CURRENCIES
GLOBAL
September 2018

HSBC Global Research

By: HSBC FX Strategy

https://www.research.hsbc.com

Currency Outlook

The running of the bulls

The consensus continues to look for a weaker USD but we expect the USD to rally further. We consider three scenarios for the US economy and associated policy. Two are bullish and one is bearish.

Terminal velocity

Rate hikes – whether recent or expected – are not supporting currencies in the way one might have thought. "Terminal rates" have mattered more for G10 FX. The longer rates stay low, the risk they never get close to "terminal" may create a further FX drag and support the USD.

Back to school revision

For those who are looking for revision notes on the busy summer, we present a short overview of major currencies and EM FX movements. We also provide a chronology of the TRY sell off.

Play video with David Bloom, Daragh Maher and Dominic Bunning

Summary

Key events

Date	Event
19 September	BoJ rate announcement
20 September	SNB rate announcement
	Norges Bank rate announcement
26 September	FOMC rate announcement
	RBNZ rate announcement
2 October	RBA rate announcement

Source: HSBC

Central Bank policy rate forecasts (%)

	Last	Q4 2018(f)	Q2 2019(f)
USD	1.75-2.00	2.25-2.50	2.75-3.00
EUR	0.00/-0.40	0.00/-0.40	0.00/-0.40
JPY	-0.10	-0.10	-0.10
GBP	0.75	0.75	0.75

Source: HSBC forecasts for Fed funds, Refi rate/Deposit rate, Overnight Call rate and Base rate

Consensus forecasts for key currencies vs USD

	3 months	12 months
EUR	1.158	1.198
JPY	109.8	108.7
GBP	1.295	1.351
CAD	1.305	1.281
AUD	0.727	0.744
NZD	0.665	0.675

Source: Consensus Economics Foreign Exchange Forecasts September 2018

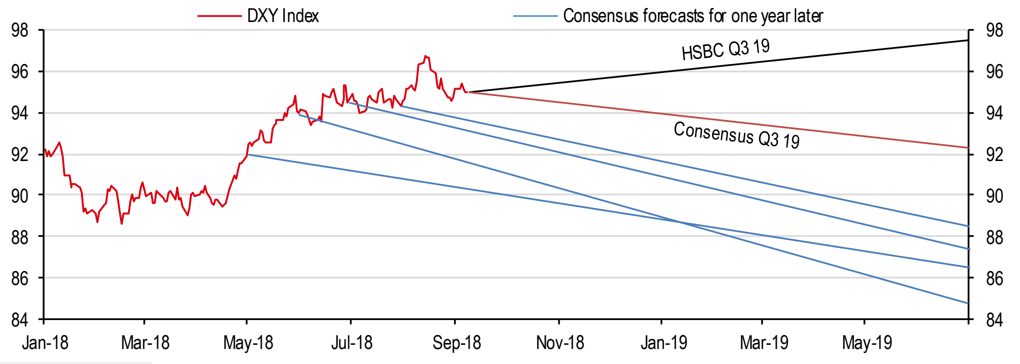
USD: The running of the bulls

- USD should capitalise on the current economic framework where the Fed seems determined to stick to its "dots"
- USD would also likely outperform in a scenario where we see a global economic downturn
- The window for USD weakness is if the market becomes confident the Fed's tightening cycle is ending early

Beware of the bull

We expect the USD to strengthen further over the coming year. The consensus does not. Having failed to forecast the USD bull run of the last five months, the consensus is steadfastly sticking to its view that the USD will weaken, pencilling in roughly a 6% depreciation over the next twelve months. In effect, it would mean a complete reversal of the USD rally seen so far this year – it's all been a temporary aberration seems to be the suggestion. The consensus is no doubt bruised and hurting, and we believe they may be about to get trampled again. This is an unloved USD bull run.

1. The consensus stubbornly still calls for USD weakness



Source: HSBC, Bloomberg

Learn to love the USD

We remain constructive on the USD, however, and in this report, we return to the themes which have underpinned our USD bullishness since April and find that they suggest the rally is not complete and unlikely to reverse any time soon. We consider three possible pathways for the US economy and associated policy, and ask whether you would still want to buy the USD. In two instances, the answer is "yes", and in only one is it "no". So in our eyes from a risk reward basis we would still be long the USD.

The three scenarios

I) USD: ☑ The current environment, Fed keeps hiking

II) USD: ☒ Goldilocks and the USD bears

III) USD: ☑ Dollar's dominance in a downturn

I) USD: ☑ The current environment, Fed keeps hiking

Here the Fed continues to deliver on the "dots" projections as the US economy prospers. This has been the theme underpinning the USD over the last five months. The Fed could continue to defy the market's dovishness and deliver rate hikes above the 'neutral' rate, and consistent with the "dots" path. In addition, this may be about levels and not rates of change. In other words, US rates are high enough to continue to suck in capital into the short end of the curve. Meanwhile, many other G10 central banks would continue to struggle to begin tightening, while those that might hike would do so very slowly. The USD is not especially rich and positioning is not stretched. Policy divergence would push the USD higher.

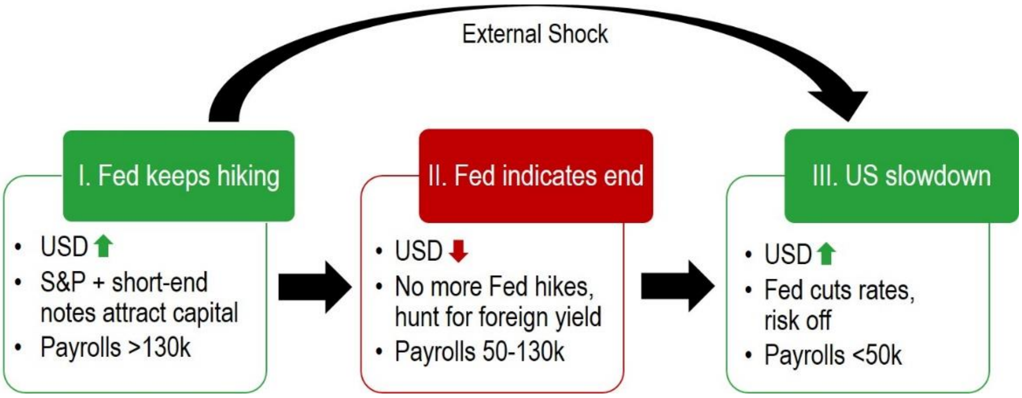
II) USD: ☒ Goldilocks and the USD bears

In this USD bearish scenario the Fed calls an early end to the tightening cycle, comfortable it has done enough to meet its twin mandate. This scenario represents the 'middle ground' between the other two scenarios, and possibly a transition between the two. The US economy is faring well but the Fed recognises that it does not need to tighten as much as it thought previously. The market's relative dovishness is validated. This would likely bring relief to EM FX as USD funding costs would be less than feared, reducing the USD's safe haven allure. It would also create a kind of "goldilocks" environment for the US economy that would foster greater confidence elsewhere and encourage other G10 central banks to normalise. Policy divergence would weaken rather than strengthen the USD.

III) USD: ☑ Dollar's dominance in a downturn

The US economy slows materially, forcing a possible policy reversal by the Fed. The debate here is about the cyclical drag on the USD against the weight of its safe-haven allure. So far, the US economy has been able to sustain its momentum while the pace of activity outside of the US has slowed. Were the US to join the "slowing" club it could prompt a policy reversal by the Fed. But after years of tightening, US policy is better placed to cope with a downturn than other G10 economies. The lack of room to ease outside of the US suggests their currencies would weaken to act as the shock-absorber. The USD would be the safe haven because easing policy could act to support growth. In such a risk-off scenario the USD will fare well but perhaps not against the JPY and the CHF. The structural frailties of fiscal policy may swing back into focus, raising concerns about the Eurozone's fiscal situation and with particular concerns regarding Italy.

2. The scenarios we examine are potentially inter-linked



Source: HSBC

There is an asymmetry in our eyes regarding the risk reward surrounding the USD, with two of the three scenarios pointing to an extension higher in the USD rally. There is also an asymmetry in terms of the probabilities that one might attach to these scenarios. The one pointing to a weaker USD requires a fine balance to be struck by US policymakers whereby they reach the end of their tightening cycle at a point which emboldens risk appetite, but not so soon that it creates worries about the US economy and a retreat in risk appetite. It is also possible the apparent stability offered by scenario two is merely a misleading transition from strong growth to a more sinister slowdown. USD bears could be caught off guard by the subsequent USD resurgence.

In any event, we shall now examine each scenario more fully in turn and explain why we believe the bearish USD consensus will be found wanting once again.

I) The current environment, Fed keeps hiking

At the core of the market's misstep on the USD is the belief that the Fed will not deliver on the "dots" projections. This gap between Fed projections and market pricing has been a long running theme. In 2016, this gap was closed by the Fed lowering its dots projections. But in 2017 and so far in 2018, the Fed has stuck to its path. It has been the market, and more recently the USD, that has had to adjust.

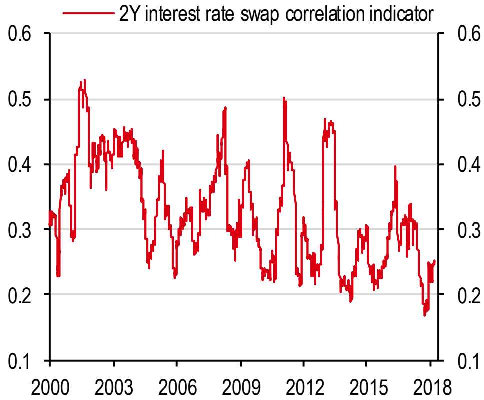
At the start of 2018, the bears argued that the US tightening cycle was, like the economy, in its late phase. The Fed would be unlikely to deliver policy tightening along the path laid out in its "dots" projections. By contrast, other central banks would only be starting their normalisation process, offering far more excitement in terms of tightening and associated currency strength.

The Fed is sticking to the dots
But US interest rate expectations have pushed higher markedly over the last year, echoed in a rising US 2Y yield (see chart 3). The pace of the rise may have flattened of late, but yields are still going up. Secondly, interest rate differentials now matter again having lost their traction during the second half of 2017. One explanation is that correlations between rates markets began to weaken (see chart 4), pointing to greater idiosyncratic opportunities on which the relative world of FX thrives.

3. US rate expectations have pushed higher

Source: HSBC, Bloomberg

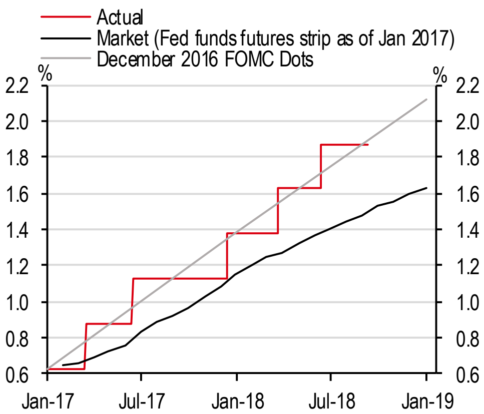
4. Rates markets have become less correlated



Source: HSBC, Bloomberg

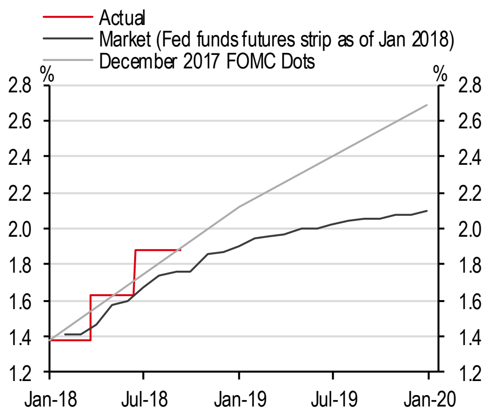
It still seems that the market is reluctant to learn from its mistakes. The Fed delivered on the "dots" during 2017 despite inflation undershooting expectations. Charts 5 rewinds the tape to the start of 2017 and shows the market's expectations at the time for the likely path of Fed funds going forward (black line). The grey line shows the Fed's "dots" projections, also from the start of 2017, and the red line is the path Fed funds actually took. A similar pattern is evident in 2018 (chart 6). The Fed has delivered on the dots again so far in 2018 and even nudged the median dots higher.

5. Fed has tightened in line with the dots…



Source: HSBC, Bloomberg

6. …but the market is resolutely dovish



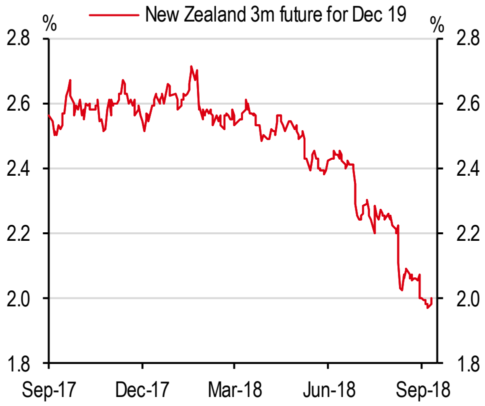
Source: HSBC, Bloomberg

Yet the market is once again fighting the Fed, arguing that the Fed will not tighten along the median path. The Fed projections suggest the median opinion is that a further 125bp of tightening is warranted by the end of 2019. The market is priced for 75bp. Expectations for US GDP growth are still being revised higher and the recent renewed push higher in the ISM readings for manufacturing and services should provide further reassurance about the pace of economic growth. The ongoing push higher in wage growth is further reason for the Fed to stick to its path.

Many other central banks are pushing rate hikes further into the future

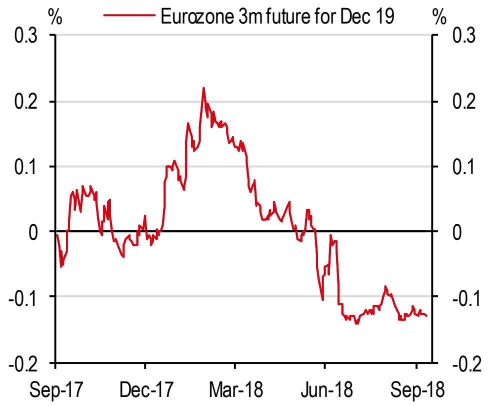
At the same time that the Fed is defying the market's more dovish perspective, many other central banks see a rather distant exit from accommodative policy. A key ingredient of the USD rally has been the snow-ploughing of interest rate expectations outside of the US ever further into the future. It is not clear that this process has stopped. At its latest meeting, the Riksbank delayed the projected starting point for its policy normalisation process. Chart 7 shows interest rate expectations for New Zealand 3M rates at the end of 2019. The market's expectations continue to retreat. The market now thinks it is more likely rates go down than up in New Zealand by the end of next year. The markets may already be dovish, but it seems that the market still manages to find reasons to become even more dovish. In the Eurozone, the market has 12bp of tightening priced in for the end of 2019, but with the pressure on GDP forecasts still in a downward direction and core inflation at a mere 1%, questions remain over whether the ECB will get to begin the normalisation next year.

7. NZ rate expectations still retreating



Source: HSBC, Bloomberg

8. ECB rate expectations



Source: HSBC, Bloomberg

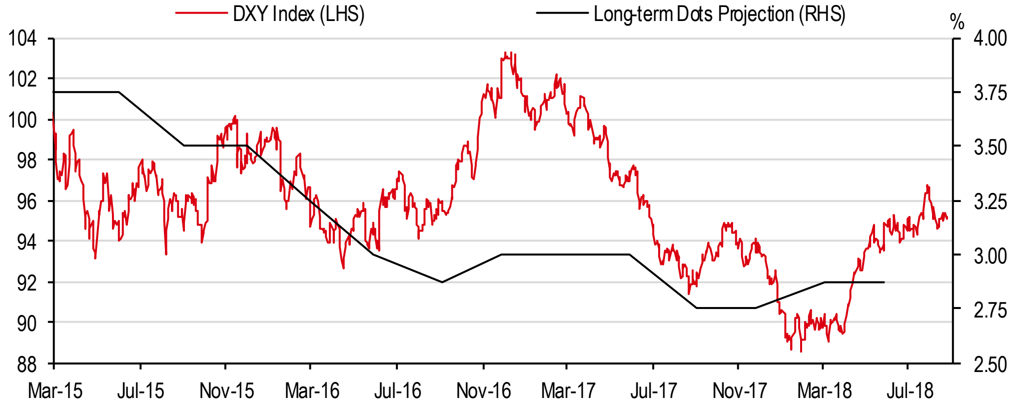
Other central banks face doubts about how high rates can ultimately go

Another problem for USD bears is that currencies may be paying more attention to where the policy rate will eventually finish, the 'terminal' rate, rather than agonising over whether and when the first/next hike is priced in[1]. Take Norway, for example. Although a rate hike during September 2018 has increasingly been priced in over recent months, the currency has weakened. We believe the issue is that the market does not see this first hike as a harbinger of many more to come. The fixation is on whether the Norges Bank is about to deliver anything even approximating a "normal" normalisation.

For currencies, it has become about the destination rather than just the timing of the journey's start. For most G10 currencies, market expectations for where that 'terminal rate' may lie has fallen over the last six months[2]. The exceptions have been the JPY, courtesy of its recent tweak to its Yield Curve Control policy, and the USD and CAD. It is worth noting that the Fed's assessment of the 'terminal rate' has shifted over the last three years, its earlier decline perhaps part of the USD's periodic weakness in 2016 and 2017. It has been more stable of late, and has not got in the way of the USD's recent rally (see chart 9).

[1] https://www.research.hsbc.com/R/10/GwmnWCVCtrNJ
[2] We use the 5Y1M rate as a proxy for the 'terminal' rate, measuring the expected 1M rate in 5 years' time.

9. The Fed's assessment of the "terminal" rate has not fallen in over a year



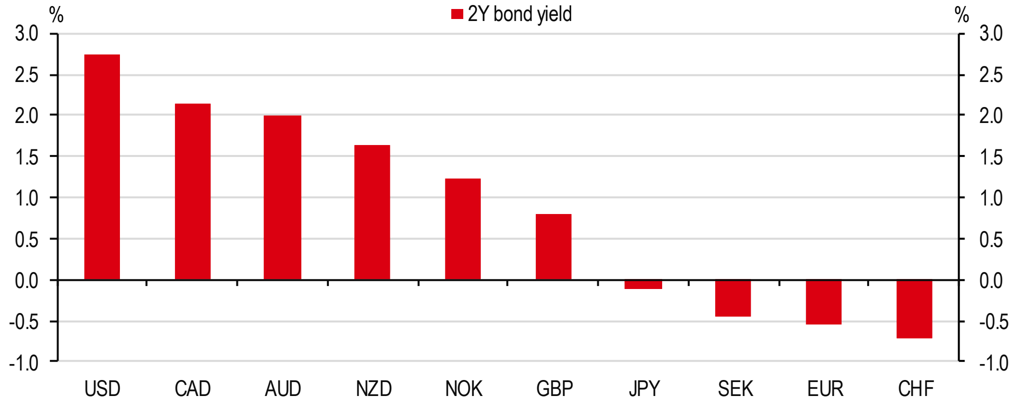
Source: HSBC, Bloomberg

The USD rally has further to run as the divergence in monetary policy plays it way through the currency. No it is not already in the price. The market is priced for 50bp less tightening than the Fed believes is appropriate. So long as the market sticks to its view that the Fed will not deliver a tightening along the path laid out in the median dots, it creates an asymmetric upside risk for the USD. Equally important is the fact that the other G10 central banks have delayed their own normalisation processes. The USD is likely to remain king under these conditions.

USD to do its "level" best

We have spent most of this section discussion the relative rate of change in central bank policy, one we believe favours the USD. However, we should also consider the *level* of interest rates in question. Even if the Fed does not quite match the path laid out in its dots projections, it would still offer the highest short-term yields on offer across G10. The Fed's terminal rate may become the hurdle another currency has to beat in order to push the USD lower in a significant way. For example, it matters less exactly how high US 2Y yields go. The reality is they are already high compared to the rest of G10. This means one can pick up a real rate on the short end of the curve with little duration risk and with the Treasury issuing more and more in this space. The point is that capital will gravitate towards these short end notes regardless of whether the Fed raise rates above or below the dots.

