11 August 2018

Currency Overview

CURRENCIES
GLOBAL

August 2018

- We believe GBP's undervaluation is justified and is likely to persist
- We think JPY will likely remain trapped around current levels
- AUD and NZD may weaken given their vulnerability to slower global growth

Summary

GBP: GBP seems justifiably undervalued and we believe it should remain so. Our GBP-USD year-end forecast is 1.30.

JPY: JPY-USD remains trapped around current levels and we forecast the pair at 110 by year end.

AUD: We are bearish on AUD-USD due to its vulnerability to a deteriorating external backdrop. Our forecast is 0.70 by year end for the exchange rate.

NZD: We expect NZD-USD to weaken to 0.65 by year end as New Zealand-US interest rate differentials may weigh on the NZD.

CAD: We forecast USD-CAD to rise to 1.35 by year-end 2018, in part reflecting our general bullishness on the USD.

RMB (CNY): USD-RMB may weaken more if additional US trade actions lead to a slower China economy. We forecast 6.70 by year end for the pair.

SGD: We believe the MAS will continue with policy normalisation in October. We forecast USD-SGD to rise to 1.38 by year end.

INR: We forecast USD-INR to appreciate to 70 by year end. FX policy has been leaning against INR weakness.

Key upcoming events

Date	Event
4 September	RBA rate announcement
5 September	BoC rate announcement
13 September	BoE rate announcement
13 September	ECB rate announcement

Source: HSBC

HSBC currency forecasts

	Spot	Q3 18	Q4 18	Q1 19	Q2 19
EUR-USD	1.1529	1.15	1.13	1.13	1.13
GBP-USD	1.2828	1.32	1.30	1.30	1.30
USD-JPY	110.85	110	110	110	110
USD-CHF	0.9937	1.02	1.06	1.08	1.11
AUD-USD	0.7365	0.72	0.70	0.69	0.68
NZD-USD	0.6612	0.67	0.65	0.63	0.62
USD-CAD	1.3043	1.32	1.35	1.35	1.35
USD-CNY	6.8372	6.65	6.70	6.60	6.50
USD-SGD	1.3669	1.37	1.38	1.36	1.34
USD-INR	68.835	69.5	70.0	70.5	71.0
USD-MYR	4.0780	4.05	4.10	4.00	3.95

Source: HSBC, Thomson Reuters Eikon as at 12:15 HKT on the 10/08/2018

Central Bank policy rate forecasts (%)

	Current	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

Real GDP forecasts (%)

	2017	2018(f)	2019(f)
US	2.3	2.8	2.4
China	6.9	6.6	6.8
Japan	1.7	0.9	0.9
Eurozone	2.6	2.0	1.7
UK	1.7	1.3	1.5

Source: HSBC forecasts

HSBC

GBP: Cheap for good reason

- We believe GBP is justifiably undervalued due to an ongoing lack of clarity over the final destination of Brexit
- Without a definitive shift towards any single outcome, GBP movements are likely to be dominated by cyclical forces
- The August rate hike is now behind us and although GBP seems cheap we see no good reason for any substantive rally

We believe GBP's undervaluation is justified and that it is likely to persist. On the political front, we maintain that GBP is a weighted-probability blend of the different outcomes from Brexit negotiations, from 'no deal' through to 'no Brexit'. The UK government's "White Paper" on its vision of future UK-EU relations points to a relatively "soft" form of Brexit and, in isolation, would point to a stronger GBP.

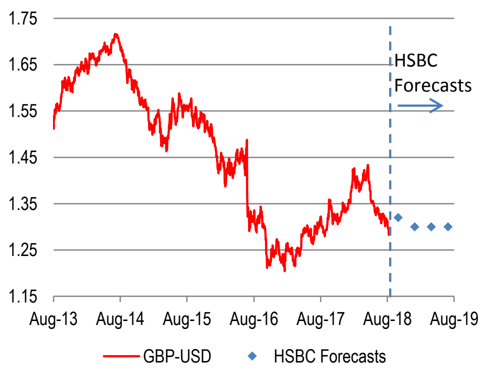
However, many issues still need to be resolved and tough negotiations lie ahead, both domestically and between the UK and EU. So it is possible that even when the UK leaves the EU on 29 March 2019, the final destination for Brexit may still not be clear. This may keep GBP in the limbo of not being able to price in a single outcome.

Political uncertainty adds to our belief that the Bank of England's (BoE) August rate hike is likely one and done. In other words we do not believe the BoE will hike again in 2018 or 2019. We are also less upbeat than the BoE on the economic outlook, with the central bank seemingly relying on a rather selective approach to the data.

