

FX & INTEREST RATE MONTHLY

Interest rates are forecast to stay low for longer in the G4.

Unconventional monetary policy measures are expected, driving further volatility in G4 exchange rates.

We continue to prefer the US dollar among the major currencies...

...but our focus is still on higher-yielding commodity and emerging market currencies.

A continuing but weak global economic recovery leads us to expect that interest rates will remain at low levels for an extended period in the G4 economies (the US, euro-zone, Japan and the UK). While we still predict that rates will rise next year (except, of course, in Japan), **we see scope for longer-term rates to decline further**, despite the yield on the benchmark ten-year German bund already at record lows below 2.5%.

With growth in developed economies expected to be subdued and interest rates at rock-bottom levels, central banks are poised to introduce further unconventional monetary policy measures, be they quantitative easing (QE) or other methods to stimulate the money supply and to keep short and long-term interest rates low. Such measures have generally had a negative impact on the local currency, producing sharp swings in FX markets. **We believe that unconventional monetary policy measures in the G4 are more likely than not over the next year**, with the US expected to lead the way. This will drive further FX volatility, but will not necessarily dictate the trend, as previous experience suggests that while early policy moves may see a currency hit, late movers suffer more.

The US economy has weakened the most obviously in recent months, and the Federal Reserve is leading the discussion over the use of further QE to tackle deflationary pressures. The market's retreat from June's high represents the pricing in of QE expectations and the postponement of interest rate rises. With these issues also set to affect the other major developed economies, we see the US dollar as relatively attractive. The yen seems most at risk, with policymakers bemoaning the impact of currency strength. Higher interest rates offer support to the euro, but only at the expense of increasing the pressure on the weak peripheral economies. **That leaves sterling appearing in a relatively favourable light**, although the Bank of England is also discussing QE.

Our positive forecast for most emerging market and 'commodity' currencies is not based on an overly-optimistic view of global recovery and commodity prices. Rather it is because the problems of developed economies will continue to weigh on G4 currencies, with unconventional policy measures deployed to support growth exerting further pressure. Provided the recovery continues to provide a degree of stability to the global economy, **we expect investors to continue to move capital into the healthier economies of the emerging world, as well as Australia and Canada.**

Currencies	Spot 17/08/2010	RBS Forecast (as of 12 Aug)				Past Performance (in %)					
		Dec-10	Mar-11	Jun-11	Sep-11	-1W	-1M	-3M	-6M	-12M	YTD
Euro vs Dollar	1.29	1.20	1.15	1.12	1.12	-1.7	-0.6	4.3	-5.7	-8.5	-10.3
Yen vs Dollar	86	90	92	95	98	0.3	1.0	7.5	5.8	9.4	8.1
Sterling vs Dollar	1.56	1.52	1.49	1.47	1.47	-1.0	1.5	8.0	-0.9	-4.5	-3.5
Swiss Franc vs Dollar	1.04	1.10	1.13	1.18	1.21	1.5	0.5	8.1	3.0	3.4	-0.9
Swiss Franc vs Euro	1.34	1.32	1.30	1.32	1.35	3.1	1.2	4.2	8.6	11.7	9.5
Australian Dollar vs Dollar	0.90	0.90	0.90	0.91	0.94	-0.6	3.5	2.8	0.5	10.1	0.5
Euro vs Sterling	0.83	0.79	0.77	0.76	0.76	-0.7	-2.2	-3.5	-5.1	-4.4	-7.6
Renminbi vs Dollar	6.79	6.70	6.65	6.60	6.55	-0.3	-0.3	0.5	0.6	0.6	0.5

