# Currency Report Card – October 2023

06 October 2023

## Forecasts

### October 2023


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Three month forecast returns

| Most bullish | Most bearish |
|---|---|
| BRL | SEK |
| MXN | GBP |
| NOK | AUD |

Source: RBC Capital Markets

12 month forecast returns

| Most bullish | Most bearish |
|---|---|
| BRL | JPY |
| MXN | GBP |
| NOK | AUD |

Source: RBC Capital Markets

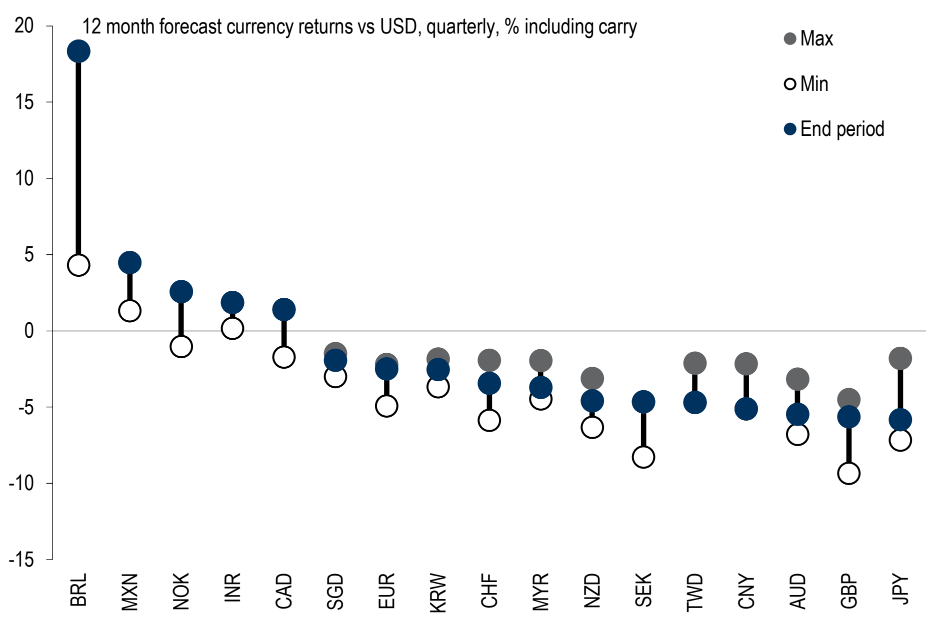
### Key forecast revisions this month include:

**USD/KRW:** Profile revised higher. End-2023 now 1370 (prior 1345). End-2024 1350 (1260).

**USD/TWD:** Profile revised higher. End-2023 now 32.60 (prior 32.20). End-2024 32.60 (31.70).

**USD/MYR:** Most of the profile revised higher. End-2023 now 4.77 (prior 4.73). End-2024 unchanged at 4.60.

BRL outperformance; JPY, GBP, AUD underperformance




Source: RBC Capital Markets

# Table of contents

US Dollar....3
Euro....4
Japanese Yen....5
Sterling....6
Swiss Franc....7
Swedish Krona & Norwegian Krone....8
Canadian Dollar....9
Australian Dollar....10
New Zealand Dollar....11
Chinese Yuan....12
Indian Rupee....13
South Korean Won....14
Taiwanese Dollar & Singapore Dollar....15
Malaysia Ringgit....16
Brazilian Real....17
Mexican Peso....18
Forecasts....19
Disclaimer....21

# US Dollar

Adam Cole

## 1-3 Month Outlook – Bias to further gains

USD extended August's gains into September and early-October, DXY hitting a new high for the year above 107. Nonetheless, the index is up only 3% year-to-date and at the lows in July, DXY was down over 3% and we think it fair to continue to characterise USD in 2023 as mostly trendless, certainly compared to the relentless rally in 2022. USD's most recent gains are once again a reflection of the asset market background, with UST 10yr yields rising close to 100bp cumulatively through August and September and equity markets reacting negatively to the rise in the discount rate this implied as yields made new 15 year highs (S&P -7% over the last two months). This has left us squarely in the "bottom right" quadrant of our four quadrants of asset markets returns framework, where markets tend to be dominated by USD direction and there is little discrimination between currencies (Figure 1). Where USD goes from here will depend critically whether we stay in this quadrant, or continue 2023's pattern of jumping between different combinations of asset market returns, and USD failing to establish a strong trend either way. The recent rise in yields is unusual in that it is not being driven by higher inflation expectations or by higher terminal Fed Funds expectations, but rather appears to reflect higher term premia in longer-term rates. Our core fixed income view is that this process will not run much further, though our strategists are reluctant to catch the falling knife just yet and as such, we would maintain a bias toward near-term USD gains. Longer-term, if US yields revert to the range-trading that characterised H1, relatives should start to dominate absolutes in FX and our bias, against the bearish consensus (Figure 2), is toward cyclical US outperformance and a steadily firmer USD. Our forecasts are unchanged this month.

## 6-12 Month Outlook – Extending strength into H1'24

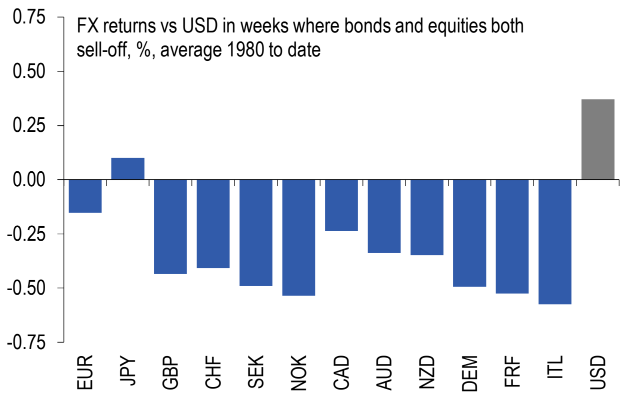
The bearish USD bias is still strong, particularly on the sell-side and we can understand where it comes from. USD looks expensive in historical terms. We have little doubt that in January 2024, short USD is likely to be one of the most popular thematic trades – as it was in Jan 2023 and 2022 and 2021 (and failed to work three years running…). But when we think about the underlying drivers for our USD view – a US economy that is more resilient than expected, a failure of bonds and equities to sustainably rally together, a slowdown in RoW growth has turned out to be deeper than thought, we don't see a reason for USD to head lower.

## Indicators

| | Current (Previous)* |
|---|---|
| **Official cash rate** | **5.25-5.50% (5.00-5.25%)** |
| Trend interest rates (10yr average) | 0.9% |
| Bias in interest rate market | Small hikes then lower |
| **Core PCE Inflation %Y/Y Aug (Jul)** | **3.9% (4.3%)** |
| Inflation target | 2%, on average |
| **Budget balance % GDP FY22 (FY21)** | **-5.5% (-12.3%)** |
| Budget balance target % GDP | - |
| GDP Growth % y/y Q2 S (Q4) | 2.4% (1.7%) |
| Trend GDP %y/y | 2.5% |
| **Purchasing Power Parity Value** | - |
| Spot | - |
| PPP Valuation | - |
| **Current account balance % GDP Q1 (Q4)** | **-3.2% (-3.4%)** |
| Trend current account balance % GDP | -2.4% |
| **Moody's Foreign Currency Rating** | **Aaa** |
| Outlook | Stable |

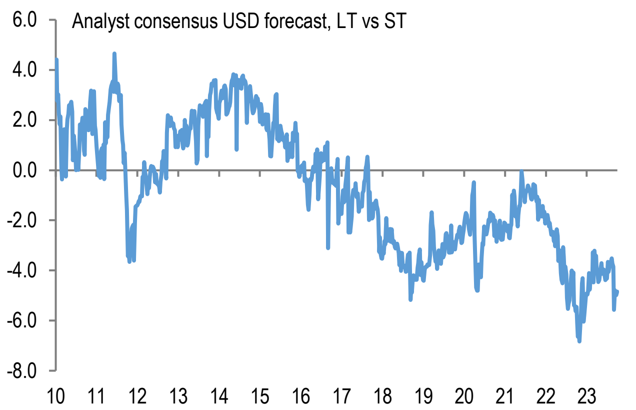
* Current is latest month, quarter or year

## 1. USD gains in twin bond/equity sell-offs




Source: RBC Capital Markets; Bloomberg

## 2. Analysts still calling USD lower




Source: Bloomberg, RBC Capital Markets

## Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **EUR/USD** | 1.08 | 1.09 | 1.06 | 1.04 | 1.03 | 1.02 | 1.05 | 1.08 |
| **USD/JPY** | 133 | 144 | 149 | 150 | 152 | 154 | 150 | 145 |
| **USD/CAD** | 1.35 | 1.32 | 1.36 | 1.38 | 1.39 | 1.39 | 1.35 | 1.31 |

Source: RBC Capital Markets estimates

# Euro

Elsa Lignos

## 1-3 Month Outlook – On track for 1.04 target

Last month EUR/USD was down 5% from the mid-July high, this month it's -6% (at one point >7%). Again this is not a EUR-specific move, rather USD strength, led by the twin sell-off in bonds and equities outlined on the previous page. Our outlook has not changed much in the past month. Though the ECB hiked rates to 4% (a move which was only 50/50 priced), EUR failed to benefit. The statement and press conference were taken as a signal the ECB is now done and the gap between EUR and G10's higher-yielders will remain. Markets have taken out all risk of one last hike and priced in more cuts for 2024 (now -50bps in the next year, Figure 1). Nevertheless we see room for the gap between the Fed and ECB to narrow further – it is not the central forecast from our economists but we could easily see both central banks on hold throughout 2024 leaving short EUR/USD picking up almost 140bps of annualized carry. Technically, EUR/USD is set for a corrective rally as valuations try to recover from oversold extremes, but the broader downtrend in place suggests valuation-driven moves to resistance at 1.0577 & 1.0677 should attract selling interest for another attempt to move lower. A break below initial support at 1.0454 would add to bearish price momentum, exposing 1.0406 & 1.0291 next. Our year-end forecast (1.04) has not changed since the start of the year and the closer we get, the more inclined we are to leave it intact.

## 6-12 Month Outlook – Unchanged outlook

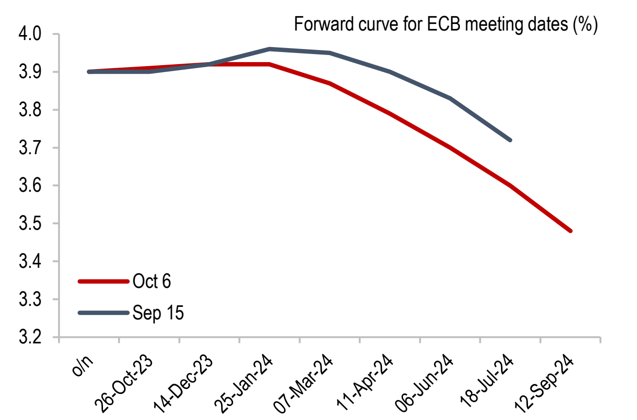
Month after month in our *Currency Report Card* we have written that we didn't understand or agree with consensus expectations for stronger growth in the EZ than the US. At the start of the year that was meant to be driven by China's re-opening but even as China disappointed, higher growth forecasts for the EZ persisted, and as it became apparent that wouldn't play out in 2023, it just got pushed back into 2024. Now for the first time, analysts are looking for (marginally) stronger growth in the US than the EZ next year (Figure 2). We think that can run a bit further though it's now a lot closer to our own view. Analyst forecasts for EUR/USD have also edged lower – from 1.15 avg for 2024 to 1.13. It is tempting to call EUR/USD higher on valuation alone but the last decade has shown valuation is not a great way to trade FX. Eventually that long-term bullish EUR/USD outlook will be right but it looks premature right now on cyclical drivers. If rates remain higher for longer but the US retains its yield advantage, we expect EUR/USD will remain "cheap" on long-term valuation metrics for the whole of 2024 as well. Our long-term forecasts are unchanged.

