and Moody's, the BRL may break higher than 4.50. On the external front, we also forecast USD/CNY weaker to keep pushing USD/BRL higher.

Our main concern into 2016 will be the unwinding of state owned financial institutions' balance sheets. The gap between the reference rate for these institutions and the main reference rate remains wide, at 7% and 14.25% respectively. This implied subsidy from the public sector to the private sector will continue to weigh negatively on fiscal accounts and investment. Petrobras is highly unlikely to contribute to the consolidated fiscal accounts. Moreover it may require additional increases in gasoline prices because international prices denominated in local currency spiked higher with a weaker BRL.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/BRL	3.20	3.10	3.95	4.50	4.80	4.70	4.40	4.30
EUR/BRL	3.43	3.46	4.41	5.00	5.38	5.45	5.10	5.03
BRL/JPY	37.6	39.5	30.4	27.8	27.5	27.4	28.6	28.6
CAD/BRL	2.52	2.48	2.97	3.31	3.58	3.53	3.36	3.31

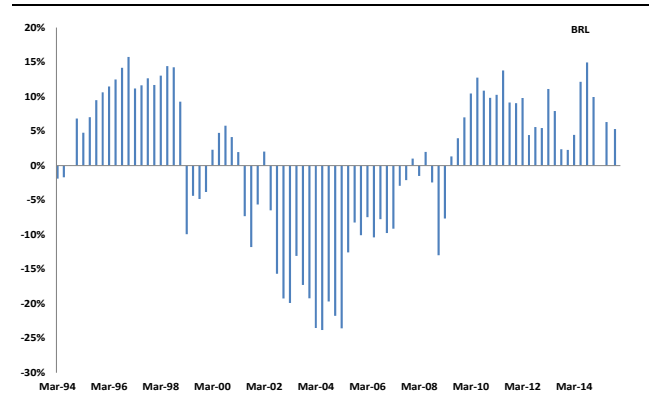
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	14.25 (14.25)
Trend interest rates (10yr average)	11.75
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	9.53 (9.56)
Inflation target	4.5% +/-1.0%
Budget balance % GDP last (prev)	-7.84 (-6.85)
Budget balance trend % GDP	-2.83
GDP Growth % y/y last (prev)	-2.6 (-1.56)
Trend GDP %y/y	3.39
RBC-POLAR misalignment	5.29%
Spot	3.93
FX Valuation	Overvalued
Current account balance % GDP last	-4.34 (-4.53)
Trend current account balance % GDP	-1.27
Moody's Foreign Currency Rating	Baa3
Outlook	Stable

* Current is latest month, quarter or year

1. RBC-POLAR: BRL


Source: RBC Capital Markets estimates, Bloomberg

2. LatAm valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
BRL	5.3%	-23.8%	Apr-17	19	-28%
COP	-18.1%	-18.1%	Jul-19	46	0%
MXN	-15.3%	-15.9%	Apr-16	7	-1%
CLP	-10.1%	-12.9%	Jan-16	4	-3%
ARS	-24.6%	-28.6%	Apr-16	7	-5%
PEN	-0.1%	-10.7%	Apr-18	31	-11%

Source: RBC Capital Markets estimates

Chilean Peso

1-3 Month Outlook – A hike

Chilean policy makers are stuck between the rock and the hard place. The latest data batch shows significantly weaker than expected industrial production but also stubbornly high inflation. In August, manufacturing production dropped to -1.4% y/y against +0.5% y/y for consensus and industrial production dropped to -5.2% y/y against -0.5% y/y for expectations. Inflation reached 5% y/y in August against 4.8% for expectations. Core inflation was higher than expected, hinting that persistent headline inflation may have contaminated core inflation.

BCCh has come across more hawkish in its last policy meeting. The reference rate is just 3%, which is well below headline inflation for well over a year now. In our opinion, policy accommodation may have failed to compensate for weak demand out of China for Chilean copper. Copper has reached new lows in September. Nevertheless, by now pass-through from a weak peso and low interest rates may have contributed to higher headline inflation rather than to higher domestic demand. Moreover, the decision to skip a lift-off in the US in September could keep Chilean monetary policy decision makers from hiking the key reference rate on October 15. We do believe BCCh hike is imminent but the decision may be postponed to later this year. This should potentially upset the market, keeping the peso near 700 and higher for a while longer. The 1y swap rate has increased to 3.8% from 3.1% two months ago as the market priced in expected hikes.

