



## FX & INTEREST RATE MONTHLY

**Global recovery gathers momentum.**

**Modest increase in US rate expectations, though inflationary pressure remains weak.**

**Dollar supported by growth and rate expectations, but emerging markets and commodity exporters are the real winners.**

**European Union's woes to drag on, leaving the euro under pressure.**

**UK election fears weigh on the currency, but valuation is favourable.**

Strong and improving purchasing managers index figures, from surveys of major companies on orders, activity and hiring intentions, are pointing to strong growth across the key advanced and emerging economies. **Manufacturing confidence is at robust levels and service sector confidence is also improving.**

Market expectations for rate increases in the US have increased modestly on the back of the improving economic outlook. However inflation remains subdued at 2.3% and with core inflation, excluding volatile energy and food prices, at only 1.1% inflationary pressures appear limited. **We therefore continue to forecast that monetary policy tightening will be led by emerging economies**, where growth and inflation are moving back above trend levels. We expect the US to be the first of the major developed economies to raise rates.

Expectations that an improving US economy would lead to higher interest rates by year end are supporting the dollar. **Based on growth prospects and current valuation the dollar is the most appealing major currency.** However, the US is likely to be outstripped by emerging and commodity-exporting economies. Politics influence exchange rates in many countries, making timing of decisions unpredictable. But Singapore, following record first-quarter GDP, has lifted its exchange rate band and set out a policy of "modest and gradual appreciation." For the commodity exporters we continue to favour the Canadian over the Australian dollar, based on valuation and fewer risks from financial imbalances for the former.

The availability of the EU and IMF funds for Greece clearly underwrites near term funding for existing debt, but does not address structural problems. Imposition of deficit reduction plans is obviously deflationary – this is theoretically good for the currency, as per Japan – but **Greece provides a counter-example of political and solvency risks that are likely to overhang the prospects for the euro.**

Politics will dominate the trading in the pound ahead of the 6 May general election, and beyond, if no party holds a majority. This compounds the anxiety over one of the highest government deficits in the world as a proportion of GDP, making sterling the currency to sell by investors concerned by solvency issues. However, **the UK is comparable to other developed countries in terms of the magnitude of its deficit, short-term funding needs and total debt outstanding, leaving sterling looking oversold.**

Currencies	Spot 16/04/2010	RBS Forecast (as of 16 April)				Past Performance (in %)					
		Jun-10	Sep-10	Dec-10	Mar-11	-1W	-1M	-3M	-6M	-12M	YTD
Euro vs Dollar	1.35	1.34	1.32	1.28	1.26	0.5	-1.8	-6.0	-9.2	2.4	-5.9
Yen vs Dollar	92	93	96	100	102	1.3	-2.0	-1.5	-1.5	7.0	0.9
Sterling vs Dollar	1.54	1.46	1.47	1.47	1.50	0.3	1.4	-5.2	-5.8	3.3	-4.6
Swiss Franc vs Dollar	1.06	1.06	1.07	1.12	1.15	0.8	-0.5	-3.4	-4.0	7.6	-2.6
Swiss Franc vs Euro	1.43	1.42	1.41	1.43	1.45	0.3	1.3	2.8	5.6	5.3	3.4
Australian Dollar vs Dollar	0.93	0.95	0.95	0.90	0.88	-0.4	1.4	0.4	1.4	28.8	3.1
Euro vs Sterling	0.88	0.92	0.90	0.87	0.84	0.1	-3.3	-0.8	-3.8	-0.9	-1.3
Renminbi vs Dollar	6.83	6.70	6.60	6.50	6.40	0.0	0.0	0.0	0.0	0.1	0.0