10. The level of yields is supportive of the USD



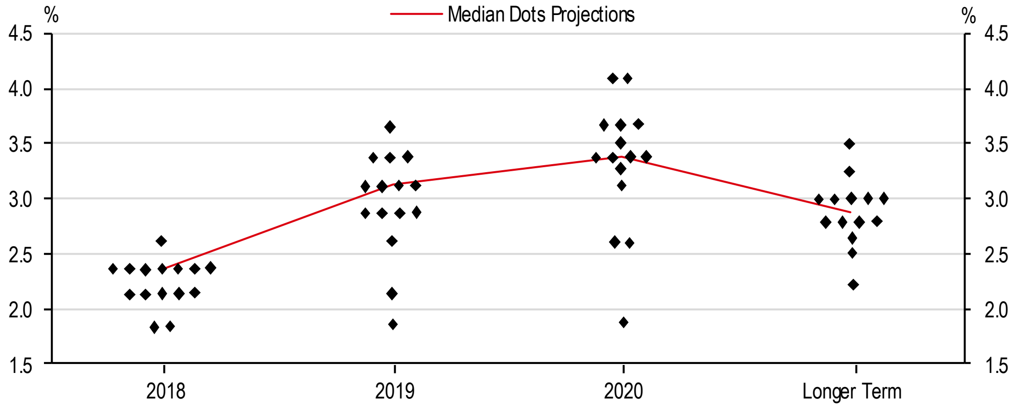
Source: HSBC, Bloomberg

II) Goldilocks and the USD bears

Not all roads lead to USD strength, and there are plausible circumstances where we could see a sustained or perhaps even temporary reversal of the USD's fortunes. Chief among these is the possibility that the Fed calls an early halt to its tightening cycle, not because the US economy is faltering, but because policymakers judge that policy has more swiftly reached a point where there is comfort that the Fed's mandate on inflation and full employment will be achieved.

As things stand, the Fed median dots suggest policy will need to be tightened in 2019 and 2020 beyond the long-run equilibrium. Two FOMC members believe rates may be above 4% by the end of 2020. As the Fed gets closer to the neutral rate after 2 or 3 more hikes, the internal debate could become livelier about whether a 'tight' setting is actually required thereafter. Atlanta Fed President Bostic recently said that "once we get to neutral, let's stay there and see". So far, such sentiments have not been echoed among the Fed's leadership but this could change.

11. Perhaps the Fed will decide not to hike beyond 'neutral'



Source: HSBC, Bloomberg

If the market became confident that the Fed tightening cycle had come to an earlier than expected end while US economic growth remained in an equilibrium state that satisfied the Fed, it would likely be a turning point downwards for the USD and rescue the consensus. After 18 months of the Fed delivering rate hikes in excess of market expectations, the realisation that not only might policy not be tightened as much as feared but more importantly the tightening cycle was over, would likely provide relief for risk assets. The rising cost of USD funding has been a growing headache for many emerging markets. In this scenario of an equilibrium state of reasonable growth coupled with an end to the tightening cycle, one could see the market go back to the hunt for yield and this could provide a welcome relief for many emerging markets.

An early halt might also suggest the Fed sees rate hikes as having greater potency than in the past tightening cycles – a little goes a long way. In turn, this could raise questions in the market about where the long-run equilibrium rate lies. The debate about the terminal rate for other G10 central banks, which is currently challenging many currencies, would then be faced by the USD.

Elusive Goldilocks might just be a transition to something worse

Although this pattern of events is plausible, we question how persistent it might be. In effect, this scenario is sandwiched between our other two USD bullish scenarios. It assumes the Fed has finished its tightening cycle with the next move being symmetrical between a cut and a hike. This type of scenario has seen the NZD weaken substantially. Here the world gets reasonable US growth without the concomitant increases in the cost of capital, global growth does not weaken, and in this goldilocks world everybody seems happy.

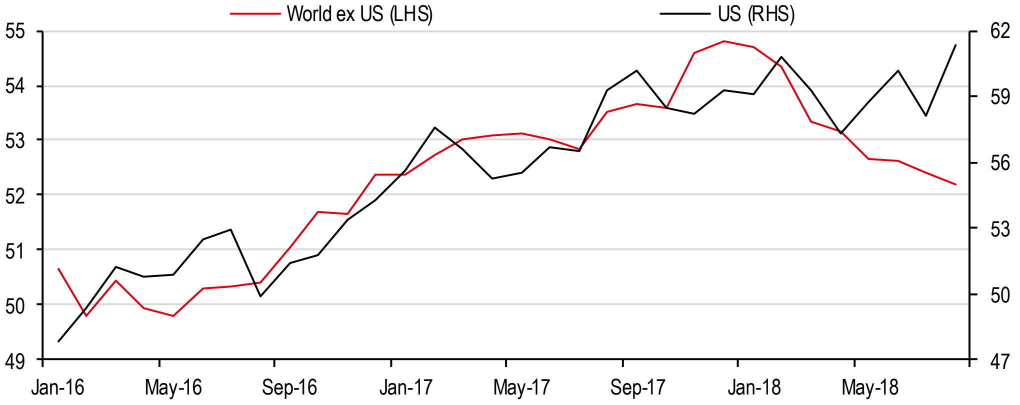
However, there will also be a danger for USD bears in this scenario. The Fed's earlier end to its tightening cycle would presumably be a function of economic data which suggested enough had been done on the policy front. However, that initially reassuring goldilocks data, an equilibrium state of not too hot/not too cold, might simply have been a transition towards something more sinister. As we discuss in the next section, we believe any such deterioration would lead to a risk-off scenario and be USD bullish. It may turn out that goldilocks, as always, ends badly for bears, this time USD bears.

III) Dollar's dominance in a downturn

There are many routes to a downturn, including the transition through a goldilocks phase described above. Alternatively, the current US recovery is "mature" by historic standards, with a recovery lasting eight years compared to an NBER calculation that says the average cycle is around 5 ½ years long. We may be 'due' a recession. Another route is that the Fed's tightening, though gradual, will prove over-zealous and growth will falter. Perhaps hawks will fixate excessively on rising price measures such as headline CPI and wages growth, and squeeze the economy too hard. A leveraged household sector would be vulnerable. Globally, history suggests that synchronised global upswings that are accompanied by greater than expected Fed tightening (which has been the case in 2017 and H1 2018) have been followed by crises elsewhere (see *The Return of the Monkey's Paw* by Stephen King, 7 August 2018). Or perhaps the world will succumb to event risks such as spiralling descent into a tit-for-tat global trade war.

Yet while the possible catalysts to a pronounced downturn are many, the currency implications may not be so different irrespective of the source. It is hard to see circumstances under which the US economy would falter at the same time as the rest of the world suddenly finds a fresh lease of life. Global economic momentum is already fading even as US growth expectations push higher. Developed market PMIs have moved lower, the trend bucked by the US (see chart 12). It is likely that were the US economy to slow materially from here, it would drag global growth lower with it.

12. Manufacturing PMIs show the US has bucked the pattern of slowing global growth

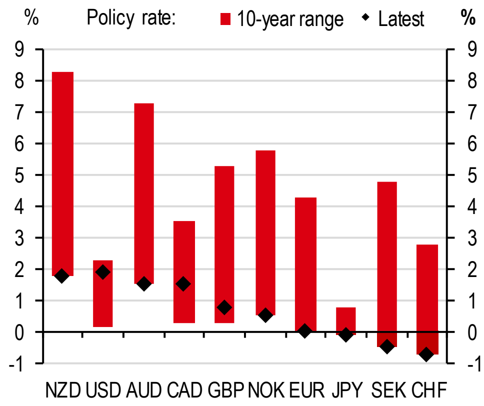


Source: HSBC, Bloomberg

The FX impact of a downturn at this juncture is likely to be different to the past. Under normal circumstances, policymakers would face a looming downturn with the starting point for their policy rate at a 'normal' or 'tight' setting. This is patently not the case currently with rates low by historical standards across the board, and in some cases still mired at zero or in negative territory.

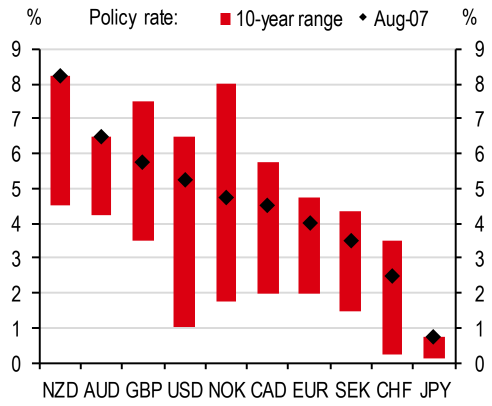
Think of the starting point for a potential loosening. Chart 13 shows the range of G10 policy rates over the last decade (the red columns) against the current level (black dot). Unsurprisingly, it shows that with the modest exceptions of the USD and CAD, central banks would face a recession with rates at historical lows. In contrast, Chart 14 shows where policy rates were before the start of the last recession in 2007 relative to their range over the previous decade. The room for manoeuvre at that time is clear.

13. Policy is not ready for a recession



Source: HSBC, Bloomberg

14. Whereas it was better placed in 2007



Source: HF: Before 2000 the SNB targeted the monetary base; NZD: Before 1999, RBNZ focused on the quantity of liquidity in the banking system

Beyond the conventional policy rate options, some may be more constrained on the unconventional policy front also. The ECB, BoJ and Riksbank all face some potential limits on how much they could ramp up their bond buying programmes due to the limited supply of bonds available.

For G10 FX, the likely logic will be if monetary policy does not have the scope to respond fully to a downturn then the currency may have to shoulder more of the burden of adjustment (i.e. weaken). The USD and CAD would enjoy the buffer built by earlier tightening. Rather than being viewed as a policy mistake, earlier tightening may be rewarded as providing scope to ease. On top of this it's likely to be a world of risk-off that favours the USD. In this scenario, the CHF and the JPY may be the prime outperformers but that does not mean it's not a bull market for the USD.

Elsewhere, the AUD, NZD, NOK and GBP would have some limited scope to cut rates but not much. The EUR and SEK would likely become "never exiteer" currencies. The less perceived scope for monetary and fiscal policy to respond, the greater the pressure the market will put on the currency to act as the shock absorber. This creates a strange situation where a central bank that has the greatest ability to cut rates may end up with the strongest currency, whereas the country where policy is most limited will see the greatest currency weakness.

Fiscal frailties and EUR 'divisibility'

We explain above why one would buy the USD even if the Fed is cutting rates, an argument which examines the cyclical aspect of policy during a downturn. However, structural considerations give further reason not to be drawn to the EUR during a marked downswing in activity. The focus here would be fiscal health.

The US would be exposed to concerns over its fiscal frailties given the starting point for the deficit is already close to 4% of GDP. Lower tax revenues and higher benefits spending would likely see the deficit widen, with implications for yields and the level of the USD. But at no point would it raise questions about the viability or longevity of the USD. By contrast, the Eurozone would also face questions about its fiscal health, with Italy one obvious focus of attention. The debt crisis in Greece raised questions about whether the EUR might break up. Those questions might return during any significant downturn that pressured government finances, not least because Italy's government bond market is nearly seven times larger than Greece's.

So cyclically and structurally, it would not make sense to flip out of the USD and into the EUR. This puts the USD top of those currencies likely to benefit. In addition, the USD has enjoyed safe haven gains during recent periods of intensifying global trade tensions. It would be the likely "go to" currency in the event of a downturn and particularly if this gravitates to a more serious risk-off environment.

USD – beware the unloved bull

In the end, nothing is certain in forecasting but we believe the weight of evidence points to an extension of the USD rally. Our central case – **The current environment, Fed keeps hiking** (scenario I) – continues to be that the market is underestimating the Fed's willingness to stick to its dots projections, but even if it does not the levels of rates on the short end may still attract capital. At the same time, many other G10 central banks are struggling to get to the exit from accommodative monetary policy. Even those that have begun to tighten, or are about to, face questions about where rates will finish in the end, questions that point to underperformance against the USD.

Our Goldilocks and the USD bears scenario II offers a path to a weaker dollar, but it is a narrow path and one which may simply be a transition to a darker environment, and another USD bullish one. In addition, even if the Fed ends up finishing sooner than expected, the USD may still enjoy some support because it would be the "high yielder", at least within G10. In a low volatility world, carry might be king. It would at least be a consideration tempering the scale of any USD reversal lower. So the USD may hold some of its gains against G10 but it would certainly lose ground to EM.

We believe an equilibrium type scenario is unlikely to last and may just be a stepping stone to scenario III – **Dollar's dominance in a downturn** here, we suspect the USD would win out courtesy of policymakers' ability to cushion the economy from the downturn with easier monetary policy or perhaps a move to a risk off world. In our view two out of our three scenarios point to a stronger USD.

Each year, a million people attend the running of the bulls at Pamplona, Spain. There is no doubt some excitement for those involved as they seek to outmanoeuvre the bulls, but in the end the risk of pain and injury is high. In FX, the USD bull run has trampled over the consensus so far this year. Battered and bruised, they still seem determined to face the bull run again but we expect the outcome to be the same. Beware the dollar bull.

Terminal velocity

- Rate hikes – whether recent or expected – are not supporting currencies in the way one might have thought
- "Terminal rates" have mattered more for G10 FX
- The longer rates stay low, the risk they never get close to "terminal" may create a further FX drag

In the fast-paced world of G10 FX, we tend to think and trade in the short-term. Rate hikes should be good for currencies right here, right now. But **in the last few months, there has been a much stronger link between FX performance and movements in longer-term forward interest rates** rather than short-term rates. This has meant that currencies have underperformed even when they have seen rising expectations for near-term rate hikes.

In our view, this change in behaviour comes down to the increased role of forward guidance. Many central banks are explicitly telling the market where they see interest rates going over the longer-term. In particular, the ever closer proximity of the Fed's current policy rate with its own assessment of "terminal rates" in the US is bringing this subject into the limelight. We think the focus on where policy rates will be in the longer-term has significant implications for FX markets.

We believe the USD is set to rally further. This could be because the Fed raises its own assessment of terminal rates the closer it gets to its current projection. Or it could be because the market downgrades expectations of terminal rates elsewhere. The risk for other currencies is that they are unable to hike rates by any significant degree in this economic cycle. This might be due to increased leverage, meaning smaller rate hikes have a bigger impact than in the past. Or it might be due to lower inflation globally, which has curbed the apparent need to tighten for many central banks. Whatever the reason, **the longer G10 policy rates are kept low, and the slower they are raised, then longer-term rate expectations will likely be dragged lower**.

In our view, **this puts the likes of the AUD, NZD, NOK and SEK at significant risk**, especially if the global economy continues to show signs of softening when the Fed continues on its tightening path. In a world focused on terminal rates, the USD has the fastest terminal velocity, in our view.

Front to back on rates

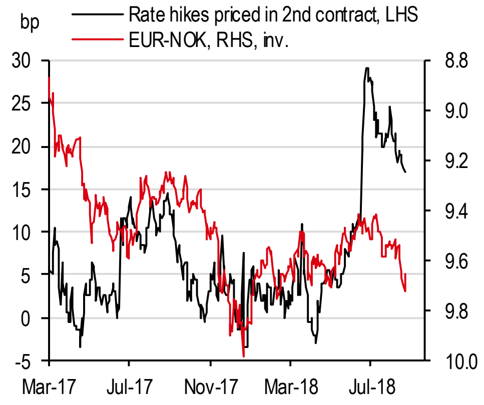
A strange thing is happening in FX. Many currencies are underperforming even though their central banks have hiked interest rates, or are expected to do so in the coming few months.

The most obvious recent example is the NOK. In June the Norges Bank hinted very strongly that it would hike rates after the summer, causing a sharp adjustment higher in rate hike expectations (Chart 1). On 16 August the Norges Bank then all but confirmed it would hike at its September meeting. And yet despite this strong forward guidance that rate hikes are coming, and their increasing proximity, the NOK has failed to rally.

One might argue that the market is concerned the Norges Bank won't deliver on this hike, and would rather wait to see a hike before turning more NOK-bullish. But the recent experience of GBP suggests this is not the case. In 2017, GBP rallied quite significantly on rising rate hike expectations. Some market participants thought this might be the start of a new Bank of England hiking cycle. But when the BoE did hike, in November 2017, it did so with little sign of a follow-through of higher rates further out. Since March 2018, GBP has fallen fairly steadily and consistently, despite the delivery of another well-flagged rate hike on 2 August (Chart 2).

So the market has learnt that neither short-term rate hike expectations nor the realisation of those expectations matter for currencies at the moment. What matters is whether we are starting a true tightening cycle and where rates are headed in the longer term.

1. NOK has not benefitted from rising rate hike expectations in 2018…



Source: Bloomberg, HSBC

2. …and GBP's reaction to rate hikes has changed from 2017 to 2018

Source: Bloomberg, HSBC

Fast forward to terminal

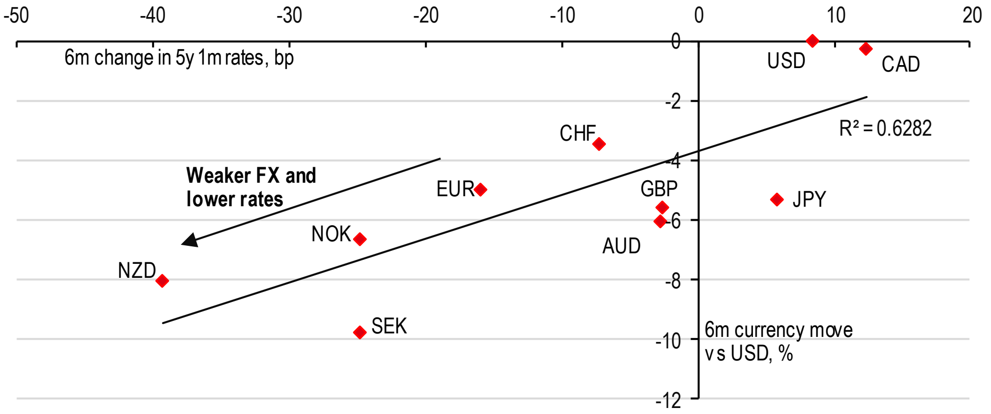
In our view, this apparent change in relationship between FX and short-term rate expectations is a function of the increased use of forward guidance by central banks. Traditionally in G10 FX we would look at short-dated rates as a guide to which currencies should be outperforming on a cyclical basis. This appears to have changed. Forward guidance is putting much more onus on where rates are headed in the longer term than on where they are in the short term. The market is increasingly focused on the "terminal rate", particularly now because the Federal Reserve in the United States – arguably the world's most influential central bank – is hiking its policy rate ever closer to its own estimate of the long-term terminal interest rate.

With the introduction of forward guidance, central banks started to gently hold the market's hand and began giving explicit guidance in many cases as to where rates will be at the end of the hiking cycle. Financial markets are always trying to price in the future. Now, many central banks are telling us explicitly what they think that future will be. **So the FX market can look at that terminal rate and trade the currency of that expectation of where rates will be over the longer-term.** This has had significant implications for FX markets.

Chart 3 shows the performance of the G10 currencies in the last six months alongside the changes in the 5y1m forward rate over the same time period. In effect, **this rate is the market's interpretation of where short-end rates will be in five years' time**. This may be different from an economist's interpretation of a theoretical long-term neutral rate, but crucially, it is a guide to where the market sees policy rates over a longer term horizon.

The USD occupies the top right of the chart – the strongest G10 currency performance and the second most positive move in rates. The CAD is in the same area – ranked number 1 on rate movements and number 2 for FX performance. The only other currency with a positive move in 5y1m rates has been the JPY as the Bank of Japan tweaked its Yield Curve Control guidance. At the other end of the spectrum is New Zealand, where the 5y1m rate has fallen by around 40bp as the RBNZ has shifted its forward guidance to a much more dovish outlook, and even suggested its next move might be to cut rates rather than hike them.