6-12 Month Outlook – The peso peaked

Since early 2013, the peso weakened from 475 to 700. Our valuation models show that above 700, the currency has landed overshooting territory. Our medium term outlook therefore incorporates a peak in the coming months and appreciation thereafter. We come to this result through an empirical exercise in which we estimate half-lives with historical valuations from our POLAR model. The Chilean peso comes up with the shortest period of undervaluation remaining within the LatAm currencies. We find that the peso is due to bottom sometime around January 2016.

Going into the first half of next year, we believe that the beginning of a tightening cycle may help anchor the peso. Meanwhile, we also believe peso appreciation might be limited because we believe China investment spending growth will continue to deteriorate. We also think that USD/CNY drifting higher towards 7.00 may effectively floor USD/CLP at 670.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CLP	624.5	639.3	696.4	710.0	720.0	700.0	680.0	680.0
EUR/CLP	670.2	712.6	778.3	788.1	806.4	812.0	788.8	795.6
JPY/CLP	37.57	39.47	30.37	27.78	27.50	27.45	28.64	28.60
CAD/CLP	492.3	511.7	523.1	522.1	537.3	526.3	519.1	523.1

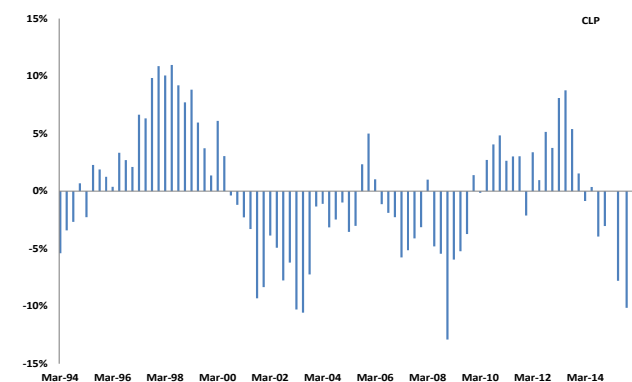
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Official cash rate	3 (3)
Trend interest rates (10yr average)	4.48
Bias in interest rate market	flat
CPI Inflation %Y/Y last (prev)	5 (4.6)
Inflation target	3% (+/-1%)
Budget balance % GDP last (prev)	-1.3 (-0.6)
Budget balance trend % GDP	-0.82
GDP Growth % y/y last (prev)	1.9 (2.51)
Trend GDP %y/y	4.39
RBC-POLAR misalignment	-10.15%
Spot	689
FX Valuation	Undervalued
Current account balance % GDP last	-0.08 (-0.5)
Trend current account balance % GDP	0.21
Moody's Foreign Currency Rating	Aa3
Outlook	Stable

* Current is latest month, quarter or year

1. RBC-POLAR: CLP



Source: RBC Capital Markets estimates, Bloomberg

2. LatAm valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
BRL	5.3%	-23.8%	Apr-17	19	-28%
COP	-18.1%	-18.1%	Jul-19	46	0%
MXN	-15.3%	-15.9%	Apr-16	7	-1%
CLP	-10.1%	-12.9%	Jan-16	4	-3%
ARS	-24.6%	-28.6%	Apr-16	7	-5%
PEN	-0.1%	-10.7%	Apr-18	31	-11%

Source: RBC Capital Markets estimates

Argentine Peso

1-3 Month Outlook – Elections, finally

In October, Argentine voters will cast a presidential ballot that for the first time in 12 years will not have a Kirchner name on it. This is important news because even Daniel Scioli, the candidate for the incumbent party will likely follow a more centrist agenda than Christina Kirchner. The presidential elections will take place on October 25 with a possible second round due on November 22. The new president will take office on December 10.

Ahead of the polls, the Blue Chip exchange rate was as high as 16 against 9.41 for the official USD/ARS exchange rate. This spread is wide for three reasons. First, the latest polls show that Scioli may win the elections. While policies may turn a touch more pragmatic, Scioli would still represent an interventionist approach institutionalized by the Kirchners. Polls also indicate that Scioli does not yet hold enough support to win outright in the first round over the main opposition candidate, Buenos Aires mayor Mauricio Macri.

Macri would seek to introduce market driven policies, perhaps allowing for interest rates to drift higher while also seeking a convergence between the Blue Chip market and the official exchange rate. If on October 25, the first-place candidate does not win either more than 45 percent of the valid vote or at least 40 percent of the valid vote and at the same time finish more than 10 percent ahead of the second-place candidate, a runoff election between the top two candidates from the first round will be held.