	Growth (GDP)			Inflation (CPI)			Interest Rates					Decision
	2009	2010(C)	2011(C)	2009	2010(C)	2011(C)	Current	Jun'10 (F)	Sep'10 (F)	Dec'10 (F)	Mar'11 (F)	Next Date
US	-2.4	3.1	3.0	-0.3	2.2	1.9	0.25	0.25	0.75	1.75	2.75	28-Apr-10
UK	-5.0	1.4	2.3	2.2	2.6	1.7	0.50	0.50	0.50	1.00	1.50	10-May-10
Eurozone	-4.0	1.1	1.5	0.3	1.1	1.4	1.00	1.00	1.00	1.00	1.25	06-May-10
Japan	-5.1	1.9	1.6	-1.4	-1.1	-0.3	0.10	0.10	0.10	0.10	0.10	30-Apr-10

(C) Consensus Forecast

(F) RBS Forecast

## STERLING vs DOLLAR

<b>Recommendation</b>	<b>Time Horizon:</b>	<b>3 Months</b>
<b>New</b>	<b>Previous</b>	<b>Conviction</b>
<b>Negative</b>	<b>Negative</b>	

<b>Performance (as of 16/04)</b>	<b>-1M</b>	<b>-3M</b>	<b>-6M</b>	<b>-12M</b>	<b>YTD</b>
Sterling vs Dollar (Reuters)	1.4	-5.2	-5.8	3.3	7.2

**Recommendation:** Politics will dominate the trading in the pound ahead of the election on 6 May and indeed beyond, if no party holds a majority. This compounds the anxiety over a government deficit which ranks amongst the highest as a proportion of GDP, making sterling the currency to sell by investors concerned by solvency issues. While we therefore remain negative against the recovering US dollar, we increasingly see sterling as oversold against other major currencies.

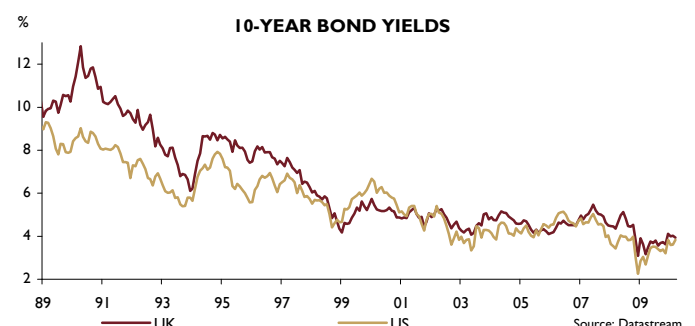
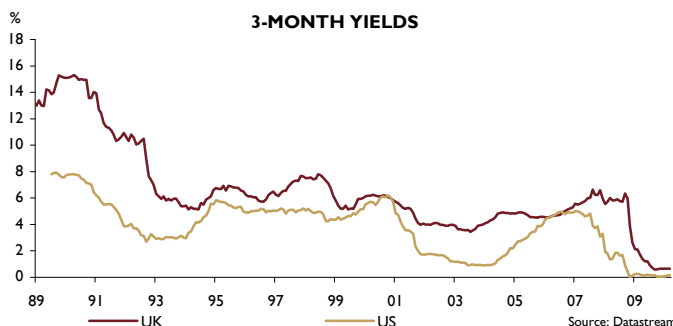
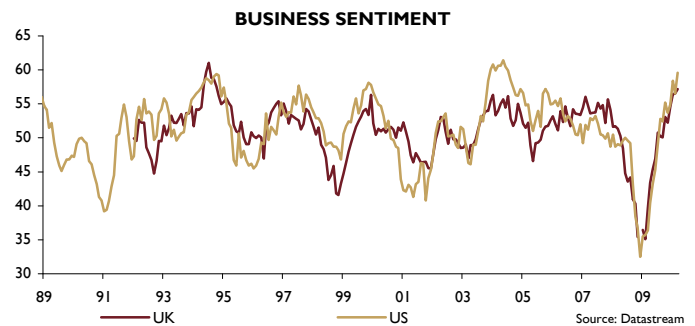
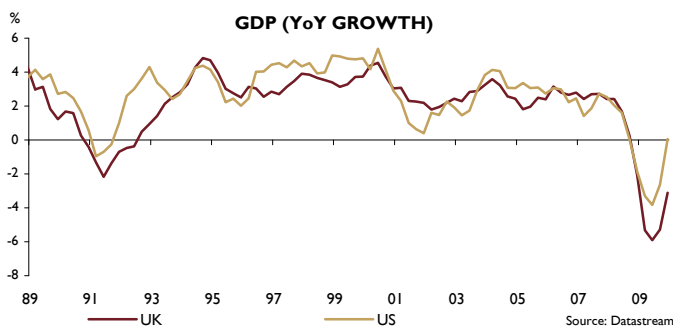
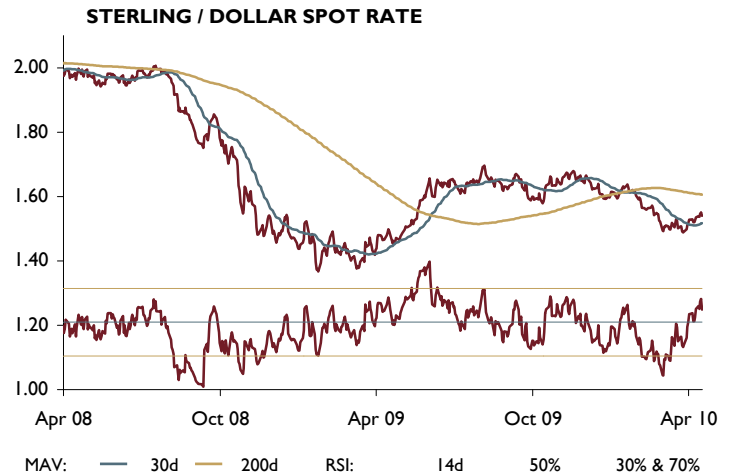
**Valuation:** Sterling is currently close to its 20-year average, though well below more recent levels.

