Foreign Exchange: Strategy - Weekly Currency View

8 April 2013

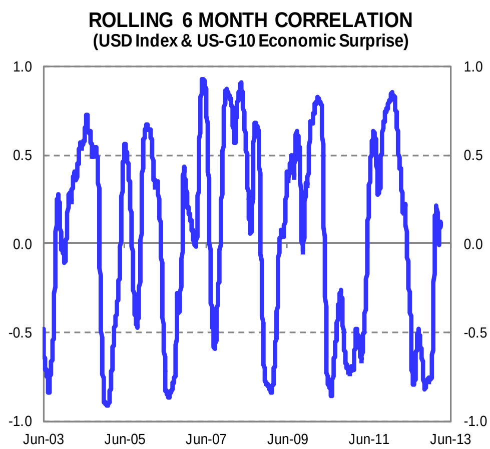
Short-term views on exchange rate direction

- **JPY remains the key focus for market participants. We expect the JPY depreciation to continue. Last week's BoJ policy announcement exceeded market expectations. Overall, the BoJ will expand its balance sheet from 35% of Japanese GDP to around 60% of Japanese GDP by end-2014. Although the market attention remains on BoJ policy measures, our core view is that the JPY is structurally deprecating driven by the collapse in Japan's current account surplus. Data released earlier today showed that Japan's current account surplus is now just 0.8% of Japanese GDP, down from 3.5% of Japanese GDP in Q1 2011.**

- **The March Australian labour force data is a key focus for the AUD this week (Thursday). Employment soared by 71,500 in February, and a number of market economists are looking for a corrective dip in March. By contrast, CBA economists are forecasting another modest increase of around 5,000 in March. Another relatively firm Australian labour force report should be AUD supportive, particularly against the JPY.**

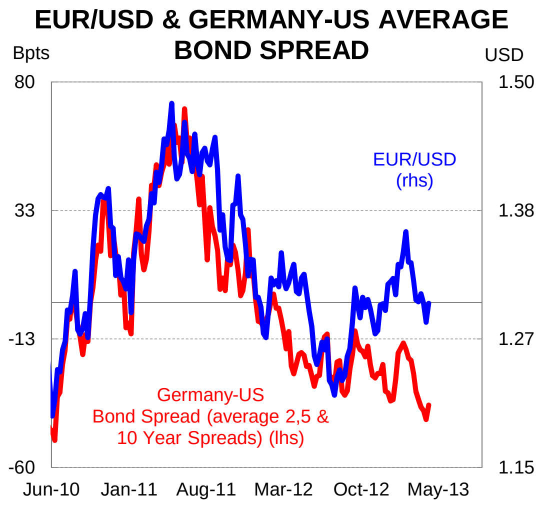
Majors	One Week Bias
USD	**Neutral**

The disappointing March US nonfarm payrolls data and subsequent dip in the USD further illustrates that the USD is becoming more correlated with the US economic cycle. The rolling 6-month correlation between the difference in the US and G10 economic surprise indices and the USD index recently moved back into positive territory for the first time since May 2011. This week March US retail sales are released (Friday). US retail sales have so far not shown any negative effects from the 1 January US payrolls tax hikes. The risk of an impact remains and we anticipate flat monthly growth in US retail sales in March. Given the correlation between the USD and the US data, soft retail sales data should weigh on the USD. Earlier in the week, the minutes of the March FOMC meeting are released (Thursday). We expect the minutes to remain consistent with our view that a change to the Fed's current aggressive policy stance is not likely to occur in the near-term. The Fed's ongoing policy stimulus, negative US real yields and the US' large current account deficit (3% of US GDP) are key factors why we cannot make a case for a sustained medium-term lift in the USD. Nevertheless, while we think the US data could weigh on the USD, in the short-term, further negative developments in North Korea, the Eurozone and/or USD demand generated by the rise in USD/JPY may provide an offsetting level of USD support.