But an uncertain and fractious political backdrop could be a further reason for BoE inaction. **Political drivers may outweigh cyclical drivers more as the clock ticks towards the admittedly uncertain deadline on negotiations.**

On a valuation basis we believe GBP is cheap. Using our valuation methodology, we think GBP-USD should be trading in the 1.45-1.58 area. However, given all these twists and turns on both the economy and on Brexit, we are sticking with our 1.30 year-end forecast for GBP-USD. **In short we think GBP is cheap and we believe it should remain so.**

GBP-USD



Source: HSBC, Thomson Reuters Eikon

FX	L-T view*	Spot	Support	Resistance	Past performance 1mth	3mth	6mth	Forecasts Q3 18	Q4 18	Q1 19	Q2 19
GBP-USD	→	1.2828	1.25	1.3173	-3.36%	-5.09%	-7.28%	1.32	1.30	1.30	1.30

Source: HSBC, Thomson Reuters Eikon as at 12:15 HKT on the 10/08/2018
*L-T = long-term

Bank of Japan adds flexibility

- The BoJ tweaked its policy framework, mainly by adding flexibility to its JGB operations including a wider range for the 10y yield
- The Bank has added a layer of sustainability without it being perceived as an exit from accommodative monetary policy
- The underwhelming policy tweaks introduced are not a game changer for the JPY

The Bank of Japan (BoJ) tweaked its policy setting at the July policy meeting. The changes were not to shift the overall policy stance with the Policy Balance Rate and 10y Japanese Government Bond (JGB) yield target unchanged at -0.10% and 0.00%. Instead, **the modification was to enhance the operational flexibility such that the easy policy setting can be maintained for a longer period of time**, given the Bank's lower inflation forecasts.

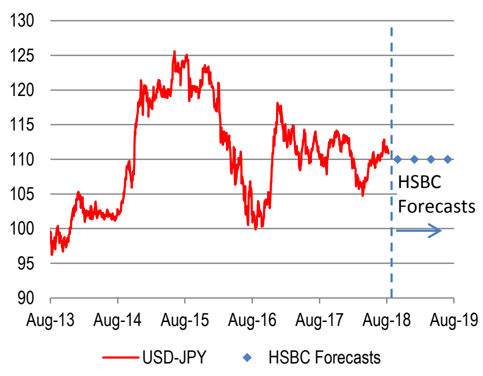
This was a meeting of tweaks and tinkering rather than a game-changing event for the JPY. The FX market will instead be forced to examine how shifts in language translate into policy responses in the coming weeks and months. In particular it will be interesting to see whether there is demonstrably greater tolerance for 10Y yields to drift further away from the 0% target, and how actively the market challenges the tolerance.

Perhaps more importantly, beyond the tweaks to language and policy parameters, the lower inflation projections are a reminder that attaining the 2% inflation target remains a distant aspiration, one which points to a sustained accommodative monetary policy in the meantime.

The persistent JPY weakness that such a strategy might imply will likely continue to be offset by factors favourable to the JPY. For example, the JPY should continue to benefit from occasional safe haven allure either during periods of wobbling global economic data or intensifying trade tensions.

On balance, we expect this will keep the JPY trapped and we forecast USD-JPY at 110 by year end. There was no drama at the BoJ meeting and the implications for the JPY are similarly undramatic. In a world where other central banks are actually tightening already or about to, the BoJ remains a laggard.

USD-JPY



Source: HSBC, Thomson Reuters Eikon

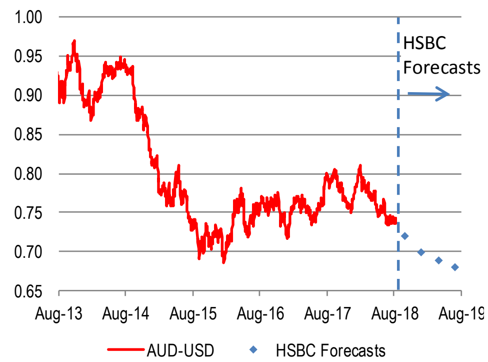
					Past performance			Forecasts			
FX	L-T view*	Spot	Support	Resistance	1mth	3mth	6mth	Q3 18	Q4 18	Q1 19	Q2 19
USD-JPY	→	110.85	109.97	112.15	-0.12%	1.34%	1.90%	110	110	110	110