	Growth (GDP)			Inflation (CPI)			Interest Rates					Decision
	2009	2010(C)	2011(C)	2009	2010(C)	2011(C)	Current	Dec'10 (F)	Mar'11 (F)	Jun'11 (F)	Sep'11 (F)	Next Date
US	-2.4	3.1	3.0	-0.3	1.7	1.5	0.25	0.25	0.25	0.25	0.75	07-Sep-10
UK	-4.9	1.3	2.1	2.2	3.0	2.3	0.50	0.50	0.50	0.75	1.00	09-Sep-10
Eurozone	-4.1	1.1	1.4	0.3	1.5	1.5	1.00	1.00	1.25	1.75	2.00	02-Sep-10
Japan	-5.3	3.2	1.6	-1.4	-1.0	-0.2	0.10	0.10	0.10	0.10	0.10	07-Sep-10

(C) Consensus Forecast

(F) RBS Forecast

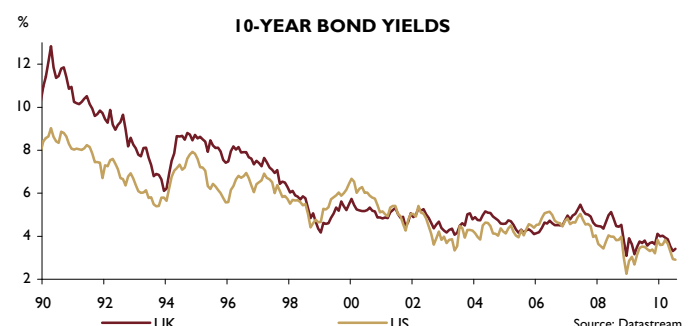
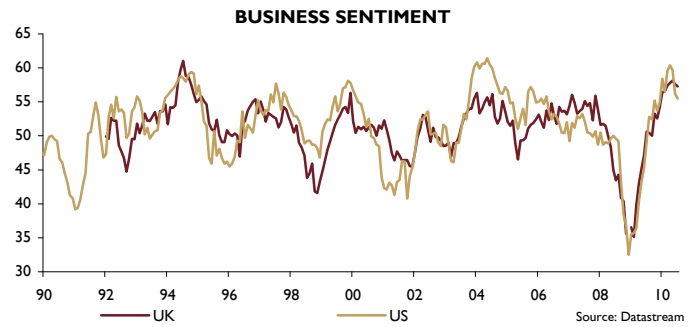
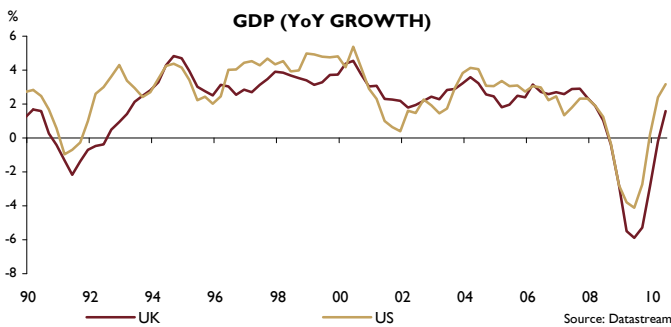
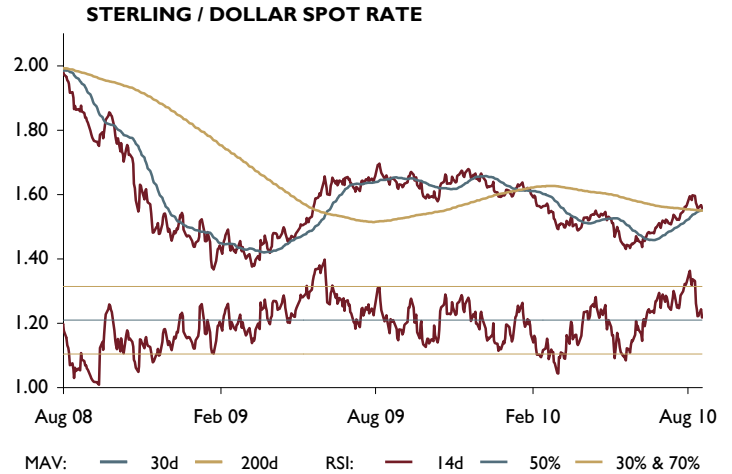
STERLING vs DOLLAR

