RBC Capital Markets

FX STRATEGY – PART OF FX SALES & TRADING

Currency Report Card

6 October 2017

Forecasts

October 2017

Three month forecast returns

Most bullish	Most bearish
JPY	GBP
NZD	CNY
AUD	SEK

Source: RBC Capital Markets

12 month forecast returns

Most bullish	Most bearish
JPY	CHF
MXN	EUR
IDR	GBP

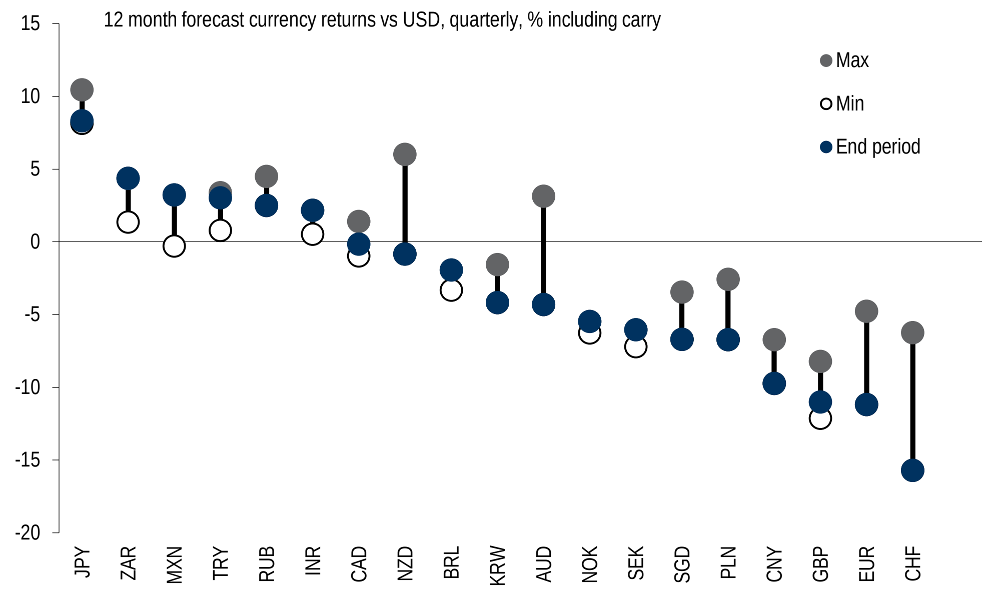
Source: RBC Capital Markets

Forecast revisions this month include:

EUR/SEK: Short-term profile revised higher. End-Q4 now 9.70 (previously 9.10). Long-term profile unchanged.

EUR/NOK: Short-term forecast revised higher. End-Q4 now 9.50 (previously 8.70). Long-term profile unchanged.

JPY outperformance; CHF, GBP and EUR underperformance



Source: RBC Capital Markets

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US Dollar

Elsa Lignos

1-3 Month Outlook – Fed Chair and tax cut prospects

USD is still one of the worst-performing currencies YTD. But month to date it's one of the best. What has changed in the last few weeks? We can point to four factors: (1) expectations increased for another hike this year, now up to 70%, guided by Fed speeches and the September dot plot; (2) with Yellen's term ending in just four months, speculation is rising on the next Fed Chair. Bookies markets have former Fed Governor Warsh in the lead (~40% probability), the most hawkish candidate on the short list; (3) the prospect of major unfunded tax cuts is back on the agenda. The nine page plan released by the GOP on Sept 27 would cost ~USD2.4trn over a decade, on static scoring according to estimates from the Tax Policy Foundation, and it is a long way from the detail needed to turn it into legislation. But even a portion of those cuts would constitute considerable fiscal stimulus. The Fed has not baked that into its forecasts and comments from SF Fed Chair Williams hint at discomfort – it would likely have to tighten monetary policy faster as an offset. Finally (4) technically, USD was due a corrective rally from oversold levels, though DXY is now approaching a strong area of congestive resistance at 94.08. Our technical analyst says a daily close below support at 92.16 is required to end the retracement phase via a bearish reversal. A close above 96.77 would be required to derail the 2017 downtrend. Going forward there is limited upside from market expectations for 2017 hikes but we still see upside in terms of 2018 hikes. There is barely more than one hike priced in for next year and even assuming tax cut plans are watered down, economic developments still point to more tightening. Figure 1 shows our measure of inflation surprises which have turned positive after most of the year in negative territory. The USD outlook may be shaken by a year-end debt ceiling showdown, renewed pessimism over the chances of tax cuts getting passed (some GOP members are already balking at the prospect of eliminating the state and local deduction, while others are uncomfortable with the exploding deficit), but looking through the noise, we expect USD to end the year firmer (our forecasts are unchanged).

6-12 Month Outlook – Repatriation is USD positive

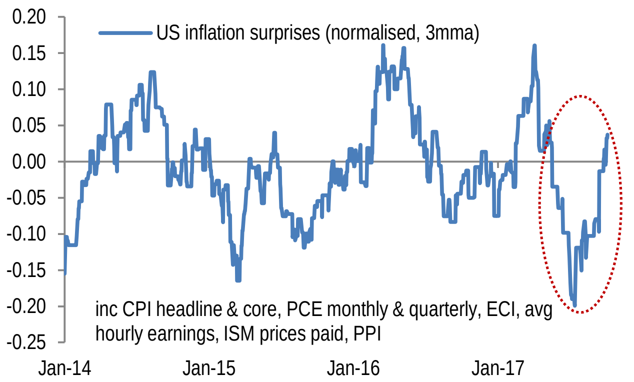
Over a longer horizon, USD will be supported by a tax break on overseas earnings. It is unlikely to be priced in ahead of time as consensus thinks there is no FX impact. We think otherwise (see pg 7), though that is likely to lead to selective USD strength rather than another bull market.

Indicators

	Current (Previous)*
Official cash rate	**1.00-1.25% (0.75-1.00%)**
Trend interest rates (10yr average)	1.9%
Bias in interest rate market	Flat
Core PCE Inflation %Y/Y Aug (Jul)	**1.3% (1.4%)**
Inflation target	Price stability
Budget balance % GDP FY16 (FY15)	**-3.1% (-2.6%)**
Budget balance target % GDP	-
GDP Growth % q/q SAAR Q2 (Q1)	3.0% (2.6%)
Trend GDP %y/y	2.5%
Purchasing Power Parity Value	-
Spot	-
PPP Valuation	-
Current account balance % GDP Q2 (Q1)	**-2.4% (-2.4%)**
Trend current account balance % GDP	-3.7%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

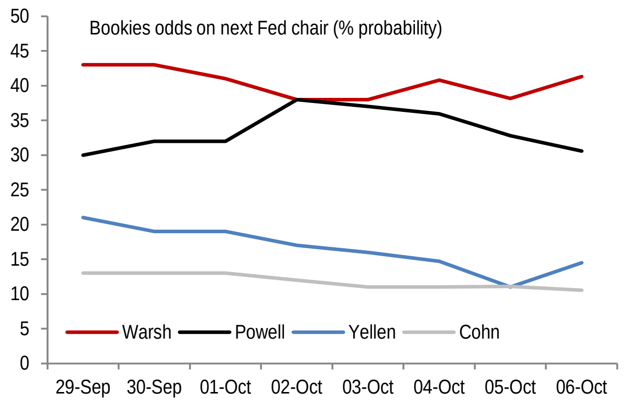
* Current is latest month, quarter or year

1. Inflation surprises building some positive momentum



Source: RBC Capital Markets; Bloomberg

2. Warsh currently in the lead in Fed Chair race



Source: RBC Capital Markets; Betfair

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.07	1.14	1.18	1.12	1.09	1.06	1.08	1.12
USD/JPY	111	112	113	103	100	102	104	106
USD/CAD	1.33	1.30	1.25	1.24	1.27	1.26	1.26	1.26

Source: RBC Capital Markets estimates

Euro

Elsa Lignos

1-3 Month Outlook – Political outlook less rosy

EUR/USD has failed to revisit the highs it hit in early September and as we go to press it is testing sub-1.17. But that is a USD rather than a EUR story. Despite mixed political developments, EUR is middle of the pack relative to other currencies. In trade-weighted terms, EUR is still going sideways; the ECB's preferred measure is flat since the September meeting when the ECB stepped up its verbal intervention. We think the arguments behind the bullish consensus are more questionable than ever. For starters, many GovCo members are increasingly sensitive to EUR appreciation (see *Total FX*, 9 Sept 2017). That will influence their thinking as they calibrate their taper at the next meeting (Oct 26). The ECB's Sept minutes and recent speeches suggest the Executive Board is considering a "lower for longer" approach. That would mean cutting monthly purchases by more than currently expected but extending QE further (e.g. end 2018). What that means for EUR depends on one's view of QE. If one thinks the total size of the balance sheet matters, it is no different to a slower faster taper. But most would agree that tapering matters as a signal for conventional monetary policy, given the ECB's pledge that rates will not rise until asset purchases have ended. A lower for longer approach means the first rate rise would still be more than 15 months away. For us that makes long EUR a tough sell. Economic data may be strong, but investors will not get "paid" for that with higher rates for years to come. Long positioning in EUR has pulled back, in line with the retracement from the highs (Fig 1), but there is scope for that to unwind further. EUR is still pricing in a low risk premium (Fig 2) so any unexpected deterioration in Spanish or Italian politics would be a downside risk. The post-French election glow is already fading and we have left our forecasts unchanged.

6-12 Month Outlook – Inflation or disappointment

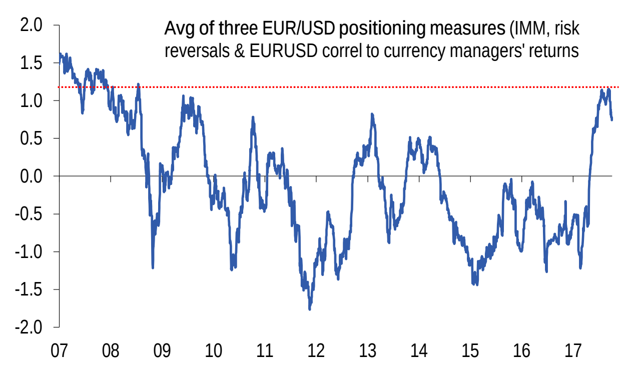
There is little to suggest inflation will pick up quickly in the Euro area and our rates strategists do not forecast a tightening cycle until 2020 at the earliest. Stories that Weidmann may be appointed ECB President when Draghi's term ends in Oct 2019 are seen as bullish EUR, but unless there is a pick-up in inflation, it is hard to see the majority of the voters on the GovCo supporting much tighter policy. With underemployment still weighing on EZ inflation (see *Total FX*, 19 May) we look for EUR to remain undervalued.