## Indicators

| | Current (Previous)* |
|---|---|
| **Official cash rate (ECB main refi rate)** | **4.50% (4.25%)** |
| Trend interest rates 10y average | 0.31% |
| Bias in interest rate market | Flat in ST |
| **HICP core Inflation %Y/Y Sep P (Aug)** | **4.5% (5.3%)** |
| Inflation target | 2.0% (symmetric) |
| **Budget balance % GDP 2022 (2021)** | **-3.6% (-5.3%)** |
| Budget balance target % GDP | 3% of GDP-Unless special circumstances |
| **GDP Growth %Y/Y Q2 (Q1)** | **0.5% (1.1%)** |
| Trend GDP %y/y | 1.5% |
| **Purchasing Power Parity Value Aug** | **1.2647** |
| Spot end-Sep | 1.0573 |
| PPP Valuation | EUR/USD is undervalued |
| Current account % GDP Q2 (Q1) | 0.4% (-0.2%) |
| Trend current account balance % GDP | 2.2% |
| **Moody's Foreign Currency Rating** | **Aaa (Germany)** |
| Outlook | Stable |

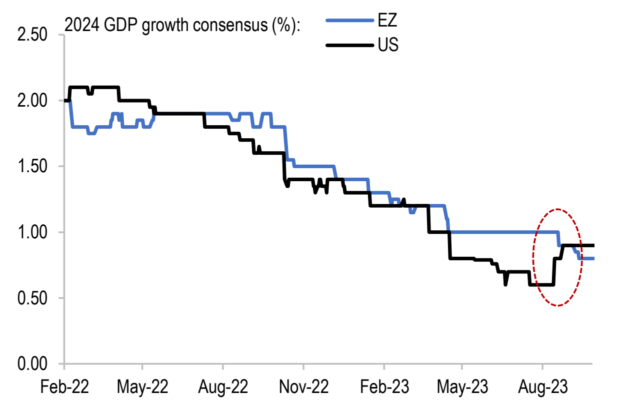
* Current is latest month, quarter or year

### 1. ECB delivered a hike but market now pricing more cuts




Source: Bloomberg, RBC Capital Markets

### 2. 2024 consensus GDP f'casts for US exceed EZ for 1st time




Source: RBC Capital Markets

## Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **EUR/USD** | 1.08 | 1.09 | 1.06 | 1.04 | 1.03 | 1.02 | 1.05 | 1.08 |
| **EUR/JPY** | 144 | 157 | 158 | 156 | 157 | 157 | 158 | 157 |
| **EUR/CAD** | 1.46 | 1.44 | 1.44 | 1.44 | 1.43 | 1.42 | 1.42 | 1.41 |

Source: RBC Capital Markets estimates

# Japanese Yen

Adam Cole

## 1-3 Month Outlook – Intervention risk elevated

After rallying steadily through September, USD/JPY popped briefly above 150 for the first time in almost a year in early-October. The move followed almost daily comments from MoF officials threatening intervention, in so many words. The violent pull back from the highs that followed the break of 150 certainly looked like intervention at the time, but the speed with which USD/JPY bounced and Vice Minister Kanda's refusal to confirm or deny intervention suggest it was more likely flow driven by the fear of intervention that drove the move. USD/JPY has reverted to grinding higher subsequently, though the threat of intervention still looms large. Our model, based on the rate of change of the nominal exchange rate and level of the real exchange rate, currently puts the probability of intervention at 22% - elevated by historical standards (Figure 1). However this is resolved in the short-term – either they do intervene and USD/JPY resumes rallying from a lower base, or USD/JPY trades sideways for a while and the risk of intervention diminishes – ultimately, we see JPY going on to new lows against USD and on most crosses. Last month we revised our forecast peak for USD/JPY up to 154 and this month we are leaving it unchanged. In part our negative view on JPY reflects markets refocusing on the *level* of G10 interest rates as rate dispersion reaches levels not seen since pre-GFC (ie the return of carry as a viable strategy). But it also reflects relentless selling flow from within Japan (see below).

## 6-12 Month Outlook – Trend JPY weakness

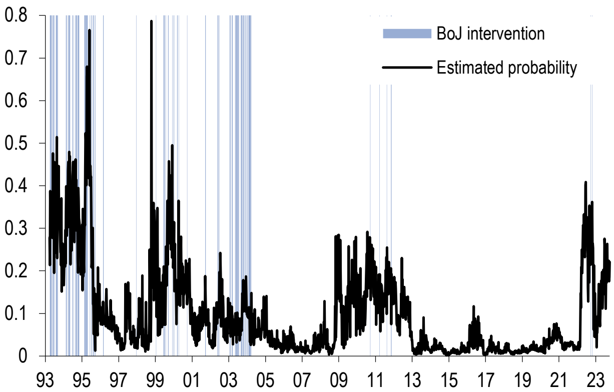
It is the balance between foreign and domestic investor flow that will be the longer-term driver of JPY. While in the short-term, there may be further bouts of selling as USD/JPY shorts are reestablished or international yields fall, in the longer-term, we think domestic investor flow will dominate. This is being driven primarily by the end of a 20-year paradigm in terms of the cost of hedging. The cost of hedging most foreign assets now far exceeds the yield on those assets and as a result, Japanese investors are removing the hedges on bonds that are already owned (JPY-negative). At some point hedge ratios will hit desired levels and the JPY selling will abate, but early indications from the Lifers' accounts for March suggest we are not there yet and history has shown they are slow-moving and reactive rather than preemptive.

## Indicators

| | Current (Previous)* |
|---|---|
| **Official cash rate** | **-0.1% (-0.1%)** |
| Trend interest rates 10y average | 0.15% |
| Bias in interest rate market | Rising |
| **CPI Inflation %Y/Y Aug (Jul)** | **3.1% (3.1%)** |
| Inflation target | 2.0% |
| **Budget balance % GDP FY21 (FY20)** | **-6.4% (-9.5%)** |
| Budget balance target % GDP | n/a |
| **GDP Growth %Y/Y Q2 (Q1)** | **1.7% (1.8%)** |
| Trend GDP %Y/Y | 1.0% |
| **Purchasing Power Parity Value Aug** | **81.22** |
| Spot end-Sep | 149.37 |
| PPP Valuation | USD/JPY is overvalued |
| Current a/c balance % GDP Q2 (Q1) | 3.9% (2.8%) |
| Trend current account balance % GDP | 2.8% |
| **Moody's Foreign Currency Rating** | **A1** |
| Outlook | Stable |

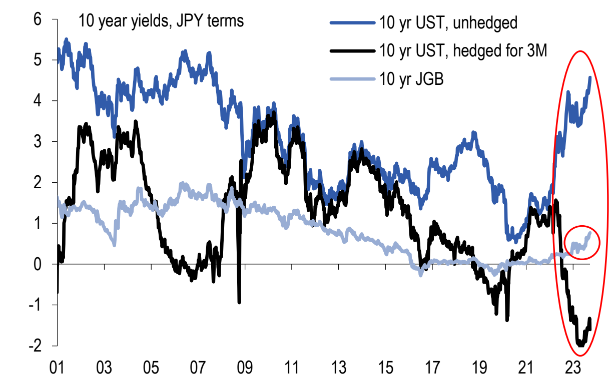
* Current is latest month, quarter or year

### 1. Intervention risk elevated




Source: RBC Capital Markets, Bloomberg

### 2. Moves in global yields trump JGBs




Source: RBC Capital Markets, Bloomberg

## Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **USD/JPY** | 133 | 144 | 149 | 150 | 152 | 154 | 150 | 145 |
| **EUR/JPY** | 144 | 157 | 158 | 156 | 157 | 157 | 158 | 157 |
| **CAD/JPY** | 98 | 109 | 110 | 109 | 109 | 111 | 111 | 111 |

Source: RBC Capital Markets estimates

# Sterling

Adam Cole

## 1-3 Month Outlook – Rates still repricing lower

Looked against a 50/50 basket of USD and EUR, GBP fell 2.5% in September and, having peaked in early-July has now given up most of the gains seen in Q2 and is flat year-to-date. GBP's Q3 decline has mostly been a conventional monetary policy story. In just one week markets had to digest weaker than expected CPI data, very weak survey data (PMIs) and an unchanged BoE decision when a hike had been widely expected. In September almost every G10 market saw front end yields dragged higher by the rise in US yields (2yr +23bp), with the UK being the only exception (2yr -28bp). After September's repricing, markets still imply a better-than-evens chance of a final rate hike in the cycle (+18bp over the next three meetings). Our economists think the hurdle for the BoE resuming the hiking cycle is very high and after the unchanged decision in September, their core view is that rates have peaked. If market reprice to this view, there is some further downside for GBP, though the more significant repricing relates to the potential for longer-term *cuts* in rates when the inflation data allow. Relative to other G10 economies, UK policy is extremely tight (Figure 2) yet, unlike the US, markets price very little future easing.

## 6-12 Month Outlook – Medium-term weakness

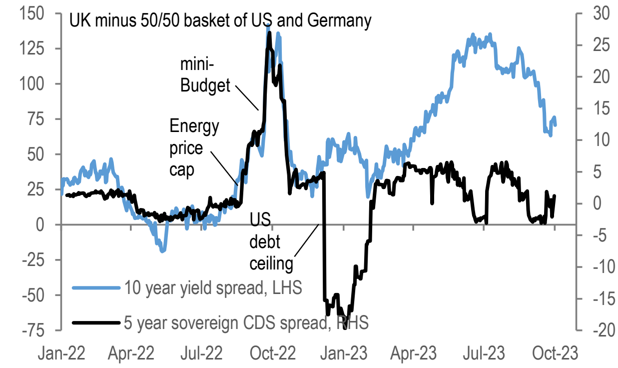
The UK's financial imbalances pre-date last year's "fiscal event" and the triple deficits the UK was already running look very similar to those the US ran in the early-2000s. The current account deficit is trending at around 4% of GDP (though recent data have been blighted by very large recording errors) and although it has been readily financed through equity sales, the outperformance of UK equities in 2022 was driven by GBP weakness. On the OECD's estimates, the structural budget deficit is 6% of GDP. The fact that the budget and current deficits are similar in magnitude reflects the UK's lack of domestic private savings, unlike other DM countries that run similar sized budget deficits (Japan, Italy). Our longer-term expectations for GBP have to include the risk that attracting the foreign inflows the UK will need "requires" a relative cheapening of UK assets via the currency. The widespread view that GBP is historically "cheap" is not supported by measures of the real exchange rate, with the UK's persistently poor productivity performance and relatively high wage growth offsetting most of the weakness of the nominal exchange rate in recent years. We expect grinding GBP underperformance to continue into the medium-term.