Second, Brazil will continue to exert meaningful uncertainty on the peso because it is Argentina's largest trade partner. Moreover, the ruling PT in Brazil has been a key Peronist ally, also adopting interventionist policies in Brazil. Third, soybean prices collapsed to the lows observed in well over a decade. This is because oil prices remain low and it remains unclear whether demand out of Asia may recover anytime soon.

6-12 Month Outlook – FX market reforms

We believe that early next year there will be a convergence between the various foreign exchange market tiers. This may require however, some sort of monetary policy tightening through higher interest rates as well as tighter fiscal policy following the elections. The interbank Badlar rate remains at 22%. While headline inflation has been released close to 14-15%, actual market price inflation is likely closer to 40%.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/ARS	8.82	9.10	9.43	9.80	10.50	11.00	11.50	12.00
EUR/ARS	9.46	10.14	10.54	10.88	11.76	12.76	13.34	14.04
ARS/JPY	13.62	13.46	12.72	12.76	12.57	11.73	10.96	10.25
CAD/ARS	6.95	7.28	7.08	7.21	7.84	8.27	8.78	9.23

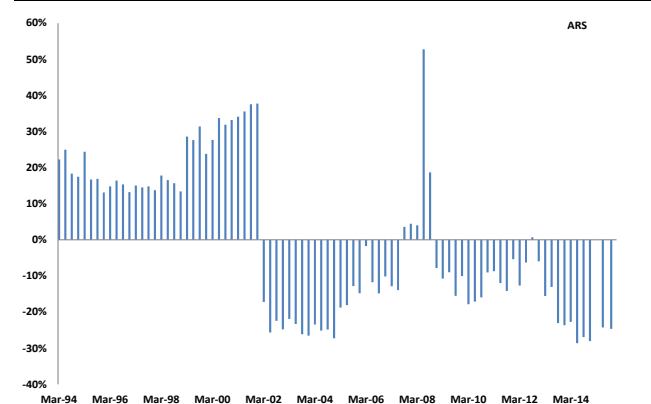
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
Private BADLAR	21.4375 (21.25)
Trend interest rates (10yr average)	12.99
Bias in interest rate market	n/a
CPI Inflation %Y/Y last (prev)	n/a
Inflation target	n/a
Budget balance % GDP last (prev)	-0.26 (-0.69)
Budget balance trend % GDP	0.50
GDP Growth % y/y last (prev)	2.3 (2.1)
Trend GDP %y/y	5.30
RBC-POLAR misalignment	-24.65%
Spot	9.44
FX Valuation	Undervalued
Current account balance % GDP last	-1.34 (-1.15)
Trend current account balance % GDP	0.89
Moody's Foreign Currency Rating	Ca
Outlook	Negative

* Current is latest month, quarter or year

1. RBC-POLAR: ARS



Source: RBC Capital Markets estimates, Bloomberg

2. LatAm valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
BRL	5.3%	-23.8%	Apr-17	19	-28%
COP	-18.1%	-18.1%	Jul-19	46	0%
MXN	-15.3%	-15.9%	Apr-16	7	-1%
CLP	-10.1%	-12.9%	Jan-16	4	-3%
ARS	-24.6%	-28.6%	Apr-16	7	-5%
PEN	-0.1%	-10.7%	Apr-18	31	-11%

Source: RBC Capital Markets estimates

Colombian Peso

1-3 Month Outlook – An unexpected hike

Despite a no hike in the US in September, BanRep opted to surprise the market with a 25bp hike on September 25, to 4.75%. We believe this was the better course of action because Colombia has limited options to avoid additional currency weakness. Inflation has surprised on the upside in August. Headline inflation reached 4.74% y/y against 4.45% for consensus and 4.46% for July. Inflation data was a surprise because seasonality should have hinted lower headline. Consensus was therefore already pricing in some sort of pass-through from a weak exchange rate to headline inflation and actual turned out even higher. Core inflation is now 4.2% and will likely rise further, from as low as 2.6% y/y a year ago. Consensus expectations are for lower headline into 2016 and just one more 25bp hike to 5% in a few months. The 2y IBR swap rate is pricing a somewhat more hawkish stance, nearing the highs for the past five years.