Indicators

	Current (Previous)*
Official cash rate	**0.00% (0.05%)**
Trend interest rates 10y average	1.9%
Bias in interest rate market	Lower
HICP core Inflation %Y/Y Sep (Aug)	**1.1% (1.2%)**
Inflation target	Close to but less than 2.0%
Budget balance % GDP FY16 (FY15)	**-1.5% (-2.1%)**
Budget balance target % GDP	3% of GDP-Unless special circumstances
GDP Growth %Y/Y Q2 (Q1)	**2.3% (1.9%)**
Trend GDP %y/y	1.1%
Purchasing Power Parity Value Aug	**1.2689**
Spot end-Sep	1.1814
PPP Valuation	EUR/USD is undervalued
Current account % GDP Q1 (Q4)	3.5% (3.5%)
Trend current account balance % GDP	0.3%
Moody's Foreign Currency Rating	**Aaa (Germany)**
Outlook	Stable

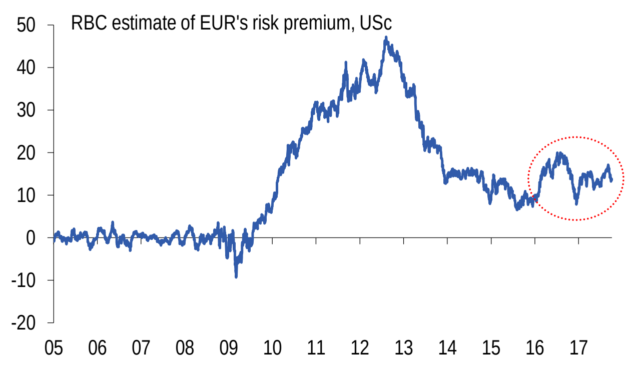
* Current is latest month, quarter or year

1. EUR/USD longs… falling but still high



Source: RBC Capital Markets; Bloomberg, CFTC, Parker

2. EUR's risk premium – historically low



Source: RBC Capital Markets; Bloomberg

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.07	1.14	1.18	1.12	1.09	1.06	1.08	1.12
EUR/JPY	119	128	133	115	109	108	112	119
EUR/CAD	1.42	1.48	1.47	1.39	1.38	1.34	1.36	1.41

Source: RBC Capital Markets estimates

Japanese Yen

Adam Cole

1-3 Month Outlook – USD/JPY topping out

A combination of better risk sentiment and higher US rates carried USD/JPY from the bottom back to the top of its recent range in late September/early October and left JPY as the worst-performing G10 currency over the last month. US rates and risk appetite will remain key drivers of JPY going forward, though with a December Fed hike now almost fully in the price, further upside for USD/JPY should be much harder work. Investors also remain long USD/JPY (Figure 1), though positioning is some way off its recent highs. Risk appetite is harder to call, but we note that JPY's status as a safe haven is undiminished when the source of the risk is local to Asia (red dots in Figure 2). Domestically, the main focus in the near-term is the lower house election on October 22. By far the most likely outcome is a returned, Abe-led, LDP government with another large majority and in these circumstances, it is likely Kuroda would be retained as BoJ Governor for another five years. Such an outcome would be broadly neutral for USD/JPY. With the main opposition Democratic Party in disarray, the tail risk into the election relates to Tokyo Governor Koike's new Party of Hope. It is unlikely, but not impossible, that Abe's majority could be cut or even wiped out. Our previous estimates were that the "Abe premium" in USD/JPY is around JPY10 and this is the kind of adjustment lower in USD/JPY we would expect in the unlikely event that the LDP loses its lower house majority this month. Absent that risk, from current elevated levels, we expect USD/JPY to resume the gentle downtrend that has held through 2017 so far.

6-12 Month Outlook – USD/JPY target 100

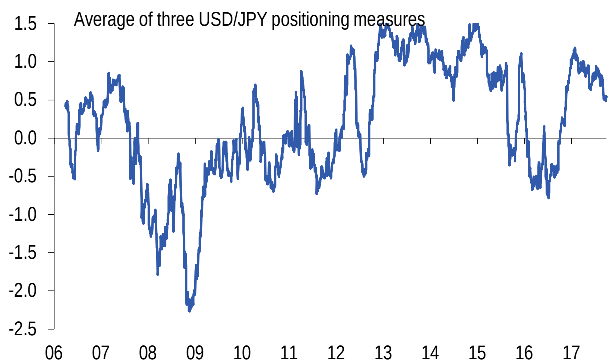
Long-term, the BoJ's tacit admission that it can't hit its 2% inflation target for three years or more could be taken as either positive or negative for JPY. The failure to lift nominal GDP through either prices or volumes should bring the unsustainability of Japan's budget imbalance back into focus and for many this is JPY-bearish, not bullish. But the public sector deficit is the counterpart to a large private sector surplus and so long as excess private sector savings fund public sector borrowing, Japan's imbalances are a purely domestic issue. Absent a specific flow to drive it up, our "default" position is that USD/JPY will naturally drift lower and the trough in our forecast profile remains at 100.

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)	**0.7% (0.5%)**
Inflation target	2.0%
Budget balance % GDP FY16 (FY15)	**-5.7% (-6.7%)**
Budget balance target % GDP	n/a
GDP Growth %Y/Y Q2 (Q1)	**1.6% (1.4%)**
Trend GDP %Y/Y	1.0%
Purchasing Power Parity Value Aug	**88.39**
Spot end-Sep	112.53
PPP Valuation	USD/JPY is overvalued
Current a/c balance % GDP Q2 (Q1)	3.9% (3.6%)
Trend current account balance % GDP	2.6%
Moody's Foreign Currency Rating	**A1**
Outlook	Stable

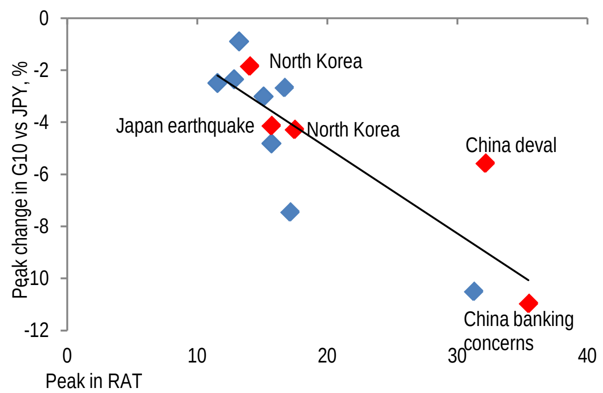
* Current is latest month, quarter or year

1. Investors still long USD/JPY



Source: RBC Capital Markets; Bloomberg

2. JPY a safe haven in all risk off periods



Source: RBC Capital Markets; Bloomberg

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/JPY	111	112	113	103	100	102	104	106
EUR/JPY	119	128	133	115	109	108	112	119
CAD/JPY	84	87	90	83	79	81	83	84

Source: RBC Capital Markets estimates

Sterling

Adam Cole

1-3 Month Outlook – September marked the peak

Against our bearish view, GBP had a fantastic September, rising between 3% and 6% against all G10 currencies. Measured against a 50/50 basket of USD and EUR, GBP is now back at levels that prevailed before the June 8 general election in which the ruling Conservatives lost their majority. It is not difficult to isolate the driver. A huge repricing of UK rate prospects leaves markets 80% priced for a November hike. Given the BoE's recent guidance it is hard to argue with this and a 25bp hike at the November meeting is our official view. However, we *would* take issue with the further 35bp of hikes priced in over the following 12 months (Figure 1) and the export-led growth the BoE forecasts that underlies this (Figure 2 and see Total FX, 18 August for more details).

Moreover, while markets have been distracted by monetary policy, the political backdrop for GBP has been quietly deteriorating and markets now appear inadequately priced for this. Why? Three related risks could push policy, Brexit policy in particular, onto a very different trajectory in relatively short order. Firstly, although the risk of a further election this year has diminished greatly, it still seems more likely than not that this government will not last its full five years. Secondly, on current evidence, an early election would result in an even less stable government than we have now, with Labour the largest party, but far short of a majority. Finally, even in the absence of an election, May's future as PM looks uncertain, to say the least, and the risk of a hardening of the Brexit agenda is rising, given the stance of her most likely replacement. Rising political risk appears to have had little impact on GBP, which is perhaps not surprising given the distraction of a huge shift in rate expectations. Going forward we would add rising concern on politics to diminishing rate hike expectations as a reason to see September's rally as marking the peak in GBP/USD. Our end-year forecast is unchanged at 1.20.

6-12 Month Outlook – Tentative bottom at 1.16

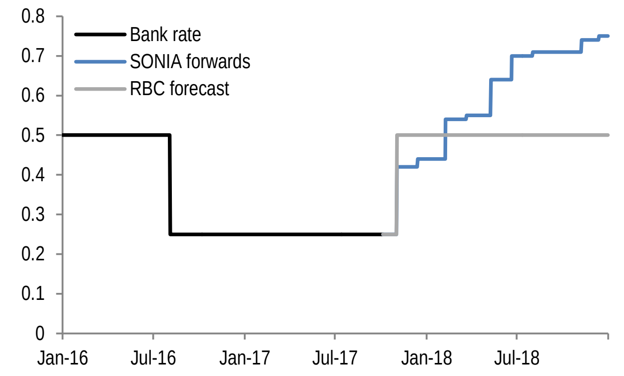
Our longer-term target for GBP/USD is 1.16 as the overhang of political risk drags on into the medium-term. We tentatively have that as the bottom for GBP, though clearly the uncertainty around that central forecast is unusually high as we head into the period of most elevated political risk for the UK.

Indicators

	Current (Previous)*
Official cash rate	**0.25% (0.25%)**
Trend interest rates 10y average	3.3%
Bias in interest rate market	Rising
CPI Inflation %Y/Y Aug (Jul)	**2.9% (2.6%)**
Inflation target (HICP)	2.0%
Budget balance % GDP FY15 (FY14)	**-4.3% (-5.7%)**
Budget balance target % GDP	Budget surplus as soon as possible
GDP Growth %Y/Y Q2 (Q1)	**1.5% (1.7%)**
Trend GDP %Y/Y	1.5%
Purchasing Power Parity Value Aug	**1.4741**
Spot end-Sep	1.3402
PPP Valuation	GBP/USD is undervalued
Current a/c balance % GDP Q2 (Q1)	-5.1% (-5.4%)
Trend current account balance % GDP	-4.5%
Moody's Foreign Currency Rating	**Aa1**
Outlook	Stable

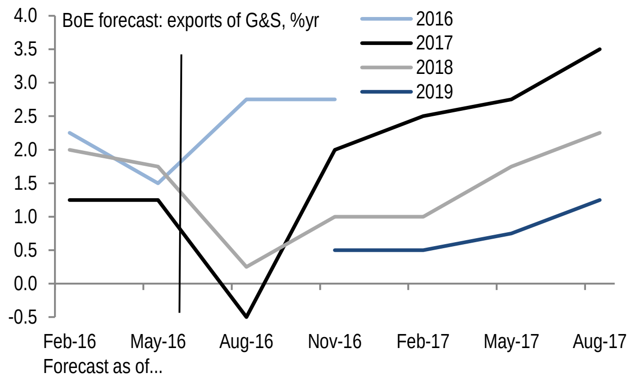
* Current is latest month, quarter or year

1. Forward curve too steep



Source: RBC Capital Markets, Bloomberg

2. BoE ever more optimistic on exports



Source: RBC Capital Markets, BoE

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
GBP/USD	1.26	1.30	1.34	1.20	1.16	1.18	1.24	1.32
EUR/GBP	0.85	0.88	0.88	0.93	0.94	0.90	0.87	0.85
GBP/JPY	140	146	151	124	116	120	129	140
GBP/CAD	1.67	1.69	1.67	1.49	1.47	1.48	1.56	1.66

Source: RBC Capital Markets estimates

Swiss Franc

Elsa Lignos

1-3 Month Outlook – Status quo

As expected, the SNB kept its rhetoric unchanged at its latest meeting. Inflation continues to creep higher though is still too low to prompt any shift by the central bank. CHF remains driven by risk appetite and technicals, though the fundamental story gets interesting on a longer-term horizon (see below). Technically, the recent rally in USD/CHF has stalled against a strong area of resistance at 0.9771 that has been tested four times since June. A daily close above this level would open up 0.9835 and 0.9944 ahead of the May high at 1.0100. Initial support is located at 0.9673 and 0.9565 followed by a quadruple bottom at 0.9444.