EUR/USD	**Neutral**

In the near-term, movements in the EUR should remain a function of USD developments and peripheral Eurozone developments. A weekend report that the Portuguese Constitutional Court has blocked the Government's plan to suspend a salary payment to state workers and pensioners highlights the ongoing fragility of the Eurozone crisis. In order for the Portuguese Government to meet the terms of its €78bn bailout, savings must now be found elsewhere. Given the poor fundamentals in the Eurozone, and ongoing uncertainty in parts of the Eurozone periphery, it remains difficult to make the case for a significant move higher in EUR. Data wise only February Eurozone industrial production is released this week (Friday). Given the dip in the manufacturing business surveys another relatively poor showing is expected. More ECB policy stimulus, or measures to repair the monetary policy transmission mechanism, remains a genuine possibility



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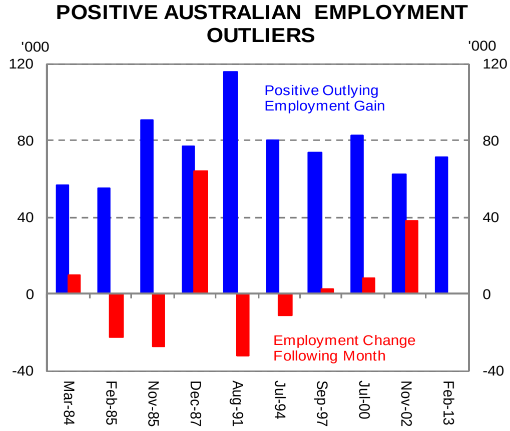
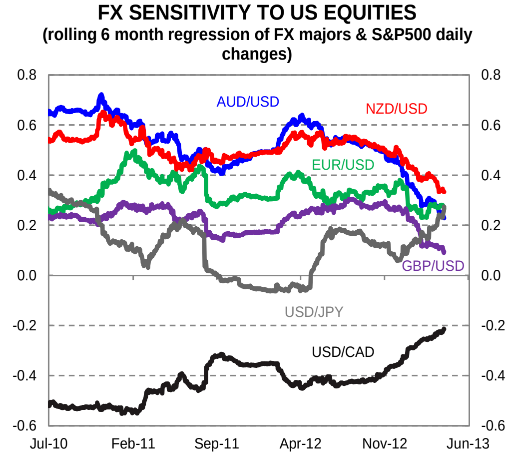
over coming months. The prospect of more stimulus should continue to keep core Eurozone bond yields under downward pressure. The German-US two-year yield spread is currently –22bpts. A substantial rise in the EUR is unlikely until German yields turn higher.



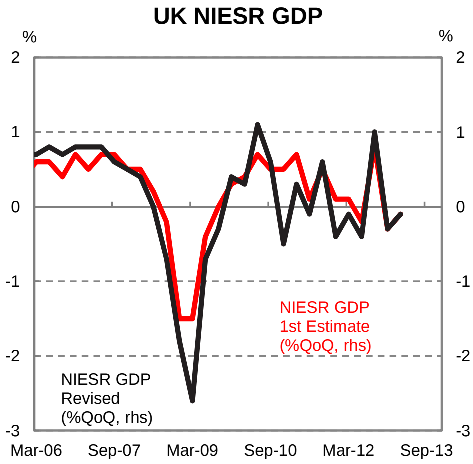


AUD/USD **Neutral**

Key focus in Australian this week will be on the March labour force data (Thursday). Employment soared by 71,500 in February, and a number of market economists are looking for a corrective dip in March. By contrast, CBA economists are forecasting another modest increase of around 5,000 in March and for the unemployment rate to stay at 5.4%. Looking back through history, monthly job gains that have been more than 2 standard deviations above the long-run average (as was the case in February 2013) have only had a pullback in the following month on a handful of occasions. Another reasonable labour market showing in March should support the AUD, as perceptions about further RBA policy stimulus are pared back. In addition, the March China CPI (Tuesday) and trade data (Wednesday) is released this week. This will provide the first non-Lunar New Year affected read on the Chinese economy of the year. We expect Chinese CPI to ease, while export and import growth are projected to come in slightly stronger than consensus. While the data developments should be AUD supportive, USD demand generated by the expected lift in USD/JPY should cap AUD gains. In the near-term AUD/USD is expected to remain towards the middle of the broader 1.0150-1.0600 range it has occupied since October 2012.