Recommendation	Time Horizon:	3 Months
New	Previous	Conviction
Negative	Negative	

Performance (as of 17/08)	-1M	-3M	-6M	-12M	YTD
Sterling vs Dollar (Reuters)	1.5	8.0	-0.9	-4.5	8.4

Recommendation: With the recent rally taking it back to the top of its recent range, we are cautious about the short-term outlook for sterling against the US dollar. The UK economy is under pressure from fiscal tightening and the Bank of England is second only to the Fed in its openness to further QE. However, the UK's coherent political and economic response to its problems gives us greater confidence for the long term, and underlines our preference for sterling over the yen and euro.

- Valuation:** Sterling is still towards the bottom end of its 20-year trading range against the US dollar.
- Activity:** The UK economy is expected to continue to lag, with consensus expectations of 1.3% growth in 2010 compared with 3.1% for the US economy.
- Liquidity:** The record net short position in sterling futures held by investors just three months ago has now been closed. This has accompanied sterling's rally. Both currencies effectively have a zero yield, so there is little to choose from on this basis, although we currently forecast that the UK will be first to raise interest rates in early 2011, ahead of the predicted US move towards the end of next year.
- Risk:** With a coordinated political and economic response to the deficit issue, we believe that the outlook for the UK has improved and investors are increasingly focusing on the US deficit ahead of the mid-term elections.
- Momentum:** The recent sterling rally has not yet challenged the longer-term technical downtrend, indicating the prospect of a retracement of at least some of its recent gains.

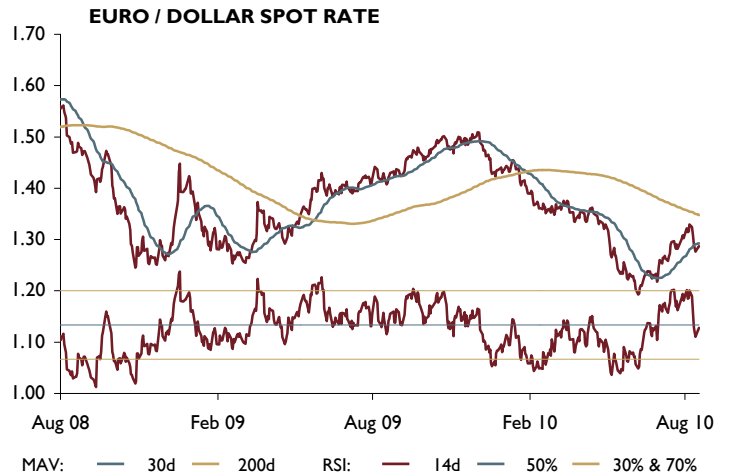


EURO vs DOLLAR

Recommendation	Time Horizon:	3 Months
New	Previous	Conviction
Negative	Negative	

Performance (as of 17/08)	-1M	-3M	-6M	-12M	YTD
Euro vs Dollar (Reuters)	-0.6	4.3	-5.7	-8.5	-10.3

Recommendation: The euro has rallied, buoyed by renewed commitment by EU institutions to provide support to the financial system. While we believe that a break-up of the euro-zone appears unlikely in the short term, our concerns over longer-term structural issues remain. While there are no obvious short-term catalysts to our negative view, we would continue to reduce exposure to the euro at current levels.