6-12 Month Outlook – Wait for repatriation flow

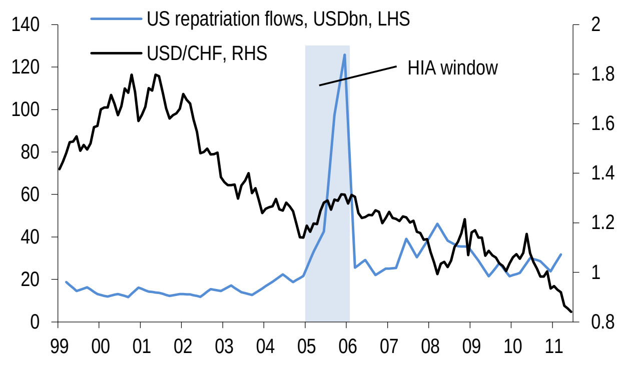
Over the longer-term, we are particularly focused on the impact on CHF of a US tax break on repatriated earnings. Developments on the latter have been positive in the last month though we are still a long way from actual legislation. The House has approved a fiscal 2018 spending blueprint, the necessary step to allow a tax bill to pass by reconciliation. The Senate Budget Committee has also approved a budget resolution which will be sent to the full Senate for a vote in the second half of October. But House and Senate need to agree on a single resolution and the House budget would currently prohibit tax reform from adding to the deficit. Ultimately we expect the tax break on overseas earnings to pass, if only because it is the easiest thing for the GOP to agree on, but the timing is still uncertain. The experience of the Homeland Investment Act suggests USD/CHF could be one of the biggest beneficiaries (see *Total FX*, 27 Jan 2017) based on USD FDI into Switzerland and liquidity in USD/CHF. Figure 1 shows the impact that HIA had on USD/CHF in 2005. That claim runs against consensus, which argues overseas earnings are held in USD already so there should be no currency impact. That same consensus claims it was Fed tightening rather than repatriation flows that drove the 2005 USD rally. But Figure 2 makes that hard to believe. The Fed tightening cycle was mostly priced in *before* the HIA window, when USD was still going down. It seems in practice there is at least some currency conversion to be done when the repatriation flows start materializing. Given the consensus view, USD/CHF strength is unlikely to materialise until they do. We flag this as the key long-term driver to watch for CHF.

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 Sep (Aug)	**0.7% (0.5%)**
Inflation target	less than 2.0%
Budget balance % GDP FY16 (FY15)	**-0.28% (-0.24%)**
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Y/Y Q2 (Q1)	**0.3% (0.6%)**
Trend GDP %Y/Y	1.80%
EUR Purchasing Power Parity Value Aug	**1.2196**
EUR/CHF spot end-Sep	1.1442
EUR/CHF PPP Valuation	EUR/CHF is undervalued
Current a/c balance % GDP Q4 (Q3)	10.7% (10.3%)
Trend current account balance % GDP	8.0%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

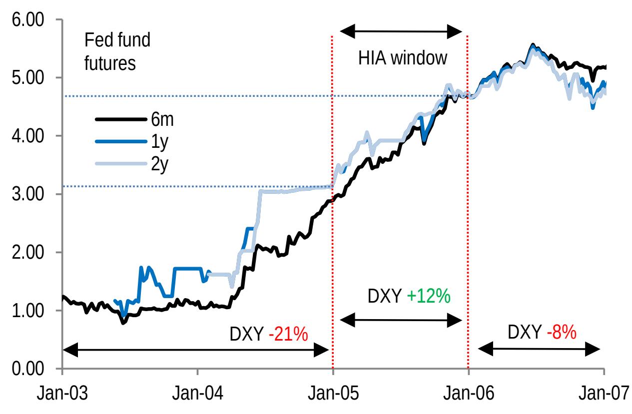
* Current is latest month, quarter or year

1. HIA led to repatriation and USD/CHF higher in 2005...



Source: RBC Capital Markets; Bloomberg

2. ...Hard to argue that was driven by Fed tightening



Source: RBC Capital Markets; Bloomberg

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CHF	1.00	0.96	0.97	1.04	1.07	1.11	1.08	1.04
EUR/CHF	1.07	1.09	1.14	1.16	1.17	1.18	1.17	1.16
CHF/JPY	111	117	116	99	93	92	96	102
CAD/CHF	0.75	0.74	0.78	0.84	0.85	0.88	0.86	0.82

Source: RBC Capital Markets estimates

Swedish Krona

Adam Cole

1-3 Month Outlook – Renewed weakness

SEK was the worst performing currency in G10 in September, but it remains the best performing year-to-date (though only by a tiny margin over EUR). One news item alone dominated SEK performance: the unexpected reappointment of Ingves as Riksbank governor for another five years. There was a very widespread expectation that Ingves would be replaced by a less dovish successor and that this would pave the way for the Riksbank to start normalising ultra-loose policy, or at least signal in its forward guidance that this was getting closer. Under Ingves, the "normalisation trade" in SEK has been a persistent disappointment, despite Sweden's strong growth and inflation fundamentals. The balance of risk is that this remains the case and SEK fails to build upside momentum going forward from a position where discretionary investors are already very long of the currency. That the fundamental background is solid is hard to dispute. Even after a slight downward revision, Q2 GDP growth is 3.1% y/y and underlying CPI inflation remained above the Riksbank's target for the second month running in August (2.3% y/y). Most of this, however, was known at the time of the September 7 Riksbank meeting, when the central bank once again disappointed by leaving its forward guidance almost entirely unchanged. Despite the persistent disappointment in recent months, RIBA futures continue to price in an earlier and steeper rise in rates than the Riksbank's forward guidance implies and the risk is that expectations are pared back if the central bank fails to validate this at the upcoming policy announcement (October 26). We also retain a concern that SEK's status as a funding currency in carry trades will continue to handicap its performance. In the light of Ingves's reappointment and the ongoing optimistic pricing of forward rates we are revising up our end-year target for EUR/SEK to 9.70 (above spot and back to the middle of the recent range) from 9.10 previously.

6-12 Month Outlook – Eventual SEK recovery

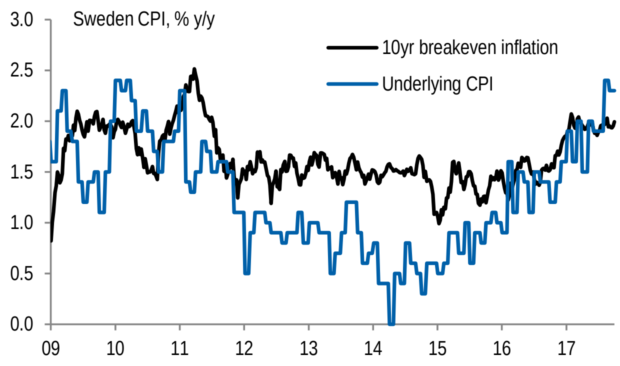
Ultimately, the bullish SEK consensus view will be right, though timing is uncertain and it will take more than just a few months of above target inflation to get the Riksbank moving. But as we get closer to the point where the Riksbank is finally forced to raise rates, we look for SEK to rebound from deeply undervalued levels (Figure 2). We have left our long-term forecasts unchanged this month.

Indicators

	Current (Previous)*
Official cash rate	**-0.5% (-0.5%)**
Trend interest rates 10y average	3.0%
Bias in interest rate market	Flat
CPIF Inflation %Y/Y Aug (Jul)	**2.3% (2.4%)**
Inflation target (UND1X)	2.0%
Budget balance % GDP FY16 (FY15)	**-0.6% (0.2%)**
Budget balance target % GDP	Cyclical average surplus of 1%
GDP Growth %Y/Y Q2 (Q1)	**3.0% (2.2%)**
Trend GDP %Y/Y	2.0%
EUR Purchasing Power Parity Value Aug	**8.8122**
Spot end-Sep	9.6244
PPP Valuation	EUR/SEK is overvalued
Current a/c balance % GDP Q2 (Q1)	4.4% (4.3%)
Trend current account balance % GDP	6.0%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

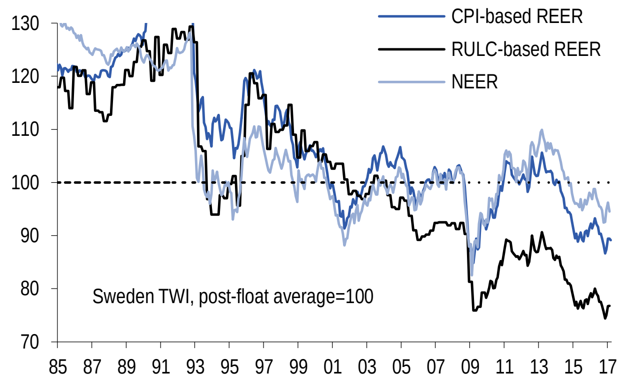
* Current is latest month, quarter or year

1. Core inflation close to cycle high



Source: RBC Capital Markets; Bloomberg

2. SEK cheap on any measure



Source: RBC Capital Markets; Bloomberg

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/SEK	8.97	8.43	8.15	8.66	8.53	8.49	8.06	7.77
EUR/SEK	9.56	9.64	9.62	9.70	9.30	9.00	8.70	8.70
NOK/SEK	1.04	1.01	1.02	1.02	1.01	1.01	1.01	1.04
CAD/SEK	6.74	6.51	6.53	6.98	6.72	6.74	6.39	6.16

Source: RBC Capital Markets estimates

Norwegian Krone

Elsa Lignos

1-3 Month Outlook – Revising EUR/NOK higher

In the very near-term, there are both technical and fundamental reasons one could be bearish EUR/NOK. On the technical side, downside risks are increasing after another failed attempt to pierce congestive resistance between 9.4040 and 9.4308. That favours a test of initial support at 9.2756, followed by the August low at 9.2212. A daily close below the latter level is required to trigger a new phase of bearish momentum that would target 9.2090 and 9.1099. On the fundamental side, NOK remains closely tied to oil and our commodity strategists have highlighted three upside risks to crude for October: (1) Trump is expected to make a decision on decertifying the Iran deal, (2) developments in Iraq's Kurdish region could lead to supply disruptions and finally (3) the US looks poised to up the economic pressure on the Maduro government by imposing new sectoral sanctions that would accelerate the pace of declines in Venezuelan oil production (for more see here). But as we have seen before, rallies in crude are met with increased US production. Norges Bank Governor Olsen has highlighted a similar point. We think any NOK strength will be temporary and look for EUR/NOK to end the year higher. Norwegian inflation has kept falling in recent months (Figure 1), dragged down by imported disinflation in particular (Figure 2). In its latest statement, Norges Bank noted "the krone is stronger than assumed in June, which in isolation will pull down inflation", adding also that "moderate wage growth will…weigh down on inflation in the coming period." The forward curve is priced for the start of normalization in 2018, with one full hike by December of next year. If the inflationary outlook remains weak, Norges Bank will have to shift its stance at its last two meetings of the year (October 26 and December 14). We have revised up our EUR/NOK end year forecast to 9.50.

6-12 Month Outlook – Keeping end-2018 unchanged

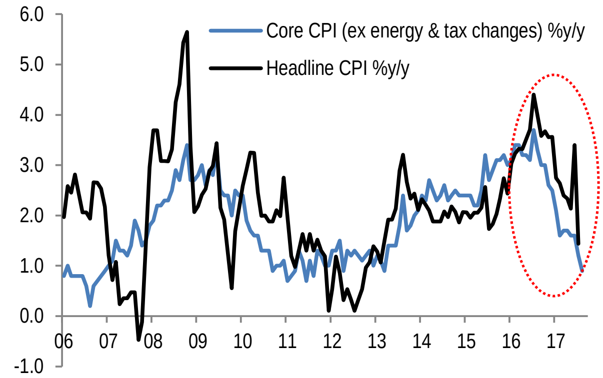
In real trade-weighted terms, NOK is not far from its 50yr low and on Norges Bank's preferred import-weighted I44 index, NOK is still ~9% below its long-run average. While core inflation is subdued, Norges Bank looks for capacity utilization to normalise by 2020. We are cautiously constructive on the currency over a longer-term horizon and have left our end-2018 EUR/NOK forecast unchanged.