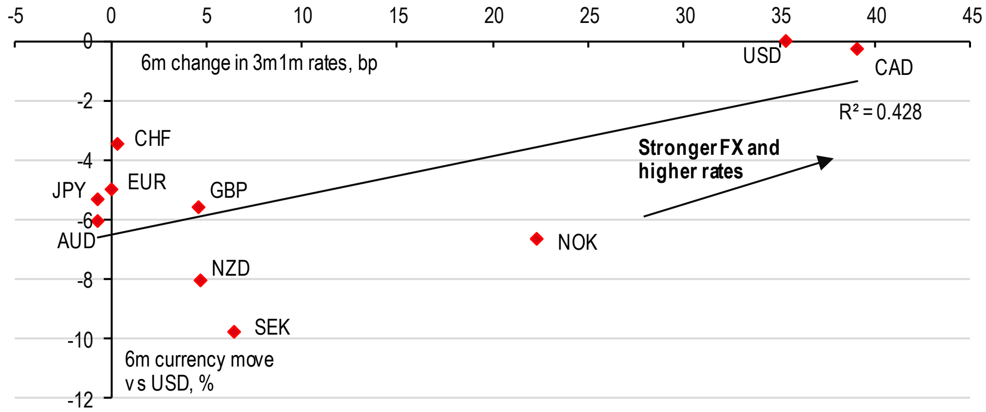
3. Strong relationship between relative FX performance and "terminal rate" movements



Note: For CAD we use the 4y1m forward rate due to a lack of available data for the 5y1m forward rate
Source: Bloomberg, HSBC

The relationship using front-end rates is weaker. Chart 4 looks at FX performance versus the changes in the 3m1m forward rate – a measure of where the market thinks short-end rates will be in just three months' time. The relationship is much less obvious, and there has not been as close a link between movements in near-term rate expectations and FX. The Scandinavian currencies are good examples. The SEK has seen front end rates move higher by 7bp in the last six months but the currency has fallen by nearly 10% versus the USD, making it the worst performer in G10 in that time. The NOK has seen a rise in rates of over 20bp but it has still struggled in terms of FX performance.

4. Front end rates have been less closely linked to FX performance



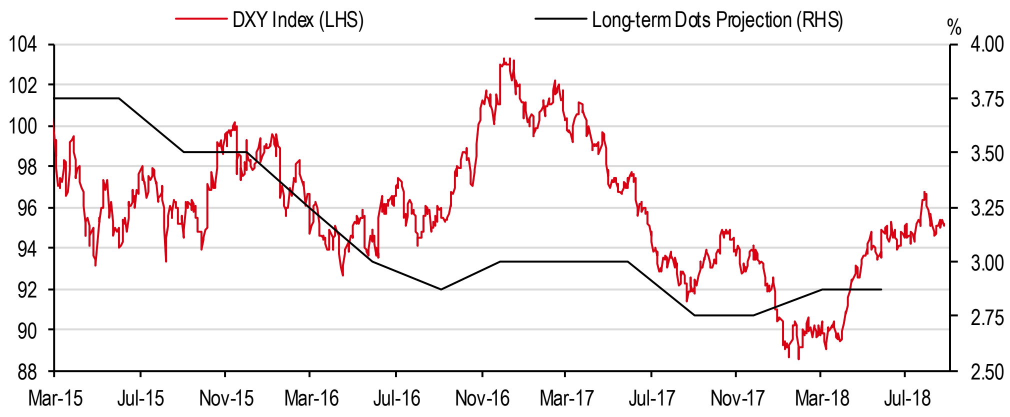
Source: Bloomberg, HSBC

The Fed and the USD – hitting terminal velocity

Perhaps the best example of how terminal rates have become more important is the USD and the Fed. The FOMC has been providing very specific forward guidance in the form of its Summary of Economic Projections and "dot plot" since 2012. This has included a view of the "long-term" Fed funds rate. Back in 2015 the Fed's median long-term dot pointed to rates rising to 3.75%. But through the course of 2015 and early 2016 this terminal rate guidance fell quite dramatically towards 3%, a move which was associated with a flat-to-softer USD (Chart 5).

The USD rally in late 2016 reflected, amongst other things, an anticipation that the Fed's long-term dot may rise, as indeed it did, as US data came in better than expected. But from mid-2017 the Fed lowered the long-term projection even further which was accompanied by a weaker USD again. The move higher in the Fed's dot in March 2018, alongside broadly better than expected data, has been one factor behind the USD rally this year.

5. The Fed's falling "terminal dot" was a factor dragging the broad USD lower



Source: HSBC, Bloomberg, Federal Reserve

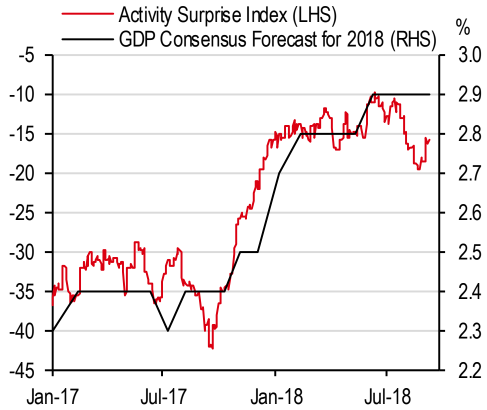
Given the US's strong economic performance so far this year – and the subsequent ratcheting up of market expectations for growth (Chart 6) – there are a number of questions being asked about the future of the Fed's hiking cycle and forward guidance and what it would mean for FX:

1) Could the Fed increase its guidance on the long-term rate?
2) Will the Fed's hiking cycle simply stop at the "terminal" rate?
3) Could the Fed hike above and beyond its current long-term rate estimate?

1) Higher long-term US rates would be USD positive
In the first scenario we would expect the USD rally to extend for obvious reasons. A market pricing that terminal rates had risen would imply a reassessment of US potential growth and a stronger rate of return for holding US assets in the future and would encourage greater capital inflow into the US. But the latest signs suggest this may not be forthcoming.

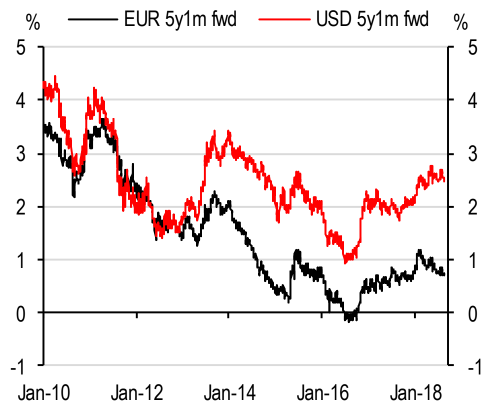
In his recent Jackson Hole speech, Fed Chair Jerome Powell pointed out that the economy's real, neutral interest rate is clouded by uncertainty. And with recent signs of US growth actually rolling over there may be less traction for the idea that the US long-term economic outlook will go from strength to strength, especially when the recent impetus from fiscal policy wears off. The Fed may be unwilling to shift its long-term rate estimate higher without more substantial positive evidence.

6. Near-term US growth expectations rose as activity outperformed



Source: HSBC, Bloomberg, Consensus Economics

7. Terminal rates have already fallen further in Europe than the US



Source: HSBC, Bloomberg

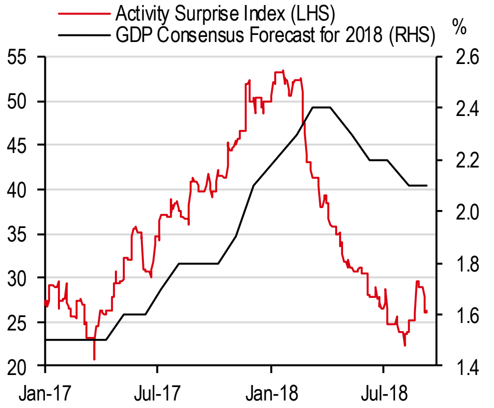
2) Fed stops at neutral – focus shifts to others
The second option would be for the Fed to simply stop tightening when policy rates hit their current estimate of "neutral". This would suggest the yield curve could stay very flat. The market may find this an attractive proposition in the near-term. With little fear about rising USD funding costs, and a neutral rather than restrictive monetary policy in the US, more capital could flow back into higher risk and higher return markets such as high beta G10 and EM. For a period of time, this could be the "goldilocks" scenario – a neutral policy that allows the economy to run not too hot, but not too cold – which would boost risk sentiment.

The downside in this scenario would be if an extended pause from the Fed makes the market look at where terminal rates are headed elsewhere. The prognosis here may not be so positive. Europe is a good example of where the market's view of policy rates over the longer term has fallen even more dramatically than in the US. In 2011, the market had similar views on where rates would be five years ahead – around 3%. Since then, the US has done a round trip down to 1% and back to 2.5%, but Europe's 5y1m rate has broadly kept falling (Chart 7).

Could Europe follow the US example and gradually see these longer-term rates push higher? This seems unlikely. There may have been a little bit of noise in the last few weeks about a slight move in yield differentials in the EUR's favour as some US data has slowed. But taking a longer view, Europe has seen a significant slowdown relative to expectations in 2018 (Chart 8). Any excitement from last year about moving to a stronger long-term growth profile is being quashed. Long-term potential growth rates in Europe do not look like they are set for a big revision higher. However, on the flip side, with rate expectations already so low in Europe it may be hard for them to push that much lower for now.

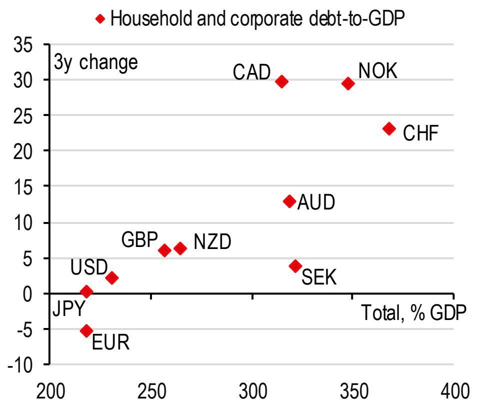
The lack of a strong argument for a move in relative terminal rates suggests that EUR-USD may not be in the limelight if this theme gains more traction. We envisage a gradual grind lower in EUR-USD in the coming months rather than a more exciting descent for the pair. The real action may be elsewhere. Terminal rate expectations have drifted lower for most currencies in the last few years. But many could still have a lot further to fall.

8. Optimism for Eurozone recovery has faded quickly



Source: HSBC, Bloomberg, Consensus Economics

9. Terminal rates could be lower in places where leverage has increased



Source: BIS, HSBC

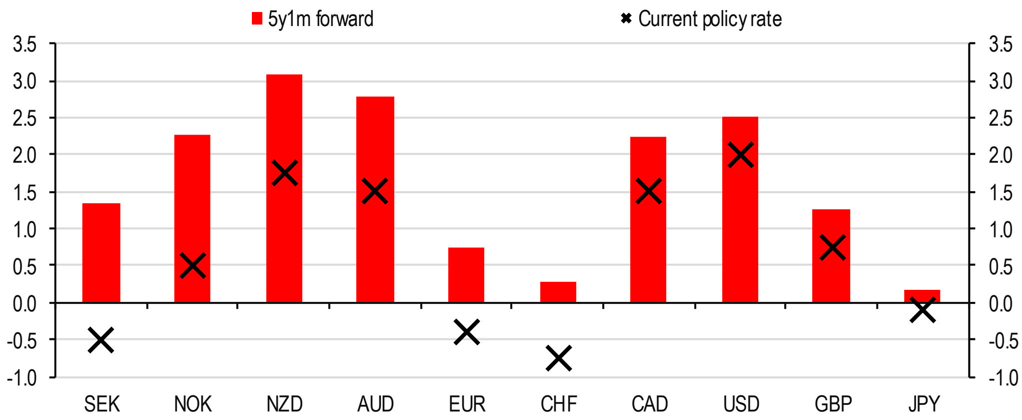
Many central bankers have talked about the uncertainty over where neutral now lies. The Philips curves that economists have previously relied on appear to have broken down and there is uncertainty over how high rates can go given the build-up of private sector leverage since the Global Financial Crisis (for example, see *The price of tightening*, by Liz Martins, 30 October 2017). With a higher sensitivity to interest rates, household debt is a primary concern given a pervasive lack of wage growth. Crucially for FX there is quite a bit of geographical dispersion in leverage growth in this sector.

Chart 9 shows the overall debt-to-GDP ratio of households and corporates for G10 economies, and the change in that ratio in the last three years. Currencies in the top right corner have seen the fastest build-up of debt and the highest overall leverage. So central banks in **Norway, Sweden, Australia and Switzerland may struggle to deliver the same degree of tightening that the Fed has delivered**. Canada has so far bucked the trend, delivering rate hikes at the second fastest pace in G10, despite the overall leverage in the economy, suggesting this may create greater pressures at some point down the line. The market should expect monetary tightening to bite sooner in these markets and may continue to downgrade terminal rate expectations accordingly.

Another factor that could play a role in rate expectations is the incredibly glacial pace at which hikes have been delivered by those that have actually managed to tighten in recent years. It has taken the Fed nearly three years to hike rates by 175bp. In 2004-2005 the same tightening took nine months. As the Fed has hiked so slowly, terminal rate expectations have been dragged lower. The longer other policy makers keep rates at ultra-low levels, the more risk they face of not hiking in the current cycle and of dragging down the market's assessment of where policy rates will be over the longer term. These "failed exiteers" (see *Currency Special*, 10 April 2018) could become "never exiteers", which would weigh on their respective currencies.

Where is this most likely? Chart 10 shows, from left to right, the currencies with the biggest gaps between the market's current terminal rate assessment and policy rates. Currencies such as the SEK, NOK, NZD and AUD have the biggest gaps and thus, in our view, the biggest potential for a significant shift lower in longer-term rate expectations.

10. Terminal rate has lots of room to be dragged lower in the "high beta" economies (%)



Source: Bloomberg, HSBC

A lack of rate hikes in the coming year (for AUD), very slow hikes (NOK and SEK) and even the possibility of a cut (NZD, as hinted by the RBNZ) could well see the market's terminal rate assessment grind lower. This would weigh further on these currencies, which have already seen underwhelming performance in the last six months.

3) Fed goes "beyond neutral" – double up on the dollar

The last option – hiking beyond the Fed's own suggestion of the long-term rate – may be the most controversial option. This seems unlikely for now, as it would invert the US yield curve, something that has been flagged far and wide, including by some members of the Fed, as a potential recession indicator. In this environment, we would see higher USD funding costs in a world where investors would be increasingly fearful of a severe slowdown in the global economy. A shift towards "risk off" assets in this case would, in our view, strongly favour the USD, which would offer both relative yield and the safety of its vast liquidity.

The biggest losers could be those currencies where the room for further policy loosening was most limited and where the currency would need to pick up more of the slack. The SEK, for example, could be especially vulnerable in this example. This is something we explored in more detail in *FX in the next downturn*, 13 April 2018.

USD's terminal velocity still the fastest in G10 FX

FX markets have been more closely linked to movements in longer-term rate expectations than shorter-term expectations in recent months. The market's assessment of where so called "terminal rates" are for each economy matters more. The risk is that terminal rates have further to fall for many currencies, given the recent experience of central banks that have actually been able to hike. The USD's apparent faster terminal velocity looks set to remain supportive for the currency in the coming months, in our view.

Brexit Strategies: What if it's 'no deal'?

This is an excerpt from a multi-asset piece discussing a "no deal" Brexit outcome. Here we present the FX implications. For the full report, please see *Brexit Strategies: What if it's 'no deal'?*, 10 September 2018.

Simplifying Brexit

The hard and the soft

In deciphering the influence of politics on GBP, we have long argued that it makes sense to look at the currency's level as a blend of possible Brexit outcomes. For simplicity, we can distil this down to two such outcomes: 'no deal', and a soft Brexit.

(1) 'No deal': GBP-USD to 1.10, EUR-GBP towards parity

The UK government has argued that "no deal is better than a bad deal", but we would expect no deal to be a very bad deal for GBP. The uncertainty unleashed regarding every aspect of the UK's relationship with the EU would be enormous. This would of course affect trade in goods and services, but it would also touch on numerous other areas including citizens' rights, air travel and the Irish border, for example. We would expect GBP-USD to fall to around 1.10 under this no-deal scenario, below the lows seen during the flash crash of October 2016.

The interesting aspect of a 'no-deal outcome is that it would not just adversely impact GBP but the EUR too. The trade and economic linkages (see *Brexit leads top 10 risks*, 3 January 2018) mean that the marked economic disruption that this scenario would imply would also hit Eurozone activity and investment sentiment. What is bad for GBP would likely be bad for the EUR, though less so, seeing EUR-GBP push towards parity.

(2) Soft Brexit: GBP-USD at 1.45

Although a no Brexit (remain) outcome is still theoretically possible, it seems highly unlikely to us. So perhaps the softest Brexit outcome worthy of serious consideration for GBP is that the UK maintains full preferential access to the single market. This implies a minimum of disruption to the UK's economic ties with the EU and a recovery in economic growth back to the pace seen ahead of the referendum.

GBP-USD would enjoy a considerable relief rally, having avoided the potentially more damaging alternatives. Political risk would remain in the background and the cyclicality of the economy take centre stage. As such, we would not expect GBP to recover all of the ground lost after the June 2016 Brexit vote when GBP-USD was trading above 1.50. The 'soft Brexit' relationship, while close to full EU membership, would not be identical. Hence we would expect GBP-USD to rise to around 1.45, still slightly undervalued relative to long-term estimates.

We do not make an explicit forecast of the political outcome, but we see a strong possibility that the process continues to drag on, and GBP-USD remains a weighted probability of potential outcomes. As such we see GBP-USD trading around the 1.30 area for the coming months, until we get more clarity in either direction on the political outcome.

US Midterm Elections

This is an excerpt from a multi-asset piece answering 16 key questions regarding US midterm elections. Here we discuss the FX implications. For the full report, please see *US Midterm Elections – What to watch and what's at stake?*, 5 September 2018.

How might the USD respond to the results of the midterm elections?

Were the Republicans to retain control of both houses of Congress, it would point to a continuation of the current political set-up and, by extension, this would not change our current view of a further strengthening of the USD over time. President Trump would likely take the result as a validation of his policy mix and so markets would anticipate more of the same. As noted elsewhere in this report, President Trump's "to-do" list would likely include further tax reform and possibly additional infrastructure spending. The currency market would face the same kind of debate seen early in 2017 as to whether such policies should be viewed cyclically as a USD positive, or structurally as a USD negative. We expect cyclical factors to be dominant, pointing to stronger US activity and validating expectations for additional Fed tightening. The USD would likely capitalise in an extension of the circumstances which have driven our USD bullish view since late April.

The USD impact of the alternative outcome of Democrats gaining control of one or both houses of Congress would depend on how President Trump responds in terms of his policy agenda. The policy reaction would be crucial to the USD's fortunes. The president would retain the power to pursue his trade protectionist agenda and, with other domestic policy channels curtailed by a gridlocked Congress, it is possible he would do so in a more aggressive way. We believe this type of reaction would drive the USD stronger. In contrast to the scenario of a Republican "clean sweep", it would reflect a safe haven bid for the USD in a global "risk-off" mood, rather than a cyclically driven USD rally. The flipside to this USD strength would be further selling pressure on EM FX and high beta G10 currencies. The EUR would also likely weaken as markets re-priced the likelihood that the ECB would ever get to raise interest rates before the next economic downturn.

However, an alternative reaction function in the scenario the Democrats gain control of one or both houses could see the president back off from some of his policy initiatives. Rather than intensifying his protectionist agenda, President Trump might seek to draw out some agreements with trade partners in order to point to the "success" of his earlier higher tariff tactics. With other aspects of policy hampered by Congress, it is possible that US politics would not be so great a focus for financial markets, should trade tensions ease. The safe haven bid for the USD would fade with equivalent upside for EM FX and high beta G10 currencies.

Back to school revision

- Trade and political tensions fuel USD strength
- Brexit developments drive GBP
- EM FX weakens significantly

A summer to remember

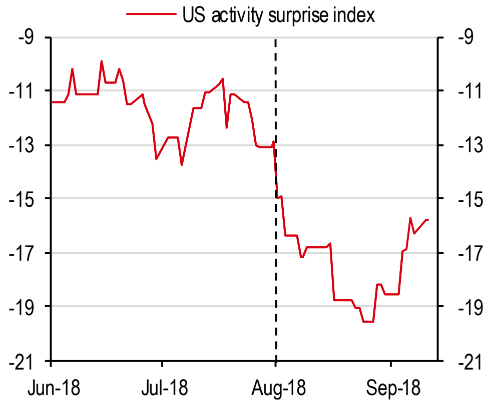
It has been a busy summer in financial markets. Trade talks and politics heated up, seeing many EM currencies get hurt while the safe havens bathed in relative warmth. For those who are looking for revision notes on what happened over the last months, we present a short overview of major currencies and EM FX movements. We also provide a daily summary of events that moved the TRY from the beginning of August.

USD: In it to win it

Heightening trade and political tensions supported the USD over the summer. The escalation in trade frictions began in June as the US threatened to impose tariffs on USD200bn of imports from China and China responded it would retaliate "forcefully". The tit-for-tat continued through the summer with tariffs on USD34bn of goods coming into effect in July and talks of increasing the size of potential tariffs from 10% to 25% in August. August also saw politics take centre stage as the US imposed new sanctions on Russia and US-Turkey relations deteriorated further with the US doubling tariffs on Turkish steel and aluminium. The DXY rose 1.3%[3] over this period[4].