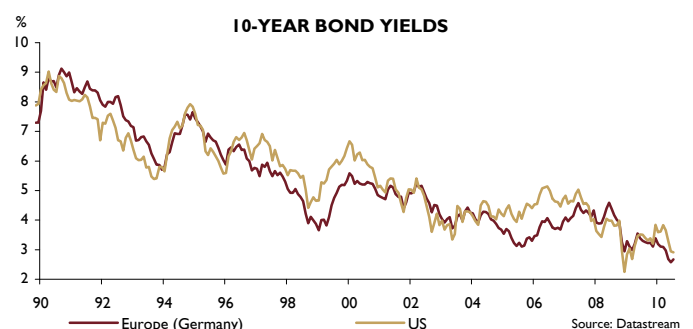
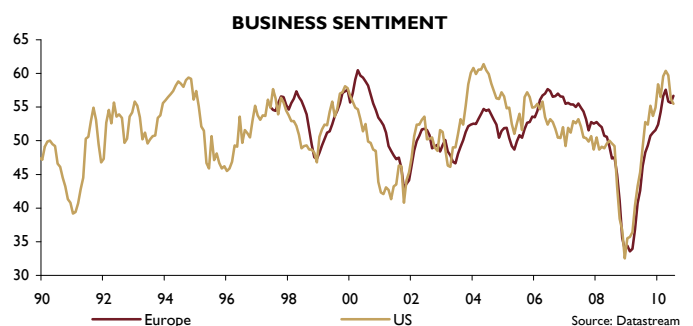
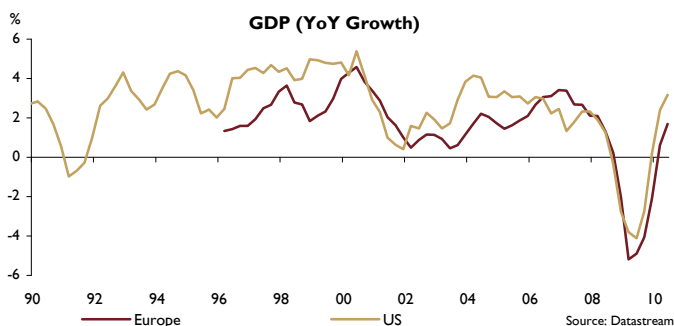
Valuation: The euro is close to its fair value on a purchasing parity basis and its ten-year average of \$1.20. The range over the ten years of the euro's existence has been huge, from \$0.82 to \$1.58.

Activity: While both US and euro-zone 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: The record net short position in euro futures held by investors just three months ago has now been closed. This has accompanied the bounce in the value of the euro. Investor positions are now in balance, though the euro has a yield advantage over the dollar.

Risk: The European Union bank stress tests and the €750bn backing for the European Financial Stability Facility has shown the commitment of politicians to EU institutions and the euro-zone. However, while this supports our contention that a break-up of the euro-zone is very unlikely in the next couple of years, it does not address the diverging levels of competitiveness that create longer-term structural problems for the euro.

Momentum: The recent euro rally has not yet challenged the longer-term technical downtrend, indicating the prospect of renewed weakness.