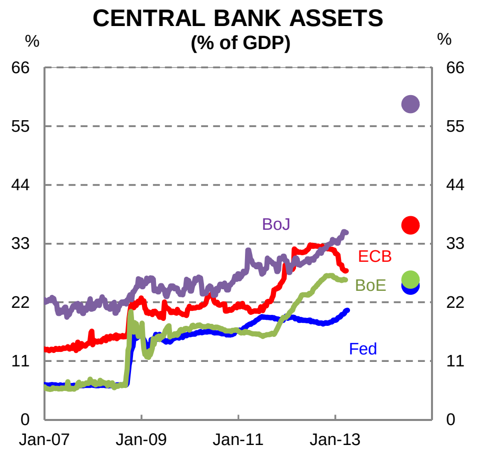
NZD/USD **Neutral**

Second tier New Zealand economic data is released throughout the week. We do not expect any of the releases to have a lasting impact on the NZD. Hence, broader global themes should remain the key drivers of NZD/USD in the near-term. Given we expect the US data to weigh on the USD; NZD/USD may edge slightly higher. However, as the NZD remains the most sensitive G10 currency to global equity market performance, a lift in vol. and/or declines in the global equities could act as an opposing force. Consequently, we think NZD/USD should respect its recent range. However, over the medium-term, strong foreign demand for NZD government securities, ongoing reinsurance inflows into New Zealand and New Zealand's relative economic strength should support the NZD.



GBP/USD **Mildly Bullish**

GBP/USD continues to squeeze higher. Positive momentum from the decision by S&P to reaffirm the UK's AAA sovereign rating late last week may see GBP edge a little higher early in the week. Nonetheless, we have not changed our bearish medium-term fundamental GBP outlook. We continue to expect GBP to ease lower over coming months. The UK economy continues to face a number of broad based headwinds, further BoE policy stimulus is expected in coming months, and the UK-US 2-year yield spread continues to track in negative territory. This week the February reading of UK industrial production (Tuesday) should remain relatively soft, although monthly improvement is likely, while the March reading of the NIESR UK GDP (Wednesday) should give a good guide as to whether the UK economy avoided a triple dip recession. Since Q3 2003, the first reading of the official UK GDP has had a 93% correlation with the NIESR measure. While leading indicators point to small positive UK growth in Q1, this would only be the 2nd positive quarter of growth since Q3 2011. Interestingly, since 2004, the NIESR measure has on average overestimated the first estimate of Q1 UK GDP by 0.17ppts.



USD/JPY **Bullish**

Last week's Bank of Japan (BoJ) policy announcement exceeded market expectations. The BoJ is now set to purchase ¥7trillion worth of assets per month (on a gross basis) until end-2014. Reports suggest the BoJ will commence its new operations this week. Overall, the BoJ will expand its balance sheet from 35% of Japanese GDP to around 60% of Japanese GDP by end-2014. From a relative sense, this will see the BoJ's balance sheet increase to more than twice the size of the other G4 central banks (the Fed, ECB and BoE). As the BoJ purchases JGBs and subsequently increases central bank reserves and, by definition, Japan`s monetary base (but not M2 money supply), JGB yields should fall and/or remain heavy. Japanese bond investors, discouraged by low nominal JGB yields may seek greater nominal bond returns offshore. These offshore purchases may, at the margin, generate some JPY weakness. Although the BoJ's policy measures continue to draw market attention, our core view is that the JPY depreciation is structural, driven by the decline in Japan's current account surplus. Adding weigh to our view, earlier today data released showed that in February Japan recorded its second monthly seasonally adjusted current account deficit in 30 years. Japan's current account surplus is now just 0.8% of Japanese GDP, down from 3.5% of Japanese GDP in Q1 2011.

USD/CAD — **Neutral**

Data released at the end of last week showed that in March total Canadian employment contracted by 54,500, its largest monthly fall since February 2009. Adding to CAD woes are renewed questions about the sustainability of the US economic recovery. These factors continue to temper market expectations regarding when the Bank of Canada (BoC) will withdraw its policy stimulus. This is keeping front-end Canadian bond yields under pressure and should continue to limit any CAD gains. Given there are no significant CAD-centric events this week, USD/CAD should be driven by the outlook for the USD. As such, USD/CAD should remain range bound. However, if US retail sales significantly underperform, CAD may come under indirect downward pressure (see USD section).