Indicators

	Current (Previous)*
Official cash rate	**0.50% (0.50%)**
Trend interest rates 10y average	3.6%
Bias in interest rate market	Lower
CPI (ex energy and taxes) %Y/Y Aug (Jul)	0.9% (1.2%)
Inflation target %	2.5%
Budget balance % GDP FY16 (FY15)	**5.5% (6.9%)**
Budget balance target % GDP	Structural, non-oil deficit < 4%
GDP Mainland Growth %q/q Q2 (Q1)	**1.7% (1.4%)**
Trend GDP %q/q	0.6%
EUR Purchasing Power Parity Value Aug	**8.6881**
Spot end-Sep	9.4056
PPP Valuation	EUR/NOK is overvalued
Current a/c balance % GDP Q2 (Q1)	4.3% (3.9%)
Trend current account balance % GDP	10.0%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

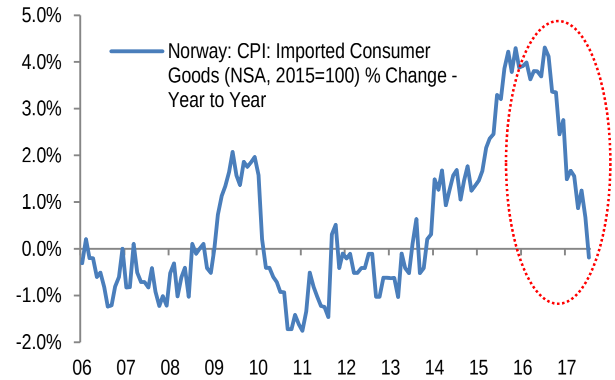
* Current is latest month, quarter or year

1. Both headline and core inflation have been falling…



Source: RBC Capital Markets, Haver

2. …And imported disinflation is one important driver



Source: RBC Capital Markets; Haver

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/NOK	8.59	8.35	7.96	8.48	8.44	8.40	7.96	7.50
EUR/NOK	9.15	9.54	9.41	9.50	9.20	8.90	8.60	8.40
NOK/SEK	1.04	1.01	1.02	1.02	1.01	1.01	1.01	1.04
CAD/NOK	6.45	6.44	6.38	6.84	6.65	6.66	6.32	5.95

Source: RBC Capital Markets estimates

Canadian Dollar

George Davis

1-3 Month Outlook – Correction in play

The multi-month decline in USD/CAD reached a climax in early September as the market digested the surprise rate hike that the BoC delivered. Since that time, the pair has commenced the price correction that we had embedded in our forecast profile for Q4, moving from the low for the year at 1.2062 to a peak of 1.2539 at the time of writing. The correction has been driven by a number of factors, including: (1) a broad-based recovery in the USD, (2) a more cautious tone contained in a September 27 speech from BoC Governor Poloz that caused 2-year US-CA interest rate differentials to widen and (3) oversold technical valuations (Figure 1).

While the corrective rally in USD/CAD has surpassed our Q4 point forecast of 1.24, any progress on US tax reform could provide a further boost to the USD into year-end as the market positions for another Fed hike. Progress around NAFTA renegotiation should also be watched closely. Although Poloz repeated that the BoC had no pre-determined path for interest rates and that they were "particularly data dependent" as they "cautiously" felt their way along as the economy approached full capacity, our 2017 growth forecast of 3.1% suggests that the output gap should close into year-end and provide the scope for one more 25 bp rate hike in Q4. This, in turn, would offset some of the topside risks that are present for USD/CAD.

6-12 Month Outlook – Raise and match

We look for the BoC to pause on the rate hike front in Q1 2018 as they assess the impact of the prior hikes on the economy – particularly on the Canadian consumer who is carrying record debt levels and a cooling housing market that is adjusting to macroprudential measures. With our US economics team looking for the Fed to hike in each quarter of 2018, the expected Q1 pause by the BoC should allow USD/CAD to reach a peak near 1.27. Our 2018 growth forecast of 2.2% points to slightly above potential growth next year that should allow the BoC to match the pace of Fed hikes from Q2 through Q4. This should limit the topside in USD/CAD and lead to a more neutral profile.

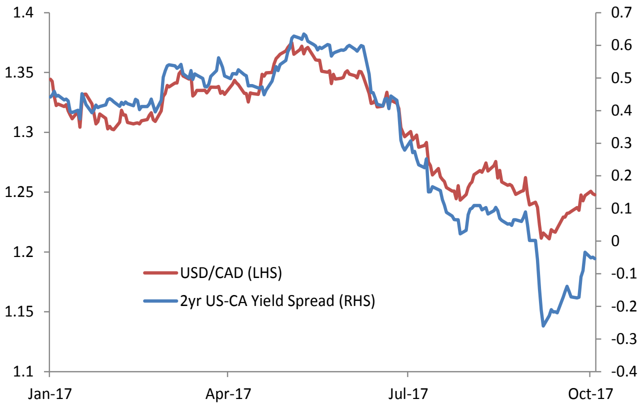
Inflation will serve as a key risk in 2018, with the BoC expecting the core measure to move back toward their 2% target in the middle of the year in response to the closure of the output gap (Figure 2). Hence, the lack of a sustained move higher would have a material impact on interest rate expectations, the path for monetary policy and CAD.

Indicators

	Current (Previous)*
Official cash rate	**1.00% (0.75%)**
Trend interest rates 10y average	1.07%
Bias in interest rate market	Higher
Core CPI Inflation (Trim) %Y/Y August (July)	**1.4% (1.3%)**
CPI inflation target range %Y/Y	1-3%
Budget balance % GDP FY16 (FY15)	**-0.1% (0.1%)**
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Q/Q saar Q2 (Q1)	**4.5% (3.7%)**
Trend GDP %Q/Q	1.72%
Purchasing Power Parity Value – Aug	**1.2378**
Spot end Sep	1.2471
PPP Valuation	USD/CAD is fairly-valued
Current account balance % GDP Q2 (Q1)	**-2.9% (-3.0%)**
Trend current account balance % GDP	-2.39%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

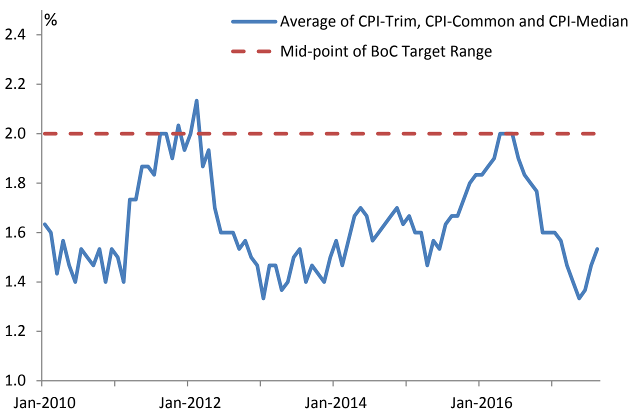
* Current is latest month, quarter or year

1. Interest rate spreads remain a key driver for USD/CAD



Source: Bloomberg, RBC Capital Markets

2. Core inflation measures stabilize



Source: Bank of Canada, Haver Analytics, RBC Capital Markets

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CAD	1.33	1.30	1.25	1.24	1.27	1.26	1.26	1.26
EUR/CAD	1.42	1.48	1.47	1.39	1.38	1.34	1.36	1.41
CAD/JPY	83.7	86.7	90.2	83.1	78.7	81.0	82.5	84.1

Source: RBC Capital Markets estimates

Australian Dollar

Elsa Lignos

1-3 Month Outlook – Looking for retracement

AUD is one of the worst-performers over the past month, though it is doing better than its rate dynamic alone would suggest. Figure 1 shows that the gap we have identified since last year between AUD/USD and 2yr AU-US swap spreads continues to persist. Even when zooming in to the last 12 months and rescaling the axes (Figure 2), the gap is impossible to erase. We put this down to the importance of the *level* of rates alongside rate dynamics. AUD remains the second highest yielder in G10. While recent comments from RBA board member Harper kept the door open to cuts, he framed it as a possible policy response to a loss in economic momentum. Right now AU data are generally beating expectations (our AU economic surprise indicator has been at or above zero for the last two months). Key to watch will be the next batch of employment data on October 18 and Q3 CPI on October 25. The RBA is also sounding more positive on the prospects for non-mining capex. Though the Q2 ABS capex survey was already pointing in that direction, the RBA's increased confidence likely reflects its own business liaison survey. One fly in the ointment and likely cause of relative underperformance for AUD over the past month is the deterioration in terms of trade and in particular the tumble in iron ore (down 25% from the late August high). Our Asia strategist argues speculative churn in Chinese iron futures has spiked after a government directive directing wealth management product flows to the commodity futures market (see *Total FX*, 1 Sept 2017) – that may cause short-term swings hitting AUD but is unlikely to change the longer-term outlook. Technically AUD/USD is looking oversold and currently testing a very strong area of support denoted by 0.7765 (an old triple top) and 0.7750 (an old double top). A daily close above resistance at 0.7946 will be required to end the correction via a bullish trend reversal. Our forecasts continue to show AUD/USD stuck around the top of the recent 0.75-0.80 trading range in the short-term.

6-12 Month Outlook – Same longer-term risks

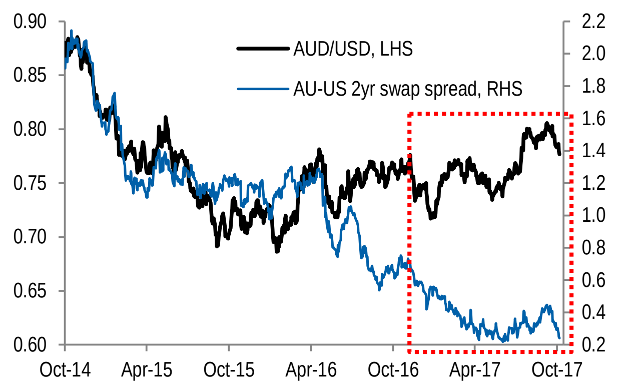
Longer-term the risks build up for AUD. China's window-dressing is less likely to continue after the October National Congress. There are risks in Chinese housing and construction (see *Total FX*, 4 Aug 2017), sectors which have been a big source of demand for AU iron ore. Fiscal consolidation is still required over the longer-term, consistent with our AU rates strategists' view that the RBA will need to do more of the work in supporting growth.

Indicators

	Current (Previous)*
Official cash rate	**1.5% (1.5%)**
Trend interest rates 10y average	4.4%
Bias in interest rate market	Downward
CPI Inflation %Y/Y Q2 (Q1)	**1.9% (2.1%)**
CPI Inflation target range %Y/Y	2.0-3.0%
Budget balance % GDP FY16/15	**-1.5%/-1.9%**
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Y/Y Q2 (Q1)	**1.8% (1.8%)**
Trend GDP %Y/Y	2.8%
Purchasing Power Parity Value Q2	**0.7311**
Spot end-Sep	0.7834
PPP Valuation	AUD/USD is overvalued
Current account balance % GDP Q2 (Q1)	**-2.1% (-1.1)**
Trend current account balance % GDP	-4.4%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

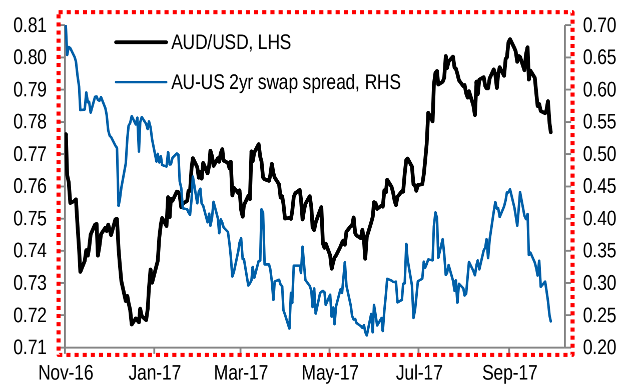
* Current is latest month, quarter or year

1. The gap between AUD/USD and rates still persists…



Source: Bloomberg, RBC Capital Markets

2. 2y rate diff is near its 12m low while AUD/USD holds up



Source: RBC Capital Markets, Bloomberg

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
AUD/USD	0.76	0.77	0.78	0.80	0.77	0.74	0.73	0.73
EUR/AUD	1.40	1.49	1.51	1.40	1.42	1.43	1.48	1.53
AUD/NZD	1.09	1.05	1.09	1.07	1.07	1.06	1.06	1.06
AUD/CAD	1.02	1.00	0.98	0.99	0.98	0.93	0.92	0.92

Source: RBC Capital Markets estimates

New Zealand Dollar

Adam Cole

1-3 Month Outlook – Political uncertainty

NZD/USD has continued to drift lower in recent weeks, after the gap lower on the election outcome (September 23). Recent weakness, however has been driven by broad USD strength rather than independent NZD weakness. After a quick election-related sell-off on the commodity crosses, NZD has quickly stabilised. The political backdrop is no clearer now than it was in the immediate wake of the election. The formal process of forming a government will not get underway until the final vote tally is known in the next few days and it remains unclear whether NZ First, who hold the balance of power, will form a coalition with one of the two major parties or choose to sit on the cross benches and support a minority government on key votes only. A detailed coalition agreement would probably take several more weeks to negotiate and the markets' revealed preference during the campaign is that a Labour-led coalition would be kneejerk negative for the currency and a National-led coalition would be kneejerk positive. Either way, we expect the impact of politics on NZD to be relatively short-lived. With a budget surplus of around 2% of GDP, NZ does not have the need for fiscal consolidation that many developed countries do. Equally, markets' concerns on the policy credibility of a left-leaning government need to be offset against the likelihood of easier fiscal policy. So, for NZD, monetary policy is likely to quickly return as the main driver. In this context, the market slightly overprices the risk of tighter policy (around 20bp of hikes over the next year). But offsetting this is ongoing demand for yield and the two forces are likely to maintain a relatively tight trading range. Near-term, our bias is a drift back toward the top of the recent range (0.75).