Meanwhile, Q2 GDP data shows a gradual catch up, likely backed by higher public investment, which is compensating for lower oil exports. The current account balance may have bottomed late last year but remains in deep deficit. We believe it will take a long time before a weaker exchange rate helps the Colombian economy transition away from its oil exports dependency to alternative sectors. In our opinion, the rate hike will likely help put a ceiling on USD/COP. Nevertheless we also believe the pair may drift back above 3200 before the end of the year. A looming crisis in Venezuela may add FX volatility.

6-12 Month Outlook – The worst likely over

According to an overshooting exercise performed across all 32 currencies in our POLAR valuation framework, we find that the COP is the only one that is effectively at its bottom. The peso is 19% undervalued. Statistically, it therefore has relatively little probability of depreciating even further from current levels. A scenario of just one more rate hike would put local rates below the progression currently priced by the local swap market. The interbank IBR rate is 4.6%, against 5.3% for the 1y swap rate. This translates into at least three additional hikes against one hike expected by consensus. We therefore believe the currency may appreciate somewhat next year but to just around 2900.

Forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/COP	2600	2605	3090	3200	3100	3000	2950	2900
EUR/COP	2790	2904	3454	3552	3472	3480	3422	3393
JPY/COP	21.6	21.3	25.8	25.6	23.5	23.3	23.4	23.6
CAD/COP	2050	2085	2321	2353	2313	2256	2252	2231

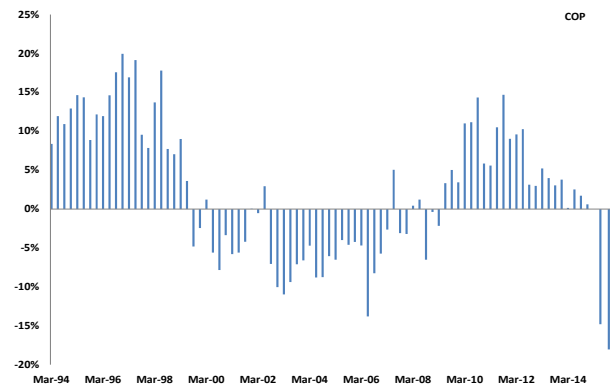
Source: RBC Capital Markets estimates

Indicators

	Current (Previous)*
1 Day Repo Rate	4.75 (4.5)
Trend interest rates (10yr average)	5.63
Bias in interest rate market	hiking
CPI Inflation %Y/Y last (prev)	4.74 (4.46)
Inflation target	3% (+/-1%)
Budget balance % GDP last (prev)	-2.49 (-3.01)
Budget balance trend % GDP	-2.73
GDP Growth % y/y last (prev)	2.8 (3.4)
Trend GDP %y/y	4.80
RBC-POLAR misalignment	-18.06%
Spot	3019
FX Valuation	Undervalued
Current account balance % GDP last	-6.39 (-5.92)
Trend current account balance % GDP	-2.50
Moody's Foreign Currency Rating	Baa2
Outlook	Stable

* Current is latest month, quarter or year

1. RBC-POLAR: COP



Source: RBC Capital Markets estimates, Bloomberg

2. LatAm valuations

Currency	Current Valuation	Potential Bottom	Expected Date of Next Bottom	Months to Next Bottom	Devaluation from Current to Bottom
BRL	5.3%	-23.8%	Apr-17	19	-28%
COP	-18.1%	-18.1%	Jul-19	46	0%
MXN	-15.3%	-15.9%	Apr-16	7	-1%
CLP	-10.1%	-12.9%	Jan-16	4	-3%
ARS	-24.6%	-28.6%	Apr-16	7	-5%
PEN	-0.1%	-10.7%	Apr-18	31	-11%