## Indicators

| | Current (Previous)* |
|---|---|
| **Official cash rate** | **5.25% (5.0%)** |
| Trend interest rates 10y average | 3.3% |
| Bias in interest rate market | Higher |
| **CPI Inflation %Y/Y Aug (Jul)** | **6.7% (6.8%)** |
| Inflation target (HICP) | 2.0% |
| **Budget balance % GDP FY21 (FY20)** | **-7.6% (-12.6%)** |
| Budget balance target % GDP | Budget surplus as soon as possible |
| **GDP Growth %Y/Y Q2 (Q1)** | **0.5% (0.5%)** |
| Trend GDP %Y/Y | 1.5% |
| **Purchasing Power Parity Value Aug** | **1.3444** |
| Spot end-Sep | 1.2199 |
| PPP Valuation | GBP/USD is undervalued |
| Current a/c balance % GDP Q1 (Q4) | -1.8% (-1.8%) |
| Trend current account balance % GDP | -3.9% |
| **Moody's Foreign Currency Rating** | **Aa1** |
| Outlook | Stable |

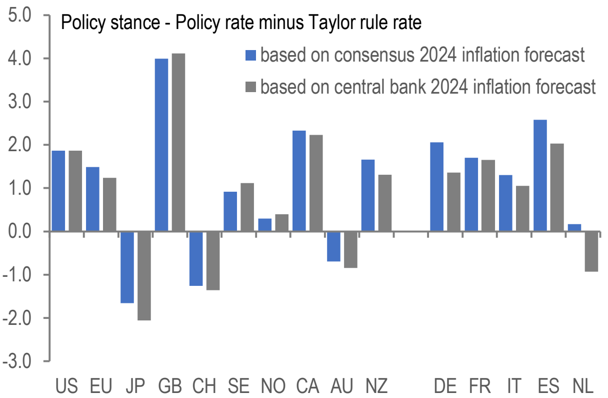
* Current is latest month, quarter or year

## 1. UK risk premia still wide




Source: RBC Capital Markets, Bloomberg

## 2. UK policy extremely tight already




Source: RBC Capital Markets, Bloomberg

## Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **GBP/USD** | 1.23 | 1.27 | 1.22 | 1.17 | 1.13 | 1.11 | 1.15 | 1.20 |
| **EUR/GBP** | 0.88 | 0.86 | 0.87 | 0.89 | 0.91 | 0.92 | 0.91 | 0.90 |
| **GBP/JPY** | 164 | 183 | 182 | 175 | 172 | 171 | 173 | 174 |
| **GBP/CAD** | 1.67 | 1.68 | 1.66 | 1.61 | 1.57 | 1.54 | 1.56 | 1.57 |

Source: RBC Capital Markets estimates

# Swiss Franc

Elsa Lignos

## 1-3 Month Outlook – CB still reducing balance sheet

EUR/CHF is up on a month ago but less than 1%. Most of the damage was done on September 21, when the SNB decided to leave rates on hold at 1.75% against consensus for a 25bp hike. But markets have adapted to that new reality and are now priced for only a small chance of one last hike, with some chance of a cut starting to creep into the profile from late 2024 (-18bp in the next two years) while EUR/CHF is grinding lower again. As we wrote last month, we expect the central bank to continue to support CHF away from conventional monetary policy. Though CHF is the second-lowest yielder in G10, with only JPY trailing it, the SNB continues to unwind its balance sheet, which is now back to March 2017 levels. Reserves declined another 2% in September, a faster pace than August and we suspect the SNB used the opportunity of some CHF weakness following its unchanged rate decision to reduce its balance sheet further. We see the SNB's focus "on selling foreign currency" keeping CHF supported. Technically, a daily close above resistance at 0.9688 is required in order to confirm a basing pattern in EUR/CHF, with the resulting bullish breakout favouring an extension toward secondary resistance levels at 0.9739 and 0.9842. While initial support is located at 0.9603, prices will have to close below a quadruple bottom at 0.9522 in order to reassert the broader downtrend, exposing the 2022 low at 0.9410 thereafter.

## 6-12 Month Outlook – 2024 recession less probable for some

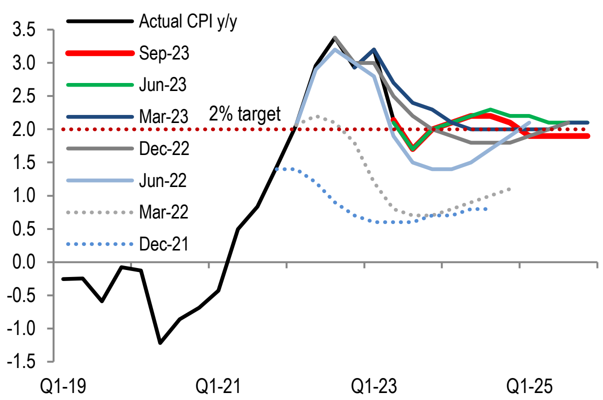
We see further CHF gains into 2024 as global recession risk rises. But stronger household balance sheets and solid income growth may keep consumption firmer than one might expect given the general speed of central bank tightening in the last two years. The BBG analyst consensus for a US recession in the next 12m for example, has been drifting lower from 65% last month to 55% now. A technical recession with shallow or even no rate cuts from the Fed and other central banks would mean no real CHF outperformance. The largest downside risk for CHF was an upside growth surprise from China, but every month that looks less and less likely. It leaves us with a grinding profile for CHF, unlikely to change until/unless we see an unexpected external shock. We still hear valuation being cited occasionally as a reason to sell CHF. But as Figure 2 shows, it is hard to take PPP seriously for CHF when USD/CHF has not traded above 'fair value' in 40 years.

## Indicators

| | Current (Previous)* |
|---|---|
| **Official cash rate** | **1.75% (1.50%)** |
| Trend interest rates average | -0.4% |
| Bias in interest rate market | Small hikes |
| **CPI Inflation %Y/Y Sep (Aug)** | **1.7% (1.6%)** |
| Inflation target | less than 2.0% |
| **Budget balance % GDP 2021 (2020)** | **-0.5% (-3.1%)** |
| Budget balance target % GDP | Balanced over the business cycle |
| **GDP Growth %Y/Y Q2 (Q1)** | **0.5% (1.5%)** |
| Trend GDP %Y/Y | 1.9% |
| **EUR Purchasing Power Parity Value Aug** | **1.0630** |
| EUR/CHF spot end-Sep | 0.9677 |
| EUR/CHF PPP Valuation | EUR/CHF is undervalued |
| Current a/c balance % GDP Q2 (Q1) | 9.82% (9.17%) |
| Trend current account balance % GDP | 6.8% |
| **Moody's Foreign Currency Rating** | **Aaa** |
| Outlook | Stable |

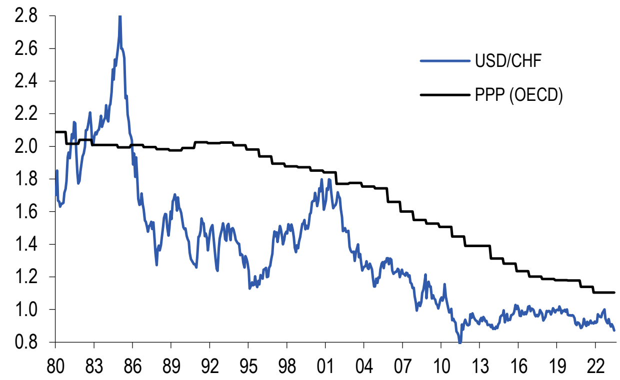
* Current is latest month, quarter or year

### 1. SNB forecasting inflation to return to target




Source: Bloomberg, RBC Capital Markets, SNB

### 2. Valuation not a reason to sell CHF




Source: Bloomberg, RBC Capital Markets

## Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **USD/CHF** | 0.92 | 0.90 | 0.92 | 0.91 | 0.91 | 0.92 | 0.89 | 0.86 |
| **EUR/CHF** | 0.99 | 0.98 | 0.97 | 0.95 | 0.94 | 0.94 | 0.93 | 0.93 |
| **CHF/JPY** | 145 | 161 | 163 | 164 | 167 | 167 | 169 | 168 |
| **CAD/CHF** | 0.68 | 0.68 | 0.67 | 0.66 | 0.66 | 0.66 | 0.66 | 0.66 |

Source: RBC Capital Markets estimates

# Swedish Krona & Norwegian Krone

Adam Cole

## Swedish Krona – Brief relief from selling

The relentless decline in SEK paused in September, with EUR/SEK pulling back to around 11.50, having spent around a month close to record highs just below 12.00. Alongside the (widely-expected) 25bp hike at the September 21 Riksbank meeting, the Bank released a notice confirming it will go ahead with its plan to hedge part of its FX reserves, an idea it first floated in June. Over a four-to-six-month period, which began on September 25, the Riksbank plans to switch USD8bn and EUR2bn, equivalent to around a quarter of reserves, into SEK. While the Riksbank goes out of its way to avoid referring to this as intervention, in buying its own currency and selling FX, by any other name, that is what it is. EUR/SEK fell sharply in the first week of Riksbank SEK buying and we will find out if purchases were front-loaded when the first weekly progress report is published (with a two-week delay). That EUR/SEK has subsequently reverted to grinding higher suggests that may have been the case. The main reason for doubting the effectiveness of intervention in anything other than the short-term, however, is that it pushes in the opposite direction of domestic policy. Alongside the September hike, the Riksbank revised up its forward guidance by just 5bp and its forecasts still show less than a 50% chance of one more hike. The presence of the Riksbank has introduced some two-way risk in EUR/SEK but we continue to think its status as a low-yielding risky currency and hence as an efficient funding currency will drive grinding underperformance.

## Norwegian Krone – EUR/NOK drifting lower

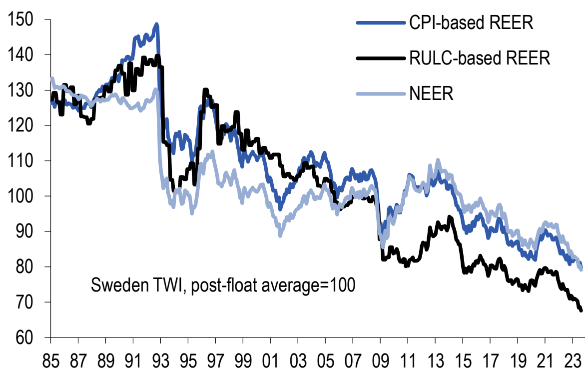
In September and early-October, EUR/NOK remained within the 11.00-11.60 range that has held since early-July, dropping to the bottom of that range as crude prices rallied to around USD95/bl (Brent), but rising back to the top after a USD100/bl pull-back. Domestically, Norges Bank raised the deposit rate by 25bp at the September 21 meeting, as was universally expected. The forward guidance maintained that one more hike is likely, probably in December. Core inflation has been stickier in Norway than elsewhere in G10, with the annual rate having plateaued between 6 and 7%, but with no sign of a sustained downtrend. We maintain a moderately constructive stance on NOK, though the outlook is of course heavily leveraged to crude and natural gas prices.

### Indicators - Sweden

| | Current (Previous)* |
|---|---|
| **Official cash rate** | **4.0% (3.75%)** |
| Trend interest rates 10y average | 0.14% |
| Bias in interest rate market | Slight hiking |
| **CPIF Inflation %Y/Y Aug (Jul)** | **4.7% (6.4%)** |
| Inflation target (UND1X) | 2.0% |
| **Budget balance % GDP 2022 (2021)** | **-0.8% (0.8%)** |
| Budget balance target % GDP | Cyclical avg. surplus of 1% |
| **GDP Growth %Y/Y Q2 (Q1)** | **-1.0% (1.0%)** |
| Trend GDP %Y/Y | 2.0% |
| **EUR Purchasing Power Parity Value Aug** | **9.3852** |
| Spot end-Sep | 11.5370 |
| PPP Valuation | EUR/SEK is overvalued |
| Current a/c balance % GDP Q2 (Q1) | 4.9% (5.0%) |
| Trend current account balance % GDP | 4.3% |
| **Moody's Foreign Currency Rating** | **Aaa** |
| Outlook | Stable |

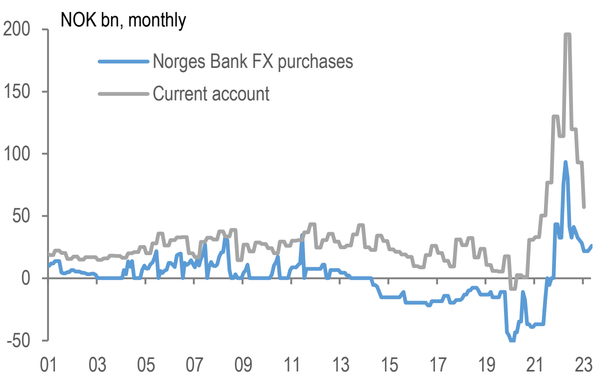
* Current is latest month, quarter or year

### 1. SEK is cheap; however it is measured




Source: RBC Capital Markets

### 2. FX purchases have declined with current account




Source: RBC Capital Markets, Bloomberg

### Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **EUR/SEK** | 11.28 | 11.78 | 11.54 | 12.00 | 12.10 | 12.00 | 11.90 | 11.80 |
| **EUR/NOK** | 11.35 | 11.71 | 11.31 | 11.30 | 11.20 | 11.20 | 11.10 | 11.00 |
| **NOK/SEK** | 0.99 | 1.01 | 1.02 | 1.06 | 1.08 | 1.07 | 1.07 | 1.07 |
| **CAD/SEK** | 7.70 | 8.15 | 8.04 | 8.36 | 8.45 | 8.46 | 8.40 | 8.34 |

Source: RBC Capital Markets estimates

# Canadian Dollar

Daria Parkhomenko

## 1-3 Month Outlook – BoC to remain on hold

Since September, ongoing USD strength, driven by a twin selloff in US bonds & equities, has pushed USD/CAD higher, with USD/CAD breaching a long-run resistance trendline going back to the COVID highs in early October. Interestingly, despite markets falling back into a USD-directional and a stronger USD environment as of writing, CAD has not been at the top of the G10 leaderboard, lagging a few of its peers (NZD & SEK).