6-12 Month Outlook – Still G10's highest yielder

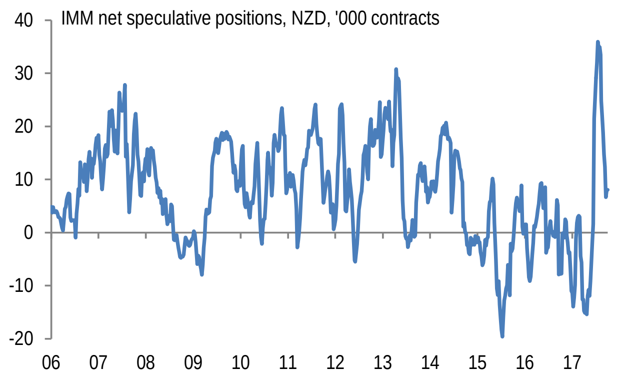
In the statement following his first meeting as caretaker Governor Spencer repeated verbatim the line that "a lower New Zealand dollar is needed" to "increase tradables inflation and help deliver more balanced growth". NZD remains overvalued relative to its long-run REER (Figure 2) and the RBNZ has a mandate to use FX intervention as a policy instrument, but the hurdle will be higher for big policy decisions under an interim governor. There is a high degree of uncertainty at the moment given the election outcome and absence of a stable government. Our long-term forecasts are unchanged this month pending more clarity on the new government and governor.

Indicators

	Current (Previous)*
Official cash rate	**1.75% (1.75%)**
Trend interest rates 10yr average	5.40%
Bias in interest rate market	Flat
CPI Inflation %Y/Y Q2 (Q1)	**1.7% (2.2%)**
Inflation target	1.0-3.0%
Budget balance % GDP FY16/FY15	**1.5%/1.4%**
Budget balance target % GDP	Balanced over business cycle
GDP Growth %Y/Y Q2 (Q1)	**2.5% (2.5%)**
Trend GDP %Y/Y	3.1%
Purchasing Power Parity Value Q2	**0.6604**
NZD/USD end-Sep	0.7209
Valuation	NZD/USD is overvalued
Current account balance % GDP Q2 (Q1)	**-2.8% (-2.9%)**
Trend current account balance % GDP	-4.2%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

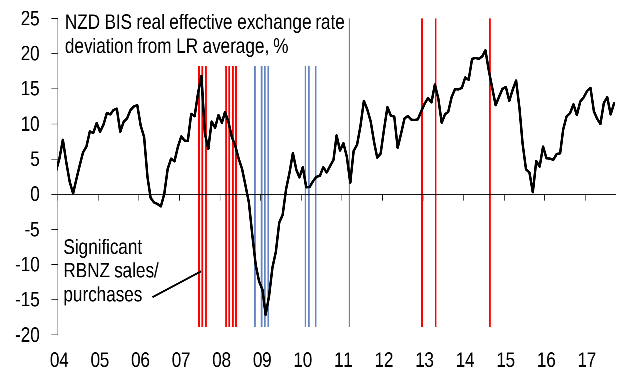
* Current is latest month, quarter or year

1. Speculative longs have mostly unwound



Source: RBC Capital markets, Bloomberg

2. RBNZ intervention threat is credible



Source: RBC Capital Markets; Bloomberg

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
NZD/USD	0.70	0.73	0.72	0.75	0.72	0.70	0.69	0.69
EUR/NZD	1.52	1.56	1.64	1.49	1.51	1.51	1.57	1.62
AUD/NZD	1.09	1.05	1.09	1.07	1.07	1.06	1.06	1.06
NZD/CAD	0.93	0.95	0.90	0.93	0.91	0.88	0.87	0.87

Source: RBC Capital Markets estimates

Chinese Yuan

Sue Trinh

1-3 Month Outlook – Pivoting around Party Congress

CNY/H has traded in the bottom half of AXJ currencies since September. In the past month, we have seen further evidence of China leaning against CNY(H) appreciation as the government lowered the ratio of FX risk reserves paid by banks for their purchases of FX forwards on behalf of their clients to 0% with effect from 8 September. Previously, financial institutions had to set aside 20% of their previous month's CNH forwards settlement amount as FX risk reserves for one year at zero interest. China has also allowed capital outflows to continue. Following an outflow of USD22.7bn in July, the largest outflow since February, August saw an outflow of USD11.5bn. We find that China's pain threshold for Yuan strength is ~6.4-6.5 in USD/CNY and ~95.5 in the CNY basket, which corresponds with the level from 8 November 2016, i.e., the level that prevailed at the time of the US election.

The Chinese Communist Party (CCP) will kick off its 19th Party Congress in Beijing on October 18, 2017 and is expected to last for one week. We will be looking for whether the Congress lasts longer (as this would signal tension in the ranks) and China's policy direction for the next five years. In addition, there has been speculation about President Xi's political theory being written into the Party Charter, further elevation to his status from "core leader" and his staying on beyond the customary two terms. If any of the above materialises, we would be discouraged about the prospects for meaningful economic reforms under Xi. Our USD/CNY(H) forecasts are under review given the underwhelming USD strength to date and the tenacity of Chinese intervention, but will reserve judgment until after the Party Congress..

6-12 Month Outlook – Consensus too complacent

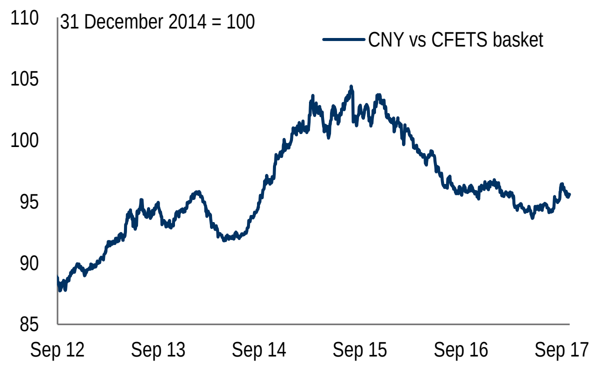
Recent efforts to deleverage the corporate sector have had unintended negative consequences. Famously thrifty Chinese households are saving less and binging on debt, shouldering more and more of the corporate debt burden while the government's budget deficit is estimated to be upwards of 12.6% of GDP, 3.3%pts wider than the IMF previously forecast. Economy wide leverage is still increasing sharply. We are skeptical China can achieve the goal of deleveraging the economy while maintaining economic growth. Recent growth upgrades are a reflection of higher leverage in the economy. Our base case remains a gradual and controlled CNY depreciation.

Indicators

	Current (Previous)*
Official cash rate	**1.5% - 4.35 % (1.5%-4.35%)**
Trend interest rates (10yr average)	2.85%-6.07%
Bias in interest rate market	Lower
CPI Inflation %Y/Y last (prev)	**1.8% (1.4%)**
Inflation target	3.0%
Budget balance % GDP last (prev)	**-3.5% (-1.80%)**
Budget balance trend % GDP	-1.21
GDP Growth % y/y last (prev)	6.9% (6.9%)
Trend GDP %y/y	9.9
RBC-POLAR misalignment	**7.5%**
Spot end-September	6.6528
FX Valuation	Overvalued
Current account balance % GDP last (prev)	**1.4% (1.5%)**
Trend current account balance % GDP	4.1
Moody's Foreign Currency Rating	**A1**
Outlook	Stable

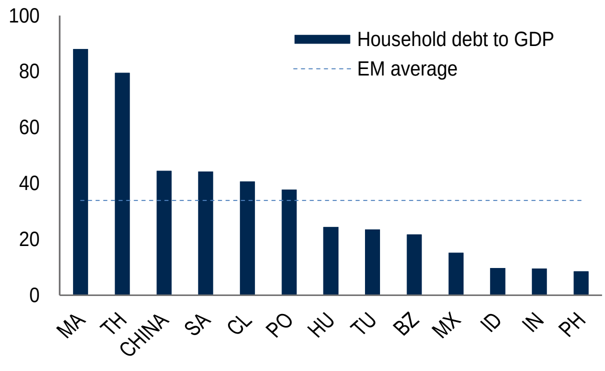
* Current is latest month, quarter or year

1. A move to cap the CNY basket



Source: RBC Capital Markets; Bloomberg

2. China household debt to GDP above EM average



Source: RBC Capital Markets; CEIC

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CNY	6.88	6.77	6.63	7.20	7.40	7.50	7.60	7.70
EUR/CNY	7.33	7.73	7.84	8.06	8.07	7.95	8.21	8.62
CNY/JPY	16.2	16.6	17.0	14.3	13.5	13.6	13.7	13.8
CAD/CNY	5.17	5.22	5.32	5.81	5.83	5.95	6.03	6.11

Source: RBC Capital Markets estimates

Indian Rupee

Sue Trinh

1-3 Month Outlook – Fiscal slippage concerns to be transitory

INR has been one of the worst performing currencies in AXJ since the start of September, trading to levels last seen in March against the USD on the back of concerns of fiscal slippage and a resurgent USD.

The RBI voted 5 to 1 to keep the repo rate at 6%, in line with expectations. The dissent vote was for a cut, but the tone of the accompanying statement was less dovish than expected, indicating the RBI is reluctant to cut rates again. It raised its inflation projection for 2HFY18 from ~4.5% in Mar18 to 4.2-4.6%, but cut its growth estimate from 7.3% to 6.7%, viewing the slowdown as transitory; RBI expects growth to recover to 7.4% in FY18, assuming a normal monsoon, fiscal consolidation in line with the announced trajectory, and no major exogenous/policy shocks.

Thus, the onus is on the government to support growth once the dust settles on the impact of GST. ET Now reported the government is weighing a possible stimulus worth INR400bn and may relax the fiscal deficit target for this year. With much of the budget having been used up (96.1% of the full-year target during April-August), there is a very real risk of fiscal slippage from the budgeted 3.2% to 3.5% on a shortfall of revenue. We would view this as a short-term setback to India's fiscal consolidation, and expect the government to reprise efforts in FY19, aided by a pick-up in GST revenues, a focus on the recovery of non-performing assets and rebuilding banks' balance sheets.

6-12 Month Outlook – Constructive

The RBI announced a "detailed review" of rules on overseas investment in debt markets which opens the door for greater access to Indian bonds by global funds. Regulatory changes will be finalised in consultation with the Government of India and the Securities Exchange Board of India (SEBI) and effective from April 2018.

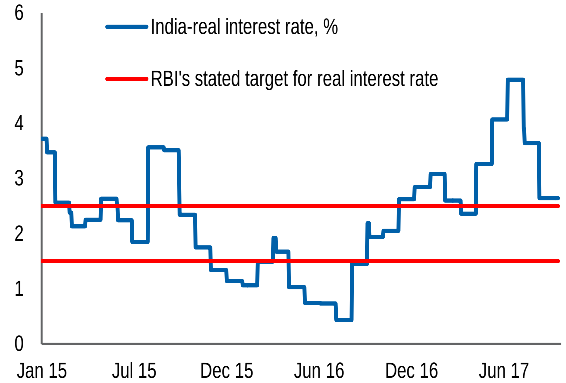
We expect INR to be one of the region's outperformers on a relative basis. Since 2013, India has accumulated the most FX reserves in the region and its balance of payments position provides a decent buffer from a rising USD and rising US interest rates.