Source: HSBC, Thomson Reuters Eikon as at 12:15 HKT on the 10/08/2018
*L-T = long-term

AUD: What lies beneath

- **We forecast the AUD-USD to fall to 0.70 by year end.** The AUD's vulnerability to a downturn in global growth and tighter financial conditions, alongside large external deficits, commodity price sensitivity and lower interest rate differentials, keeps us cautious.
- **On the surface, local cyclical drivers look quite healthy**. GDP growth is running around potential (2.5-3%), inflation seems to be edging up, albeit very gradually, and employment growth is relatively strong.
- **However, we think a number of factors could temper the rosy cyclical outlook and that higher US interest rates could weigh on the AUD.** These factors include sensitivity to a trade war, global growth concerns, declining house prices, pressure on disposable incomes with real wage growth at 0% and tighter lending conditions.

AUD-USD



Source: HSBC, Thomson Reuters Eikon

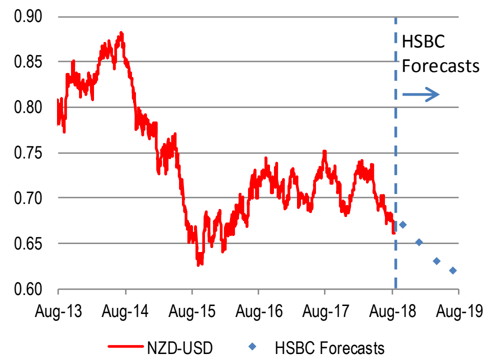
FX	L-T view*	Spot	Support	Resistance	Past performance 1mth	3mth	6mth	Forecasts Q3 18	Q4 18	Q1 19	Q2 19
AUD-USD	↘	0.7365	0.716	0.7464	-1.25%	-2.22%	-5.72%	0.72	0.70	0.69	0.68

Source: HSBC, Thomson Reuters Eikon as at 12:15 HKT on the 10/08/2018
*L-T = long-term

NZD: Cratering confidence

- **We believe the NZD-USD will continue to weaken, reaching 0.65 by year end.** Similar to the AUD, vulnerability to a deteriorating external back-drop may weigh on the NZD.
- Local cyclical drivers also look quite healthy on the surface with GDP growth near potential, inflation rising slowly and employment growth strong. **However, digging a little deeper suggests that lower New Zealand interest rates than in the US will continue to be a drag for the NZD.**
- Surveyed business confidence hit a ten-year low in July which has historically been a strong leading indicator on activity, associated with the pricing of rate cuts and a weaker NZD. **This leads us to believe the risk-reward for the NZD is skewed to the downside**.

NZD-USD



Source: HSBC, Thomson Reuters Eikon

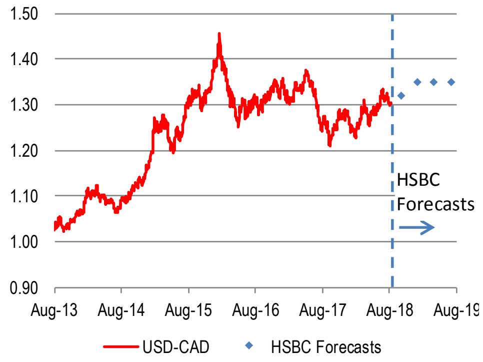
FX	L-T view*	Spot	Support	Resistance	Past performance 1mth	3mth	6mth	Forecasts Q3 18	Q4 18	Q1 19	Q2 19
NZD-USD	↘	0.6612	0.64	0.6835	-3.28%	-5.01%	-8.72%	0.67	0.65	0.63	0.62

Source: HSBC, Thomson Reuters Eikon as at 12:15 HKT on the 10/08/2018
*L-T = long-term

CAD: Good news largely priced in

- **We expect USD-CAD to rise to 1.35 by year-end 2018.** In part this reflects our general bullishness on the USD where the Fed remains on track to deliver rate hikes along the path laid out in its "dots" projections.
- **The CAD is enjoying support currently from a run of better than expected data but we believe most of the good news is now in the price**. The market is priced for another 25bp hike before year-end with a follow-up hike nearly fully priced for Q1 2019. The data needs to remain upbeat to support this pace of tightening, in our opinion.
- **The main threat to the economic outlook stems from trade uncertainty**. Negotiations over NAFTA continue but significant obstacles remain unresolved. The US administration's strategy of raising tariffs on the exports of its trading partners poses extra risks. Trade uncertainty poses a threat to export growth but it may also hold back investment appetite, a key support to the economy of late.