**Activity:** The UK has lagged the global upturn, with recovery emerging later, in the final quarter of 2009, and at a slower pace with only 1.2% annualised growth, roughly a fifth of the 5.9% pace for the US in the same quarter. The UK economy is expected to continue to lag with consensus expectations of 1.4% growth for the UK in 2010 compared with 3.1% for the US economy.

**Liquidity:** There is a net short speculative trade position in sterling against the dollar. Both currencies effectively have a zero yield, so there is little to choose from on this basis. Even in terms of quantitative easing, which acts to weaken the currency, both countries' central banks have been active over the past year in boosting the money supply, although the Federal Reserve is leading the way in planning the withdrawal of this support as the domestic economy recovers.

**Risk:** The bias of risk has shifted against the UK, with the government and its budget forecasts appearing unconvincing to financial markets.

**Momentum:** Sterling has fallen below key technical levels. While sterling is currently oversold against the US dollar and there is scope for a rebound, the longer-term trend has turned negative.



## EURO vs DOLLAR

<b>Recommendation</b>	<b>Time Horizon:</b>	<b>3 Months</b>		
<b>New</b>	<b>Previous</b>	<b>Conviction</b>		
<b>Negative</b>	<b>Negative</b>			

<b>Performance (as of 16/04)</b>	<b>-1M</b>	<b>-3M</b>	<b>-6M</b>	<b>-12M</b>	<b>YTD</b>
Euro vs Dollar (Reuters)	-1.8	-6.0	-9.2	2.4	-5.9

**Recommendation:** We are positive on the outlook for the US dollar against the euro. We forecast that a strong economic recovery leads to higher interest rates, reversing the yield gap against the euro, where we forecast growth will lag. While there are political risks on both sides, we see the Greek crisis as representing a more fundamental challenge for the euro than the US federal deficit does for the dollar.