Asian Currencies — One Week Bias

USD/CNY — **Neutral**

The new policy measures announced by the BoJ and a sharply higher USD/JPY are likely to lift USD/CNY fixings this week. At the same time, the PBoC is expected to cap the USD/CNY midpoint as onshore CNY demand persists and interbank liquidity condition remains flush. All in all, USD/CNY is expected to remain range bound this week.

USD/KRW — **Mildly Bullish**

USD/KRW continued to edge higher last week following the BoJ induced surge in the JPY crosses. Moreover, the escalation in the geopolitical tussle in the region is another factor keeping USD/KRW well supported. This comes despite the significant KRW valuation support from South Korea's favourable terms-of-trade. The Bank of Korea (BoK) is scheduled to meet this week (Thursday) and market participants expect the BoK to remain on hold. Even though we expect the USD to remain range bound, we think USD/KRW can continue to drift higher.

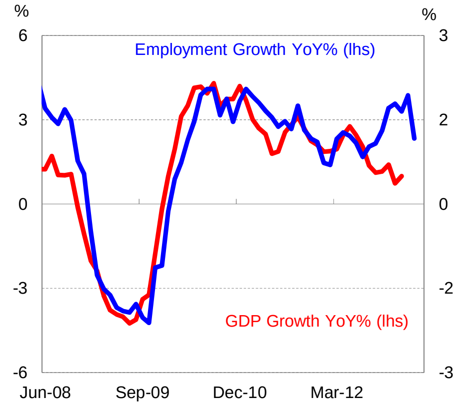
USD/IDR — **Mildly Bullish**

USD/IDR rose above 9,700 last week. The chronic onshore USD shortage continues to rattle investor confidence in the domestic currency. Interestingly, data shows that foreign demand for local currency government bonds may have reached its saturation point in the last two months. Despite our neutral near-term USD outlook, USD/IDR may continue to grind higher in the near-term.

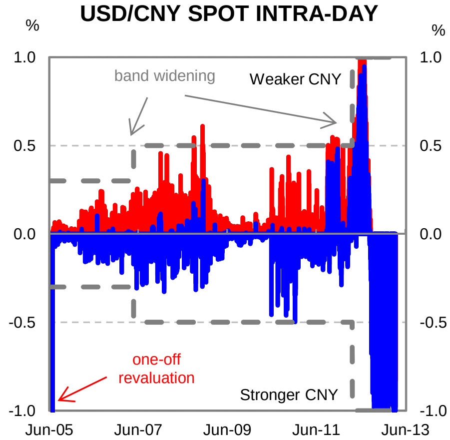
USD/SGD — **Neutral**

The SGD nominal effective exchange rate (NEER) was little changed last week. This week, the Monetary Authority of Singapore (MAS) will meet to review its policy framework (Friday). Market participants expect the MAS to keep its gradual appreciation stance intact, given both the

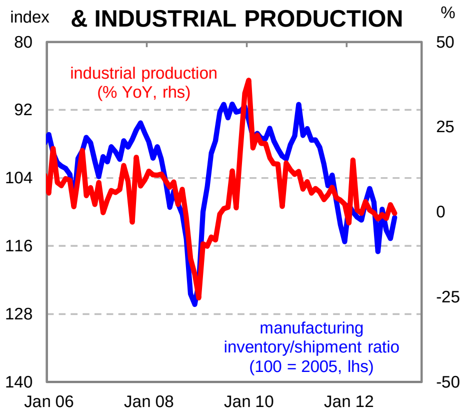
CANADIAN EMPLOYMENT AND GDP



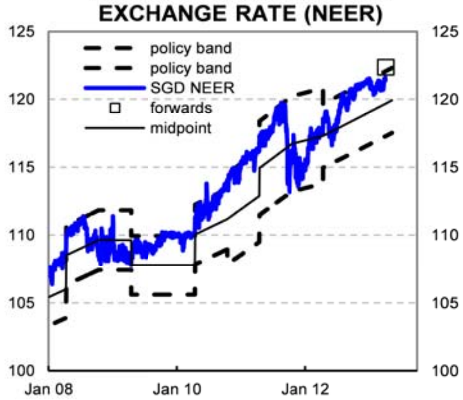
USD/CNY SPOT INTRA-DAY



INVENTORY/SHIPMENT RATIO & INDUSTRIAL PRODUCTION



SGD NOMINAL EFFECTIVE EXCHANGE RATE (NEER)



elevated headline Singapore CPI and acute underlying inflationary pressures. If the MAS surprises, USD/SGD may edge a little higher. Otherwise we think USD/SGD should track sideways in the near term.