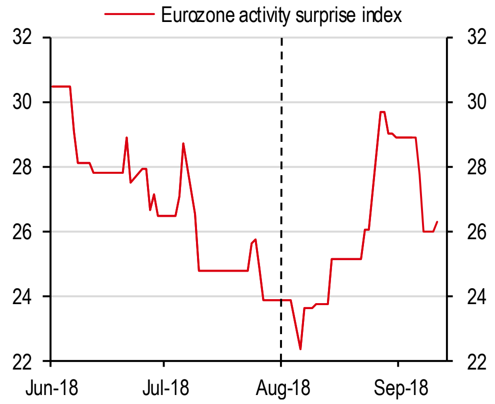
The continued USD rally was all the more interesting as it happened in light of US activity data rolling over. Chart 1 shows US activity data has been coming in broadly weaker than expected since mid-July. However, the USD remained supported as, despite the softer data, the Fed continued to reaffirm further gradual rate hikes will be appropriate. All eyes will now shift to the Fed's 26 September meeting.

1. US activity rolled over…



Source: HSBC, Bloomberg

2. …while Eurozone activity bounced back



Source: HSBC, Bloomberg

[3] All prices in this piece are taken from Bloomberg
[4] From 01/06/18 to 07/09/18

EUR: Two against one

Two key factors weighed on the EUR this summer: (1) the divergence of monetary policy with the Fed, (2) fears of contagion from Turkey. In June, the ECB announced the end date of QE as end of December 2018, while also pledging to keep rates on hold at least through summer 2019. In the following months, the ECB did not provide any more detail on the dovish rate guidance while the Fed provided a clear counterpoint. The pressure on the EUR escalated in August as the turmoil in Turkey raised fears of contagion that Turkish borrowing could have on Eurozone banks. While the weakness of data through most of the summer also took its toll on the EUR, Eurozone data showed some signs of improvement during the second half of August. Chart 2 shows this bounce back in Eurozone activity data, which provided some support for the EUR in late August, seeing EUR-USD jump from 1.13 to around 1.16.

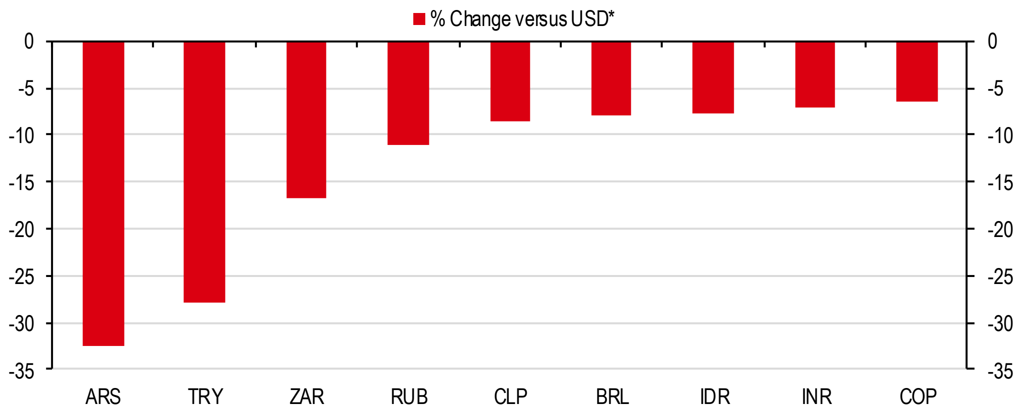
GBP: Brexit in the driver's seat

GBP was mainly driven by Brexit developments. The passage of the EU Withdrawal Bill came in focus in June with choppy GBP reaction as the bill bounced between the House of Commons and House of Lords before eventually passing on 21 June. Political tensions escalated in July with Boris Johnson's resignation from his post as UK foreign secretary. The prospect of a "no deal" outcome grew in the beginning of August with UK Trade Secretary Liam Fox citing a 60% chance for such an outcome, putting GBP under more pressure. However, Chief EU negotiator Michel Barnier's comment on 29 August stating the EU is prepared to offer the UK a partnership like no other country and on 10 September that there is a "realistic" likelihood of getting a Brexit deal in 6-8 weeks provided relief for GBP, which bounced back above 1.30 versus the USD.

EM FX: Sun burnt

Emerging market currencies came under significant pressure in August. In Argentina, the central bank hiked rates by 15ppt to 60% on 30 August in response to the currency weakening 24% from the beginning of the month, but still failed to curb ARS depreciation. The RUB was weighed down by a new round of US sanctions on Russia (See *RUB – Escalation fears are real*, 9 August 2018). The INR and IDR also moved lower as deficit currencies bore the brunt of higher external funding costs. The TRY was under pressure due to political and macroeconomic factors (See *TRY – Who's selling?*, 10 August 2018). In the next two pages, we provide a daily summary of events that moved the TRY from the beginning of August.

3. EM FX sell off from August to beginning of September



*Shows XXX-USD move from 01/06/18 till 07/09/18
Source: HSBC, Bloomberg

Anatomy of the TRY sell off

On 1 August, US imposed sanctions on two Turkish ministers over the continued detention of American Pastor Andrew Brunson. The sanctions were not particularly wide ranging and the direct implications are modest. But the market's justified concern that this could be the start of an escalating process saw **USD-TRY break above 5.00 for the first time eve**r.

On 2 August, Turkish finance minister Berat Albayrak responded to the US sanctions by stating that negotiations for short and medium-term foreign financing are ongoing in a positive direction and the sanctions will have "limited" impact on Turkey's economy.

On 3 August, Turkey CPI came out below expectations at 15.85% YoY (16.30% expected), core CPI was a touch higher than expected at 15.10%. Despite the slightly lower than expected headline data, the market was unable to view this development in too positive a light, as it still showed an acceleration in pricing pressures and further eroded the real interest rate buffer.

On 6 August, the CBRT announced a tweak to its reserve requirement policy, which would release an additional USD2.2bn of liquidity into the system over the next two weeks. It appeared that the market was looking for a much stronger policy step. The sense that the CBRT was not willing to do more to curb Turkey's large economic imbalances saw a sharp move higher in **USD-TRY, which traded up above 5.43 before closing around 5.33**.

On 9 August, the TRY once again fell as scheduled diplomatic talks between US and Turkish representatives in Washington failed to provide any supportive news. The currency was not aided by reports that the Treasury were looking to keep the budget deficit below 2% of GDP in 2018, nor of news that the government sees 2019 GDP growth at 3-4%, a more realistic stance than the previous forecast of 5.5%. **By the end of the day, the TRY had weakened further to 5.55 against the USD**.

On 10 August, the TRY weakened 17% against the USD. USD-TRY jumped from 5.49 to 6.30 ahead of expected speeches from the president and the finance minister. In his speech, President Erdogan showed no sign of changing his view on interest rates as he stated "The dollar cannot block our path. The interest rate lobby won't be able to crush this nation." The finance minister Albayrak's tone was less abrasive, stating that Turkey will see a soft landing in 2018-19, with lower inflation, and smaller current account and budget deficits. But the lack of specific policy measures or numerical targets meant the TRY was unable to stabilise meaningfully. **USD-TRY hit a high of around 6.87** when US President Trump announced the doubling of tariffs on steel (to 50%) and aluminium (to 20%) and **closed around 6.43**.

On 13 August, after the weekend, **USD-TRY opened above 7.00 and hit a high of 7.2362** (Bloomberg) during the Asian trading session, before retracing as the CBRT responded. The CBRT cut reserve requirement ratios by 250 to 400bp. It announced this would release TRY10bn and USD6bn of liquidity into the system, as well as USD3bn worth of gold.[5] It also announced a range of measures to improve both TRY and FX liquidity in the banking sector including allowing banks to borrow FX deposits for a one-month as well as one-week maturity.[6]

The banking regulator (BDDK) also announced a measure to restrict currency swap transactions, whereby the total notional principal amount of banks' currency swaps and other similar products cannot exceed 50% of the bank's regulatory capital.[7] USD-TRY closed the day at around 7.

On 14 August, the TRY recovered further and ended the day around **8% stronger against the USD at 6.35**. Bloomberg reported the BDDK issued an order on capital adequacy ratio calculations.

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5 http://www.tcmb.gov.tr/wps/wcm/connect/en/tcmb+en/main+menu/announcements/press+releases/2018/ano2018-32
6 http://www.tcmb.gov.tr/wps/wcm/connect/en/tcmb+en/main+menu/announcements/press+releases/2018/ano2018-31
7 https://www.bddk.org.tr/WebSitesi/english/Announcements/Press_Releases/17174duyuru_0649_01.pdf

On 15 August, the BDDK further restricted currency swap transactions from 50% to 25% of the bank's regulatory capital. The curbing of FX swaps helped to push short-term TRY funding costs significantly higher, with overnight and tomorrow-next forward points rising significantly. Turkish government announced it will impose an additional taxes on US rice, spirits and cars, in response to the US tariffs. A Turkish court rejected an appeal to release Brunson from house arrest (CNN TURK). This somewhat negative news was offset, however, by a report that Qatar pledged USD15bn of investment in Turkey. **The TRY ended the day around 6% stronger versus the USD, and closed below 6.00 for the first time since 9 August at around 5.95**.

On 16 August, industrial production slowed from 6.4% YoY in May to 3.2% in June. Bloomberg reported Finance Minister Albayrak stated capital controls would never be on Turkey's agenda. US Treasury Secretary Mnuchin said there would be more sanctions if Pastor Brunson is not released, however, **TRY ended the day around 3.5% stronger versus the USD at 5.83**.

On 17 August, consumer confidence came out at 68.3, the lowest since December 2017. S&P downgraded Turkey's sovereign credit rating from BB- to B+, citing extreme TRY volatility and forecasting a recession next year. Moody's also cut its rating deeper into "junk" territory from Ba2 to Ba3. The BDDK widened its restrictions on currency swap positions to cover forwards, options, and other non-swap derivative instruments, such positions can no longer exceed 25% of bank equity.

On 20 August, there was news that Qatar and Turkey's central banks had signed a currency swap agreement over the weekend to provide liquidity and support for financial stability. It was also reported that the Trump administration rejected an offer by Turkey to tie the release of US Pastor Brunson to the dropping of a probe into alleged Iran sanctions violations by Halkbank (WSJ).

On 21 – 24 August Turkish markets were closed for religious celebration (Eid Al-Adha).

On 27 August, the TRY was under pressure as markets reopened. USD-TRY began the day at 6.0211 and quickly rose to 6.2974 before **closing at 6.1591**.

On 28 August, Business HT, a local news agency, reported that the government is considering creating an asset backed security, where the underlying asset will be a portion of the unsold real estate stock that has been built up over the past few years. Separately, WSJ reported Germany is considering to offer financial help to Turkey; which saw the TRY strengthen briefly. However, the TRY quickly reversed these gains on news that Germany will not offer Turkey direct financial aid and is looking at other options.

On 29 August, the trade deficit widened to USD5.98bn from USD5.50bn previously.

On 30 August, Turkish markets were closed for a public holiday. Reuters reported that CBRT Deputy Governor Erkan Kilimci resigned and will join the Turkish Development Bank. **The TRY weakened 4.6% against the USD to 6.7151**.

On 31 August, Turkish government cut taxes on TRY deposits and hiked taxes on FX deposits. Reuters reported CBRT gross FX reserves fell to USD72.9bn as of 20 August from USD79.1bn on 10 August. CBRT launched an FX swap market to increase the efficiency in TRY and FX liquidity management.

On 3 September, CPI for August came out at 2.30% MoM and 17.90% YoY (versus expectations of 1.84% MoM and 17.60% YoY).

On 4 September, the government passed a law requiring at least 80% of export proceeds to be brought to Turkey and converted into TRY. The law will remain in place for six months.

On 10 September, GDP came out at 5.2% YoY, in line with expectations.

Sweden election: Coalition building begins

- Sweden faces a period of political uncertainty…
- …after a general election that left the two main power blocks – centre-left and centre-right – virtually tied
- The immediate economic implications are limited given the strength of Swedish growth

James Pomeroy
Economist
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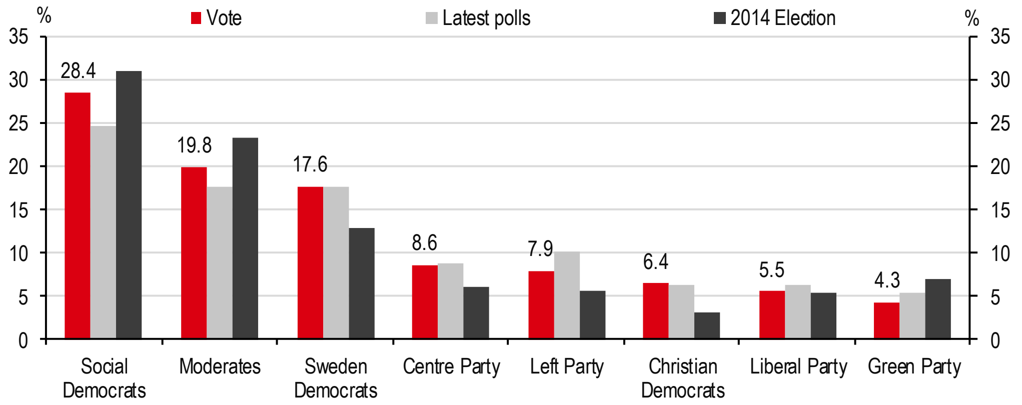
Facts

Depending on how you look at it, almost every party will claim some success from the election results in Sweden. The results were not too far from the polls, but the Social Democrats and the Moderates both received more votes than the polls suggested, despite being notably down on their respective vote shares from the 2014 election (chart 1). Every other party, other than the Greens, made gains in the parliament – with the biggest increase coming for the nationalist Sweden Democrats, who garnered much media attention during the campaign. They ended up with 17.6% of the vote, compared with 12.9% in 2014. The other big winners in terms of seats in the Riksdag, the Swedish Parliament, was the Left party, which picked up 7.9% of the vote. Swedish voters may have leant away from the centre, but not by as much as the polls suggested a month or so ago.

While political gridlock could be seen as a negative in many countries, in Sweden's case this could be seen as more market positive given that going into the election the fear was that the nationalist Sweden Democrats could pick up an even bigger share of the vote.

1. Sweden's election results



Source: HSBC, Swedish Election Authority

The question now is, who governs? The two coalitions appear to be almost tied with the centre-left bloc of the Social Democrats, the Greens and the Left party picking up 40.6% of the vote and the 'Alliance' of the Moderates, Centre, Liberals and Christian Democrats collecting 40.3%.

Given how close the vote is, the next few days and weeks will be uncertain as talks get underway to build a viable coalition. Current Prime Minister Stefan Lofven, of the Social Democrats has said that he will not resign, and will try to form a viable coalition that could work together before Parliament opens again in two weeks. Betting markets don't appear so sure that that will be possible, with the latest pricing from Betfair implying a 64% chance that Moderate leader Ulf Kristersson will become the new Prime Minister. The centre-left coalition will try to gather support from the opposition in order to dull the influence of the Sweden Democrats, who may see their end result as disappointing given that they were polling close to 25% around a month ago. Nonetheless the Sweden Democrats now hold 62 of the 349 seats in the Parliament and could try to exert their influence, even though other parties have said they will not work with them. Jimmie Akesson, the leader of the Sweden Democrats said "We strengthen our kingmaker role… we see that we will have an immense influence over what happens in Sweden in the coming weeks, months, years. Nobody can take that away from us."

Implications

The current gridlock in terms of the result means that clarity over the shape of the Swedish Government will be unclear in the coming weeks. The first hurdle is Wednesday's final result, and after that we will have to see how the discussions play out between the various parties. There will no doubt be plenty of political noise, but the impact on the economy is likely to be limited. Given how strong Swedish growth is and how healthy the fiscal position is, whichever side ends up governing Sweden will have little impact on near-term economic performance. What is likely to be far more important for markets is the actions of the Riksbank who, after the *dovish statement* on 6 September, will be interesting to watch in coming weeks, with the minutes from that meeting, released on 17 September likely to frame market expectations for the coming months in terms of monetary policy.

Dollar bloc: Kiwi in the coalmine

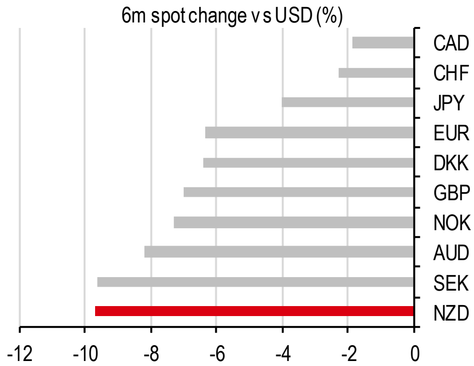
- The NZD has been the worst performing G10 currency over the last six months while rates now price in some probability of easing
- The sensitivity of the economy and kiwi dollar to global growth makes us wonder if this is a signal of a broader malaise
- In particular, RBNZ pricing has been a good predictor of turning points in the global cycle in the past

In FX, we are often asked whether one currency's performance could be a 'leading indicator' for the global economic cycle. Guided mostly by backward-looking economic data, markets are always looking for a 'canary' in the coalmine of global growth. That PMIs are still generally consistent with decent expansion around the world has left some economists scratching their head at the recent volatility in risky asset classes.

Could that 'canary' actually be a 'kiwi'? After all, New Zealand is a small open economy and the kiwi dollar has been the worst performing G10 currency over the last six months, falling 10% against the USD (Chart 1), and now trades close to our year-end forecast of 0.65. This six month period coincides with a re-evaluation of previous optimism around the synchronised global upswing. What's more, NZD front-end rates have even begun to price in a non-negligible probability of rate cuts recently (Chart 2).

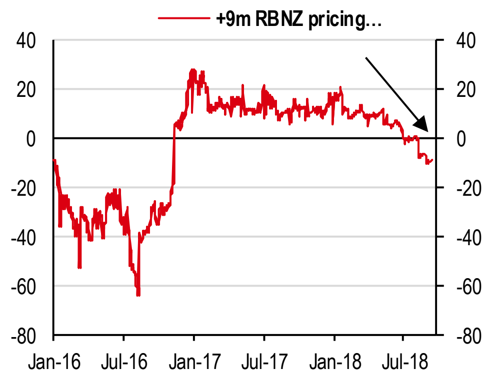
Locally, there are a number of ways to rationalise the kiwi's descent. Surveys of business confidence have fallen to ten-year lows and the RBNZ has shifted in a more dovish direction since Adrian Orr joined as Governor in March.

1 The NZD has fallen the most in G10 over the last six months…



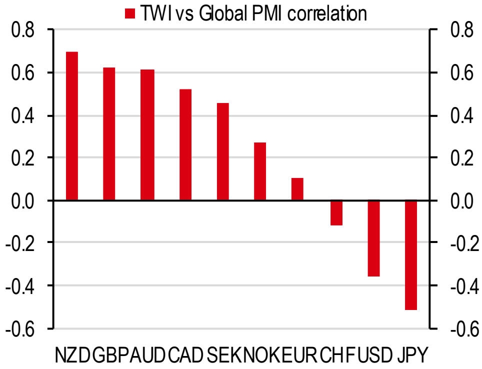
Source: HSBC, Bloomberg

2. …and rates have moved to price in cuts



Source: HSBC, Bloomberg

3. The NZD has the highest correlation to global PMIs in G10



Source: HSBC, Bloomberg, Thomson Reuters Datastream
*shows correlation of annual change in FX vs Global PMI since 2007

4. NZD rate pricing has tended to lead the global cycle

Correlation: policy rate pricing vs Global PMI*

months	NZD	AUD	SEK	NOK	CAD	
-3	0.25	0.18	0.28	0.32	0.15	Rates lagging
-2	0.37	0.32	0.39	0.45	0.26	
-1	0.48	0.44	0.50	0.59	0.34	
0	0.57	0.52	0.58	0.70	0.41	
1	0.63	0.56	0.62	0.75	0.44	
2	0.68	0.56	0.62	0.73	0.45	
3	0.71	0.55	0.58	0.67	0.43	
4	0.73	0.49	0.51	0.58	0.39	
5	0.73	0.42	0.45	0.48	0.35	
6	0.69	0.35	0.39	0.38	0.34	Rates leading

Source: HSBC, Bloomberg, Thomson Reuters Datastream
*shows correlation of 9m fwd policy rate pricing vs Global PMI since 2007

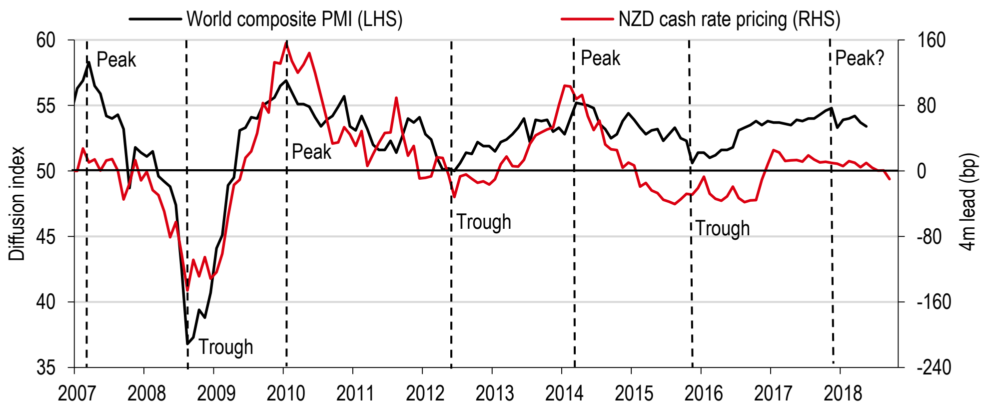
Yet, the presence of other high beta names at the bottom of the G10 league table – including the SEK, NOK and AUD – as well as an associated rise in market volatility and a sharp fall in EM FX lately, strongly implies the existence of a global driver.