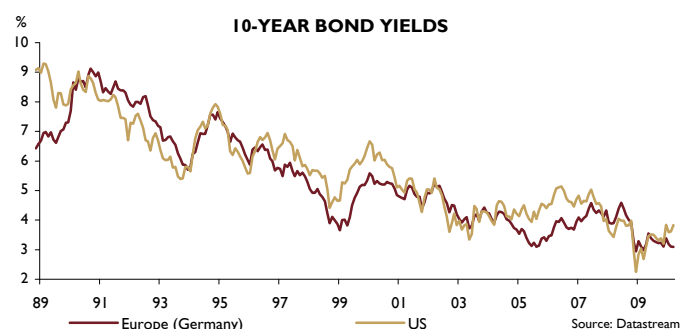
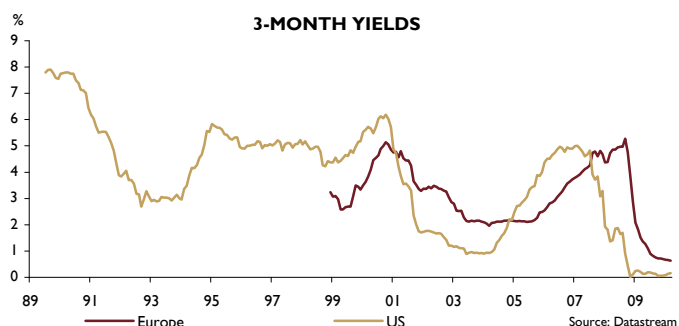
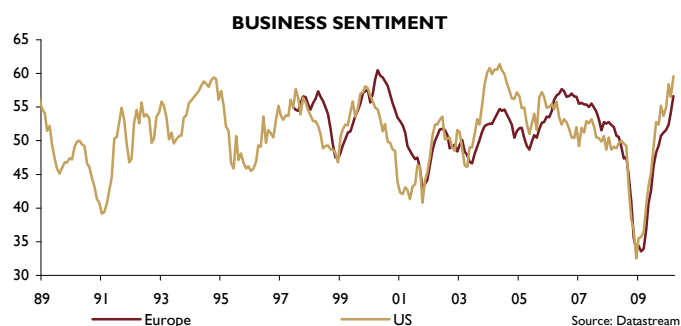
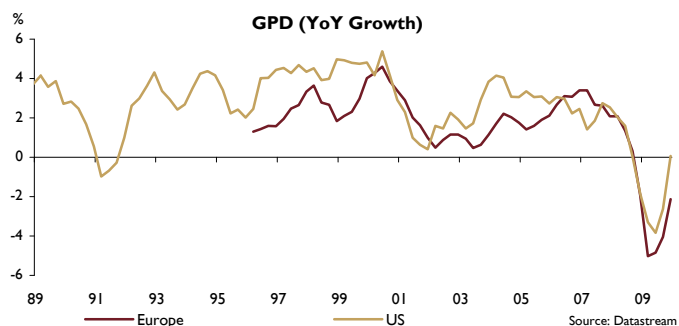
**Valuation:** The euro appears expensive against its average value since its creation in 1999, although the range over the ten years of its existence has been huge, from \$0.82 to \$1.58.

**Activity:** While both economies have emerged from recession, the euro-zone experienced a more severe downturn than the US and the consensus expectation is that its recovery will be substantially slower, at 1.1% compared with 3.1% for the US this year.

**Liquidity:** Investors hold a net short position in the euro, despite its short-term yield advantage over the dollar. This could drive a rally in the euro if it is unwound.

**Risk:** The expectation that the European Union will have to bail out the Greek government and extend greater liquidity support to other troubled member states has triggered weakness in the euro. This outweighs concerns over the US budget deficit.

**Momentum:** The euro has broken key technical levels this year, resulting in a negative long-term trend for the technical outlook.