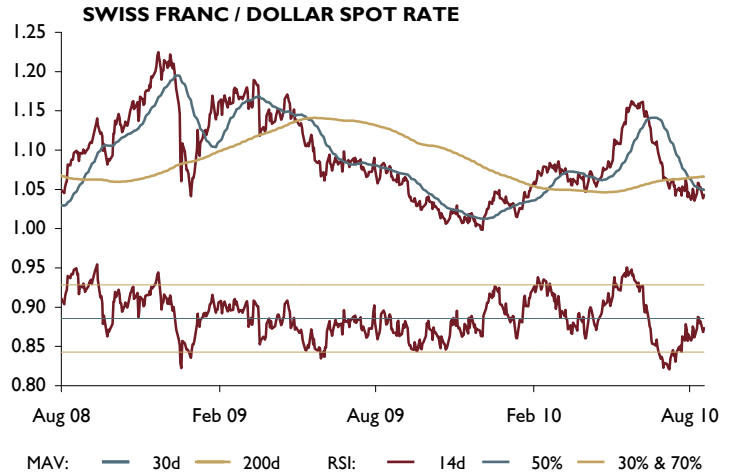


SWISS FRANC vs DOLLAR

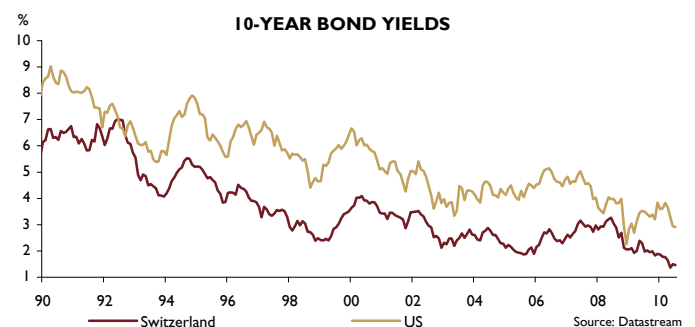
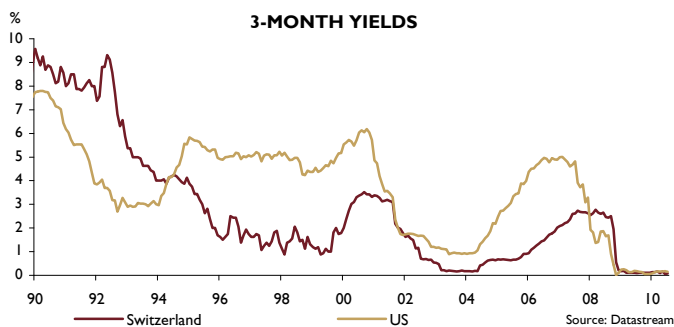
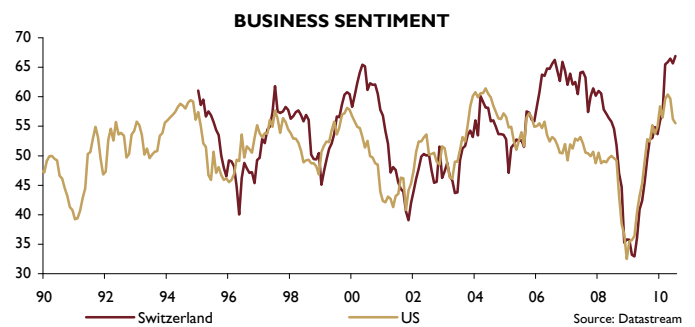
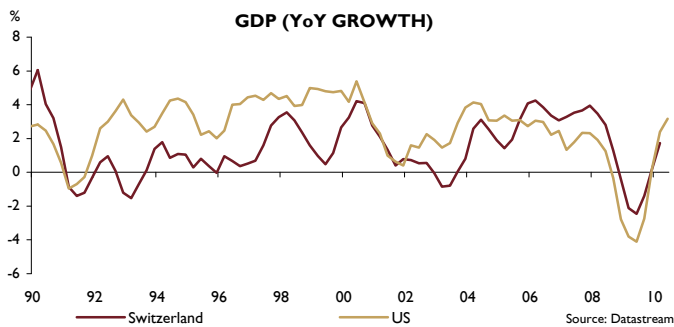
Recommendation	Time Horizon:	3 Months
New	Previous	Conviction
Negative	Negative	

Performance (as of 17/08)	-1M	-3M	-6M	-12M	YTD
Swiss Franc vs Dollar (Reuters)	0.5	8.1	3.0	3.4	-0.9

Recommendation: We see the franc as overvalued against the dollar, since its rapid appreciation in the wake of the end of FX intervention by the Swiss National Bank. A five-fold increase in foreign currency reserves since March 2009 curtailed further intervention in the face of increased domestic inflation risks. However, the franc may still make further modest gains against the euro.