Could NZD be leading the way?

A dive into the data adds to the view that the NZD's weakness could be a signal of a broader malaise. First, the NZD has the greatest sensitivity to global PMIs of G10 currencies going back more than ten years, outstripping other small or medium-sized open markets with high beta currencies such as the AUD, SEK, NOK and CAD (Chart 3). Even comparing with the emerging world, the NZD's 0.70 correlation with the global PMI is only marginally lower than that of the KRW (0.78), which is more broadly used as a gauge of the health of the global economy.

Extending this analysis to the rates market is even more revealing. Not only do strong correlations surface again for New Zealand but it seems that monetary policy pricing tends to lead the global cycle by about 4 months (Chart 4). In particular we find that NZD front-end rates did a very good job of pre-empting slowdowns in the global cycle after peaks in 2007, 2010 and 2014 and upswings after troughs in 2008, 2012 and 2016 (Chart 5).

5. Front-end NZD rates have provided a good signal of turning points in the global cycle



Source: HSBC, Bloomberg, Thomson Reuters Datastream

Viewed in this context the recent move to price in a possibility of RBNZ easing – as much as 10bp by the middle of next year – should not be ignored. For kiwi watchers, the near-term outlook for the NZD hinges somewhat on the Q2 GDP print (released 20 September). Yet, given the RBNZ has signalled it may cut by as much as 100bps if growth remains slow, a disappointing print could have a wider significance for financial markets.

G10 at a glance

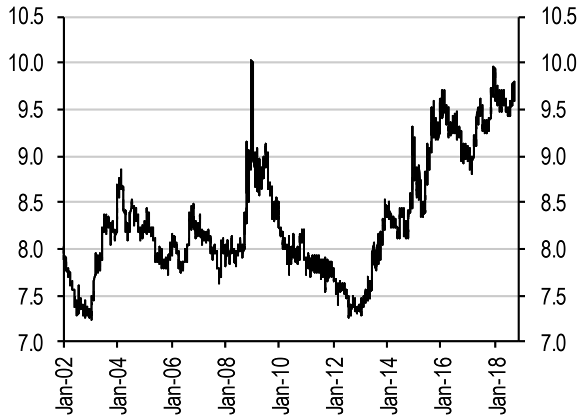
USD-CAD

Source: HSBC, Bloomberg

Canada: NAFTA uncertainty

- We expect USD-CAD to finish the year at 1.35, in part reflecting our bullish USD view but also some caution regarding the CAD. A key determinant will be the outcome of ongoing NAFTA negotiations. The bilateral deal between the US and Mexico has introduced a 30 September deadline into proceedings if Canada is to be woven into the agreement. While likely injecting some urgency into the talks, the currency now faces an immediate event risk that NAFTA will split into bilateral outcomes.
- The market is 85% priced for a rate hike by the BoC at the October meeting. Our economics team believe this overstates the likelihood of a move, especially if the trade talks should fail to deliver by the end of the month. The resultant uncertainty could temper the outlook for business investment and also undermine non-energy export growth which has been rather lacklustre.
- Even if an October hike is delivered, it is largely priced in and the market is already priced for an additional 25bp by April. The balance of risks is for a more dovish tone than implied by the market, and for CAD weakness.

EUR-NOK

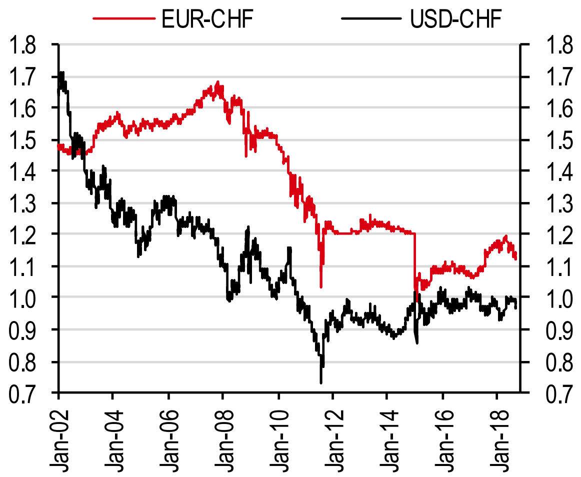


Source: HSBC, Bloomberg

Norway: Set for a hike but not a rally

- The Norges Bank looks set to hike rates at its 20 September meeting. The central bank's commentary has guided markets to price in a hike in the last six months, and the recent data pulse looks strong enough for the central bank to deliver.
- Inflation has pushed above 3% while core inflation is now at 1.9%, pretty close to the Norges Bank's target. GDP is running at 0.5% q/q and policy makers also want to push rates higher in order to better manage rising financial stability risks after years of record low policy rates.
- A 25bp hike would be the first tightening since 2011, but would only put policy rates at 0.75%. For FX, the most important question is whether this hike is the start of a more aggressive tightening cycle or not. June's Monetary Policy Report showed a projection for a further 50bp of hikes in 2019. If this is pushed higher, then the NOK would have more room to rally. Otherwise, there will be little fresh impetus for NOK outperformance in our view.

CHF



Source: HSBC, Bloomberg

CHF: Safe haven status back in vogue

- The CHF has been the best performing G10 currency since August as global financial market sentiment soured and the CHF regained its allure as a safe haven currency. The key characteristics of the CHF – its large net external surplus and deep liquidity – suggest this is justified. That said, we had not expected the CHF to perform as well as it did in the past, due to its negative yield, the risk of intervention or looser SNB policy, and the prominence of the USD as an alternative safe haven.
- Domestic fundamentals have improved with inflation rising above 1% and growth coming in better than expected. But further CHF strength will likely be driven by a significant deterioration in global sentiment accompanied by a lack of response by the SNB, in our view. The domestic backdrop may allow the SNB to hold off shifting to a more dovish reaction function for the time being.
- Even if the SNB maintains its dovish stance, should we move into a world where growth is slowing and other central banks are turning even more dovish, then the SNB may not look out of place. This suggests the CHF may not weaken in this scenario as we had previously expected.

Asia – regional overview

Amid intra-EM contagion fears (after the sharp declines in the TRY and ARS), the current account deficit currencies – the INR, IDR and PHP – and those with high external debt – the MYR – performed poorly during the past month. The INR's weakness was notable as there was some debate about FX policy – whether the authorities are doing enough to stem depreciation – and concerns that high oil prices could cause the 'core' deficit (current account balance + net FDI) to widen further. We have raised our USD-INR forecasts to 73 for year-end 2018 (from 70 previously) and to 74 for mid-2019 (from 71; see *Asian FX Focus: INR: New forecasts and top 10 questions*, 3 September 2018).

In contrast to the Reserve Bank of India and the INR, Bank Indonesia appears to be more actively and openly supporting the IDR and sentiment with verbal intervention, USD sales, secondary market bond purchases and administrative measures to curb imports (biofuel mandate, tax on consumer goods, deferring some infrastructure projects). However, some of the IDR's 'fundamentals' appear weaker than the INR – for example, the size of the current account deficit, foreigners' positioning in the bond market, FX reserves coverage ratios and FX market depth both onshore and offshore.

The PHP's issue is slightly different from the INR and IDR. The Philippines' inflation continues to surprise on the upside and significantly overshooting Bangko Sentral ng Pilipinas' target. The PHP's real yield advantage vis-à-vis the USD has narrowed substantially and is now negative by some measures. This is affecting exchange rate expectations and causing residents to seek other investment opportunities abroad. HSBC economists are expecting 50bp more of rate hikes by the BSP before year-end, matching the Fed, but that may not be enough to stabilise the PHP. The BSP also announced on 7 September that it is reactivating the Currency Risk Protection Programme (CRPP), which is basically a non-deliverable, PHP-settled FX forward hedging facility. See *Asian FX Focus: PHP: Down the rabbit hole?*

The current account surplus currencies – KRW, SGD, THB and TWD – have been resilient through the external headwinds, given their strong fundamentals and partly anchored by China's policy support for the RMB and a temporary lull in US-Sino trade tensions. On 27 August, the People's Bank of China restored the so-called counter-cyclical factor in the USD-CNY fixing mechanism, which basically slows the rise in the fixings and puts a floor on the CFETS RMB index. Offshore USD-CNH forward points have also periodically squeezed higher in recent weeks, which some market participants have attributed to actions by large state-owned banks to deter speculators short-selling the RMB (Bloomberg, 7 September 2018).

Now that the public consultation period for the US administration's proposal of tariffs on another USD200bn of Chinese imports has ended (on 6 September), the US President Trump may be able to act on that proposal and announce something "very soon" (Bloomberg, 8 September 2018). In fact, the President even signalled that he is willing to put punitive tariffs on *all* of US's imports from China if necessary. Should US-Sino trade tensions escalate further, the RMB and the 'surplus' currencies may start to partially catch up to the earlier weakness seen in the 'deficit' currencies.

A good example is the SGD. The SGD NEER has been trading in a narrow range in the upper quadrant of the band. We believe some market participants still have as their base case – like HSBC research – another slope increase in the SGD NEER policy band (to 1% per annum) by the Monetary Authority of Singapore come October (likely on the 12th). But the MAS seems to be becoming more concerned about the negative impact on global growth and the Singapore economy, from the uncertainty caused by prolonged US-Sino trade tensions. The decision could be a very close call.

Asia at a glance

USD-CNY

Source: HSBC, Bloomberg

China: Trade concerns back on radar

- Now that the public consultation period for the US administration's proposal of tariffs on another USD200bn of Chinese imports has ended, President Trump may be able to act on that proposal and announce something "very soon" (Bloomberg, 8 September 2018). In fact, the US President even signalled that he is willing to put punitive tariffs on all of the US's imports from China if necessary.
- Trade war concerns have been the main driver behind the RMB's weakness over the past couple of months. The trade war is putting downward pressure on the RMB in several ways: 1) It could reduce China's goods trade surplus. 2) It could narrow China's yield advantage over the US. 3) Some market participants may speculate that RMB depreciation could be used as a form of retaliation, since China does not import enough from the US to implement tit-for-tat tariffs.
- That said, we believe China is not going to purposefully weaken its currency as retaliation. And there is room for a modest RMB recovery, if there is no breakout of a trade war, in our view.

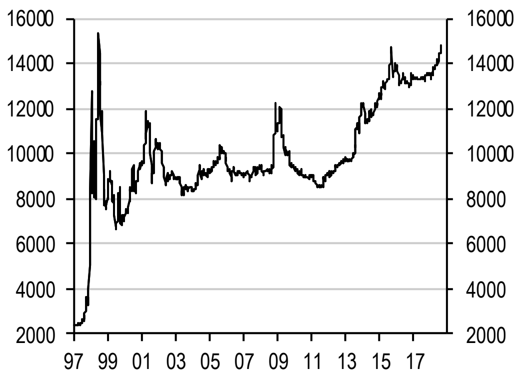
USD-INR

Source: HSBC, Bloomberg

India: So where will the Rupee settle?

- We now see USD-INR at 73 by end-2018, bearing in mind 1) Higher USD funding costs, 2) EM contagion pressures, 3) A widening current account deficit, 4) Rising oil prices, and 5) Investors' concerns about India's fiscal consolidation/reforms as the election cycle goes into full swing.
- Our view is that the RBI does not intervene to strongly defend specific levels in USD-INR. Instead, we found that its intervention has always been more strongly correlated with foreigners' portfolio flows. We believe the RBI's FX policy is pragmatic, recognising that the path of least resistance for USD-INR is naturally upwards and the path for INR NEER is downwards, given India's current account deficit and relatively high inflation.
- That said, as long as there is credibility on the monetary policy front (to anchor inflation expectations) and ample FX reserves, residents should retain some basic level of confidence in the INR as a long-term store of value and the risk of capital flight is low.

USD-IDR



Source: HSBC, Bloomberg

Indonesia: It ain't over till it's over

- USD-IDR is now trading at levels not seen since the Asian Financial Crisis. The IDR has weakened nearly 10% YTD. This is because the current account deficit widened and net FDI inflows fell at a time when external headwinds (Fed hikes, broad USD strength, EM growth concerns) are strong – preventing the IDR from receiving the portfolio inflows it needs to plug the largest core deficit gap since 2013 (1.6% of GDP).
- The IDR is also vulnerable to intra-EM contagion and VaR shocks (arising from crises in TRY and ARS) given high foreign positioning in its equities and bond markets and because of relatively low FX reserves adequacy.
- The Indonesian authorities are implementing measures to raise the IDR's yield advantage and curb imports. They are also thinking about how to reduce reliance on foreigners' bond inflows and lower the government's foreign currency debt issuance.

USD-SGD

Source: HSBC, Bloomberg

Singapore: More dovish *and* more hawkish

- The MAS's Recent Economic Developments report suggests it is acknowledging the materialization of some of the downside risks to growth. There were notable changes to its views on growth: 1) Global economy: "grow more gradually" in H2; 2) China: growth to "slow more discernibly as US trade tariffs broaden"; 3) Singapore: "Slower expansion is forecast" for H2 due to "negative spill overs from global trade frictions".
- However, the MAS was not totally dovish, as the labour market recovery and rising wage growth were unchanged from past reports. Moreover, the MAS explicitly mentioned that "core inflation is expected to trend towards 2%" in H2, which is more hawkish than past comments about inflation "rising gradually".
- HSBC's base case since the April MPS is that the MAS will make another slope increase in October. But judging from the recent developments in the SGD NEER and USDSGD forward points, we believe market expectations for a MAS move in October have been pared back recently to at best 50-50 now.

USD-THB

Source: HSBC, Bloomberg

Thailand: Don't get carried away

- The THB outperformed other Asian and EM currencies through August amid strong external headwinds, as it is not as susceptible to intra-EM contagion concerns due to low foreigners' bond ownership (around 11%). The outperformance may also have been due to strong growth (Q2 GDP growth: 4.6% y/y) and expectations of an imminent rate hike. Investors may even seek temporary shelter in THB markets, given the large current account surplus (10% of GDP on a 4qma basis).
- The BoT is meeting on 19 September. HSBC economists expect a rate hike. It is possible the THB may exhibit a "buy on rumour, sell on fact" pattern. After all, the relationship between US-Thailand interest rate differential and USD-THB has never been that obvious. In any case, the THB is still going to have a sizeable yield disadvantage since the Fed is also expected to hike rates in September.
- Meanwhile, the decline in Chinese tourist arrivals (-0.9% y/y in July vs 26% growth in H1) after the Phuket boat accident may exacerbate the typical tourism lull season in Sept-Oct.

USD-PHP

Source: HSBC, Bloomberg

Philippines: Down the rabbit hole?

- The PHP is trading at the lowest levels since 2005 as inflation persistently remains above the upper-end of the BSP's target range (2-4%). Prices in August rose at 6.4% y/y – the highest in nearly a decade – and that pushed the average YTD inflation to 4.8%, which is close to the BSP's full year forecast of 4.9%.
- In our view, inflation is turning out to be a bigger and more persistent problem than one would have imagined a few months ago. Hence, despite the BSP's 100bps in rate hikes since May, the real yield premium remains low. HSBC economists now expect the BSP to hike rates by 25bps in the upcoming meeting on 27 September, and by another 25bps in Q4. However, we think even if the BSP matches the Fed's rate hike trajectory, this may not be sufficient to stabilize the PHP.
- In our view, the PHP now requires a much higher level of risk premium particularly as residents have already been investing abroad to seek higher returns. However, the BSP may be reluctant to make an aggressive response, preferring to partly rely on legislative measures to curb inflation.

LatAm – regional overview

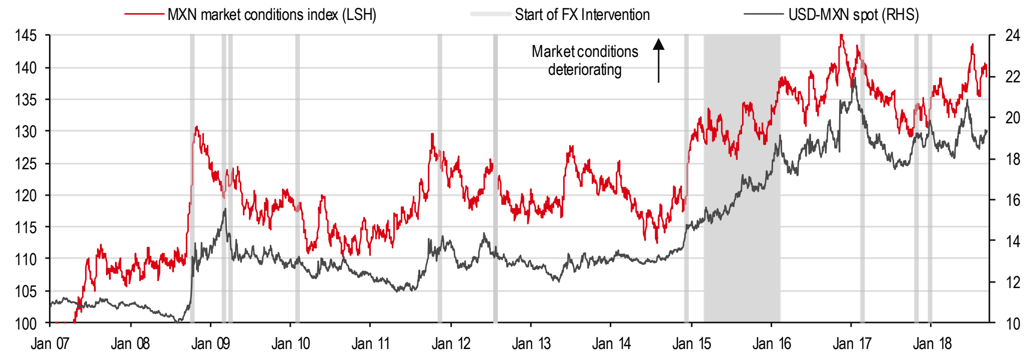
LatAm currencies weakened by more than 8% in August, based on a trade and volume weighted FX basket, with ARS and BRL the biggest underperformers. The situation in Turkey was an important catalyst for the move, exacerbating Argentina's woes as market players attempted to identify potential contagion risks. Investors have been testing the more vulnerable EM currencies, namely those with higher foreign currency debt exposure and external account deficits. Apart from this, a buoyant USD and the potential for an escalation in global trade tensions have also been a cap on LatAm FX performance, with the latter having an impact on commodity currencies like COP, CLP and PEN.

Contagion fears remain. Despite Argentinian authorities' best efforts, the currency depreciated 26% in nominal terms during August, with the government seeking early disbursements from the IMF stand-by agreement, which was brokered only a few months ago. BCRA hiked policy rates by 1500bps to 60% at the end of August with a commitment to not reduce rates before December, while also increasing private bank reserve requirements. We anticipate macro imbalances to driver further ARS nominal weakness to the 42 level vs USD level by year-end.

Meanwhile, MXN has been an outperformer in the region, with two themes pushing and pulling on the currency, namely NAFTA renegotiations and a new Mexican administration (taking office 1 December). On the former, a lot of uncertainty still exists, though a trilateral deal among the US, Mexico and Canada could help see MXN gains into the USD-MXN 18.00-18.50 range. However, we do not see that level as sustainable, as political risks from the incoming Mexican administration will reassert themselves closer to year end. While we do not believe there is any immediate threat of policy reversal from the new government, the focus will be on how it will reconcile fiscal policy with campaign promises.

Electoral risks continue to wear on BRL, with recent polls from Ibope and Datafolha showing growing support for left-leaning candidates like Ciro Gomes and Fernando Haddad, while market friendly candidate Gerardo Alckmin has not seen a significant pickup despite the start of TV and radio advertising. Trading has been volatile, with the central bank only stepping in with additional swaps when USD-BRL breached 4.20 spot. We expect pressures on BRL to remain through the end of the second round on 28 October (first round is 7 October).