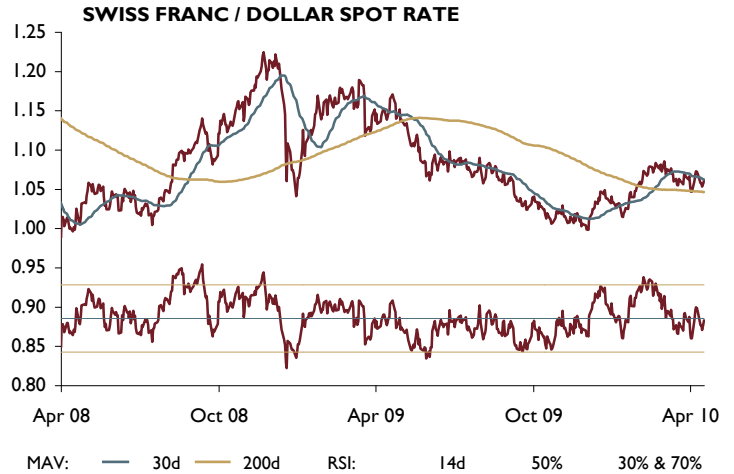


## SWISS FRANC vs DOLLAR

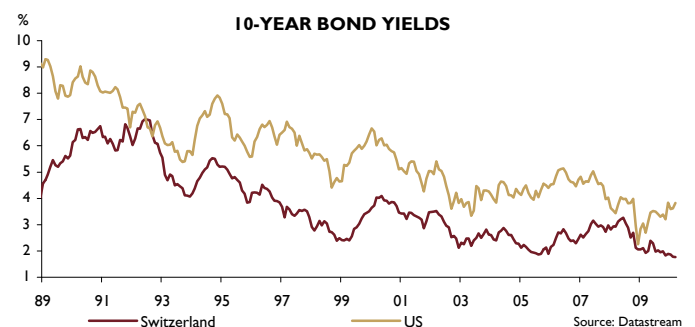
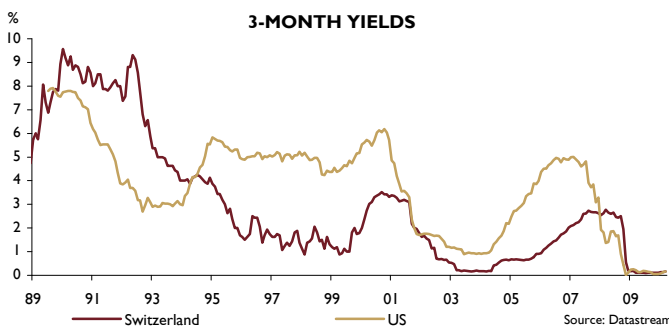
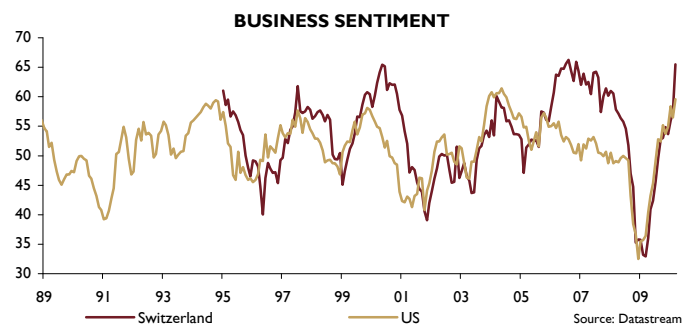
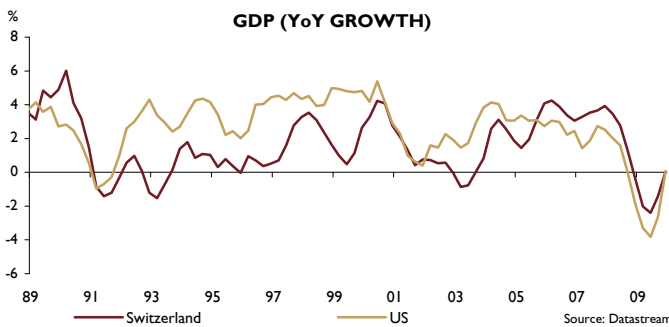
<b>Recommendation</b>	<b>Time Horizon:</b>	<b>3 Months</b>
<b>New</b>	<b>Previous</b>	<b>Conviction</b>
<b>Negative</b>	<b>Neutral</b>	