AUD Crosses	One Week Bias

AUD/NZD — **Mildly Bullish**

The Australian February labour market data (Thursday) is the most likely of the local data releases to influence AUD/NZD this week. The market consensus (-7.5K) appears to expect some payback for February's outsized jobs gain. If our economists are right, and employment lifts modestly in February, we expect AUD should garner some support, and AUD/NZD should lift. However, beyond this potential influence, we expect AUD/NZD to remain within a similar range to last week.

AUD/EUR — **Mildly Bullish**

AUD/EUR has drifted modestly lower over the past week. However, given the broad divergence in the outlooks for the Australian and Eurozone economies, combined with the wide Australia-Germany yield differential, we cannot foresee further sustained declines in AUD/EUR. Another relatively robust Australian labour force print (Thursday) and positive Chinese trade data (Wednesday) should be AUD supportive. While the policy framework now in place in the Eurozone has reduced the risks of a disorderly outcome, pockets of concern continue to flare up and the macro environment remains weak. An extensive appreciation in the EUR (or decline in AUD/EUR) is unlikely until the Eurozone's economic prospects show significant improvement.

AUD/GBP — **Neutral**

AUD/GBP has eased off its highs. However, we do not expect this to be the start of a sustained down trend. The fundamental outlook for the UK economy remains weak. This continues to be in stark contrast to Australia and broader Asia. A positive March Australian labour force print (Thursday) should further highlight the wide gap between Australia's and the UK's economic fortunes and support AUD/GBP. Over coming months, the prospect of more BoE policy stimulus continues to contrast our view that the RBA will remain on hold. Assuming vol. remains subdued, the wide Australia-UK yield differential remains an avenue of support for AUD/GBP.

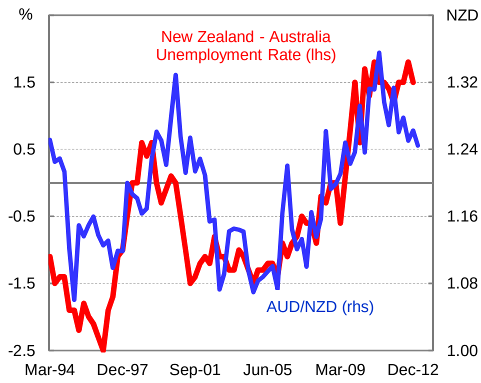
AUD/JPY — **Bullish**

We think AUD/JPY can continue to lift over the coming week. AUD/JPY is very sensitive to interest rate differentials, particularly when vol. is low. The BoJ's aggressive policy stance (see JPY section) should keep Japanese bond yields under pressure. By contrast, Australian bond yields remain relatively attractive. Another relatively solid Australian employment report (Thursday) should see market participants reduce expectations for further RBA policy easing. While the BoJ policy measures continue to gain market attention, our core view is that the JPY is depreciating because of the structural decline in Japan's current account surplus. Focus on the BoJ is accelerating these structural moves.

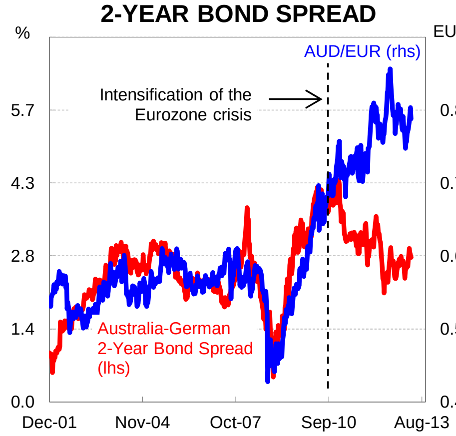
AUD/CAD — **Mildly Bullish**

AUD/CAD has remained range bound over the past 2 months. With little in terms of CAD-centric events due this week, movements in AUD/CAD should remain highly contingent on the AUD side of the equation. Firm Chinese trade data (Wednesday) and Australian labour force data (Thursday) should be AUD and AUD/CAD supportive. Another factor that could indirectly support AUD/CAD in the near-term is the March US retail sales data (Friday). We expect US retail sales to come in slightly softer than the market consensus (see USD section). Given the close trade ties between Canada and the US, concerns about the US