Source: RBC Capital Markets estimates



Forecasts

Spot forecasts

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.07	1.11	1.12	1.11	1.12	1.16	1.16	1.15
USD/JPY	120	123	120	125	132	129	126	123
GBP/USD	1.48	1.57	1.51	1.56	1.65	1.71	1.68	1.67
USD/CHF	0.97	0.94	0.97	0.99	0.99	0.97	0.97	0.99
USD/SEK	8.63	8.29	8.37	8.65	8.57	8.19	8.10	8.09
USD/NOK	8.1	7.9	8.5	8.6	8.4	7.9	7.8	7.8
USD/CAD	1.27	1.25	1.33	1.36	1.34	1.33	1.31	1.30
AUD/USD	0.76	0.77	0.70	0.69	0.68	0.67	0.67	0.67
NZD/USD	0.75	0.68	0.64	0.61	0.60	0.59	0.58	0.57
USD/CNY	6.20	6.21	6.36	6.56	6.70	6.80	6.90	6.95
USD/INR	62.3	63.6	65.6	67.0	67.0	68.5	69.5	71.0
USD/KRW	1109	1120	1185	1200	1210	1240	1270	1310
USD/SGD	1.37	1.35	1.42	1.45	1.48	1.53	1.57	1.60
USD/MYR	3.71	3.75	4.39	4.30	4.50	4.60	4.70	4.80
USD/IDR	13071	13351	14603	14500	14600	14900	15200	15600
USD/TWD	31.3	30.9	33.0	33.5	34.0	35.0	36.0	37.0
USD/TRY	2.60	2.68	3.03	3.15	3.25	3.35	3.40	3.10
USD/RUB	58.21	55.32	65.47	65.00	63.00	61.00	61.00	61.00
USD/ZAR	12.13	12.17	13.86	14.50	14.75	15.00	15.50	14.50
USD/PLN	3.80	3.76	3.80	3.83	3.75	3.53	3.49	3.48
USD/HUF	280	283	280	279	277	263	259	257
USD/CZK	25.7	24.5	24.3	24.6	24.2	23.3	23.3	23.5
USD/ILS	3.98	3.77	3.92	4.20	4.30	4.50	4.50	4.30
USD/MXN	15.27	15.74	16.91	17.00	16.50	15.80	15.50	16.00
USD/BRL	3.20	3.10	3.95	4.50	4.80	4.70	4.40	4.30
USD/CLP	625	639	696	710	720	700	680	680
USD/ARS	8.82	9.10	9.43	9.80	10.50	11.00	11.50	12.00
USD/COP	2600	2605	3090	3200	3100	3000	2950	2900

Source: RBC Capital Markets estimates



EUR Crosses

	2015				2016			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.07	1.11	1.12	1.11	1.12	1.16	1.16	1.15
EUR/JPY	129	137	134	139	148	150	146	141
EUR/GBP	0.72	0.71	0.74	0.71	0.68	0.68	0.69	0.69
EUR/CHF	1.04	1.04	1.09	1.10	1.11	1.12	1.13	1.14
EUR/SEK	9.26	9.24	9.36	9.60	9.60	9.50	9.40	9.30
EUR/NOK	8.65	8.76	9.52	9.60	9.40	9.20	9.10	9.00
EUR/CAD	1.36	1.39	1.49	1.51	1.50	1.54	1.52	1.50
EUR/AUD	1.41	1.45	1.59	1.61	1.65	1.73	1.73	1.72
EUR/NZD	1.44	1.65	1.75	1.82	1.87	1.97	2.00	2.02
EUR/CNY	6.65	6.92	7.10	7.28	7.50	7.89	8.00	7.99
EUR/INR	67	71	73	74	75	79	81	82
EUR/KRW	1190	1249	1325	1332	1355	1438	1473	1507
EUR/SGD	1.47	1.50	1.59	1.61	1.66	1.77	1.82	1.84
EUR/MYR	3.98	4.18	4.91	4.77	5.04	5.34	5.45	5.52
EUR/IDR	14026	14882	16322	16095	16352	17284	17632	17940
EUR/TWD	33.5	34.4	36.9	37.2	38.1	40.6	41.8	42.6
EUR/TRY	2.79	2.99	3.38	3.50	3.64	3.89	3.94	3.57
EUR/RUB	62.47	61.67	73.18	72.15	70.56	70.76	70.76	70.15
EUR/ZAR	13.02	13.57	15.49	16.10	16.52	17.40	17.98	16.68
EUR/PLN	4.07	4.19	4.25	4.25	4.20	4.10	4.05	4.00
EUR/HUF	300	315	313	310	310	305	300	295
EUR/CZK	27.55	27.28	27.19	27.30	27.15	27.00	27.00	27.00
EUR/ILS	4.27	4.21	4.38	4.66	4.82	5.22	5.22	4.95
EUR/MXN	16.38	17.54	18.91	18.87	18.48	18.33	17.98	18.40
EUR/BRL	3.43	3.46	4.41	5.00	5.38	5.45	5.10	4.95
EUR/CLP	670	713	778	788	806	812	789	782
EUR/ARS	9.5	10.1	10.5	10.9	11.8	12.8	13.3	13.8
EUR/COP	2790	2904	3454	3552	3472	3480	3422	3335

Source: RBC Capital Markets estimates



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