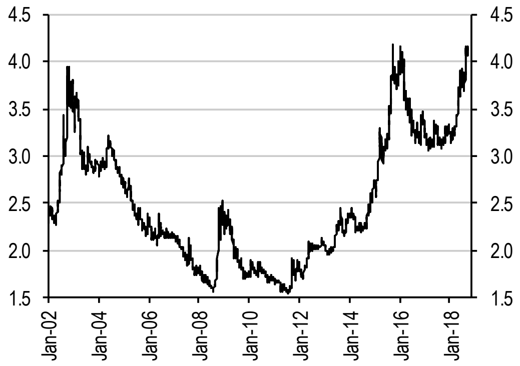
Market conditions index show little pressure for MXN intervention



Source: HSBC, Bloomberg

Latin America at a glance

USD-BRL



Source: HSBC, Bloomberg

Brazil: Election uncertainty jades investors

- Now less than a month away from the first round of the elections, investors are keenly focused on who may win the presidency. There are still no clear front runners and second-round scenarios also leave much up in the air.
- The latest poll at the time of writing (Ibope) has right-wing candidate Jair Bolsonaro leading with 22% support, followed by leftists Marina Silva and Ciro Gomes tied on 12%. Centrist Geraldo Alckmin has 9% while PT candidate Fernando Haddad has 6%. However, Alckmin may improve given his large share of free TV time (based on coalition size), while Haddad may improve now that he has formal backing from Lula. Most candidates beat Bolsonaro in second round simulations.
- With the external environment still shaky amid trade uncertainties and heightened political risks, we expect the BRL to remain towards the weaker side of recent ranges.

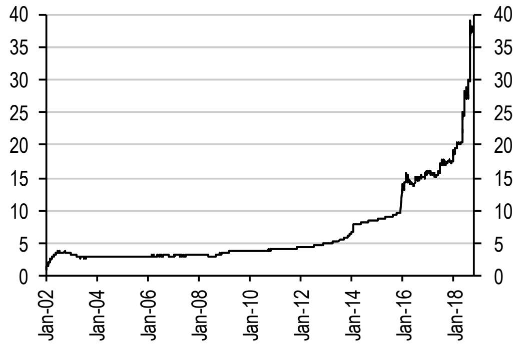
USD-MXN

Source: HSBC, Bloomberg

Mexico: Trade talks continue

- The US and Mexico announced a trade agreement on 27 August as a product of the NAFTA renegotiations started last year, though the uncertainty over the details of a final agreement has not abated and puts a constraint on better MXN performance.
- If a trilateral deal is reached that includes Canada, we would expect market players to become more constructive on MXN, although we think this would be more of a knee-jerk reaction than a sustained search for a new equilibrium level. In that case, MXN strength could be capped somewhere between 18.00-18.50 vs USD before weakening again.
- Political risks from the incoming Mexican administration will reassert themselves closer to year end, as President-elect Andres Manuel Lopez Obrador takes office in December. While we do not believe there is any immediate threat of policy reversal, the focus will be on how he will reconcile fiscal policy with his campaign promises.

USD-ARS



Source: HSBC, Bloomberg

Argentina: Please sir, I want some more

- Argentina has returned to the IMF, asking for a more accelerated disbursement schedule to cover their 2019 funding needs. The IMF board is expected to vote on the request by the end of September, according to Economy Minister Nicolas Dujovne (Bloomberg), but it could be earlier.
- While the IMF may grant the request, they may also tighten the conditionality on the country's financial metrics, especially fiscal accounts. That said, the government is taking a number of steps to shore up fiscal accounts, including reducing the number of ministries and raising revenues via export taxes.
- The central bank looks to be seeking a balance between limited intervention to provide some USD supply in the market and trying to avoid excessive FX reserve losses. Extreme monetary policy tightening should also help the ARS find some stability relative to recent months' price action, but we still anticipate nominal weakness. We see USD-ARS rising to 42.0 by year-end and to 50.0 by end-2019.

CEEMEA – regional overview

We have been bearish on most CEEMEA currencies since April, although we would admit to be somewhat surprised by the sheer scale of the recent depreciation seen in the region's currencies since early August, especially amongst the high yielders. That said, we are not looking expecting a significant or long-lasting retracement in CEEMEA. The factors which remain in place – a broadly stronger USD and increasingly challenging domestic conditions in the region – remain firmly in place. This suggests that **further local currency weakness is likely as we head into Q4.**

The TRY has been at the forefront of the recent sell-off, facing an unsavoury cocktail of tricky political, structural and cyclical factors. The catalyst for the sharp depreciation in August was the heightened political tension with the US – the announcement of limited sanctions and increased tariffs. The subsequent FX weakness fuelled concerns about upcoming external debt repayments and the ongoing financing requirement for the current account deficit amidst tighter USD liquidity. Add to this the sharp spike in inflation from FX weakness – which could accelerate in the coming months – and the prognosis looks bleak. **Therefore, we revise our year-end USD-TRY forecast to 7.0** from 5.50. In our view, we need to see a coordinated policy of much tighter monetary and fiscal policies alongside a plan to deal with the foreign currency debt overhang, in order for the TRY to stabilise.

The **RUB has also faced significant political headwinds** with an announcement of a second round of sanctions by the US and the threat of more to come in the coming months. The weakness of the RUB alongside certain base effects is pushing inflation higher, making a previously very positive domestic macro backdrop look less enticing. For the RUB to stabilise we believe the CBR will need to become more hawkish to maintain its well-earned credibility as an inflation targeting monetary authority.

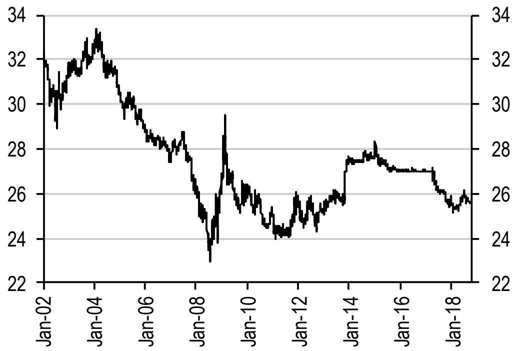
The **ZAR completes the trio of high-yielding currencies**. As with the others, depreciation has been based on a combination of external and domestic factors. While we had expected this to some extent, the deterioration of these drivers has been even more aggressive than we forecast. Most notably, the economy went into recession H1 and inflation has started to rise. This leaves the SARB with a difficult decision regarding the policy direction in the coming months. Weaker growth also makes the fiscal outlook even more precarious, while the large external funding requirement is a source of vulnerability given external developments. **We see USD-ZAR pushing to 17 this year.**

In CEE, our bearishness is based less on political and structural factors and centres more on monetary policy outlooks, which remain resolutely dovish for the most part. Activity data has been broadly surprising to the downside, although it is still quite healthy in absolute terms. But this is coming against a back drop of rising inflation. So the risks of stagflation are building, which potentially leaves local central banks caught between whether to loosen policy to stabilise growth or tighten to stave off higher inflation. For the HUF and the PLN a lot of the work of loosening would potentially fall on the currency, given rates are at all-time lows for both. **For the CZK, we expect modest regional outperformance** given the CNB has been tightening for the last year, and the expected rate profile into the end of 2018 has risen again following the CNB's guidance for two more hikes this year. In Poland, the NBP continue to suggest they will not hike until 2020 at the earliest, while in Hungary the earliest possible timing for a hike is mid-to-late 2019 according to the authorities.

In Israel, despite a deteriorating trade deficit, the cyclical picture remains positive and there are increasingly hawkish signs from the BoI. If the central bank does shift to a tightening bias in late 2019 then it will provide another pillar of support for the ILS to outperform the region, even if the currency still faces some downside risks versus the USD.

CEEMEA at a glance

EUR-CZK



Source: HSBC, Bloomberg

CZK: CNB's tightening mode is supportive

- The Czech central bank is clearly the most 'orthodox' in CEE. Facing signs of an overheating economy, the CNB has accelerated the pace of its rate hikes. It delivered two hikes of 25bp in a row and could deliver a third one at its next meeting at the end of September.
- We believe that this proactive policy is CZK-supportive. However, this policy only points to outperformance versus its peers and will not necessarily drive EUR-CZK lower.
- It is worth emphasising that the CNB appears to be front-loading its rate hikes as, contrary to its expectations, EUR-CZK has stayed elevated. The FX market is increasingly driven by where the terminal rate will be and the CNB has actually not changed its assumption about where the policy rate should be over the medium-term. Therefore, although we see CZK outperforming, EUR-CZK should move higher, ending 2018 at 26.0.

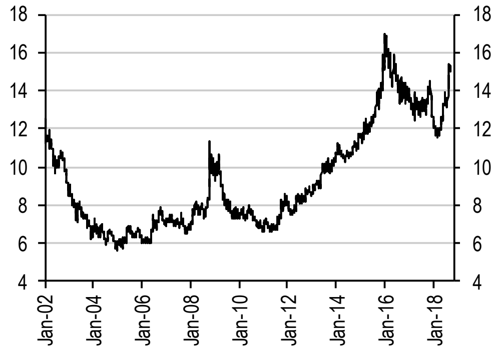
EUR-RON

Source: HSBC, Bloomberg

RON: conditions for depreciation

- The Romanian currency has fared very well during the recent EM FX sell-off. Local market features and the central bank's ability to manage the currency via liquidity instruments may explain EUR-RON stability. But the deterioration of some macro variables and the lack of meaningful monetary tightening should lead to a move higher of EUR-RON, in our view.
- Against expectations, the NBR left its policy unchanged in August on the view that inflationary pressures will recede. The reality is still that inflation is still high, at over 5% y/y, which keeps real rates in deeply negative territory as the policy rate is currently at 2.50%. This is not positive for the RON with a resilient economy but facing higher import prices, tight labour market conditions and a widening external deficit.
- Overall, we believe that EUR-RON is likely to move higher to 4.75 by year-end.

USD-ZAR



Source: HSBC, Bloomberg

ZAR: 17 again

- South Africa's cyclical and structural drivers have deteriorated significantly. The worsening of the three critical drivers that we highlighted previously was even bigger and faster than we were expecting. We now see USD-ZAR pushing to 17 this year.
- The economy fell into a recession in H1 as and forward looking indicators do not point to a notable improvement in Q3. Meanwhile, inflation could push higher as ZAR weakness feeds into domestic prices. Hence, the ZAR is now facing a potentially negative feedback loop of stagflation and currency weakness.
- Fiscal challenges and a still wide external funding requirement will also make the ZAR subject to external volatility amid a strong USD trend.

HSBC Volume-Weighted REERs

For full details of the construction methodology of the HSBC REERs, please see "*HSBC's New Volume-Weighted REERs*" *Currency Outlook April 2009*.

The value of a currency

Since FX prices are always given as the amount of one currency that can be bought with another, the inherent value of a currency is not defined. For example, if EUR-USD goes up, this could be because the EUR has increased in value, the USD has decreased in value, or a combination of both.
One possible method for getting some insight into changes in the value of a currency is to look at movements in the value of a basket of other currencies against the currency of interest. For example, if EUR-USD increased over some time period, one could see how EUR had performed against a range of other currencies to determine whether EUR has become generally more valuable or whether this was simply a USD-based move. An effective exchange rate is an attempt to do this and to represent the moves in index form.

There are two main approaches to building an effective exchange rate: Nominal Effective Exchange Rates (NEERs) and Real Effective Exchange Rates (REERs). NEERs simply track the weighted average returns of a basket of other currencies against the currency being investigated; REERs deflate the returns in an attempt to compensate for the differing rates of inflation in different countries. The reason for doing this is that, particularly over long time frames, inflation can have a large impact on the purchasing power of a currency.

How should we weight the basket?

If we are trying to create an index for the change in value of a currency against a basket of other currencies, we now need to decide on how to weight our basket. One possible solution would be to simply have an equally-weighted basket. The rationale for this would be that there is no *a priori* reason for choosing to put more emphasis on any one exchange rate. However, this could clearly lead to the situation where a large move in a relatively small currency can strongly influence the REERs and NEERs for all other currencies. To avoid this, the indices are generally weighted so that more "important" currencies get higher weighting. This, of course, begs the question of how "importance" is defined.

Trade Weights
Weighting the basket by bilateral trade-weights is the most common weighting procedure for creating an effective exchange rate index. This is because the indices are often used to measure the likely impact of exchange rate moves on a country's international trade performance.

Volume Weights
The daily volume traded in the FX market dwarves the global volume of physical trade. From this it is possible to make a convincing argument that the weighting which would be really important would be to weight the currency basket by financial market flows, rather than bilateral trade.

To do this properly would require us to have accurate FX volumes for all currency pairs considered in the index. However, these are not available. The BIS triennial survey of FX volumes only gives data for a small number of bilateral exchange rates. However, the volumes are split by currency for over 30 currencies. From these volumes we can estimate financial weightings for each currency. We believe that this gives another plausible definition for “importance”, and one which may be more relevant for financial investors than trade weights. We call this procedure volume weighting and the indices produced through this procedure we call the HSBC volume-weighted REERs.

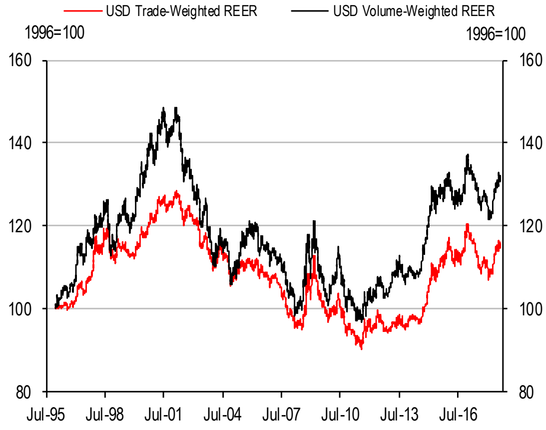
We would argue that if you are a financial market investor, the effective value of a currency you would be exposed to is more accurately represented by the HSBC volume-weighted index rather than the trade-weighted index.

Data Frequency

This is something which is rarely considered when constructing REERs – inflation data is generally released at monthly frequency at best so the usual procedure is to simply create monthly indices by default. However, some countries release their inflation data only quarterly. The usual procedure for these countries is to simply *pro-rata* the change over the period. Here there is an implicit assumption that the rate of inflation changes slowly. We take this assumption one step further and assume that it is valid to spread the inflation out equally over every day in the month.

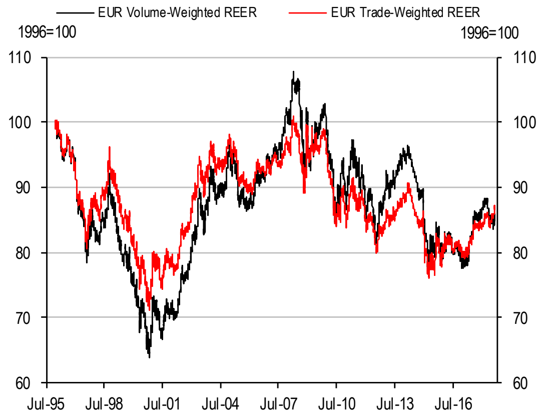
HSBC Volume-Weighted REERs

USD REER index



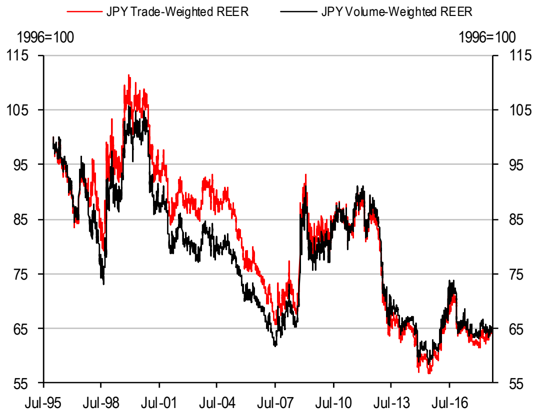
Source: HSBC

EUR REER index



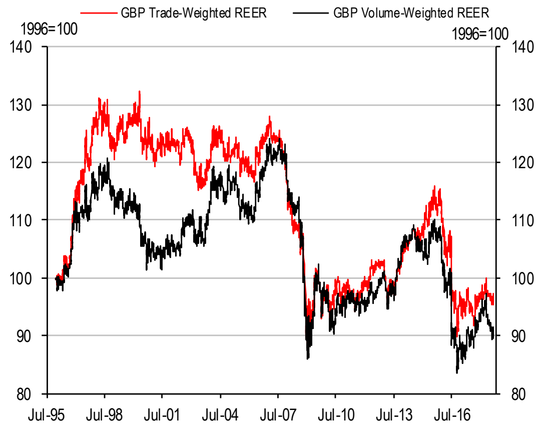
Source: HSBC

JPY REER index



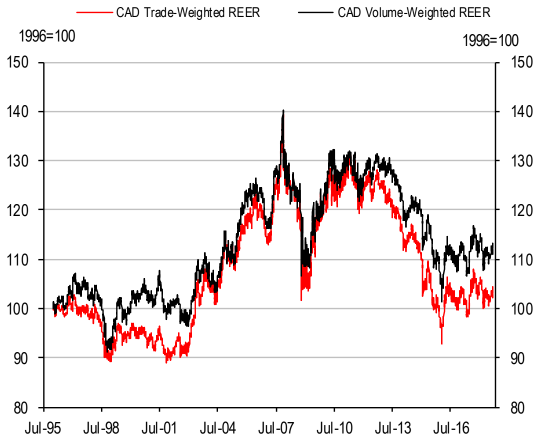
Source: HSBC

GBP REER index



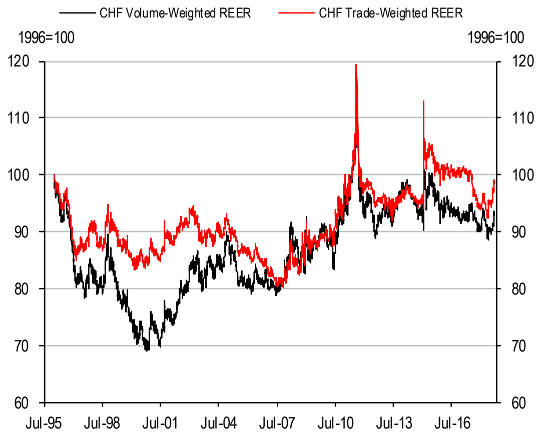
Source: HSBC

CAD REER index



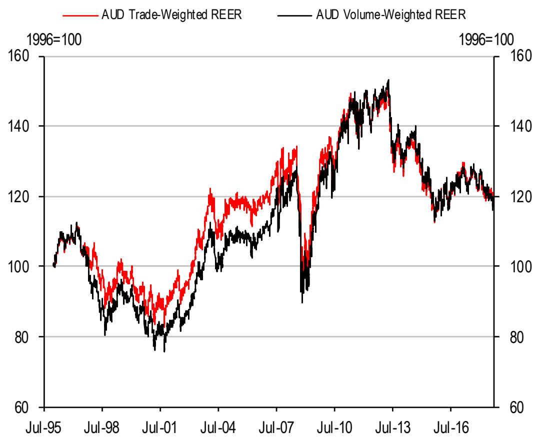
Source: HSBC

CHF REER index



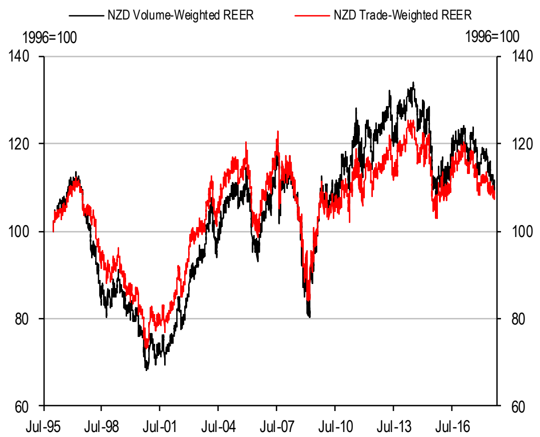
Source: HSBC

AUD REER index



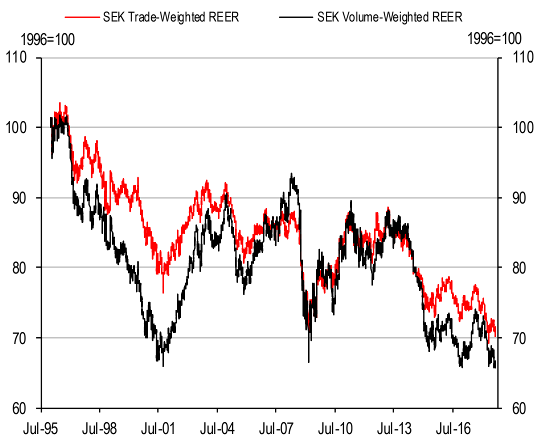
Source: HSBC

NZD REER index



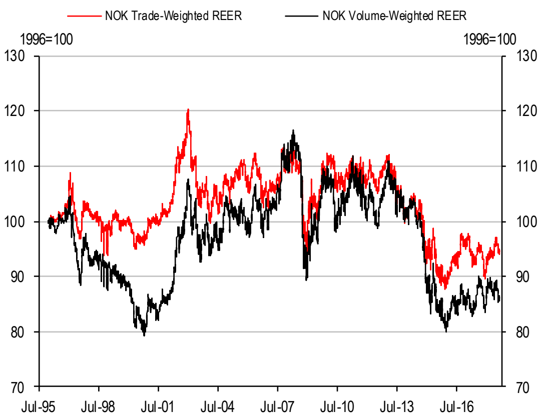
Source: HSBC

SEK REER index



Source: HSBC

NOK REER index



Source: HSBC

HSBC Little Mac Valuation Ranges

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

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

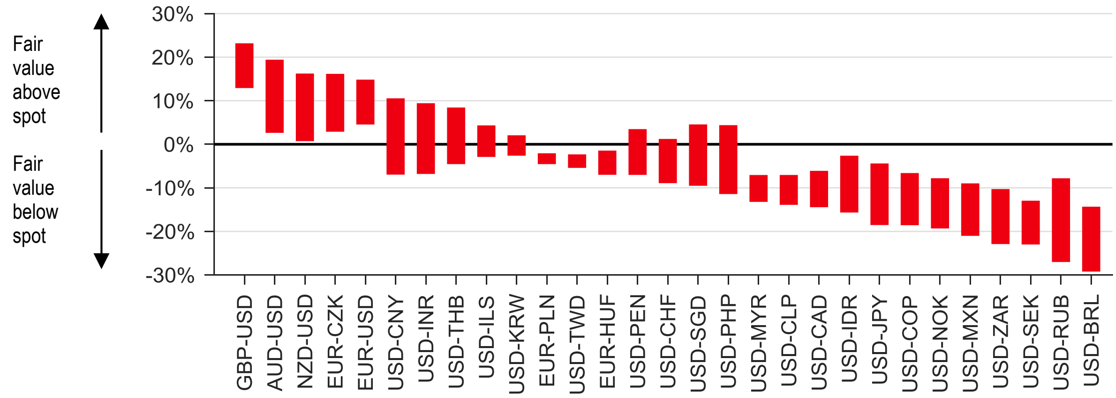
Our methodology circumvents this problem by using all possible window lengths of five years and more. Each window choice gives a different valuation and we use the entire range of these valuations. If they **all** give a consistent valuation signal then this gives us some confidence of the direction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