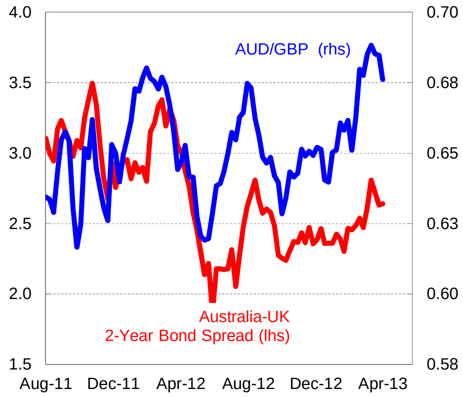
AUD/NZD: UNEMPLOYMENT RATES



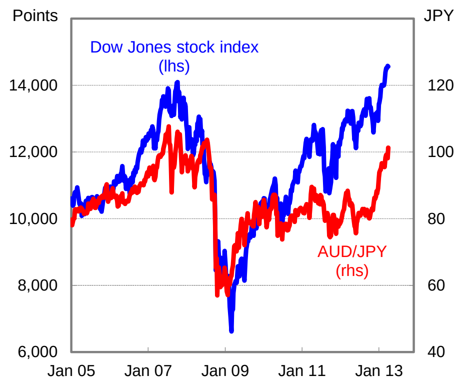
AUD/EUR VS AUS-GERMAN 2-YEAR BOND SPREAD



AUD/GBP
TWO-YEAR BOND SPREAD



AUD/JPY AND US EQUITIES



economic outlook should have more of an impact on CAD than AUD.

European Crosses	One Week Bias

EUR/GBP — **Mildly Bearish**

With little in terms of key market moving data on either side of the channel due this week, we think EUR/GBP should continue to respect its recent range. Nonetheless, any bias in the short-term remains for the cross to ease towards the bottom of its range. The unresolved issues in the Eurozone periphery continue to provide an element of support for GBP against the EUR. Furthermore, the UK-German yield differential continues to track in the UK's favour. This is another factor that continues to exert some modest downward pressure on EUR/GBP.

EUR/JPY — **Mildly Bullish**

The new and aggressive BoJ policy should continue to weigh on the JPY (see JPY section). This should support EUR/JPY. The balance sheet expansion of the BoJ remains in stark contrast to the ECB's balance sheet which is currently contracting. The decline in the ECB's balance sheet is being driven by the repayment of borrowed LTRO funds by Eurozone banks. The relative balance sheet differential of the BoJ and ECB has provided a good guide for EUR/JPY over recent years. Adding to this is the continued structural decline in Japan's current account surplus, which is driving a structural depreciation in the JPY.

EUR/CHF and **USD/CHF** — **Neutral** & **Neutral**

The March reading of Swiss CPI is released on Tuesday. Another deflationary reading is expected. Indeed, the Swiss National Bank (SNB) expects deflation to persist in Switzerland until Q3 2013. As such the Swiss CPI should not have a lasting impact on the CHF. Hence, near-term direction in both EUR/CHF and USD/CHF should remain contingent on our views on EUR and the USD (see EUR and USD sections). Consequently the bias for both EUR/CHF and USD/CHF appears to be to drift within its recent range over the coming week, barring a pickup in vol. brought on by a spike in risk aversion.

NZD Crosses	One Week Bias

NZD/AUD — **Mildly Bearish**

The Australian labour market data (Thursday) is the most likely of the local data releases to influence NZD/AUD this week. The market consensus (-7.5K) appears to expect some payback for February's outsized gain. If our economists are right, and employment lifts modestly in February, we expect AUD should garner some support, and NZD/AUD should ease. However, beyond this potential influence, we expect AUD/NZD to remain somewhat range bound within a similar range to last week.