- Valuation:** The Swiss franc still stands close to the top of its long-term historical range versus the dollar.
- Activity:** With the global economy now clearly growing, we would expect the US economy to see a stronger recovery, with a consensus forecast of 3.1% growth compared with 2.0% for Switzerland in 2010.
- Liquidity:** Investor positions in the futures market are long of the Swiss franc against the US dollar. This could drive a rally in the dollar if it is unwound. The Swiss National Bank has withdrawn from its previous commitment to fight 'excessive appreciation' of the Swiss franc, after FX reserves ballooned to five times their March 2009 level. We forecast that the SNB will raise interest rates in early 2011, while the US follows only at the end of the year.
- Risk:** The Swiss franc is a traditional safe haven for investors in times of market or economic uncertainty.
- Momentum:** The Swiss franc has rallied strongly and is now attempting to consolidate its technical position. The outlook is therefore closely balanced, though marginally in favour of renewed weakness.



YEN vs DOLLAR

Recommendation	Time Horizon:	3 Months
New	Previous	Conviction
Negative	Negative	

Performance (as of 17/08)	-1M	-3M	-6M	-12M	YTD
Yen vs Dollar (Reuters)	1.0	7.5	5.8	9.4	8.1

Recommendation: Renewed concerns over the outlook for US growth and increased risk aversion among investors have driven the yen to new highs. However, we see the combination of weakening US demand and a strong yen undermining Japan's own recovery. With both the finance minister and the Bank of Japan highlighting the negative impact on growth from the unwelcome loss of competitiveness, we forecast that the yen will weaken.

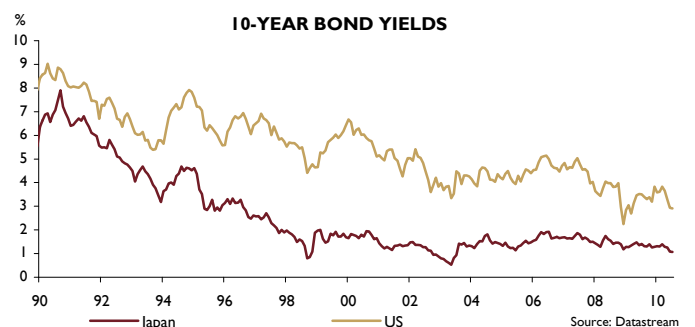
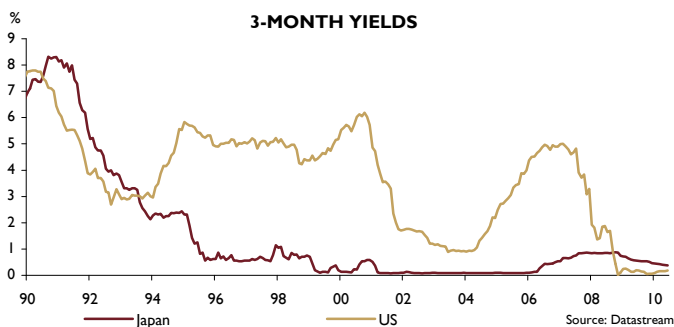
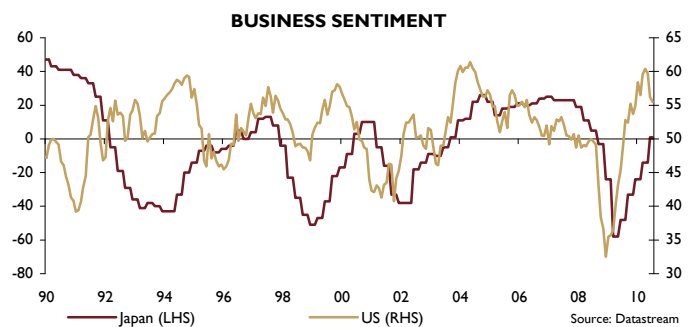
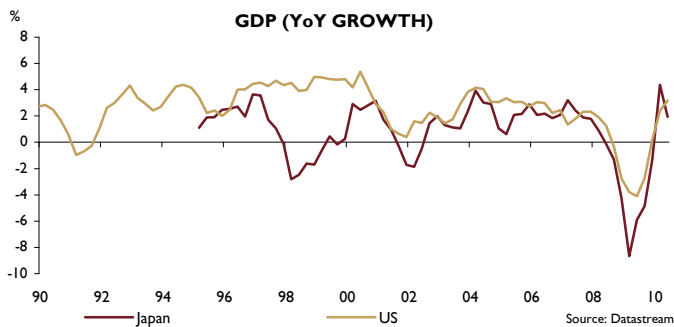
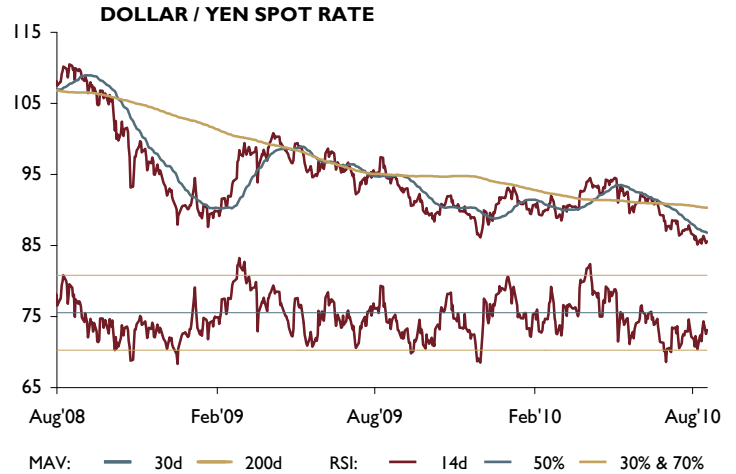
Valuation: The last time the yen was below 100 to the US dollar was in 1995. Then, it was overvalued. Now, adjusted for relative inflation, it appears little more than fairly valued.