Indicators

	Current (Previous)*
Official cash rate (Repurchase Rate)	**6.00% (6.25%)**
Trend interest rates (10yr average)	6.75%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	**3.36% (2.36%)**
Inflation target	5% by FY-end 2017/18
Budget balance % GDP last (prev)	**-4.2% (-3.5%)**
Budget balance trend % GDP	-5.15
GDP Growth % y/y last (prev)	5.7% (6.1%)
Trend GDP %y/y	6.4
RBC-POLAR misalignment	**1.3%**
Spot end-September	65.28
FX Valuation	Overvalued
Current account balance % GDP last (prev)	**-1.24% (-0.7%)**
Trend current account balance % GDP	-1.35%
Moody's Foreign Currency Rating	**Baa3**
Outlook	Positive

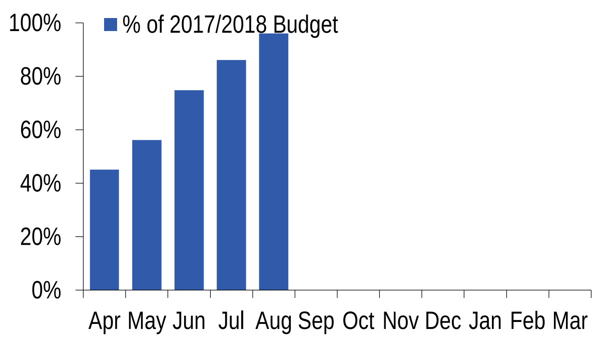
* Current is latest month, quarter or year

1. Real rates have come down as inflation picked up



Source: RBC Capital Markets; RBI, Bloomberg

2. Fiscal slippage likely



Source: RBC Capital Markets; RBI, Bloomberg

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/INR	64.8	64.6	65.3	65.5	66.0	66.5	66.8	67.1
EUR/INR	69.0	73.8	77.2	73.4	71.9	70.5	72.1	75.2
INR/JPY	1.72	1.74	1.72	1.57	1.52	1.53	1.56	1.58
CAD/INR	49	50	52	53	52	53	53	53

Source: RBC Capital Markets estimates

South Korean Won

Sue Trinh

1-3 Month Outlook – North Korea overshadows domestic data

KRW followed up a poor August with an equally poor September, and was again one of the worst performing AXJ currencies in the month (-2% versus USD). Relatively encouraging domestic data was overshadowed by repeated provocations on the part of North Korea. Days after the UN Security Council approved stricter sanctions, North Korea fired a missile over Japan, with a range sufficient to hit US territory Guam in a follow up to a similar launch in August.

North Korea may conduct more provocative acts near the anniversary of the founding of its communist party on 10 October or to coincide with China's Communist Party Congress on 18 October, keeping KRW under pressure.

Domestically, the latest set of data indicates economic momentum picked up in Q3. Industrial production remained firm and output in the semiconductor sector has increased sharply, consistent with the new product cycle in the global smartphone market. Consumer confidence peaked in July, but at 107.7, the index sits well above the 100 level, supporting the services sector. Expansion in the manufacturing and services sectors puts GDP growth on track to reach ~3% in Q3, up from 2.7% in Q2.

With fiscal stimulus doing most of the heavy lifting in supporting growth, the BoK's next move will be a rate hike. Conditions are very accommodative with the real overnight rate ~-1%. Meantime, the BoK has warned that prolonged accommodation could worsen imbalances from high household debt. But the BoK is likely to stick to unchanged monetary policy through at least the end of Governor Lee's term in March 2018 amid heightened geopolitical tensions on the Peninsula and government measures to cool the property market.

6-12 Month Outlook – Continued pressure

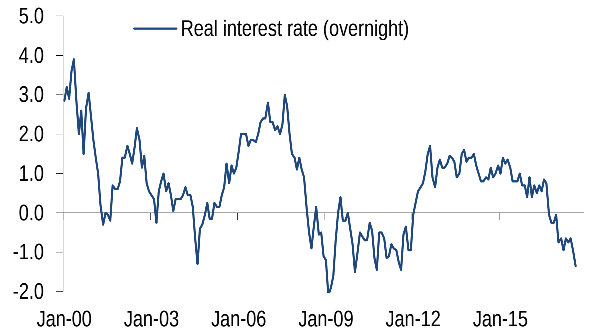
KRW will sit in the shadow of North Korean geopolitical tensions and renewed calls from the US to revise its bilateral trade deal with South Korea amid charges of artificial depression of the Won. South Korea's relatively high exposure to China also leaves it vulnerable. Meanwhile, we see limited upside risk to rate expectations with consensus already fully anticipating 30bps of rate hikes by the end of 2018. We target 1160 by end-2017 and 1190 by end-Q2 2018.

Indicators

	Current (Previous)*
Official cash rate	**1.25% (1.25%)**
Trend interest rates (10yr average)	3.45%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	**2.1% (2.6%)**
Inflation target	2.0% (2016-2018)
Budget balance % GDP last (prev)	**0.5% (-0.03%)**
Budget balance trend % GDP	1.4
GDP Growth % y/y last (prev)	2.7% (2.7%)
Trend GDP %y/y	4.1
RBC-POLAR misalignment	**0.6%**
Spot end-September	1145.3
FX Valuation	Fair Valued
Current account balance % GDP last (prev)	**5.7% (6.4)**
Trend current account balance % GDP	3.1%
Moody's Foreign Currency Rating	**Aa2**
Outlook	Stable

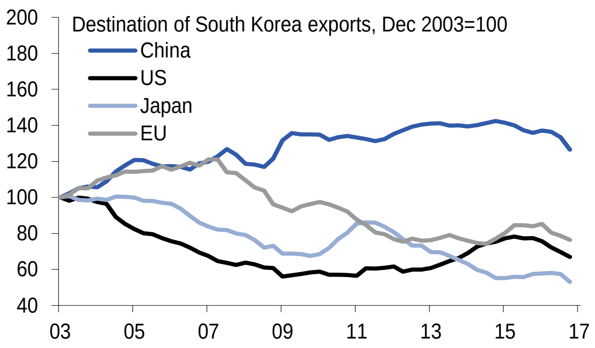
* Current is latest month, quarter or year

1. Very accommodative monetary policy



Source: RBC Capital Markets, BoK, Bloomberg

2. South Korea's economic dependence on China



Source: RBC Capital Markets, Bloomberg

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/KRW	1118	1145	1145	1160	1180	1190	1210	1250
EUR/KRW	1191	1309	1353	1299	1286	1261	1307	1400
JPY/KRW	10.0	10.2	10.2	11.3	11.8	11.7	11.6	11.8
CAD/KRW	839	884	918	935	929	944	960	992

Source: RBC Capital Markets estimates

Singaporean Dollar

Sue Trinh

1-3 Month Outlook – MAS: Easing is more likely

SGD is up modestly since the start of September, but even with just a 0.4% gain against the USD, SGD is one of the best performing AXJ currencies over this period. Recent growth and inflation indicators showed signs of pick up and have seen SGD outperforming on expectations of a less dovish Monetary Authority of Singapore (MAS), with some speculating on a potential tightening. MAS will release its Monetary Policy Statement no later than 13 October. At its last policy decision in April, the MAS said it will keep the neutral SGD NEER policy by an "extended" period of time and signaled that it was not comfortable with the strength in the SGD NEER. We estimate that the SGD NEER is ~0.3% higher and is trading just above the mid-point of the band. We think any discussion of potential monetary tightening is premature while employment is contracting; the MAS has never tightened while employment growth has been negative. Employment contracted in both Q1 and Q2 for a total of 14.6k in what was the first consecutive quarterly contraction since 2009. This presents serious headwinds to domestic demand.

Based on Singapore's growth/inflation mix, the SGD NEER should be closer to the low end of the policy band, rather than the mid-point, in our view. Monetary policy has been unchanged since April 2016 when MAS shifted to a stance of zero appreciation in the trade-weighted exchange rate from gradual and modest appreciation. We think risks are still asymmetrically skewed toward more MAS easing. Re-centering the SGD NEER to a lower level would allow more scope for currency depreciation, supporting domestic demand. Renewed easing in the region (eg., Bank Indonesia, Reserve Bank of India, State Bank of Vietnam) may give MAS the added confidence to ease monetary policy. If we are wrong, the MAS will deliver no change to the zero appreciation of the SGD NEER slope, midpoint or bandwidth. In the event, we expect the MAS to be dovish rather than hawkish as the market expects. We have an end-2017 target for USD/SGD of 1.41.

6–12 Month Outlook–Steady drift

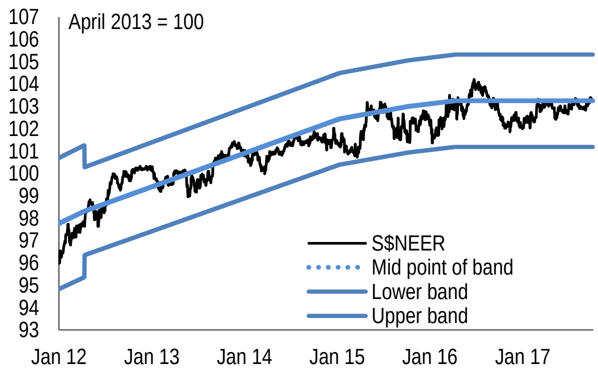
Corporate loan growth slowed sharply from 10.4% in June to 5.8% in August, portending the peak in the business cycle. We expect USD/SGD to drift toward 1.46 by end-2018.

Indicators

	Current (Previous)*
Official S$NEER Target	**Zero percent appreciation**
Trend interest rates (10yr average)	1.85%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	**0.4% (0.6%)**
Inflation target	**0.5–1.5%**
Budget balance % GDP last (prev)	**-1.0% (-1.0%)**
Budget balance trend % GDP	0.4
GDP Growth % y/y last (prev)	2.9% (2.5%)
Trend GDP %y/y	5.4
RBC-POLAR misalignment	**0.3%**
Spot end-September	1.3576
FX Valuation	Fairly valued
Current account balance % GDP last (prev)	**19.6% (19.8%)**
Trend current account balance % GDP	20.1
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

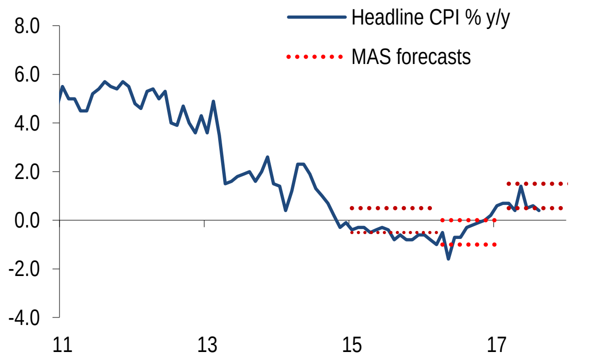
* Current is latest month, quarter or year

1. Room to move on the S$NEER



Source: RBC Capital Markets; Bloomberg

2. Inflation is languishing relative to MAS forecasts



Source: RBC Capital Markets; Bloomberg

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/SGD	1.40	1.38	1.36	1.41	1.42	1.45	1.45	1.46
EUR/SGD	1.49	1.57	1.60	1.58	1.55	1.54	1.57	1.64
SGD/JPY	79.7	81.6	82.9	73.0	70.4	70.3	71.7	72.6
CAD/SGD	1.05	1.06	1.09	1.14	1.12	1.15	1.15	1.16

Source: RBC Capital Markets estimates

Indonesian Rupiah

Sue Trinh

1-3 Month Outlook – BI has front loaded its easing

IDR has been one of the worst performing currencies in AXJ since the start of September, trading down 1.7% against the USD to levels last seen in December 2016. Much of the underperformance was prompted by the second surprise rate cut by BI in as many months, catching the market wrong-footed and prompting momentum driven liquidation of bonds and equities by foreign investors. BI lowered its 7-day reverse repo policy rate by another 25bp to 4.25% on 22 September. It was the eighth rate cut since the start of 2016 and expected by only 7 out of 27 economists surveyed by Bloomberg; the rest had expected unchanged policy, RBC included.