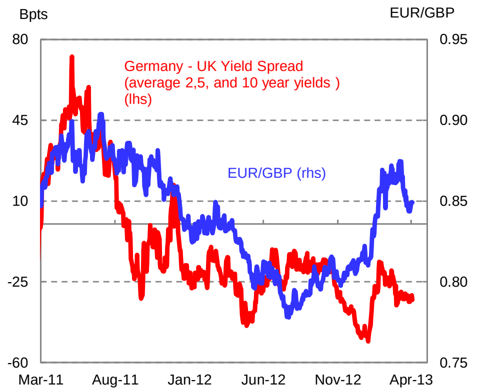
NZD/EUR — **Neutral**

NZD/EUR has drifted off last week's high, but remains very firm, and only around 3% below its all-time high. There are no major New Zealand developments scheduled for this week that are likely to influence NZD or NZD/EUR significantly. However, we expect NZD/EUR to be supported, reflecting the divergence between the economic performance of New Zealand and the Eurozone, and New Zealand's relatively attractive sovereign yields. A sustained lift in EUR and/or subsequent decline in NZD/EUR is unlikely to occur until the Eurozone's economic prospects improve.

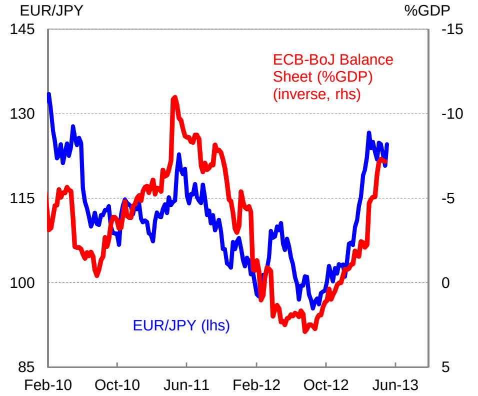
NZD/GBP — **Neutral**

NZD/GBP has eased around 1.7% off the record high set last week as GBP has lifted. Nonetheless, the cross rate remains historically high, and is unlikely to ease significantly over the week ahead, particularly

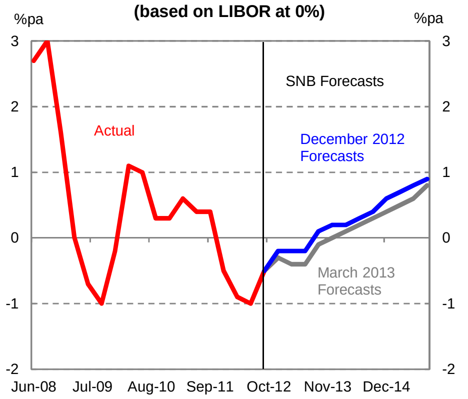
GERMANY - UK YIELD SPREAD & EUR/GBP



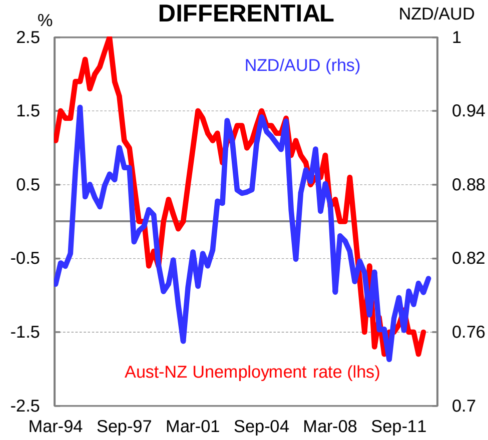
BALANCE SHEET DIFFERENTIALS



SNB SWISS INFLATION FORECASTS
(based on LIBOR at 0%)



NZD/AUD & UNEMPLOYMENT RATE DIFFERENTIAL

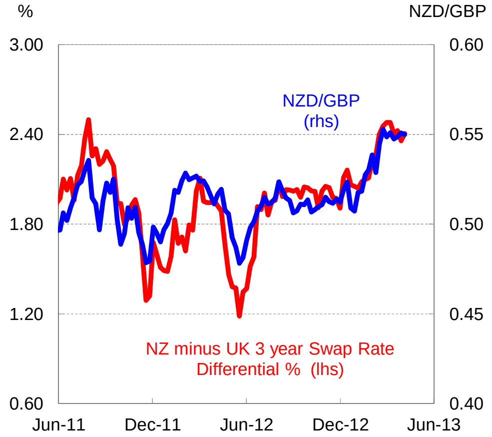


given the favourable NZ-UK 3-year swap spread. We expect that NZD/GBP should garner initial support around the 50-day moving average of 0.5456 this week, and can re-test last week's high over the coming months. The fundamental economic outlook for the UK remains very weak (see GBP section). There are no New Zealand economic events that are likely to trigger a lift in NZD or NZD/GBP this week, rather moves in the cross rate are likely to be a function of UK events and broader GBP movements.