Where do we go from here? Last month we had written that our bias was to use pullbacks in USD/CAD as a buying opportunity amid our view for modest USD gains into H1 2024 – our targets were at 1.38 by year-end and a peak of 1.39 in H1 2024. In the past weeks, the upside momentum in US yields has been relentless. Although it remains to be seen whether the move higher in yields has run its course, we think that with USD/CAD reaching overbought levels and the risk-reward starting to skew towards some tactical USD/CAD downside at current levels (~1.37), we have opted to keep our USD/CAD profile unchanged.

Locally, we think the BoC will be on hold into H1 2024 (mkt: +23bps cumulative by March 2024), as our economists see the softer growth environment continuing in the coming quarters. RBC forecasts growth at -0.5% q/q ann. in Q3 vs Governor Macklem stating post the September decision that growth is likely to be "a little less than 1% in the next few quarters". The August CPI report was on the firmer side, with the average 3m ann. rate for CPI-trim & -median accelerating to 4.5%, above the prior reading of 3.5% and the 3.5-4.0% range that has dominated since late last year. Although this report has raised the risk of a hike, inflation tends to lag the economic cycle. If the current signs that prior BoC rate increases are feeding through into softer growth dynamics and an easing in the labor market continue, then the BoC is likely to stand pat. Additionally, our economists note that the details of the September labor report were more mixed than strong headlines would suggest. Ahead of the BoC's MPR meeting on October 25, the key remaining are the quarterly business & consumer outlook surveys (Oct 16) and one more CPI report (Oct 17).

## 6-12 Month Outlook – Profile unchanged

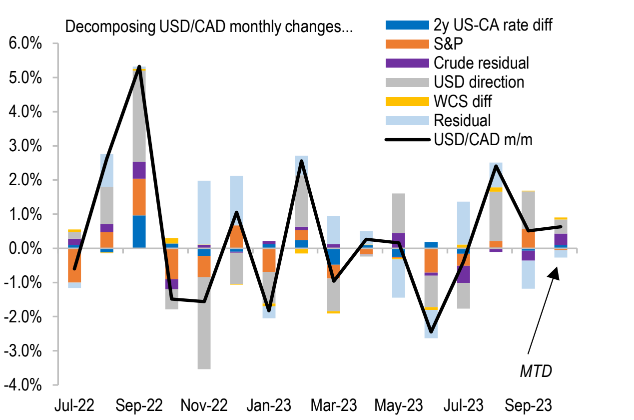
Our longer-run profile is also unchanged. We have USD/CAD peaking at 1.39 in H1 2024, followed by a decline in H2 2024 on the assumption of an eventual turn lower in USD (see pg. 3). We expect a prolonged hold from the BoC, with a base case that rate cuts will begin in Q3 2024, compared to our central scenario for the Fed to start easing in Q2 2024.

### Indicators

| | Current (Previous)* |
|---|---|
| **Official cash rate** | **5.00% (5.00%)** |
| Trend interest rates 10y average | 1.3% |
| Bias in interest rate market | Hikes |
| **Core CPI Inflation (Trim) %Y/Y Aug (Jul)** | **3.9% (3.6%)** |
| CPI inflation target range %Y/Y | 1-3% |
| **Budget balance % GDP FY22 (FY21)** | **-c3.2% (-12.5%)** |
| Budget balance target % GDP | Declining over the business cycle |
| **GDP growth %Q/Q saar Q2 (Q1)** | **-0.2% (2.6%)** |
| Trend GDP %Q/Q | 2.1% |
| **Purchasing Power Parity value Aug** | **1.2200** |
| Spot end-Sep | 1.3577 |
| PPP valuation | USD/CAD is overvalued |
| **Current account balance % GDP Q2 (Q1)** | **-1.0% (-0.6%)** |
| Trend current account balance % GDP | -2.2% |
| **Moody's foreign currency rating** | **Aaa** |
| Outlook | Stable |

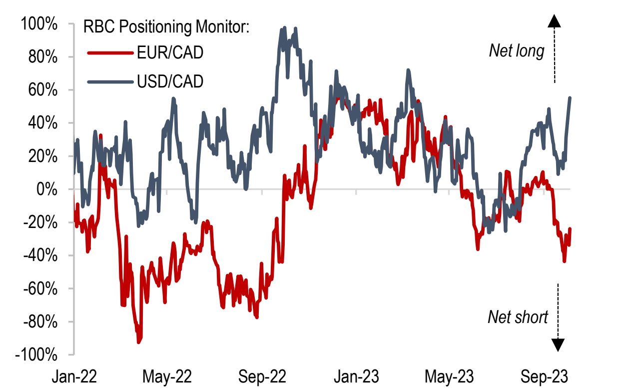
* Current is latest month, quarter or year

### 1. USD/CAD was weaker than it 'should' be in September




Source: Bloomberg, RBC Capital Markets; Latest reading as of 06 Oct 2023

### 2. Mkt long CAD vs EUR, but short CAD vs USD




Source: RBC Capital Markets; Latest reading as of 04 Oct 2023

### Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **USD/CAD** | 1.35 | 1.32 | 1.36 | 1.38 | 1.39 | 1.39 | 1.35 | 1.31 |
| **EUR/CAD** | 1.46 | 1.44 | 1.44 | 1.44 | 1.43 | 1.42 | 1.42 | 1.41 |
| **CAD/JPY** | 98.3 | 109.0 | 110.0 | 108.7 | 109.3 | 110.8 | 111.1 | 110.7 |

Source: RBC Capital Markets estimates

# Australian Dollar

Elsa Lignos

## 1-3 Month Outlook – Rates not enough to help AUD

AUD/USD hit new YTD lows in early October, trading to levels last seen in November 2022, before China re-opening was officially confirmed. It marks a long round-trip for the currency though one that has been mostly driven by USD direction. Our AUD framework shows last month's losses were 3/4 down to USD direction with 1/4 explained by equity weakness and the negative impact partly offset by 2yr rates moving in Australia's favour. Australia is one of the few places with tightening rather than easing priced for the next 6-9 months. A 25bps hike is ~80% discounted by Q1 2024. Key to the decision will be the Q3 CPI data (October 25) and seeing whether they mirror the surprising decline in the monthly data (albeit with a tick up to 5.2%y/y in the August release). New Governor Michele Bullock has taken over but there is still a lot going on at the RBA, including recruitment for Deputy Governor and Assistant Governor (Eco), COO and Chief Comms Officer as well as progressing on the recommendations of the Review, all of which likely add to the hurdle to hike. Nevertheless, policy is still less restrictive than most in G10, the tightening bias in the RBA's statement remains and we expect one last 25bp hike to be delivered. Where does that leave AUD? We have left our FX forecasts unchanged, with AUD a relative underperformer in G10 as the theme of G10 carry starts to matter more (see pg 11) and one more hike is not enough to change that for AUD. Stretched valuations warn of a short-term bounce in AUD/USD, but the broader downtrend in place favours using corrective rallies to resistance at 0.6497 and 0.6618 as a selling opportunity. A daily close below 0.6291 would extend the decline, exposing the 2022 low at 0.6170.

## 6-12 Month Outlook – Worsening valuations

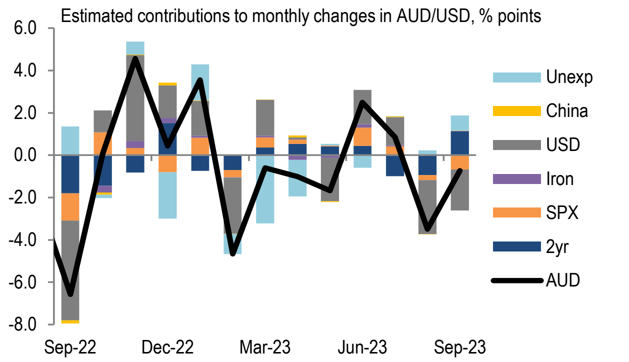
Longer-term concerns on valuation still stand. While the RBA looks for improving productivity to offset the sharp increases in wages, there are limited signs of that so far, leaving unit labour costs on an upward trajectory. ULCs are a key driver of long-term valuation and in theory, rising ULCs in the long-term requires a lower nominal exchange rate to maintain competitiveness. Valuation rarely works as a trading strategy in FX and we have evidence from a number of other countries that a currency's fair value can go down in RULC terms without any mechanism for it to correct (see *Chart of the Day*, 7 June 2023). Nevertheless, from a longer-term perspective that reinforces our view that AUD/USD is likely to grind lower over time.

## Indicators

| | Current (Previous)* |
|---|---|
| **Official cash rate** | **4.10% (4.10%)** |
| Trend interest rates 10y average | 1.6% |
| Bias in interest rate market | Hiking |
| **CPI Inflation %y/y Aug (Jul)** | **5.2% (4.9%)** |
| CPI Inflation target range %Y/Y | 2.0-3.0% |
| **Budget balance % GDP FY22/21** | **-1.4%/-6.4%** |
| Budget balance target % GDP | Balanced over the business cycle |
| **GDP Growth %Y/Y Q2 (Q1)** | **2.3% (2.4%)** |
| Trend GDP %Y/Y | 2.8% |
| **Purchasing Power Parity Value Aug** | **0.7392** |
| Spot end-Sep | 0.6435 |
| PPP Valuation | AUD/USD is undervalued |
| **Current account balance % GDP Q2 (Q1)** | **1.2% (1.4%)** |
| Trend current account balance % GDP | -1.4% |
| **Moody's Foreign Currency Rating** | **Aaa** |
| Outlook | Stable |

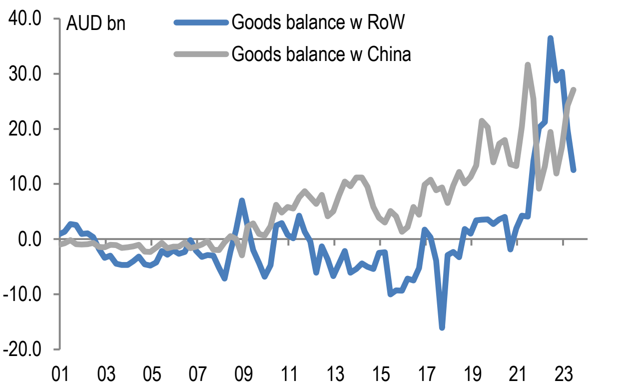
* Current is latest month, quarter or year

### 1. Sept losses driven by USD strength & equity weakness




Source: RBC Capital Markets, Bloomberg

### 2. China becoming more not less important to AU trade




Source: RBC Capital Markets, Bloomberg

## Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **AUD/USD** | 0.67 | 0.67 | 0.64 | 0.62 | 0.61 | 0.60 | 0.61 | 0.62 |
| **EUR/AUD** | 1.62 | 1.64 | 1.64 | 1.68 | 1.69 | 1.70 | 1.72 | 1.74 |
| **AUD/NZD** | 1.07 | 1.09 | 1.07 | 1.07 | 1.07 | 1.07 | 1.07 | 1.07 |
| **AUD/CAD** | 0.90 | 0.88 | 0.87 | 0.86 | 0.85 | 0.83 | 0.82 | 0.81 |