Procedure to calculate the HSBC Little Mac Valuation Ranges

1. We create single currency pair REERs, beginning at 100 in January 1999.
2. We calculate average values of the REER for all recent time windows which are at least five years in length[8].
3. We use the spot moves since the most recently available inflation data to estimate the value of the REER today[9].
4. For each average value of the REER calculated in step 2, we calculate what value of the exchange rate would move our estimated value of the REER today (step 3) to the average. We use this value as one of our estimated PPP values.
5. The range of the entire set of the estimated PPP values (step 4) constitutes our HSBC Little Mac Valuation Range for this currency pair.

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

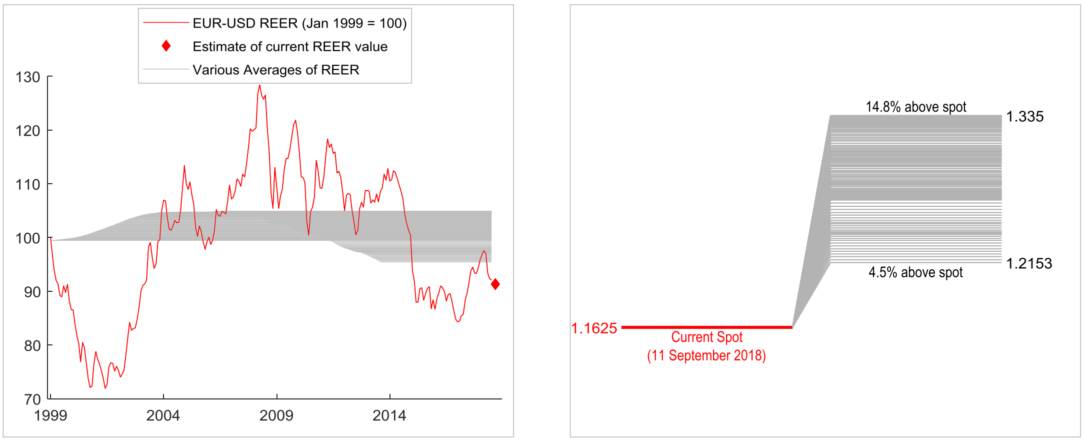
Current valuation ranges



Fair value for USD-TRY is 44-52% below spot
Source: HSBC, Thomson Reuters Datastream

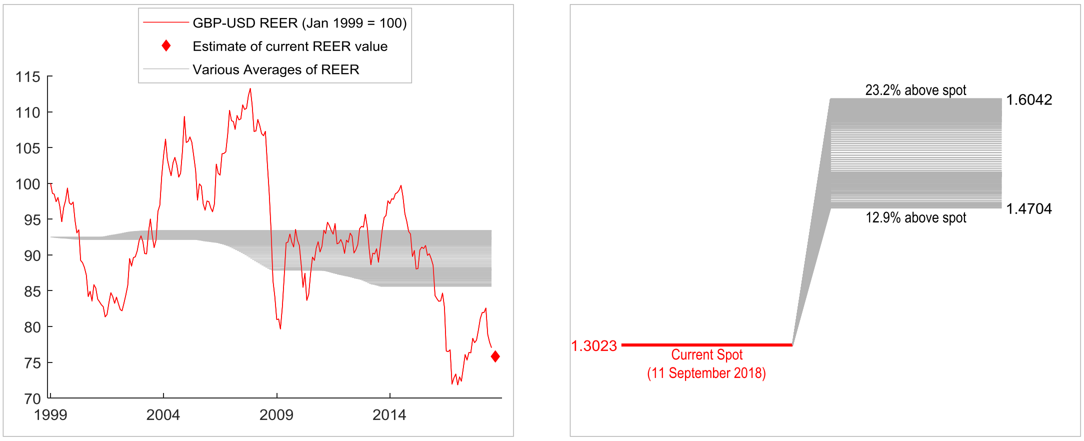
8 The maximum window length over which we calculate an average value is from January 1999 to today.
9 We make the assumption that the most recently observed YoY change in CPI will also be the YoY change observed for this month in estimating this REER value.

EUR-USD HSBC Little Mac Valuation Range



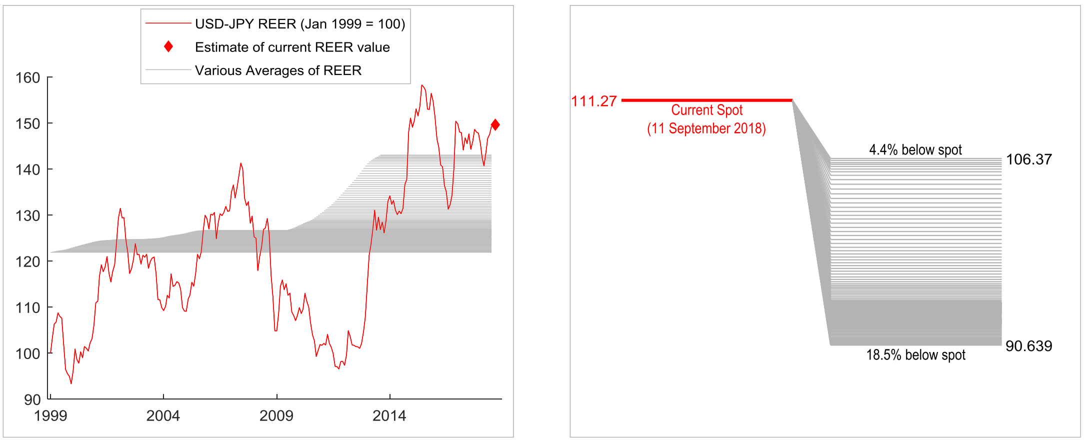
Source: HSBC, Thomson Reuters Datastream

GBP-USD HSBC Little Mac Valuation Range



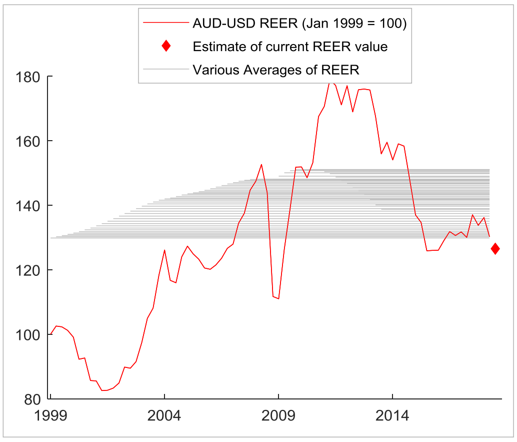
Source: HSBC, Thomson Reuters Datastream

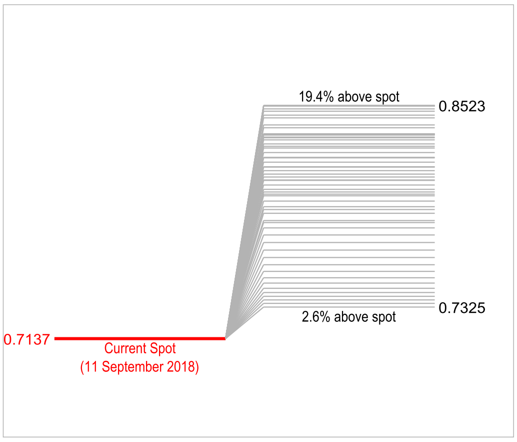
USD-JPY HSBC Little Mac Valuation Range



Source: HSBC, Thomson Reuters Datastream

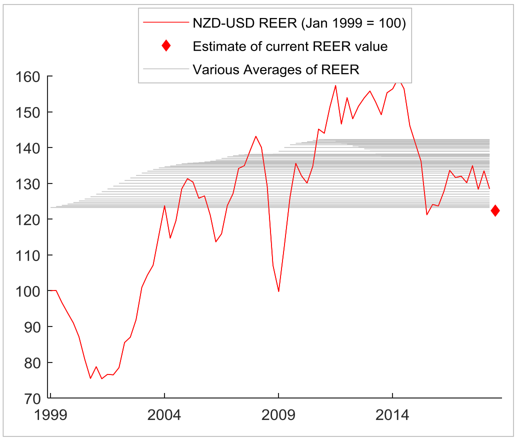
AUD-USD HSBC Little Mac Valuation Range

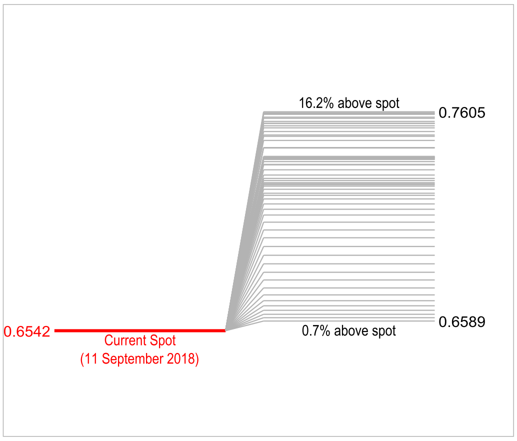




Source: HSBC, Thomson Reuters Datastream

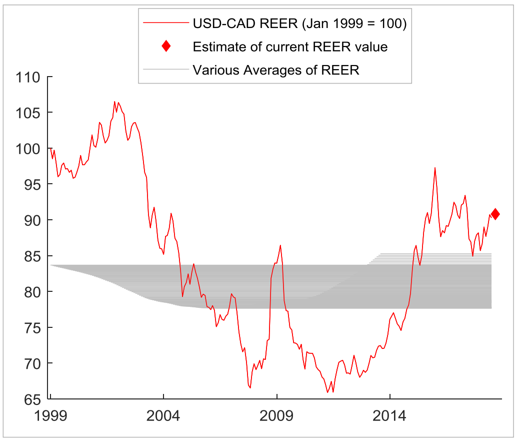
NZD-USD HSBC Little Mac Valuation Range

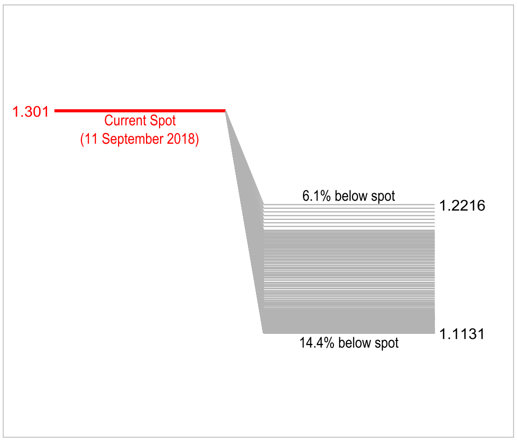




Source: HSBC, Thomson Reuters Datastream

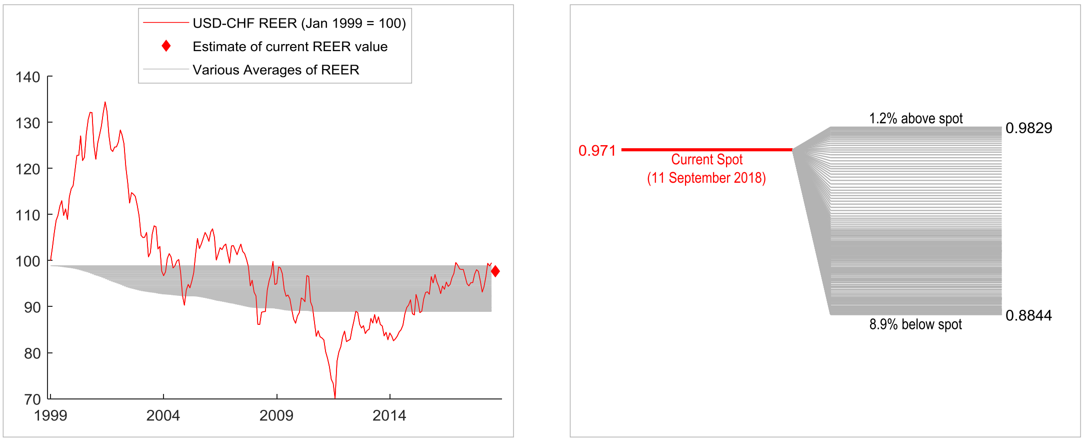
USD-CAD HSBC Little Mac Valuation Range





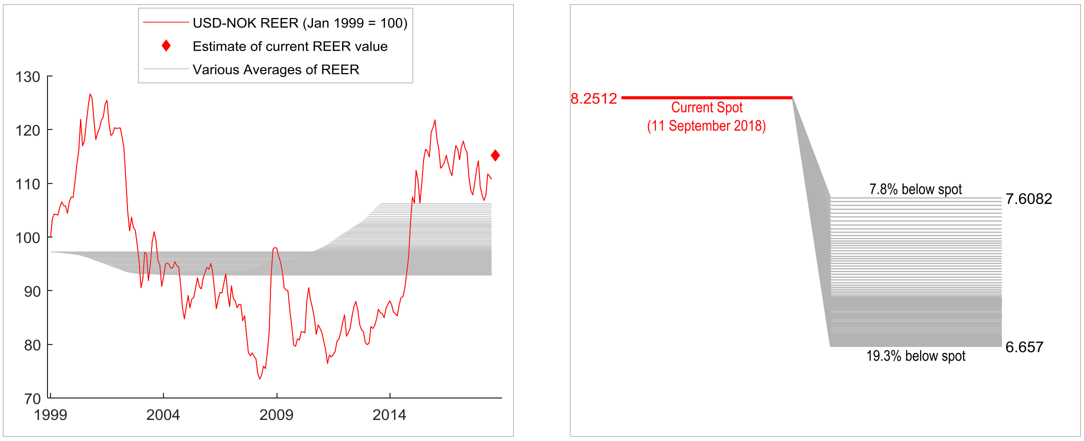
Source: HSBC, Thomson Reuters Datastream

USD-CHF HSBC Little Mac Valuation Range



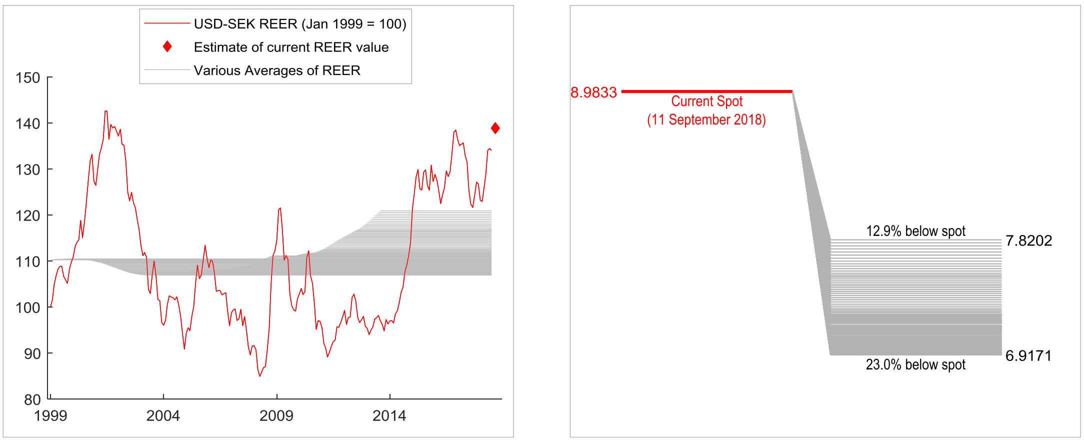
Source: HSBC, Thomson Reuters Datastream

USD-NOK HSBC Little Mac Valuation Range



Source: HSBC, Thomson Reuters Datastream

USD-SEK HSBC Little Mac Valuation Range



Source: HSBC, Thomson Reuters Datastream

HSBC forecasts vs forwards

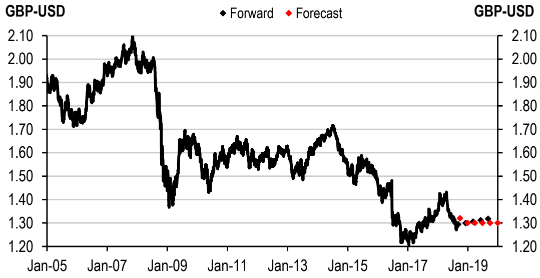
EUR-USD vs forwards

Source: Thomson Reuters Datastream, Reuters, Bloomberg, HSBC

EUR-CHF vs forwards

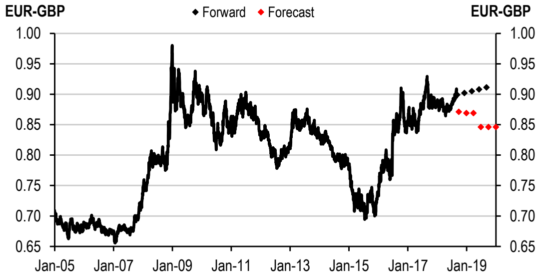
Source: Thomson Reuters Datastream, Reuters, Bloomberg, HSBC

GBP-USD vs forwards



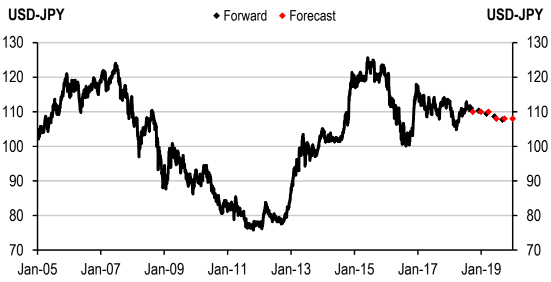
Source: Thomson Reuters Datastream, Reuters, Bloomberg, HSBC

EUR-GBP vs forwards



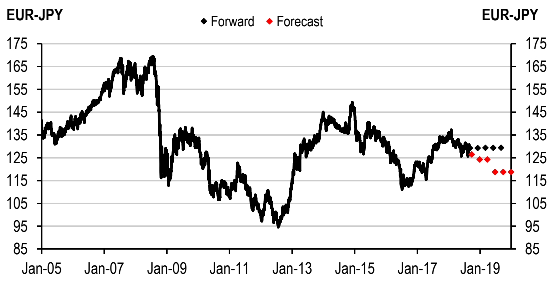
Source: Thomson Reuters Datastream, Reuters, Bloomberg, HSBC