USD-CAD



Source: HSBC, Thomson Reuters Eikon

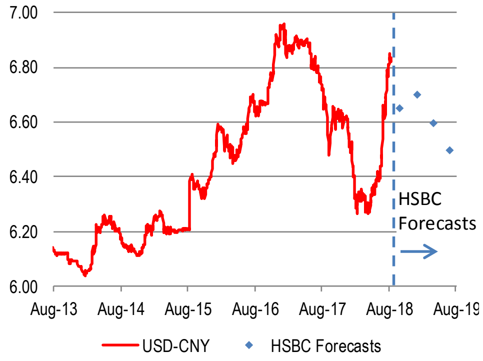
					Past performance			Forecasts			
FX	**L-T view***	**Spot**	**Support**	**Resistance**	**1mth**	**3mth**	**6mth**	**Q3 18**	**Q4 18**	**Q1 19**	**Q2 19**
USD-CAD	↗	1.3043	1.2966	1.329	-0.50%	2.18%	3.71%	1.32	1.35	1.35	1.35

Source: HSBC, Thomson Reuters Eikon as at 12:15 HKT on the 10/08/2018
*L-T = long-term

China (CNY): First warning

- **The People's Bank of China (PBoC) recently imposed a 20% reserve requirement (RR) on banks that sell USDs to clients using forward contracts.** The same 20% RR measure was first implemented in October 2015, after the PBoC observed a sharp rise in USD forward purchases.
- **This marks the first tightening step of the PBoC's FX policy, which had hitherto been 'hands-off' despite the sharp weakening of the RMB since mid-June.** The PBoC said it has to curb corporates 'pro-cyclical' behaviour that has emerged recently amid rising US-Sino trade frictions.
- This is in line with our view that the RMB will not be used as a retaliation tool amid US-Sino trade frictions**.** Nevertheless, **the RMB may weaken more, if additional US trade actions lead to a slower China economy and a further loosening of monetary conditions, hence a narrower China-US yield advantage**.

USD-CNY



Source: HSBC, Thomson Reuters Eikon

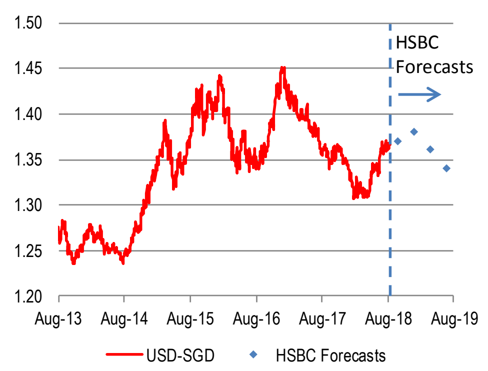
					Past performance			Forecasts			
FX	**L-T view***	**Spot**	**Support**	**Resistance**	**1mth**	**3mth**	**6mth**	**Q3 18**	**Q4 18**	**Q1 19**	**Q2 19**
USD-CNY	↘	6.8372	6.74	6.8935	3.13%	7.77%	8.59%	6.65	6.70	6.60	6.50

Source: HSBC, Thomson Reuters Eikon as at 12:15 HKT on the 10/08/2018
*L-T = long-term

SGD: Shaken, not stirred

- **We look for the USD-SGD to rise to 1.38 by year end.** We believe the Monetary Authority of Singapore (MAS) will continue with policy normalisation in October, by further increasing the slope of the policy band to 1%. However, its earlier conviction has probably been somewhat shaken by the unexpected escalation of US-Sino trade tensions.
- **The key variables we monitor for MAS policy** – labour market tightness, inflation expectations, and breadth of the growth recovery – **suggest that core inflation price pressures are building up as per the MAS's expectations**.
- **For now, market participants seem to be taking the cue from the MAS** and from the data (note: core inflation for June rose above the consensus forecast) – USD-SGD forward points fell in July despite the rise in spot.