Source: RBC Capital Markets estimates

# New Zealand Dollar

Elsa Lignos

## 1-3 Month Outlook – The G10 carry trade

Having underperformed in relative terms through the summer, NZD has been a relative outperformer over the past month. It is in fact the best-performing currency globally since US Labor Day in spot terms, and even in total returns, it is beaten only by the ludicrously high-yielding ARS. With rates at 5.5% and markets still looking for one more hike in this cycle to 5.75%, it feels like investors are finally coming around to the idea that in a higher-for-longer world, that NZD is a winner in the G10 carry trade. The RBNZ's October statement was short and to the point, highlighting current rates are working in constraining activity and reducing inflationary pressures, with no hints to further tightening. But new and stronger wording in the minutes/ summary made reference to remaining at restrictive levels "for a more sustained period of time" as opposed to "for the foreseeable future." Again this higher-for-longer theme supports NZD against other lower-yielders. NZD has also been helped by avoiding even a technical recession. Q1 was revised up to 0.0%q/q and Q2 beat expectations coming in at 0.9%q/q. NZ's current account has also been markedly improving as we thought would happen (see below). Still to come are key Q3 data for CPI and the labour market (16 Oct and 31 Oct respectively) which will be key inputs for the RBNZ ahead of its last meeting of the year on 29 Nov. A hike is 50/50 priced and if it is not delivered, it may well just slip back to 2024 unless the RBNZ's guidance actively pushes back on it. While its hard to see the forward curve pricing in much more relative to other markets, rates in a static sense continue to support NZ. Indeed the size of NZD's unexplained residual for September (light blue bars in Figure 1) may be down to that role of carry coming through (not captured by 2yr rate spreads which are a dynamic measure). Technically, there is still a medium-term downtrend in place for NZD/USD with resistance at 0.6061 and 0.6235 and support coming in at 0.5881. A close below there is required to reassert the downtrend.

## 6-12 Month Outlook – Is the current acct a problem?

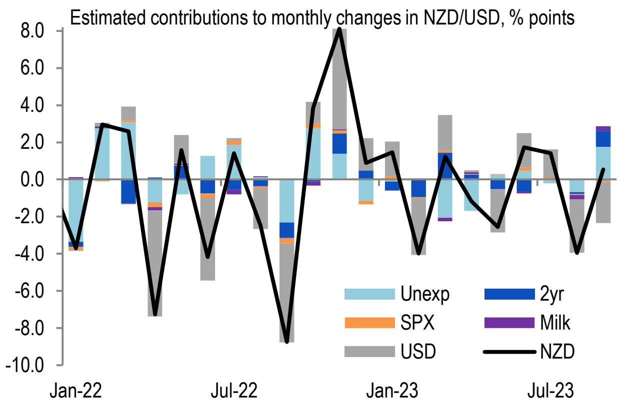
We have looked into NZ's huge c/a deficit and argued that a large part of it was down to post-COVID timing mismatches in spending. The closure of NZ's only refinery in April last year didn't help but the deficit is already improving faster than expected (-8.5% to 7.5% in Q2, cons -8.0%). We expect the current account to continue to recover through 2024.

### Indicators – New Zealand Dollar

| | Current (Previous)* |
|---|---|
| **Official cash rate** | **5.50% (5.25%)** |
| Trend interest rates 10y average | 2.1% |
| Bias in interest rate market | Hiking |
| **CPI Inflation %y/y Q2 (Q1)** | **6.0% (6.7%)** |
| CPI Inflation target range %Y/Y | 2.0-3.0% |
| **Budget balance % GDP 2021 (2020)** | **-4.1% (-5.3%)** |
| Budget balance target % GDP | Balanced over the business cycle |
| **GDP Growth %Y/Y Q2 (Q1)** | **1.8% (2.2%)** |
| Trend GDP %Y/Y | 2.8% |
| **Purchasing Power Parity Value Q2** | **0.5967** |
| Spot end-Aug | 0.5998 |
| PPP Valuation | NZD/USD is close to neutral |
| **Current account balance % GDP Q2 (Q1)** | **-7.5% (-8.2%)** |
| Trend current account balance % GDP | -2.9% |
| **Moody's Foreign Currency Rating** | **Aaa** |
| Outlook | Stable |

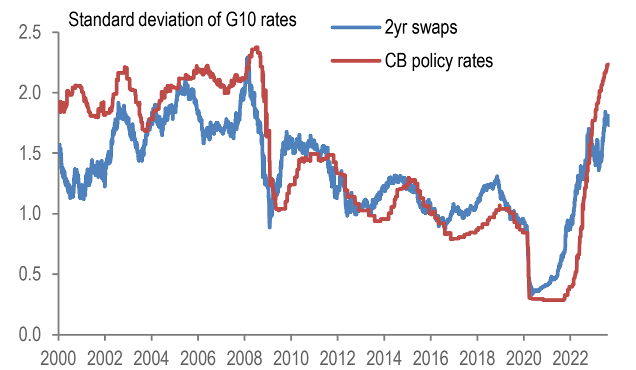
* Current is latest month, quarter or year

### 1. Stronger USD offset by large residual and rates spreads




Source: Bloomberg, RBC Capital Markets

### 2. With rates dispersing in G10, NZD emerges as a winner




Source: RBC Capital Markets, Bloomberg

### Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **NZD/USD** | 0.63 | 0.61 | 0.60 | 0.58 | 0.57 | 0.56 | 0.57 | 0.58 |
| **EUR/NZD** | 1.73 | 1.78 | 1.76 | 1.79 | 1.81 | 1.82 | 1.84 | 1.86 |
| **AUD/NZD** | 1.07 | 1.09 | 1.07 | 1.07 | 1.07 | 1.07 | 1.07 | 1.07 |
| **NZD/CAD** | 0.85 | 0.81 | 0.81 | 0.80 | 0.79 | 0.78 | 0.77 | 0.76 |

Source: RBC Capital Markets estimates

# Chinese Yuan

Alvin T. Tan

## 1-3 Month Outlook – Ongoing economic malaise

China's economic dataflow lately is indicating a stabilising slowdown. The government has unveiled various targeted stimulus measures that together might just be enough to maintain the year's GDP growth at 5%, but a decisive economic turnaround is unlikely given the paucity of sizeable fiscal-driven stimulus.

The moribund property and construction sectors have become a major drag for the economy. Mortgage rates for the overwhelming majority of outstanding mortgages have been cut, and additional supportive housing market measures have been introduced. Further RRR and interest rate cuts are also expected. But there is a considerable overhang of housing supply in Tier-2 and Tier-3 cities that is likely to take a long while to clear.

Net foreign portfolio outflows have petered out, and exports growth have stumbled this year too. Persistently below-expectations USD/CNY fixes have returned as the PBOC leans against the yuan's depreciation trend, as has tightened funding conditions for the offshore CNH. Thus, USD/CNY has been restrained at around 7.30, despite the US dollar's broad advance, ahead of the national day holiday period.

The trade-weighted CFETS Index has been rising through September as a result. The containment of CNY weakness is at cross-purposes to the PBOC's easy monetary policy path, particularly in the context of continuing US dollar strength. Moreover, the USD continues to possess a significant carry premium over CNY. The attempt to restrain USD/CNY around 7.30 is consequently likely to be abandoned sooner than later.

## 6-12 Month Outlook – More monetary easing needed

China's multi-year property and construction boom has ended definitively, and policymakers are unwilling to reflate it. This is exacerbating caution among households and firms, who have suffered financially through the pandemic, and undermining domestic demand.

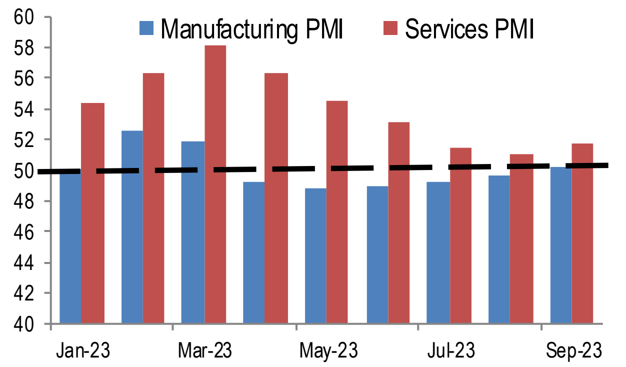
Weak domestic demand and exports are headwinds for the yuan. Beijing continues to evince an aversion to large-scale fiscal stimulus. Hence, the need for easier monetary policy to support the economy, and further currency depreciation will help in this regard.

### Indicators

| | Current (Previous)* |
|---|---|
| **China 1-year loan prime rate** | **3.45%** |
| Trend interest rates (10yr average) | 3.88% |
| Bias in interest rate market | Lower |
| **CPI Inflation %Y/Y last (prev)** | **0.1% (-0.3%)** |
| Inflation target | 3.0% |
| **Budget balance % GDP last (prev)** | **-4.7% (-3.8%)** |
| Budget balance trend % GDP | -3.1% |
| GDP Growth % y/y last (prev) | 6.3% (4.5%) |
| Trend GDP %y/y | 5.0% |
| **Purchasing Power Parity Value Aug** | **6.8709** |
| Spot end-Sep | 7.2980 |
| PPP valuation | USD/CNY is overvalued |
| **Current account balance % GDP last (prev)** | **2.2% (2.2%)** |
| Trend current account balance % GDP | 1.6% |
| **Moody's Foreign Currency Rating** | **A1** |
| Outlook | Stable |

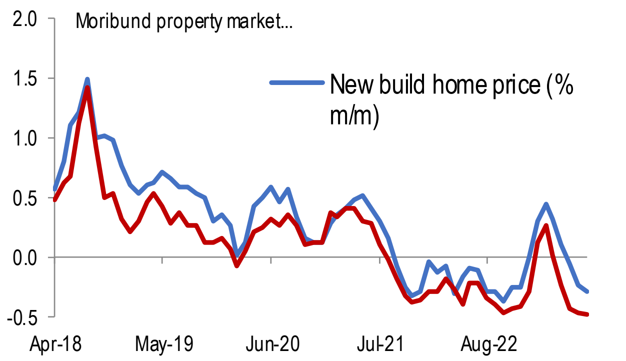
* Current is latest month, quarter or year

### 1. Growth slowdown is stabilising




Source: RBC Capital Markets; Bloomberg

### 2. Housing remains a drag




Source: RBC Capital Markets; Bloomberg

### Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **USD/CNY** | 6.87 | 7.25 | 7.30 | 7.40 | 7.45 | 7.50 | 7.45 | 7.35 |
| **EUR/CNY** | 7.45 | 7.91 | 7.72 | 7.70 | 7.67 | 7.65 | 7.82 | 7.94 |
| **CNY/JPY** | 19.3 | 19.9 | 20.5 | 20.3 | 20.4 | 20.5 | 20.1 | 19.7 |
| **CAD/CNY** | 5.09 | 5.48 | 5.38 | 5.36 | 5.36 | 5.40 | 5.52 | 5.61 |

Source: RBC Capital Markets estimates

# Indian Rupee

Alvin T. Tan

## 1-3 Month Outlook – Renewed growth vigour

India's economic dataflow continues to demonstrate surprising strength. The September composite PMI reading of 61.0 suggests solid growth momentum right through the third quarter. On the flipside, the perennial trade deficit has worsened again, with higher energy import prices being a factor.

At the same time, the planned inclusion of Indian bonds into the JPM GBI-EM index starting next June has boosted investor sentiment on both local bonds and the rupee. This development is particularly helpful because there has been net foreign capital outflows from local equities lately.

Waning core inflation pressures should keep the RBI on its policy pause setting. Although the USD/INR pair has not been immune to the USD advance, the rupee has been relatively stable among the Asia FX complex, with help from RBI interventions. Its relatively high carry also helped in H2 2023, though carry is less of a consideration in recent weeks.