NZD/JPY **Mildly Bullish**

NZD/JPY is trading at its highest level since 2008, when New Zealand had an extremely attractive interest rate advantage over Japan. The NZD/JPY strength at present is a function of both a firm NZD, and the structural depreciation in JPY over late 2012 and early 2013. The catalyst for last week's JPY drop, and NZD/JPY lift, was the BoJ's latest policy announcement (see JPY section). We expect the JPY to continue to depreciate over coming weeks and NZD/JPY will press higher. The risk is our September target of 85.00 is reached early than expected.

NZD/GBP INTEREST RATE SPREAD



Foreign Exchange Forecasts

	End Period			
	Jun-13	**Sep-13**	**Dec-13**	**Mar-14**
Majors				
EUR/USD	1.3500	1.3700	1.3800	1.4000
USD/JPY	98.00	100.00	100.00	104.00
GBP/USD	1.4800	1.4600	1.4600	1.4700
AUD/USD	1.0400	1.0400	1.0400	1.0300
NZD/USD	0.8400	0.8500	0.8500	0.8600
USD/CAD	0.9900	0.9900	0.9800	0.9800
USD/CHF	0.9370	0.9343	0.9348	0.9286
USD/CNY	6.1600	6.1200	6.0000	5.9000
AUD cross rates				
AUD/EUR	0.7704	0.7591	0.7536	0.7357
AUD/GBP	0.7027	0.7123	0.7123	0.7007
AUD/JPY	101.92	104.00	104.00	107.12
AUD/NZD	1.2381	1.2235	1.2235	1.1977
AUD/CAD	1.0296	1.0296	1.0192	1.0094
AUD/CHF	0.9745	0.9717	0.9722	0.9564
AUD/CNY	6.4064	6.3648	6.2400	6.0770
AUD/SGD	1.2636	1.2480	1.2376	1.2051
NZD cross rates				
NZD/EUR	0.6222	0.6204	0.6159	0.6143
NZD/GBP	0.5676	0.5822	0.5822	0.5850
NZD/JPY	82.32	85.00	85.00	89.44
NZD/AUD	0.8077	0.8173	0.8173	0.8350
NZD/CAD	0.8316	0.8415	0.8330	0.8428
NZD/CHF	0.7871	0.7942	0.7946	0.7986
NZD/CNY	5.1744	5.2020	5.1000	5.0740

**Forecasts were adjusted on 27 January 2013*

**JPY forecasts were originally lowered on 19 December 2012*

	End Period			
	Jun-13	**Sep-13**	**Dec-13**	**Mar-14**
European cross rates				
EUR/JPY	132.30	137.00	138.00	145.60
EUR/GBP	0.9122	0.9384	0.9452	0.9524
EUR/CHF	1.2650	1.2800	1.2900	1.3000
EUR/AUD	1.2981	1.3173	1.3269	1.3592
EUR/NZD	1.6071	1.6118	1.6235	1.6279
GBP/JPY	145.04	146.00	146.00	152.88
GBP/CHF	1.3868	1.3641	1.3648	1.3650
GBP/AUD	1.4231	1.4038	1.4038	1.4272
GBP/NZD	1.7619	1.7176	1.7176	1.7093
Non-Japan Asia				
USD/SGD	1.2150	1.2000	1.1900	1.1700
USD/HKD	7.7500	7.7500	7.7500	7.7500
USD/THB	29.40	29.20	28.90	29.00
USD/IDR	9500	9200	9000	9000
USD/TWD	28.50	28.25	28.00	27.75
USD/KRW	1025	1000	950	925
USD/MYR	3.00	2.90	2.85	2.80
USD/VND	22000	22000	22000	22000
USD/PHP	40.00	39.50	39.00	38.50
USD/INR	51.00	49.00	48.00	47.50

Unless otherwise noted, all data is sourced from Australian Bureau of Statistics material (www.abs.gov.au).

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