<b>Performance (as of 16/04)</b>	<b>-1M</b>	<b>-3M</b>	<b>-6M</b>	<b>-12M</b>	<b>YTD</b>
Swiss Franc vs Dollar (Reuters)	-0.5	-3.4	-4.0	7.6	-2.6

**Recommendation:** Our forecast of continued recovery in the US economy, with interest-rate increases later in the year, supports a higher US dollar against the Swiss franc. The Swiss National Bank has also been intervening to weaken the franc over the past year. However, the Swiss economy appears healthier than its neighbours in the euro-zone, while the franc retains its 'safe haven' status, both factors that could limit the downside.



- Valuation:** The Swiss franc still stands towards the top of its long-term historical range versus the dollar.
- Activity:** With the global economy now clearly rebounding, we would expect the US economy to see a stronger recovery, with a consensus forecast of 3.1% growth compared with 2.1% for Switzerland in 2010.
- Liquidity:** Investor positions in the futures market are currently broadly balanced between longs and shorts in the Swiss franc. The US made much more use of quantitative easing to boost the money supply in 2009, which acted to weaken the dollar, but the Federal Reserve is now talking of withdrawing these measures. The Swiss National Bank has also withdrawn some of its quantitative measures, but has continued to intervene against strong appreciation by the Swiss franc, buying up to \$45bn in FX markets over the past year.
- Risk:** The Swiss franc is a traditional safe haven for investors at a time of market or economic uncertainty. However, this has been undermined by the repeated interventions by the monetary authorities to prevent unwanted appreciation of the Swiss franc.
- Momentum:** The Swiss franc has broken key technical levels in its recent fall. While the Swiss franc is currently off its lows and set to re-test the trend, we see a reversal of the last year's technical uptrend.



## YEN vs DOLLAR

<b>Recommendation</b>	<b>Time Horizon:</b>	<b>3 Months</b>
<b>New</b>	<b>Previous</b>	<b>Conviction</b>
<b>Negative</b>	<b>Negative</b>	

<b>Performance (as of 16/04)</b>	<b>-1M</b>	<b>-3M</b>	<b>-6M</b>	<b>-12M</b>	<b>YTD</b>
Yen vs Dollar (Reuters)	-2.0	-1.5	-1.5	7.0	0.9

**Recommendation:** The US dollar has benefited from clear signs of continuing economic recovery. This supports our forecast that US interest rates will increase later this year, re-opening the yield gap compared with the yen. While Japan is also seeing recovery, it continues to experience deflation and the government is seeking to reinvigorate the economy, which is likely to involve further unconventional monetary measures.