Activity: While consensus forecasts are for Japan to grow by 3.2% in the current year, more than the US, the underlying trend is weaker. Expectations are for a slowdown to 1.6% for Japan in 2011, compared to a sustained 3.0% pace for the US economy.

Liquidity: Investors hold long yen positions against the US dollar in the futures market. Current ultra-low US interest rates mean that the dollar does not have its historical yield advantage, though this will eventually change as we forecast US interest rate increases by the end of next year.

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 Prime Minister has talked of the need for a weaker yen in conjunction with action from the Bank of Japan to support the relatively fragile Japanese economic recovery.

Momentum: The yen has hit new highs, underlining the positive technical position against the US dollar.



Issued by Coutts & Co, which is authorised and regulated by the Financial Services Authority. Coutts & Co is registered in England No. 36695. Registered office: 440 Strand, London WC2R 0QS.

The value of investments, and the income from them, can go down as well as up, and you may not recover the amount of your original investment. Past performance should not be taken as a guide to future performance. Where an investment involves exposure to a foreign currency, changes in rates of exchange may cause the value of the investment, and the income from it, to go up or down.

The information in this document is not intended as an offer or solicitation to buy or sell securities or any other investment or banking product, nor does it constitute a personal recommendation. The information is believed to be correct but cannot be guaranteed. Any opinion or forecast constitutes our judgement as at the date of issue and is subject to change without notice. Any Coutts company, or a connected company, its clients and officers may have a position or engage in transactions in any of the securities mentioned.

The analysis contained in this document has been procured, and may have been acted upon, by Coutts & Co and connected companies for their own purposes, and the results are being made available to you on this understanding. To the extent permitted by law and without being inconsistent with any applicable regulation, neither Coutts & Co nor any connected company accepts responsibility for any direct or indirect or consequential loss suffered by you or any other person as a result of your acting, or deciding not to act, in reliance upon such analysis.

Not all products and services offered by the individual Coutts companies are available in all jurisdictions, and some products and services may be available only through particular Coutts companies.

None of the overseas Coutts companies or offices is an Authorised Person subject to the rules and regulations made under the Financial Services and Markets Act 2000 for the protection of investors and depositors, and compensation under the Financial Services Compensation Scheme will not be available in respect of business transacted with them.