More importantly, the rupee has evinced low correlations to other Asian currencies this year, and continues to march to its own tune. This has added to the INR's appeal among regional currencies at a time of CNY weakness. Thus, the rupee's outlook might not be bullish in an absolute sense, but it is relatively bullish within the EM Asia FX universe.

## 6-12 Month Outlook – Index inclusion

Indian bonds offer among the highest nominal yields among Asian EM currencies, but real yields are paltry due to high domestic inflation. India historically runs a higher inflation rate than the rest of the world. On top of this, the structural fiscal and trade deficits are likely to remain sizeable. These are hurdles for the rupee in a fundamental and relative sense over the longer term.

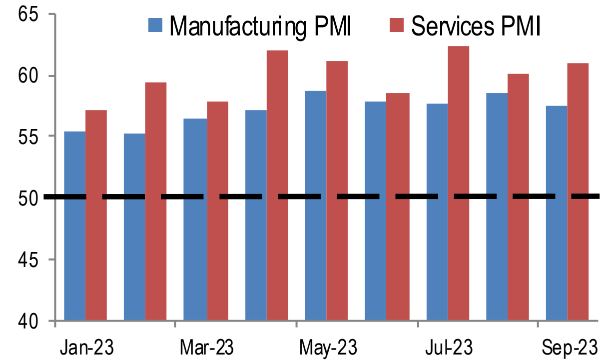
The public debt is large relative to GDP, but is almost entirely denominated in rupee. India's inclusion in the JPM GBI-EM is expected to spur $20-40bn of portfolio inflows in coming years, providing a tailwind for the rupee. The development is also likely to increase speculation of additional index inclusion going forward. This is a key potential positive factor for the rupee in the medium-term.

## Indicators

| | Current (Previous)* |
|---|---|
| **RBI policy repo rate** | **6.50%** |
| Trend interest rates (10yr average) | 6.25% |
| Bias in interest rate market | Lower |
| **CPI Inflation %Y/Y last (prev)** | **6.8% (7.1%)** |
| Inflation target | 4% +/- 2% |
| **Budget balance % GDP last (prev)** | **-6.6% (-6.4%)** |
| Budget balance trend % GDP | -4.4% |
| GDP Growth % y/y last (prev) | 7.8% (6.1%) |
| Trend GDP %y/y | 5.0% |
| **Purchasing Power Parity Value Aug** | **82.24** |
| Spot end-Sep | 83.04 |
| PPP valuation | USD/INR is overvalued |
| **Current account balance % GDP last (prev)** | **-1.7% (-2.0%)** |
| Trend current account balance % GDP | -1.4% |
| **Moody's Foreign Currency Rating** | **Baa3** |
| Outlook | Negative |

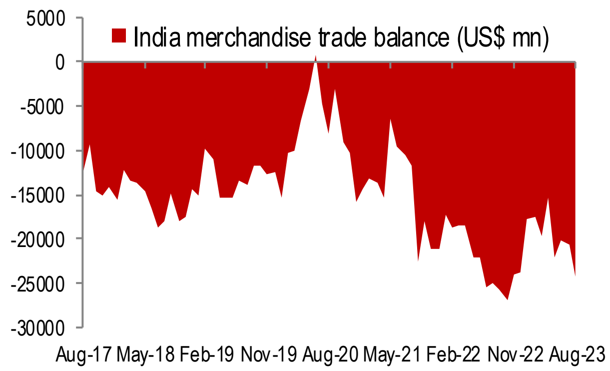
* Current is latest month, quarter or year

## 1. Very resilient growth momentum




Source: RBC Capital Markets; Bloomberg

## 2. Persistent external balance deficit




Source: RBC Capital Markets; Bloomberg

## Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **USD/INR** | 82.2 | 82.0 | 83.0 | 83.5 | 83.5 | 83.6 | 83.3 | 83.0 |
| **EUR/INR** | 89.1 | 89.5 | 87.8 | 86.8 | 86.0 | 85.3 | 87.5 | 89.6 |
| **INR/JPY** | 1.62 | 1.76 | 1.80 | 1.80 | 1.82 | 1.84 | 1.80 | 1.75 |
| **CAD/INR** | 61 | 62 | 61 | 61 | 60 | 60 | 62 | 63 |

Source: RBC Capital Markets estimates

# South Korean Won

Alvin T. Tan

## 1-3 Month Outlook – Buffeted by global tides

South Korea's trade-dependent economy remains buffeted by the negative macro headwinds emanating from Fed tightening, China's slowdown, and the exports downturn. The BOK's tightening cycle has also tightened domestic monetary conditions and undercut domestic demand.

The trade balance has been driven into a rare deficit over the past year, though it has improved markedly in recent months. The related and ongoing global semiconductor slump is another negative factor on exports. Indications of a bottoming exports downturn need to be balanced against China's ongoing economic malaise, given that it is Korea's chief trading partner by far.

The Korean won's outlook has become more difficult lately amid the surge in global bond yields and related drop in overall risk sentiment. Hence, foreign portfolio inflows into local equities have tended to be net negative in recent months.

The won continues to demonstrate a heightened sensitivity to external macro factors. USD/KRW, for example, evinces the highest persistent "USD beta" among the major Asia EM currencies, averaging +0.95 in the past two years. Downside pressure in the neighbouring JPY and CNY currencies have also been dragging on the won. The best that can be said is that the won is likely to outperform among the Asia FX complex.

## 6-12 Month Outlook – Cheap amid deep uncertainties

The won's persistent weakness in 2021 and 2022 has rendered it among the cheapest of the major Asian currencies. BOK rate hikes over that period also mean that the won now offers a decent carry among the Asia FX complex, albeit still less than the US dollar.

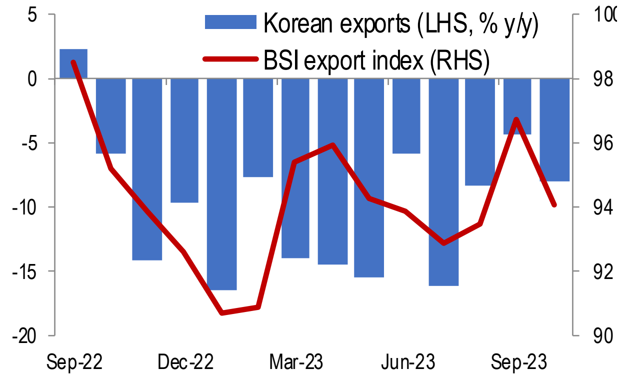
The months ahead promise a more favorable outlook for the won as existing macro headwinds fade in time. The semiconductor cycle in particular is anticipated to start turning soon. However, this needs to be balanced against deep uncertainties about the state of external demand, given the economy's heavy export-dependence, plus the US dollar's resilience.

## Indicators

| | Current (Previous)* |
|---|---|
| **BOK Base Rate** | **3.50%** |
| Trend interest rates (10yr average) | 1.68% |
| Bias in interest rate market | Lower |
| **CPI Inflation %Y/Y last (prev)** | **3.7% (3.4%)** |
| Inflation target | 2.0% |
| **Budget balance % GDP last (prev)** | **0.2% (-0.8%)** |
| Budget balance trend % GDP | 1.3% |
| GDP Growth % y/y last (prev) | 0.9% (0.9%) |
| Trend GDP %y/y | 2.5% |
| **Purchasing Power Parity Value Aug** | **1053.61** |
| Spot end-Sep | 1348.02 |
| PPP valuation | USD/KRW is overvalued |
| **Current acct balance % GDP last (prev)** | **0.4% (0.6%)** |
| Trend current acct. balance % GDP | 5.0% |
| **Moody's Foreign Currency Rating** | **Aa2** |
| Outlook | Stable |

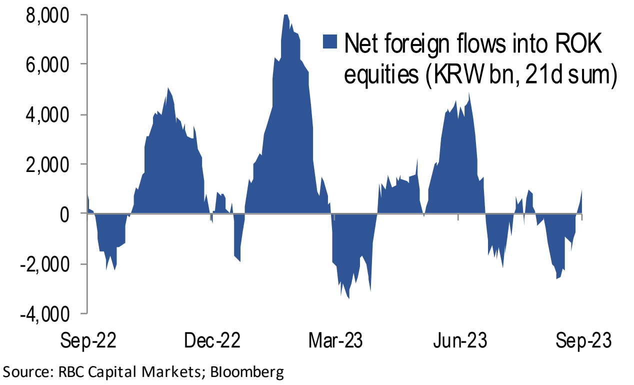
* Current is latest month, quarter or year

### 1. Exports slump not fully turning yet




Source: RBC Capital Markets; Bloomberg

### 2. Mixed foreign equity flows in recent months




Source: RBC Capital Markets; Bloomberg

## Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **USD/KRW** | 1302 | 1318 | 1348 | 1370 | 1390 | 1380 | 1365 | 1350 |
| **EUR/KRW** | 1411 | 1438 | 1425 | 1425 | 1432 | 1408 | 1433 | 1458 |
| **JPY/KRW** | 9.8 | 9.1 | 9.0 | 9.1 | 9.1 | 9.0 | 9.1 | 9.3 |
| **CAD/KRW** | 963 | 995 | 993 | 993 | 999 | 993 | 1011 | 1031 |

Source: RBC Capital Markets estimates

# Taiwanese Dollar & Singapore Dollar

Alvin T. Tan

## Taiwan Dollar – Tied to CNY risks

Similar to South Korea, Taiwan is suffering through a deep exports slump. The island continues to run a very sizeable external surplus, but the local stock market has seen more persistent net portfolio outflows than Korea. Part of this might be due to investors' growing concern with geopolitical risks. Cross-strait tensions have not risen lately, but neither have they receded significantly.

Among Asia EM currencies, the TWD is also the most affected by the renminbi's broad weakness. Mainland China is Taiwan's largest trade partner by a wide margin, and the two currencies tend to be highly correlated. The upside risks to USD/CNY in coming months consequently imply upside risks to USD/TWD too.

Moreover, TWD is not as attractive as KRW on valuation grounds, and the carry it offers is also lacking. The near-term outlook for TWD is therefore mixed-to-poor, and it will probably continue to lag the Asia FX complex.

## Singapore Dollar – Supported by existing policy settings

Singapore's growth momentum and inflation pressures have decelerated. The MAS tightening cycle has ended definitively as growth concerns gradually take centre stage. The trade-weighted SGD's appreciation has already slowed noticeably this year.

However, the current estimated 1.5% annualised appreciation path of the trade-weighted exchange rate has and should continue to support further gradual gains in SGD against its main trading partners' currencies. The large current account surplus also offers robust fundamental support.

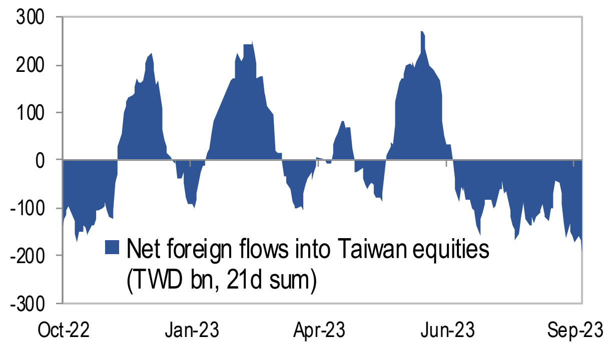
The SGD has been a consistent middling performer among Asian currencies this year so far, whether measured year-to-date or in each quarter. It is less affected by China's slowdown that the likes of TWD or KRW, but also more impacted than the likes of INR. The SGD's implied carry is also decidedly in the middle of its regional peers. It is difficult to see this middling performance shifting abruptly in the final quarter of the year.