We had expected BI to wait and monitor the effects of its surprise August rate cut before pulling the trigger again. But the low inflation environment, lackluster credit growth and stable IDR allowed BI to opportunistically cut rates at this juncture. As such, we view the September rate cut as a front loading of expected future easing and think it will now move to the sidelines. Any further easing will depend on inflation. It has set a target range for inflation of 3-5% for 2017 and 2.5-4.5% in 2018 and 2019.

The likely implementation of macro-prudential policy to boost funding reinforces an on-hold stance while Governor Martowardojo said the policy rate is "adequate enough". We expect to see USD/IDR reverse back below 13,450-13,500 in the short-term with BI capping gains and IDR supported by attractive yields and growth.

6-12 Month Outlook – Better fundamentals, room to catch up

Investment is showing tentative signs of a much awaited pick-up in growth, lifting from 4.2% in June 2016 to 5.4% in June 2017. Admittedly, the pace of recovery has been disappointing, but nonetheless, the government's infrastructure program and reform agenda should help boost both the business environment and private investment. IDR stands to benefit over the longer term, particularly given its extreme underperformance year to date. The low volatility environment should ensure a latent bid in IDR.

Indicators

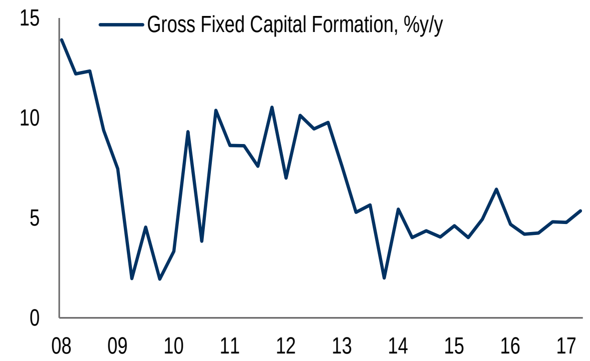
	Current (Previous)*
Official cash rate (7d Reverse repo rate)	**4.25% (4.50%)**
Trend interest rates (10yr average)	-
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	**3.72% (3.82%)**
Inflation target	4%+/-1.0%
Budget balance % GDP last (prev)	**-2.4% (-2.6%)**
Budget balance trend % GDP	-2%
GDP Growth % y/y last (prev)	5.01% (5.01%)
Trend GDP %y/y	5.5
RBC-POLAR misalignment	**0.9%**
Spot end-September	13,472
FX Valuation	Fair Valued
Current account balance % GDP last (prev)	**-1.5% (-1.5%)**
Trend current account balance % GDP	-0.5
Moody's Foreign Currency Rating	**Baa3**
Outlook	Positive

* Current is latest month, quarter or year

1. Sharp rally in USD/IDR after 2nd surprise BI cut

Source: RBC Capital Markets; Bloomberg

2. Long awaited investment pick-up coming?



Source: RBC Capital Markets; Bloomberg

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/IDR	13330	13335	13466	13450	13500	13550	13600	13650
EUR/IDR	14200	15237	15909	15064	14715	14363	14688	15288
JPY/IDR	119.7	118.7	119.7	130.6	135.0	132.8	130.8	128.8
CAD/IDR	10012	10289	10798	10847	10630	10754	10794	10833

Source: RBC Capital Markets estimates

Russian Ruble

Daria Parkhomenko

1-3 Month Outlook – Range-bound

We expect USD/RUB will remain range-bound (56 to 58) with positive carry adding some support to RUB, while uncertainty about potential US sanctions on sovereign debt and the impact of geopolitics on oil will act as the main risks to our forecast for a relatively stable RUB.

RUB is likely to remain a beneficiary of the carry trade (annual carry for short USD/RUB is 725bp), albeit to a lesser extent than earlier in the year. Russia has one of the highest interest rates in EM and the 1M implied vol for USD/RUB is at the lowest level since August 2014. Even with our view for 50bp in cuts in Q4 (Bloomberg consensus & market expecting -40bp), short USD/RUB appears attractive. We do not expect a deeper RUB sell-off as that would increase the probability of CBR reducing FX purchases while we do not expect any material increase in foreign interest in local currency bonds (OFZs).

There are two risks to highlight. The first one is the possibility that the US imposes sanctions on investing in Russian sovereign debt. In June, the US Senate published an "Order of Procedure," which states under Sec.242 that "No later than 180 days after the date of the enactment of this Act, the Secretary of the Treasury […] shall submit to the congressional committees a report describing in detail the potential effects of expanding sanctions […] to include sovereign debt". It seems the market is assigning a low probability to this event, but if this were to materialize, USD/RUB is likely to overshoot our forecast as foreign investors reduce their holdings (~30% of the total OFZ market). The second risk is oil. If the three geopolitical risks that our Commodity Strategists recently highlighted develop and cause an oil rally, USD/RUB's sensitivity to oil may rise, posing downside risk to our forecast.

6-12 Month Outlook – USD/RUB gradually higher

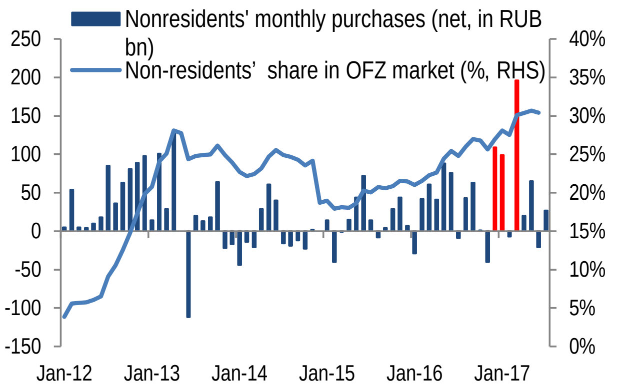
Over the longer-term, RUB is at risk from narrowing rate differentials to the US and any increase in vol undermining the good environment for carry trades. Meanwhile, we think the strong Q2 GDP growth is not likely to be the new norm. It will take time for the transition from a savings to a consumption model to materialize. Consensus is forecasting Russia's growth to underperform those of other EM and G10 countries (e.g. US, EZ, CEE-3, CA, MX, TU). We look for USD/RUB to gradually trend higher.

Indicators

	Current (Previous)*
Official key rate	**8.5 (9.0)**
Trend interest rates (historical average)	9.8
Bias in interest rate market	Easing
CPI Inflation %Y/Y Sep (Aug)	**3.0 (3.3)**
Inflation target	4.00%
Budget balance % GDP 2016 (2015)	**-3.65 (-3.39)**
Budget balance trend % GDP	0.2
GDP Growth % y/y Q2 (Q1)	2.5 (0.5)
Trend GDP %y/y	1.7
RBC-POLAR misalignment	**2.8%**
Spot end-September	57.55
FX Valuation	Close to neutral
Current account % GDP 2016 (2015)	**2.0 (5.0)**
Trend current account balance % GDP	5.7
Moody's Foreign Currency Rating	**Ba1**
Outlook	Stable

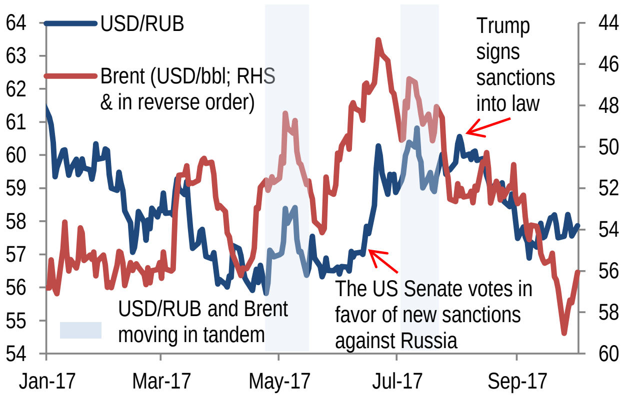
* Current is latest month, quarter or year

1. March foreign flows into OFZs were highest on record



Source: RBC Capital Markets, Central Bank of Russia

2. US Senate's vote on sanctions pushed USD/RUB higher



Source: Bloomberg, RBC Capital Markets

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/RUB	56.3	58.0	57.6	57.0	59.0	60.0	61.0	62.0
EUR/RUB	59.9	66.3	68.0	63.8	64.3	63.6	65.9	69.4
RUB/JPY	1.98	1.94	1.96	1.81	1.69	1.70	1.70	1.71

Source: RBC Capital Markets estimates

Mexican Peso

Tania Escobedo Jacob

1-3 Month Outlook – All eyes on NAFTA

MXN lost 3.8% against USD from Sep 1 to Oct 6, the third worst performing EM currency after TRY (-5.2%) and ZAR (-5.8%). USD/MXN broke the 17.58 – 17.98 range in which it fluctuated for the last couple of months and touched a high of 18.5487. Part of the move was explained by broad USD strength but was exacerbated by risks specific to the Mexican economy, particularly those related with the NAFTA renegotiation. The third round of meetings on the treaty ended in Ottawa (23-27 Sep) without major breakthroughs but the stance of the three parties became more astringent on topics including labor market regulations and a proposal to impose seasonal limits to Mexican exports of agricultural goods. Other controversial subjects such as the US-Mexico trade deficit, rules of origin and potential changes to Chapter 19 (on trade disputes), were left out of the agenda again. We still expect a higher NAFTA-related risk premium to be incorporated into prices as it becomes more difficult to maintain the positive rhetoric without concrete agreements on some of the difficult matters. Technically, the next target for USD/MXN is 18.5907, followed by 18.8230. The 18.3419 level should act as support for now and attract buying interest. Our year-end target for USD/MXN is at 18.82.

On monetary policy, Banxico kept the ON rate unchanged at 7% (in line with consensus) but recognized that risks to its inflation outlook “could have deteriorated” since the last meeting, emphasizing risks coming from MXN fluctuations, a tighter labor market and supply shocks resulting from the sequence of natural disasters in Mexico and the US, though those are expected to be temporary. We maintain our view that Banxico will keep rates at 7% for the rest of 2017 (in line with consensus and curve pricing), conditional on stable inflation dynamics.

6-12 Month Outlook – The road to elections

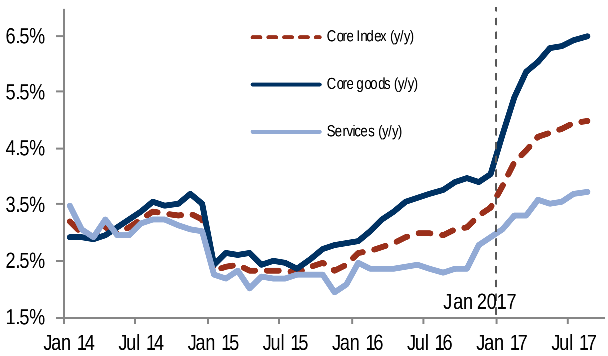
Longer term, the Presidential elections in Mexico (Jul 2018) will be the dominant event. The consolidation of the early leading contender, Lopez Obrador, should prove negative for MXN, since his left-leaning platform is likely to scale back some of the biggest reforms adopted by the current administration. In particular, the opening of the energy sector to private investment. We expect USD/MXN to price in a larger election premium once the campaigns kick off properly. In the 2 previous elections where AMLO was also a candidate with a serious chance of winning, the rally started around 4 months ahead of the election. (Fig 2).