USD-JPY vs forwards



Source: Thomson Reuters Datastream, Reuters, Bloomberg, HSBC

EUR-JPY vs forwards



Source: Thomson Reuters Datastream, Reuters, Bloomberg, HSBC

Policy Rates

end period		2018				2019			
	Current	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
North America									
US	1.75-2.00	1.50-1.75	1.75-2.00	2.00-2.25	2.25-2.50	2.50-2.75	2.75-3.00	2.75-3.00	2.75-3.00
Canada	1.50	1.25	1.25	1.50	1.50	1.50	1.50	1.75	1.75
Asia									
China	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
India	6.50	6.00	6.25	6.50	6.75	6.75	6.75	6.75	6.75
Indonesia	5.50	4.25	4.50	5.75	6.00	6.00	6.00	6.00	6.00
South Korea	1.50	1.50	1.50	1.50	1.75	1.75	1.75	2.00	2.00
Malaysia	3.25	3.25	3.25	3.25	3.25	3.25	3.50	3.50	3.50
Thailand	1.50	1.50	1.50	1.75	1.75	2.00	2.00	2.00	2.00
Australia	1.50	1.50	1.50	1.50	1.50	1.50	1.75	1.75	2.00
New Zealand	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.00	2.25
Western Europe									
EMU - Refi	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
EMU - Deposit	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.25
UK	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Norway	0.50	0.50	0.50	0.75	0.75	0.75	1.00	1.00	1.00
Sweden	-0.50	-0.50	-0.50	-0.50	-0.25	-0.25	0.00	0.00	0.25
Switzerland	-1.25/-0.25	-1.25/-0.25	-1.25/-0.25	-1.25/-0.25	-1.25/-0.25	-1.25/-0.25	-1.25/-0.25	-1.00/0.00	-1.00/0.00
CEEMEA									
Poland	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Hungary	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90
Turkey*	24.00	12.75	19.00	24.00	24.00	24.00	24.00	24.00	24.00
Russia	7.25	7.25	7.25	7.25	7.25	7.25	7.25	7.00	6.75
Israel	0.10	0.10	0.10	0.10	0.10	0.25	0.50	0.50	0.50
South Africa	6.50	6.50	6.50	6.50	6.75	7.00	7.00	7.00	7.00
Latin America									
Brazil	6.50	6.50	6.50	6.50	7.00	7.00	7.00	7.00	7.50
Chile	2.50	2.50	2.50	2.50	2.75	3.25	3.50	3.75	4.00
Mexico	7.75	7.50	7.50	7.75	8.00	8.00	7.50	7.00	6.50

Source: HSBC   *one-week repo rate

Exchange Rates vs USD

end period		2017		2018				2019			
		Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
G10											
Eurozone	EUR-USD	1.18	1.20	1.23	1.17	1.15	1.13	1.13	1.10	1.10	1.10
UK	GBP-USD	1.34	1.35	1.40	1.32	1.32	1.30	1.30	1.30	1.30	1.30
Japan	USD-JPY	113	113	106	111	110	110	110	108	108	108
Australia	AUD-USD	0.78	0.78	0.77	0.74	0.72	0.70	0.69	0.68	0.68	0.68
New Zealand	NZD-USD	0.72	0.71	0.72	0.68	0.67	0.65	0.63	0.62	0.62	0.62
Canada	USD-CAD	1.25	1.26	1.29	1.31	1.32	1.35	1.35	1.37	1.37	1.38
Sweden	USD-SEK	8.15	8.19	8.34	8.94	9.13	9.56	9.73	10.18	10.27	10.27
Norway	USD-NOK	7.96	8.20	7.84	8.15	8.61	8.85	8.85	9.27	9.36	9.36
Switzerland	USD-CHF	0.97	0.97	0.95	0.99	1.02	1.02	1.02	0.98	0.98	0.98
Asia											
North Asia											
China	USD-CNY	6.65	6.51	6.28	6.62	6.65	6.70	6.70	6.70	6.70	6.70
Hong Kong	USD-HKD	7.81	7.81	7.85	7.85	7.80	7.80	7.80	7.80	7.80	7.80
Taiwan	USD-TWD	30.3	29.7	29.1	30.5	30.8	31.0	31.0	31.0	31.0	31.0
South Korea	USD-KRW	1145	1067	1064	1115	1130	1140	1140	1140	1140	1140
South Asia											
India	USD-INR	65.3	63.9	65.2	68.5	72.0	73.0	73.5	73.5	74.0	74.0
Indonesia	USD-IDR	13472	13555	13728	14330	14500	14700	14800	14900	14950	15000
Malaysia	USD-MYR	4.22	4.05	3.86	4.04	4.05	4.10	4.10	4.10	4.10	4.10
Philippines	USD-PHP	50.9	49.9	52.2	53.4	54.0	54.5	54.5	54.5	55.0	55.0
Singapore	USD-SGD	1.36	1.34	1.31	1.36	1.37	1.38	1.38	1.38	1.38	1.38
Thailand	USD-THB	33.3	32.6	31.2	33.0	33.5	34.0	34.0	34.0	34.0	34.0
Vietnam	USD-VND	22730	22698	22794	22938	23100	23200	23200	23200	23200	23200
CEEMEA											
Czech Republic	USD-CZK	22.0	21.2	20.6	22.2	22.4	23.0	23.0	23.6	23.6	23.6
Hungary	USD-HUF	264	259	254	282	287	296	299	309	309	309
Poland	USD-PLN	3.65	3.48	3.42	3.74	3.83	3.98	4.03	4.18	4.18	4.18
Israel	USD-ILS	3.53	3.48	3.49	3.66	3.60	3.65	3.65	3.65	3.65	3.65
Russia	USD-RUB	57.6	57.7	57.3	62.8	66.0	68.0	69.0	70.0	70.0	70.0
Turkey	USD-TRY	3.56	3.80	3.96	4.59	6.50	7.00	7.10	7.25	7.35	7.50
South Africa	USD-ZAR	13.56	12.38	11.84	13.73	15.50	17.00	17.25	17.50	17.50	17.50
LatAm											
Argentina	USD-ARS	17.32	18.62	20.14	28.93	39.00	42.00	44.00	46.00	48.00	50.00
Brazil	USD-BRL	3.16	3.31	3.31	3.88	3.95	4.05	4.05	4.05	4.05	4.05
Chile	USD-CLP	639	615	604	654	650	660	660	660	660	660
Mexico	USD-MXN	18.25	19.66	18.18	19.91	19.50	19.50	19.50	19.50	19.50	19.50
Colombia	USD-COP	2938	2986	2794	2932	2900	2950	2950	2950	2950	2950
Peru	USD-PEN	3.27	3.24	3.23	3.29	3.29	3.30	3.30	3.30	3.30	3.30

Source: HSBC

G10 Exchange Rates

end period		2017		2018				2019			
		Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
vs USD											
Eurozone	EUR-USD	1.18	1.20	1.23	1.17	1.15	1.13	1.13	1.10	1.10	1.10
UK	GBP-USD	1.34	1.35	1.40	1.32	1.32	1.30	1.30	1.30	1.30	1.30
Japan	USD-JPY	113	113	106	111	110	110	110	108	108	108
Canada	USD-CAD	1.25	1.26	1.29	1.31	1.32	1.35	1.35	1.37	1.37	1.38
Australia	AUD-USD	0.78	0.78	0.77	0.74	0.72	0.70	0.69	0.68	0.68	0.68
New Zealand	NZD-USD	0.72	0.71	0.72	0.68	0.67	0.65	0.63	0.62	0.62	0.62
Sweden	USD-SEK	8.15	8.19	8.34	8.94	9.13	9.56	9.73	10.18	10.27	10.27
Norway	USD-NOK	7.96	8.20	7.84	8.15	8.61	8.85	8.85	9.27	9.36	9.36
Switzerland	USD-CHF	0.97	0.97	0.95	0.99	1.02	1.02	1.02	0.98	0.98	0.98
vs EUR											
US	EUR-USD	1.18	1.20	1.23	1.17	1.15	1.13	1.13	1.10	1.10	1.10
UK	EUR-GBP	0.88	0.89	0.88	0.89	0.87	0.87	0.87	0.85	0.85	0.85
Japan	EUR-JPY	133	135	131	129	127	124	124	119	119	119
Canada	EUR-CAD	1.47	1.51	1.59	1.53	1.52	1.53	1.53	1.51	1.51	1.52
Australia	EUR-AUD	1.51	1.54	1.60	1.58	1.60	1.61	1.64	1.62	1.62	1.62
New Zealand	EUR-NZD	1.64	1.69	1.70	1.73	1.72	1.74	1.79	1.77	1.77	1.77
Sweden	EUR-SEK	9.63	9.83	10.28	10.45	10.50	10.80	11.00	11.20	11.30	11.30
Norway	EUR-NOK	9.41	9.84	9.66	9.52	9.90	10.00	10.00	10.20	10.30	10.30
Switzerland	EUR-CHF	1.14	1.17	1.18	1.16	1.17	1.15	1.15	1.08	1.08	1.08
vs GBP											
US	GBP-USD	1.34	1.35	1.40	1.32	1.32	1.30	1.30	1.30	1.30	1.30
Eurozone	GBP-EUR	1.14	1.13	1.14	1.13	1.15	1.15	1.15	1.18	1.18	1.18
Japan	GBP-JPY	151	152	149	146	145	143	143	140	140	140
Canada	GBP-CAD	1.67	1.70	1.81	1.73	1.74	1.76	1.76	1.78	1.78	1.79
Australia	GBP-AUD	1.71	1.73	1.83	1.78	1.83	1.86	1.88	1.91	1.91	1.91
New Zealand	GBP-NZD	1.86	1.90	1.94	1.95	1.97	2.00	2.06	2.10	2.10	2.10
Sweden	GBP-SEK	10.93	11.06	11.71	11.81	12.05	12.42	12.65	13.24	13.35	13.35
Norway	GBP-NOK	10.68	11.07	11.00	10.76	11.36	11.50	11.50	12.05	12.17	12.17
Switzerland	GBP-CHF	1.30	1.32	1.34	1.31	1.34	1.33	1.33	1.27	1.27	1.27

Source: HSBC

HSBC

Asia Exchange Rates

end period		2017		2018				2019			
		Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
vs USD											
China	USD-CNY	6.65	6.51	6.28	6.62	6.65	6.70	6.70	6.70	6.70	6.70
Hong Kong	USD-HKD	7.81	7.81	7.85	7.85	7.80	7.80	7.80	7.80	7.80	7.80
Taiwan	USD-TWD	30.3	29.7	29.1	30.5	30.8	31.0	31.0	31.0	31.0	31.0
South Korea	USD-KRW	1145	1067	1064	1115	1130	1140	1140	1140	1140	1140
India	USD-INR	65.3	63.9	65.2	68.5	72.0	73.0	73.5	73.5	74.0	74.0
Indonesia	USD-IDR	13472	13555	13728	14330	14500	14700	14800	14900	14950	15000
Malaysia	USD-MYR	4.22	4.05	3.86	4.04	4.05	4.10	4.10	4.10	4.10	4.10
Philippines	USD-PHP	50.9	49.9	52.2	53.4	54.0	54.5	54.5	54.5	55.0	55.0
Singapore	USD-SGD	1.36	1.34	1.31	1.36	1.37	1.38	1.38	1.38	1.38	1.38
Thailand	USD-THB	33.3	32.6	31.2	33.0	33.5	34.0	34.0	34.0	34.0	34.0
Vietnam	USD-VND	22730	22698	22794	22938	23100	23200	23200	23200	23200	23200
vs EUR											
China	EUR-CNY	7.86	7.81	7.73	7.74	7.65	7.57	7.57	7.37	7.37	7.37
Hong Kong	EUR-HKD	9.23	9.38	9.67	9.17	8.97	8.81	8.81	8.58	8.58	8.58
Taiwan	EUR-TWD	35.8	35.7	35.9	35.6	35.4	35.0	35.0	34.1	34.1	34.1
South Korea	EUR-KRW	1353	1281	1311	1302	1300	1288	1288	1254	1254	1254
India	EUR-INR	77.1	76.7	80.3	80.0	82.8	82.5	83.1	80.9	81.4	81.4
Indonesia	EUR-IDR	15916	16273	16918	16743	16675	16611	16724	16390	16445	16500
Malaysia	EUR-MYR	4.99	4.86	4.76	4.72	4.66	4.63	4.63	4.51	4.51	4.51
Philippines	EUR-PHP	60.1	59.8	64.3	62.4	62.1	61.6	61.6	60.0	60.5	60.5
Singapore	EUR-SGD	1.60	1.60	1.62	1.59	1.58	1.56	1.56	1.52	1.52	1.52
Thailand	EUR-THB	39.4	39.1	38.4	38.6	38.5	38.4	38.4	37.4	37.4	37.4
Vietnam	EUR-VND	26853	27249	28091	26801	26565	26216	26216	25520	25520	25520
vs GBP											
China	GBP-CNY	8.92	8.79	8.81	8.74	8.78	8.71	8.71	8.71	8.71	8.71
Hong Kong	GBP-HKD	10.47	10.55	11.01	10.36	10.30	10.14	10.14	10.14	10.14	10.14
Taiwan	GBP-TWD	40.7	40.2	40.8	40.2	40.7	40.3	40.3	40.3	40.3	40.3
South Korea	GBP-KRW	1536	1442	1492	1471	1492	1482	1482	1482	1482	1482
India	GBP-INR	87.5	86.3	91.5	90.4	95.0	94.9	95.6	95.5	96.2	96.2
Indonesia	GBP-IDR	18066	18308	19263	18917	19140	19110	19240	19370	19435	19500
Malaysia	GBP-MYR	5.66	5.47	5.42	5.33	5.35	5.33	5.33	5.33	5.33	5.33
Philippines	GBP-PHP	68.2	67.3	73.2	70.5	71.3	70.9	70.9	70.8	71.5	71.5
Singapore	GBP-SGD	1.82	1.80	1.84	1.80	1.81	1.79	1.79	1.79	1.79	1.79
Thailand	GBP-THB	44.7	44.0	43.8	43.6	44.2	44.2	44.2	44.2	44.2	44.2
Vietnam	GBP-VND	30482	30658	31985	30281	30492	30160	30160	30160	30160	30160

Source: HSBC

CEEMEA Exchange Rates

end period		2017		2018				2019			
		Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
vs USD											
Czech Republic	USD-CZK	22.0	21.2	20.6	22.2	22.4	23.0	23.0	23.6	23.6	23.6
Hungary	USD-HUF	264	259	254	282	287	296	299	309	309	309
Poland	USD-PLN	3.65	3.48	3.42	3.74	3.83	3.98	4.03	4.18	4.18	4.18
Romania	USD-RON	3.89	3.89	3.78	3.99	4.13	4.20	4.20	4.32	4.32	4.32
Egypt	USD-EGP	17.64	17.78	17.65	17.89	18.00	18.00	18.00	18.00	18.00	18.00
Israel	USD-ILS	3.53	3.48	3.49	3.66	3.60	3.65	3.65	3.65	3.65	3.65
Russia	USD-RUB	57.6	57.7	57.3	62.8	66.0	68.0	69.0	70.0	70.0	70.0
Turkey	USD-TRY	3.56	3.80	3.96	4.59	6.50	7.00	7.10	7.25	7.35	7.50
South Africa	USD-ZAR	13.56	12.38	11.84	13.73	15.50	17.00	17.25	17.50	17.50	17.50
vs EUR											
Czech Republic	EUR-CZK	26.0	25.5	25.3	26.0	25.8	26.0	26.0	26.0	26.0	26.0
Hungary	EUR-HUF	312	311	312	329	330	335	338	340	340	340
Poland	EUR-PLN	4.31	4.18	4.21	4.37	4.40	4.50	4.55	4.60	4.60	4.60
Romania	EUR-RON	4.60	4.67	4.65	4.66	4.75	4.75	4.75	4.75	4.75	4.75
Egypt	EUR-EGP	20.84	21.34	21.76	20.90	20.70	20.34	20.34	19.80	19.80	19.80
Israel	EUR-ILS	4.18	4.18	4.30	4.27	4.14	4.12	4.12	4.02	4.02	4.02
Russia	EUR-RUB	68.0	69.3	70.7	73.3	75.9	76.8	78.0	77.0	77.0	77.0
Turkey	EUR-TRY	4.21	4.56	4.87	5.37	7.48	7.91	8.02	7.98	8.09	8.25
South Africa	EUR-ZAR	16.02	14.87	14.59	16.04	17.83	19.21	19.49	19.25	19.25	19.25
vs GBP											
Czech Republic	GBP-CZK	29.5	28.7	28.9	29.4	29.6	29.9	29.9	30.7	30.7	30.7
Hungary	GBP-HUF	354	350	356	372	379	385	389	402	402	402
Poland	GBP-PLN	4.90	4.70	4.80	4.94	5.05	5.18	5.23	5.44	5.44	5.44
Romania	GBP-RON	5.22	5.25	5.30	5.27	5.45	5.46	5.46	5.61	5.61	5.61
Egypt	GBP-EGP	23.66	24.01	24.77	23.62	23.76	23.40	23.40	23.40	23.40	23.40
Israel	GBP-ILS	4.74	4.70	4.90	4.83	4.75	4.75	4.75	4.74	4.74	4.74
Russia	GBP-RUB	77.2	77.9	80.5	82.9	87.1	88.4	89.7	91.0	91.0	91.0
Turkey	GBP-TRY	4.78	5.13	5.55	6.06	8.58	9.10	9.23	9.42	9.55	9.75
South Africa	GBP-ZAR	18.18	16.73	16.62	18.12	20.46	22.10	22.43	22.75	22.75	22.75

Source: HSBC

LatAm Exchange Rates

end period		2017		2018				2019			
		Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
vs USD											
Argentina	USD-ARS	17.32	18.62	20.14	28.93	39.00	42.00	44.00	46.00	48.00	50.00
Brazil	USD-BRL	3.16	3.31	3.31	3.88	3.95	4.05	4.05	4.05	4.05	4.05
Chile	USD-CLP	639	615	604	654	650	660	660	660	660	660
Mexico	USD-MXN	18.25	19.66	18.18	19.91	19.50	19.50	19.50	19.50	19.50	19.50
Colombia	USD-COP	2938	2986	2794	2932	2900	2950	2950	2950	2950	2950
Peru	USD-PEN	3.27	3.24	3.23	3.29	3.29	3.30	3.30	3.30	3.30	3.30
Uruguay	USD-UYU	28.96	28.74	28.41	31.48	31.50	32.00	32.00	32.00	32.00	32.00
vs EUR											
Argentina	EUR-ARS	20.46	22.36	24.82	33.80	44.85	47.46	49.72	50.60	52.80	55.00
Brazil	EUR-BRL	3.74	3.98	4.07	4.53	4.54	4.58	4.58	4.46	4.46	4.46
Chile	EUR-CLP	755	739	744	764	748	746	746	726	726	726
Mexico	EUR-MXN	21.57	23.60	22.41	23.26	22.43	22.04	22.04	21.45	21.45	21.45
Colombia	EUR-COP	3471	3584	3443	3425	3335	3334	3334	3245	3245	3245
Peru	EUR-PEN	3.86	3.89	3.98	3.84	3.78	3.73	3.73	3.63	3.63	3.63
Uruguay	EUR-UYU	34.21	34.51	35.01	36.78	36.23	36.16	36.16	35.20	35.20	35.20
vs GBP											
Argentina	GBP-ARS	23.22	25.15	28.26	38.19	51.48	54.60	57.20	59.80	62.40	65.00
Brazil	GBP-BRL	4.24	4.47	4.64	5.12	5.21	5.27	5.27	5.26	5.26	5.26
Chile	GBP-CLP	857	831	847	863	858	858	858	858	858	858
Mexico	GBP-MXN	24.48	26.55	25.51	26.28	25.74	25.35	25.35	25.35	25.35	25.35
Colombia	GBP-COP	3939	4033	3921	3870	3828	3835	3835	3835	3835	3835
Peru	GBP-PEN	4.38	4.37	4.53	4.34	4.34	4.29	4.29	4.29	4.29	4.29
Uruguay	GBP-UYU	38.84	38.82	39.86	41.55	41.58	41.60	41.60	41.60	41.60	41.60

Source: HSBC

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[1104076]

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