### Indicators - Taiwan

| | Current (Previous)* |
|---|---|
| **CBC discount rate** | **1.875%** |
| Trend interest rates (10yr average) | 1.51% |
| Bias in interest rate market | Flat |
| **CPI Inflation %Y/Y last (prev)** | **2.9% (2.5%)** |
| Inflation target | None |
| **Budget balance % GDP last (prev)** | **1.2% (1.4%)** |
| Budget balance trend % GDP | 0.0% |
| GDP Growth % y/y last (prev) | 1.4% (-3.3%) |
| Trend GDP %y/y | 3.2% |
| **Purchasing Power Parity Value Aug** | **25.43** |
| Spot end-Sep | 32.24 |
| PPP valuation | USD/TWD is overvalued |
| **Current account balance % GDP last (prev)** | **11.9% (12.1%)** |
| Trend current account balance % GDP | 12.1% |
| **Moody's Foreign Currency Rating** | **Aa3** |
| Outlook | Positive |

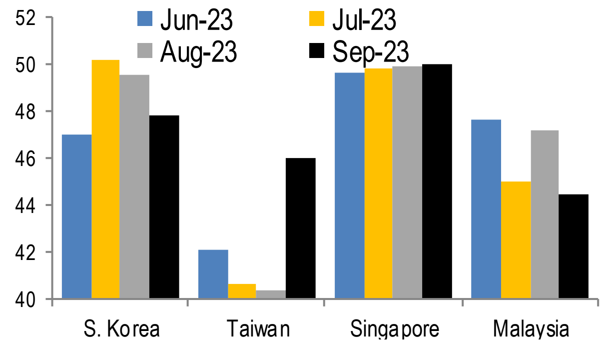
* Current is latest month, quarter or year

### 1. Persistent outflows from Taiwan equities since June




Source: RBC Capital Markets; Bloomberg

### 2. Singapore's PMI new exports orders sub-index has gradually risen back to 50.0




Source: RBC Capital Markets

### Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **USD/TWD** | 30.49 | 31.15 | 32.24 | 32.60 | 33.10 | 33.00 | 32.80 | 32.60 |
| **EUR/TWD** | 33.04 | 33.99 | 34.09 | 33.90 | 34.09 | 33.66 | 34.44 | 35.21 |
| **TWD/JPY** | 4.4 | 4.6 | 4.6 | 4.6 | 4.6 | 4.7 | 4.6 | 4.4 |
| **CAD/TWD** | 22.56 | 23.53 | 23.75 | 23.62 | 23.80 | 23.74 | 24.30 | 24.89 |

Source: RBC Capital Markets estimates

# Malaysia Ringgit

Alvin T. Tan

## 1-3 Month Outlook – Positive factors in short supply

The bloom from Malaysia's post-Covid economic recovery has long faded. The country's manufacturing PMI has been running consistently below the 50 level for more than a year. Malaysia's exports too have joined the regional slump. It also has the largest trade exposure to China among the major ASEAN economies, and this has been a drag for the ringgit.

The local equity market is among the worst performing in Asia-Pacific year-to-date, and MYR has been bedeviled by net foreign equity portfolio outflows for much of the past year, though this has turned more recently. Bond yields are relatively mediocre too. The prices of key commodity exports of oil & gas and palm oil have been volatile lately, and turned lower in recent weeks, robbing MYR of support.

Without an exciting growth story, Malaysian financial assets will struggle to generate significant interest from global investors. The incumbent coalition government remains fragile, making it challenging to undertake needed structural reforms to reduce the persistent fiscal deficit and boost potential growth.

The government's plan to reduce subsidies, which are a huge fiscal drain, will likely continue to be slow to implement. On the other hand, government revenues remain highly dependent on the price of crude oil, and that has helpfully risen back above the current budget's assumed US$80/bbl price.

## 6-12 Month Outlook – Cheap valuation awaiting a catalyst

The main fundamental positive factor for the ringgit is that it is arguably cheap on a number of long-term valuation metrics. The ringgit is the cheapest Asian currency according to the famous "Big Mac Index" for example. Malaysia's trade balance is also expected to stay positive through 2024. The currency, however, still awaits a catalyst to reverse its cheapness.

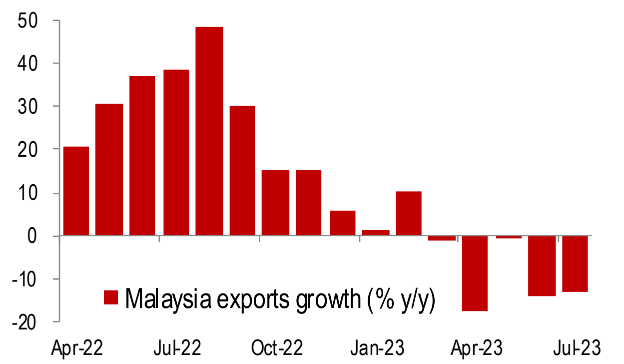
On the flipside, the country's fiscal challenges will keep investors cautious. Malaysia's interest rates continue to lag US ones and those of several of its Asian peers. Finally, it is difficult to foresee a significant improvement in the local political situation.

### Indicators

| | Current (Previous)* |
|---|---|
| **BNM official overnight rate** | **3.00%** |
| Trend interest rates (10yr average) | 2.80% |
| Bias in interest rate market | Lower |
| **CPI Inflation %Y/Y last (prev)** | **2.0% (2.0%)** |
| Inflation target | None |
| **Budget balance % GDP last (prev)** | **-5.2% (-5.1%)** |
| Budget balance trend % GDP | -4.2% |
| GDP Growth % y/y last (prev) | 2.9% (5.6%) |
| Trend GDP %y/y | 4.0% |
| **Purchasing Power Parity Value Aug** | **2.9384** |
| Spot end-Sep | 4.6950 |
| PPP valuation | USD/MYR is overvalued |
| **Current acct bal % GDP last (prev)** | **3.3% (3.0%)** |
| Trend current acct balance % GDP | 3.7% |
| **Moody's Foreign Currency Rating** | **A3** |
| Outlook | Stable |

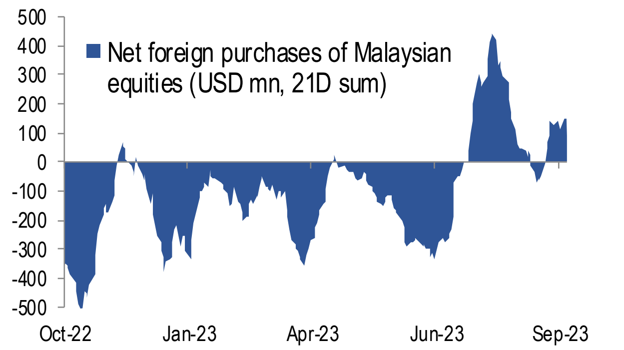
* Current is latest month, quarter or year

### 1. Exports weak amid the regional slump




Source: RBC Capital Markets; Bloomberg

### 2. Equity outflows predominated for much of the past year




Source: RBC Capital Markets; Bloomberg

### Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **USD/MYR** | 4.42 | 4.67 | 4.70 | 4.77 | 4.80 | 4.82 | 4.75 | 4.60 |
| **EUR/MYR** | 4.79 | 5.09 | 4.96 | 4.96 | 4.94 | 4.92 | 4.99 | 4.97 |
| **MYR/JPY** | 30.1 | 30.9 | 31.8 | 31.4 | 31.7 | 32.0 | 31.6 | 31.5 |
| **CAD/MYR** | 3.27 | 3.52 | 3.46 | 3.46 | 3.45 | 3.47 | 3.52 | 3.51 |

Source: RBC Capital Markets estimates

# Brazilian Real

Daria Parkhomenko

## 1-3 Month Outlook – BCB to maintain pace of cuts

Despite a resurgent USD, USD/BRL was range-bound between ~4.85 & 5.00 for most of September, before breaking above the psychological '5.00' level as the external backdrop finally took its toll on BRL, and Brazil's high yield was no longer a sufficient cap on BRL's losses. With USD/BRL potentially entering a higher trading range than we had previously expected, we have revised our forecasts higher, albeit keeping the downtrend in USD/BRL intact and the longer-run target of 4.50 unchanged.

In September, the BCB once again cut rates by 50bps (as expected), with the statement repeating that "members unanimously anticipate further reductions of the same magnitude in the next meetings" and "the need to persist on a contractionary monetary policy". We expect the BCB to cut by 50bps at each of the two meetings left this year (mkt: -93bps), and we continue to think that the risk of the BCB accelerating the pace of cuts is more likely a question for early 2024, rather than this year: (1) a further improvement in inflation/inflation expectations anchoring around the BCB's inflation target and progress on the fiscal front are required for an acceleration (the September statement inserted a line emphasizing "the importance of the execution of the fiscal targets") and (2) two members' terms expire in December (with the appointments to be made by President Lula). Assuming the BCB does not accelerate cuts this year and given Brazil's high real policy rate (Figure 1), BRL should be able to recover ground vs its peers, *if* US yields/USD calm down.

## 6-12 Month Outlook – Fiscal commitment

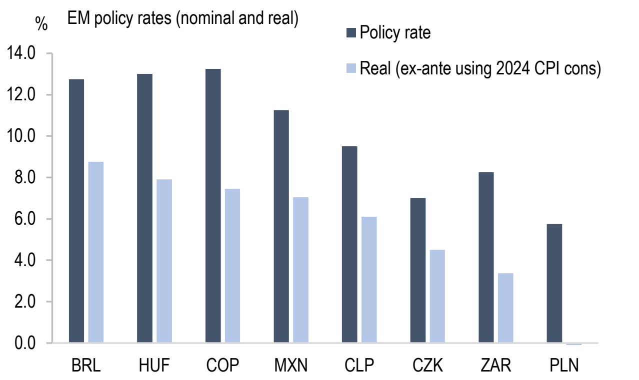
The government's commitment & ability to rein in the fiscal finances is key for USD/BRL's longer-run trajectory. The government is aiming to zero the primary deficit next year, with the plan hinging on BRL 168.5bn in extra revenues. The target is a double-edged sword. On the one hand, it is ambitious and raises the hurdle to surprise positively, but on the other hand, a less ambitious target would result in an un-anchoring of inflation expectations. Attention remains on any progress or lack thereof in Congress passing the necessary measures to raise more revenues. Although there have been delays (e.g. the vote on a bill to tax exclusive & offshore funds postponed likely to Oct 24), we have opted to maintain our long-run target of 4.50, but we stand ready to reassess, if the fiscal process faces more significant delays/lack of progress.