Indicators

	Current (Previous)*
Official cash rate	**7.00 (6.75)**
Trend interest rates (10yr average)	4.62
Bias in interest rate market	Hiking
CPI Inflation %Y/Y Aug (Jul)	**6.66 (6.44)**
Inflation target	3.0 (+/-1%)
Budget balance % GDP 3Q (2Q)	**-1.2 (-0.66)**
Budget balance trend % GDP	-3.14
GDP Growth % y/y 2QP (1Q)	1.8 (2.8)
Trend GDP %y/y	2.41
Purchasing Power Parity	17
Spot	**18.46**
FX Valuation	Undervalued
Current account balance % GDP Q1 (Q4)	**-2.09 (-2.13)**
Trend current account balance % GDP	-2.54
Moody's Foreign Currency Rating	**A3**
Outlook	Negative

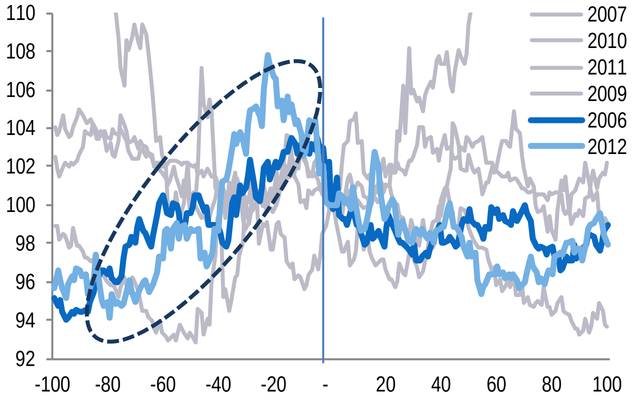
* Current is latest month, quarter or year

1. Stabilization of core prices points to stable rates in 4Q17



Source: RBC Capital Markets, Bloomberg.

2. USD/MXN (Index, Election Day=0)



Source: RBC Capital Markets, El Economista.

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/MXN	18.72	18.12	18.25	18.82	18.85	19.00	19.50	19.00
EUR/MXN	19.94	20.71	21.57	21.08	20.55	20.14	21.06	21.28
MXN/JPY	5.95	6.20	6.16	5.47	5.31	5.37	5.33	5.58
CAD/MXN	14.06	13.98	14.64	15.18	14.84	15.08	15.48	15.08

Source: RBC Capital Markets estimates

Brazilian Real

Tania Escobedo Jacob

1-3 Month Outlook – Politics & reforms

BRL was little changed in September; it lost 0.5% against USD, while comparable currencies such as ZAR TRY and MXN fell between 2.5% and 5.0% in the same period. This comes after a period of relative underperformance amid political uncertainty and increasing difficulties for the government to comply with its fiscal targets. On the political front, as widely expected by the market, Prosecutor General Rodrigo Janot charged the Brazilian president Michel Temer with obstruction of justice and leading a criminal organization. As in the previous episode, we think Congress will most likely dismiss the new charges but the new vote (expected in mid-October) will inevitably result in paralysis and delays in the legislative agenda. Temer's survival will also come at a cost as he will need to use more of the political capital he has left to secure the votes he needs. Losing bargaining chips at this stage of his government could prove critical to the future of the pension reform, considering the strong disagreements within Congress - even inside the govt's coalition- and the proximity of the 2018 electoral process. All in all, we think that the government plan, which still envisages passing the pension reform in before Dec, is too ambitious and will have to be postponed. Otherwise, the bill would have to be watered down to a point where it wouldn't make a real difference in the fiscal prospects of the Brazilian govt.

On Monetary policy, we expect the central bank to reduce the pace of monetary easing and cut 75 bps on Oct 26, taking rates to 7.50% (fully priced in the swap curve). The last move of 2017 will depend on price dynamics, growth and the progress of structural reforms; the market is currently pricing 45 bps of cuts in Dec. We leave our year-end target for USD/BRL at 3.30 on the back of political risks and also, a relatively less attractive carry profile.

6-12 Month Outlook – Presidential elections in sight

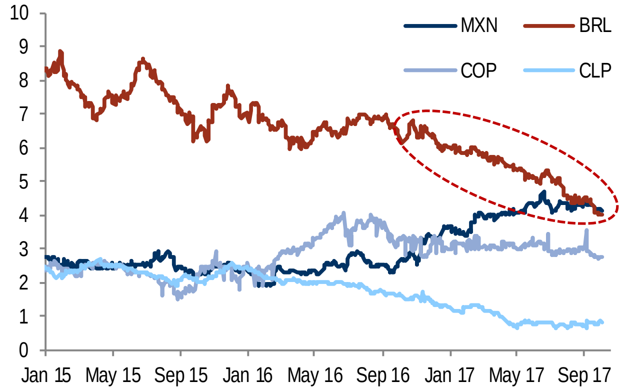
As for the first half of 2018, we think the presidential election will be in the driving seat for BRL, particularly if the pension reform becomes a topic for the next administration. Former President Luiz Inacio Lula da Silva keeps a clear lead in the polls despite being convicted for corruption, but markets are still not reacting, based on the hope that he won't be able to run (in which case the election becomes anyone's game). If Lula is found innocent after the appeal, or if the sentence is not confirmed before the election, he would still be allowed to run for president and it would likely trigger a rally in USD/BRL.

Indicators

	Current (Previous)*
Official cash rate	**8.25 (9.25)**
Trend interest rates (10yr average)	11.00
Bias in interest rate market	Cutting
CPI Inflation %Y/Y Aug (Jul)	**2.46 (2.71)**
Inflation target	4.5% +/- 1.5%
Budget balance % GDP 2Q (1Q)	**-9.24 (-8.68)**
Budget balance trend % GDP	-7.53
GDP Growth % y/y 2Q (1Q)	**+0.3 (+1.0)**
Trend GDP %y/y	-2.0
Purchasing Power Parity	**3.35**
Spot	**3.15**
FX Valuation	Undervalued
Current account balance % GDP 2Q (1Q)	**-0.71 (-1.03)**
Trend current account balance % GDP	-3.29
Moody's Foreign Currency Rating	**Ba2**
Outlook	Stable

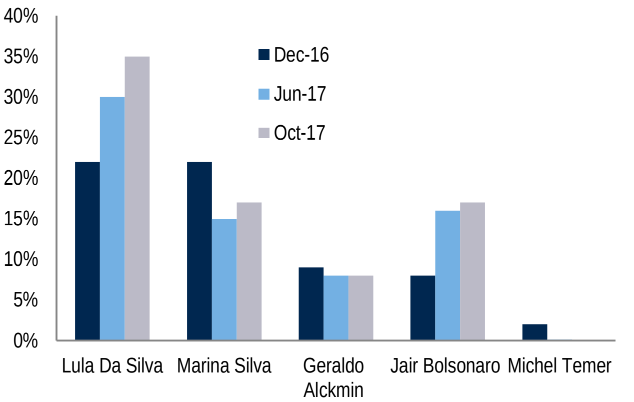
* Current is latest month, quarter or year

1. BRL is relatively less attractive among high-yielders



Source: RBC Capital Markets, Bloomberg.

2. Lula has widened his lead on polls



Source: RBC Capital Markets, Datafolha.

Forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/BRL	3.12	3.31	3.16	3.30	3.35	3.38	3.40	3.40
EUR/BRL	3.33	3.78	3.74	3.70	3.65	3.58	3.67	3.81
BRL/JPY	35.7	34.0	35.6	31.2	29.9	30.2	30.6	31.2
CAD/BRL	2.34	2.55	2.54	2.66	2.64	2.68	2.70	2.70

Source: RBC Capital Markets estimates

Forecasts

Spot forecasts

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.07	1.14	1.18	1.12	1.09	1.06	1.08	1.12
USD/JPY	111	112	113	103	100	102	104	106
GBP/USD	1.26	1.30	1.34	1.20	1.16	1.18	1.24	1.32
USD/CHF	1.00	0.96	0.97	1.04	1.07	1.11	1.08	1.04
USD/SEK	8.97	8.43	8.15	8.66	8.53	8.49	8.06	7.77
USD/NOK	8.59	8.35	7.96	8.48	8.44	8.40	7.96	7.50
USD/CAD	1.33	1.30	1.25	1.24	1.27	1.26	1.26	1.26
AUD/USD	0.76	0.77	0.78	0.80	0.77	0.74	0.73	0.73
NZD/USD	0.70	0.73	0.72	0.75	0.72	0.70	0.69	0.69
USD/CNY	6.88	6.77	6.63	7.20	7.40	7.50	7.60	7.70
USD/CNH	6.87	6.78	6.65	7.23	7.43	7.53	7.63	7.73
USD/HKD	7.77	7.81	7.81	7.77	7.78	7.78	7.80	7.80
USD/INR	64.8	64.6	65.3	65.5	66.0	66.5	66.8	67.1
USD/KRW	1118	1145	1145	1160	1180	1190	1210	1250
USD/SGD	1.40	1.38	1.36	1.41	1.42	1.45	1.45	1.46
USD/MYR	4.43	4.30	4.22	4.40	4.50	4.52	4.54	4.56
USD/IDR	13330	13335	13466	13450	13500	13550	13600	13650
USD/TWD	30.3	30.4	30.3	31.0	31.5	32.0	32.5	33.0
USD/THB	34.4	33.9	33.3	34.5	34.7	35.0	35.0	35.2
USD/PHP	50.2	50.5	50.9	51.0	51.5	52.0	52.0	52.5
USD/TRY	3.64	3.52	3.56	3.65	3.80	3.85	3.90	3.95
USD/ZAR	13.42	13.06	13.57	13.70	13.80	13.90	14.00	14.10
USD/PLN	3.97	3.70	3.65	3.78	3.85	3.93	3.86	3.72
USD/RUB	56.3	58.0	57.6	57.0	59.0	60.0	61.0	62.0
USD/MXN	18.72	18.12	18.25	18.82	18.85	19.00	19.50	19.00
USD/BRL	3.12	3.31	3.16	3.30	3.35	3.38	3.40	3.40

Source: RBC Capital Markets estimates

EUR Crosses

	2017				2018			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.07	1.14	1.18	1.12	1.09	1.06	1.08	1.12
EUR/JPY	119	128	133	115	109	108	112	119
EUR/GBP	0.85	0.88	0.88	0.93	0.94	0.90	0.87	0.85
EUR/CHF	1.07	1.09	1.14	1.16	1.17	1.18	1.17	1.16
EUR/SEK	9.56	9.64	9.62	9.70	9.30	9.00	8.70	8.70
EUR/NOK	9.15	9.54	9.41	9.50	9.20	8.90	8.60	8.40
EUR/CAD	1.42	1.48	1.47	1.39	1.38	1.34	1.36	1.41
EUR/AUD	1.40	1.49	1.51	1.40	1.42	1.43	1.48	1.53
EUR/NZD	1.52	1.56	1.64	1.49	1.51	1.51	1.57	1.62
EUR/CNY	7.33	7.73	7.84	8.06	8.07	7.95	8.21	8.62
EUR/CNH	7.34	7.32	7.75	7.85	8.10	8.10	7.98	8.24
EUR/HKD	8.28	8.92	9.23	8.70	8.48	8.25	8.42	8.74
EUR/INR	69	74	77	73	72	70	72	75
EUR/KRW	1191	1309	1353	1299	1286	1261	1307	1400
EUR/SGD	1.49	1.57	1.60	1.58	1.55	1.54	1.57	1.64
EUR/MYR	4.71	4.91	4.99	4.93	4.91	4.79	4.90	5.11
EUR/IDR	14200	15237	15909	15064	14715	14363	14688	15288
EUR/TWD	32	35	36	35	34	34	35	37
EUR/THB	36.6	38.7	39.4	38.6	37.8	37.1	37.8	39.4
EUR/PHP	53.4	57.7	60.1	57.1	56.1	55.1	56.2	58.8
EUR/TRY	3.87	4.02	4.21	4.09	4.14	4.08	4.21	4.42
EUR/ZAR	14.30	14.93	16.03	15.34	15.04	14.73	15.12	15.79
EUR/PLN	4.23	4.23	4.31	4.23	4.20	4.17	4.17	4.17
EUR/RUB	59.9	66.3	68.0	63.8	64.3	63.6	65.9	69.4
EUR/MXN	19.9	20.7	21.6	21.1	20.5	20.1	21.1	21.3
EUR/BRL	3.33	3.78	3.74	3.70	3.65	3.58	3.67	3.81

Source: RBC Capital Markets estimates

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