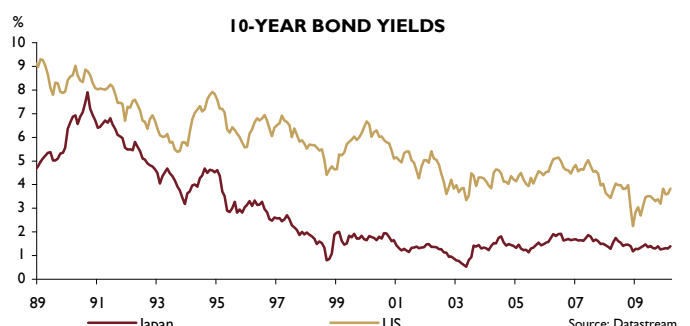
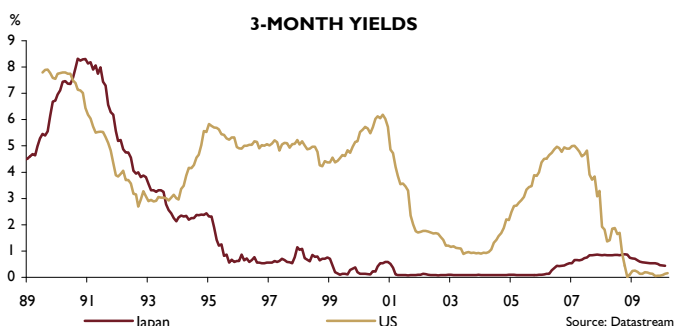
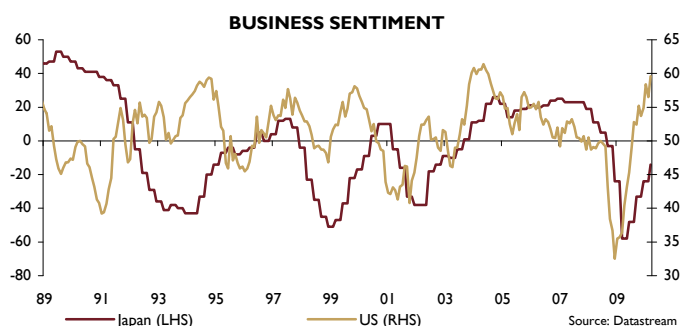
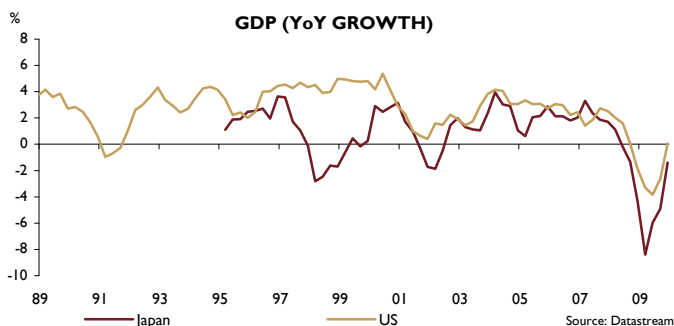
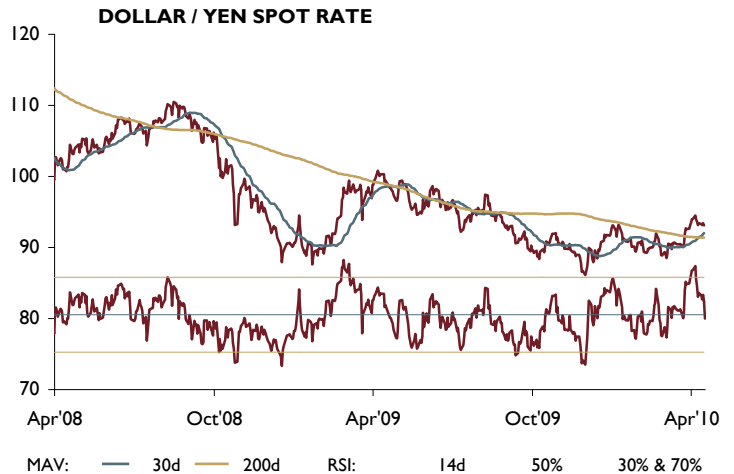
**Valuation:** The last time the yen was below 100 to the US dollar was in 1995. Then, it was overvalued. Now, adjusted for relative inflation, it appears fairly valued.

**Activity:** Consensus forecasts are for Japan to grow by 1.3% in 2010 compared to a 3.1% pace for the US economy.

**Liquidity:** There is a modest net short position in the yen futures market against the US dollar. Current ultra-low US interest rates mean that the yen does not have its historical yield disadvantage, though this is set to change as we forecast US interest-rate increases this year. A small short position in yen does not appear significant and could easily rise if investors use yen funding to take positions in higher yielding assets as their risk appetite increases on the back of the recovery.

**Risk:** The performance of the yen during last year's market turmoil clearly identifies it as a beneficiary of increased risk aversion and de-leveraging. However, the new Japanese Finance Minister has talked of the need for a weaker yen in conjunction with the new budget stimulus and action from the Bank of Japan to support the relatively fragile Japanese economic recovery.

**Momentum:** The recent weakness of the yen appears to have broken the positive technical trend.



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