## Indicators

| | Current (Previous)* |
|---|---|
| **Official policy rate** | 12.75 (13.25) |
| Trend interest rates (10yr average) | 9.4 |
| Bias in interest rate market | Easing |
| **CPI Inflation %Y/Y Aug (Jul)** | 4.61 (3.99) |
| Inflation target (2023) | 3.25% |
| **Budget balance % GDP Q2 (Q1)** | -7.7 (-4.9) |
| Budget balance % GDP (10y avg) | -6.6 |
| GDP Growth % y/y Q2 (Q1) | 3.4 (4.0) |
| Trend GDP %y/y | 0.5 |
| **Purchasing Power Parity Value Aug** | 3.6195 |
| Spot end-Sep | 5.0325 |
| PPP Valuation | USD/BRL is overvalued |
| **Current account balance % GDP Q2 (Q1)** | -2.7 (-2.7) |
| Trend current acct balance % GDP (10y avg) | -2.7 |
| **Moody's Foreign Currency Rating** | Ba2 |
| Outlook | Stable |

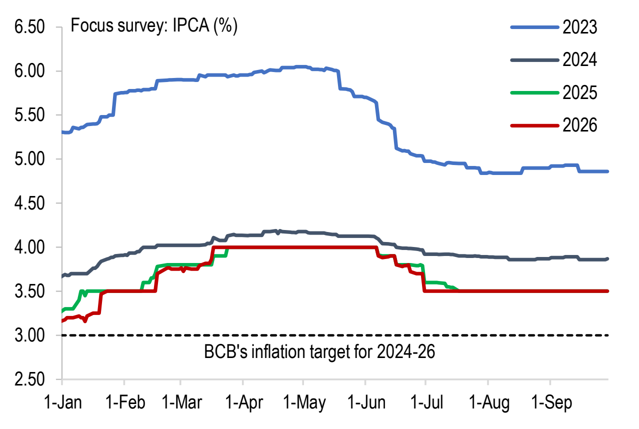
* Current is latest month, quarter, or year

### 1. BCB rate cuts have not yet eroded Brazil's high real rate




Source: RBC Capital Markets, Bloomberg

### 2. Market analysts' inflation expectations still above targe




Source: RBC Capital Markets; BCB, Bloomberg

## Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **USD/BRL** | 5.06 | 4.79 | 5.03 | 5.00 | 4.90 | 4.75 | 4.50 | 4.50 |
| **EUR/BRL** | 5.49 | 5.22 | 5.32 | 5.20 | 5.05 | 4.85 | 4.73 | 4.86 |
| **BRL/JPY** | 26.2 | 30.1 | 29.7 | 30.0 | 31.0 | 32.4 | 33.3 | 32.2 |
| **CAD/BRL** | 3.75 | 3.62 | 3.71 | 3.62 | 3.52 | 3.42 | 3.33 | 3.44 |

Source: RBC Capital Markets estimates

# Mexican Peso

Daria Parkhomenko

## 1-3 Month Outlook – MXN losing its 'shine'?

Since September, MXN has been one of the worst performers in EM, with the local currency falling victim to the souring of the external backdrop, the market's negative reaction post Banxico's press release on August 31 about reducing its currency hedging program, and a significant unwind of short USD/MXN positions (Figure 1). The RBC Positioning Monitor shows that the market has now turned slightly net long USD/MXN. Domestically, Banxico maintained the overnight rate at 11.25% on September 28, with the central bank reiterating the need to hold the policy rate "at its current level for an extended period" and that the inflationary outlook is still "complicated and uncertain throughout the entire forecast horizon, with upward risks". Banxico also raised most of its headline and core inflation profile albeit still expecting inflation to converge to 3.1% over its forecast horizon. Thus, although headline and core inflation are decelerating y/y, we do not see Banxico cutting rates until H1 2024 next year, putting the central bank in stark contrast to some of the other EM central banks that have already started cutting rates. This along with a high real policy rate should lend support to MXN, if the external backdrop stabilizes. We have opted to keep our end-2023 forecast unchanged at 18.00.

## 6-12 Month Outlook – More idiosyncratic risk

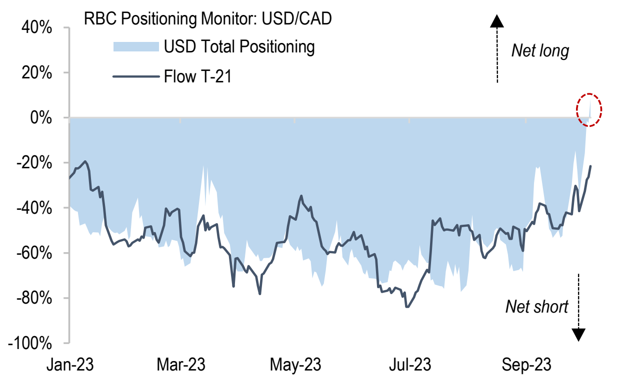
Under our central scenario, US rates will remain high for longer and we expect a mild US recession. As the recession takes hold, this may temper flows into Mexico (e.g. remittances) and weigh on Mexico's economy due to the strong linkages. Then, volatility may increase as idiosyncratic risks rise ahead of the 2024 elections in Mexico and the US, with AMLO's surprise move to change the fee structure for airports according to early October news reports serving as a reminder of such potential idiosyncratic developments. In all, these factors may further erode MXN's outperformance from this year. We are keeping our USD/MXN forecasts unchanged, but there is likely upside risk to this profile.

## Indicators

| | Current (Previous)* |
|---|---|
| **Official cash rate (%)** | 11.25 (11.25) |
| Trend interest rates (10yr average) | 5.96 |
| Bias in interest rate market | Flat, then cuts |
| **Core CPI Inflation %Y/Y Aug (Jul)** | 6.08 (6.64) |
| Inflation target | 3% |
| **Budget balance % GDP Q4 (Q3)** | -3.75 (-2.85) |
| Budget balance target % GDP | -2.2 |
| GDP Growth % y/y Q2 (Q1) | 3.6 (3.8) |
| Trend GDP %y/y | 1.5 |
| **Purchasing Power Parity Value Aug** | 16.3650 |
| Spot end-Sep | 17.4227 |
| PPP Valuation | USD/MXN is overvalued |
| **Current account balance % GDP Q2 (Q1)** | -1.18 (-1.61) |
| Trend current acct balance % GDP (10y avg) | -1.1 |
| **Moody's Foreign Currency Rating** | Baa2 |
| Outlook | Stable |

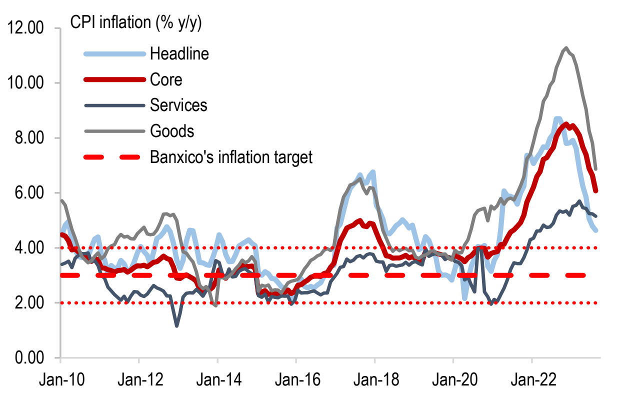
* Current is latest month, quarter, or year

## 1. Market turns net long USD/MXN




Source: RBC Capital Markets

## 2. CPI decelerating y/y, but Banxico not in a rush to cut




Source: RBC Capital Markets; Bloomberg

## Forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **USD/MXN** | 18.05 | 17.12 | 17.42 | 18.00 | 18.50 | 18.50 | 18.50 | 18.50 |
| **EUR/MXN** | 19.56 | 18.68 | 18.42 | 18.72 | 19.06 | 18.87 | 19.43 | 19.98 |
| **MXN/JPY** | 7.36 | 8.43 | 8.57 | 8.33 | 8.22 | 8.32 | 8.11 | 7.84 |
| **CAD/MXN** | 13.35 | 12.93 | 12.83 | 13.04 | 13.30 | 13.31 | 13.70 | 14.12 |

Source: RBC Capital Markets estimates

# Forecasts

## Spot forecasts

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **EUR/USD** | 1.08 | 1.09 | 1.06 | 1.04 | 1.03 | 1.02 | 1.05 | 1.08 |
| **USD/JPY** | 133 | 144 | 149 | 150 | 152 | 154 | 150 | 145 |
| **GBP/USD** | 1.23 | 1.27 | 1.22 | 1.17 | 1.13 | 1.11 | 1.15 | 1.20 |
| **USD/CHF** | 0.92 | 0.90 | 0.92 | 0.91 | 0.91 | 0.92 | 0.89 | 0.86 |
| **USD/SEK** | 10.40 | 10.80 | 10.91 | 11.54 | 11.75 | 11.76 | 11.33 | 10.93 |
| **USD/NOK** | 10.47 | 10.74 | 10.70 | 10.87 | 10.87 | 10.98 | 10.57 | 10.19 |
| **USD/CAD** | 1.35 | 1.32 | 1.36 | 1.38 | 1.39 | 1.39 | 1.35 | 1.31 |
| **AUD/USD** | 0.67 | 0.67 | 0.64 | 0.62 | 0.61 | 0.60 | 0.61 | 0.62 |
| **NZD/USD** | 0.63 | 0.61 | 0.60 | 0.58 | 0.57 | 0.56 | 0.57 | 0.58 |
| **USD/CNY** | 6.87 | 7.25 | 7.30 | 7.40 | 7.45 | 7.50 | 7.45 | 7.35 |
| **USD/KRW** | 1302 | 1318 | 1348 | 1370 | 1390 | 1380 | 1365 | 1350 |
| **USD/INR** | 82.18 | 82.04 | 83.04 | 83.50 | 83.50 | 83.60 | 83.30 | 83.00 |
| **USD/TWD** | 30.49 | 31.15 | 32.24 | 32.60 | 33.10 | 33.00 | 32.80 | 32.60 |
| **USD/SGD** | 1.33 | 1.35 | 1.37 | 1.38 | 1.39 | 1.39 | 1.37 | 1.36 |
| **USD/MYR** | 4.42 | 4.67 | 4.70 | 4.77 | 4.80 | 4.82 | 4.75 | 4.60 |
| **USD/HKD** | 7.85 | 7.84 | 7.83 | 7.84 | 7.84 | 7.83 | 7.83 | 7.82 |
| **USD/MXN** | 18.05 | 17.12 | 17.42 | 18.00 | 18.50 | 18.50 | 18.50 | 18.50 |
| **USD/BRL** | 5.06 | 4.79 | 5.03 | 5.00 | 4.90 | 4.75 | 4.50 | 4.50 |

Source: RBC Capital Markets estimates

## EUR Crosses

| | 2023 | | | | 2024 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4f | Q1f | Q2f | Q3f | Q4f |
| **EUR/USD** | 1.08 | 1.09 | 1.06 | 1.04 | 1.03 | 1.02 | 1.05 | 1.08 |
| **EUR/JPY** | 144 | 157 | 158 | 156 | 157 | 157 | 158 | 157 |
| **EUR/GBP** | 0.88 | 0.86 | 0.87 | 0.89 | 0.91 | 0.92 | 0.91 | 0.90 |
| **EUR/CHF** | 0.99 | 0.98 | 0.97 | 0.95 | 0.94 | 0.94 | 0.93 | 0.93 |
| **EUR/SEK** | 11.28 | 11.78 | 11.54 | 12.00 | 12.10 | 12.00 | 11.90 | 11.80 |
| **EUR/NOK** | 11.35 | 11.71 | 11.31 | 11.30 | 11.20 | 11.20 | 11.10 | 11.00 |
| **EUR/CAD** | 1.46 | 1.44 | 1.44 | 1.44 | 1.43 | 1.42 | 1.42 | 1.41 |
| **EUR/AUD** | 1.62 | 1.64 | 1.64 | 1.68 | 1.69 | 1.70 | 1.72 | 1.74 |
| **EUR/NZD** | 1.73 | 1.78 | 1.76 | 1.79 | 1.81 | 1.82 | 1.84 | 1.86 |
| **EUR/CNY** | 7.45 | 7.91 | 7.72 | 7.70 | 7.67 | 7.65 | 7.82 | 7.94 |
| **EUR/KRW** | 1411 | 1438 | 1425 | 1425 | 1432 | 1408 | 1433 | 1458 |
| **EUR/INR** | 89.07 | 89.50 | 87.80 | 86.84 | 86.01 | 85.27 | 87.47 | 89.64 |
| **EUR/TWD** | 33.04 | 33.99 | 34.09 | 33.90 | 34.09 | 33.66 | 34.44 | 35.21 |
| **EUR/SGD** | 1.44 | 1.48 | 1.44 | 1.44 | 1.43 | 1.42 | 1.44 | 1.47 |
| **EUR/MYR** | 4.79 | 5.09 | 4.96 | 4.96 | 4.94 | 4.92 | 4.99 | 4.97 |
| **EUR/HKD** | 8.51 | 8.55 | 8.28 | 8.15 | 8.08 | 7.99 | 8.22 | 8.45 |
| **EUR/MXN** | 19.56 | 18.68 | 18.42 | 18.72 | 19.06 | 18.87 | 19.43 | 19.98 |
| **EUR/BRL** | 5.49 | 5.22 | 5.32 | 5.20 | 5.05 | 4.85 | 4.73 | 4.86 |

Source: RBC Capital Markets estimates

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