USD-SGD



Source: HSBC, Thomson Reuters Eikon

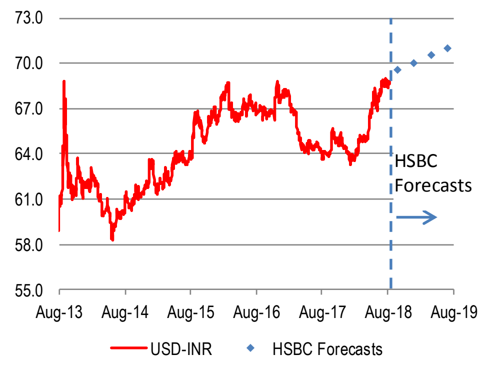
					Past performance			Forecasts			
FX	L-T view*	Spot	Support	Resistance	1mth	3mth	6mth	Q3 18	Q4 18	Q1 19	Q2 19
USD-SGD	↘	1.3669	1.3572	1.3746	0.74%	2.22%	2.82%	1.37	1.38	1.36	1.34

Source: HSBC, Thomson Reuters Eikon as at 12:15 HKT on the 10/08/2018
*L-T = long-term

INR: Rolling up its sleeves

- The INR moved on to steadier ground over the last month as the Reserve Bank of India (RBI) raised rates by 25bps to 6.50% in its August meeting while maintaining its 'neutral' policy stance. **We forecast the USD-INR to move up to 70 by year end.**
- Additionally, **FX policy has been leaning against INR weakness in a strong manner**. Data from the RBI suggest that it sold nearly USD25bn in Q2. This is comparable to the total intervention it did during the 'taper tantrum' in the middle of 2013.
- **The RBI is demonstrating greater determination to manage INR volatility** this time around in order to prevent a repeat of the experience during the 'taper tantrum' period, where the USD-INR surged over 25% in May-August 2013.

USD-INR



Source: HSBC, Thomson Reuters Eikon

					Past performance			Forecasts			
FX	L-T view*	Spot	Support	Resistance	1mth	3mth	6mth	Q3 18	Q4 18	Q1 19	Q2 19
USD-INR	↗	68.835	67.7395	69.1275	0.12%	2.37%	6.94%	69.5	70.0	70.5	71.0

Source: HSBC, Thomson Reuters Eikon as at 12:15 HKT on the 10/08/2018
*L-T = long-term

Glossary

Dovish	Dovish refers to an economic outlook which generally supports low interest rates as a means of encouraging growth within the economy
Hawkish	Hawkish is typically used to describe monetary policy which favours higher interest rates, and tighter monetary controls to keep inflation in check
MoM, YoY	Month on month, Year on year
RMB CFETS Index	This index refers to the currency basket accepted by China Foreign Exchange Trade System (CFETS) comprising 13 currencies vs. RMB
Libor	A benchmark rate that some of the world's leading banks charge each other for short-term loans
Curve	Refers to the yield curve for the respective country's sovereign bonds
2's-30's curve	Refers to the difference in yield between 2yr and 30yr sovereign bonds for the specified country
NEER	Nominal Effective Exchange rate
PMI	Purchasing Managers Index – an indicator of economic health of the manufacturing sector (>50 represents expansion vs. previous month)
QFII	Qualified Foreign Institutional Investor (QFII) is a program that permits certain licensed international investors to participate in China's mainland stock exchange. Quotas determine the amount that licensed foreign investors can invest in China's capital markets and these can be adjusted to reflect and respond to China's economic and financial situation
FDI	Foreign Direct Investment is an investment made by a company or entity based in one country, into a company or entity based in another country. It typically involves the investor having a significant degree of influence and control over the company in which the investment is made.

Fed	Federal Reserve System (US Central Bank)
ECB	European Central Bank (Eurozone Central Bank)
BoE	Bank of England (UK Central Bank)
BoJ	Bank of Japan (Japanese Central Bank)
BoC	Bank of Canada
PBoC	People's Bank of China (China Central Bank)
RBA	Reserve Bank of Australia
RBNZ	Reserve Bank of New Zealand
SNB	Swiss National Bank, the central bank of Switzerland
MAS	Monetary Authority of Singapore
BNM	Bank Negara Malaysia (Malaysia's Central Bank)
Mario/Draghi	Mario Draghi, President of the European Central Bank (ECB)
Powell	Jerome Powell, Chair of the Board of Governors of the Federal Reserve System (Fed)
Carney	Mark Carney, Governor of the Bank of England
Abe	Shinzo Abe, Prime Minister of Japan
Kuroda	Haruhiko Kuroda, Governor of the Bank of Japan

Explanation of terms	**Support (S), Resistance (R):** Significant previous lows and highs plus retracement levels. **Meaning of the arrows:** As per HSBC Global Research, an upward sloping (↗) / downward sloping (↘) arrow indicates that the first currency quoted in the pair is expected to appreciate/depreciate against the second currency quoted by the end of the last forecast period shown in the report. For example, an upward sloping arrow for EUR-USD means that the EUR is expected to appreciate against the USD by the end of the last forecast period. A sideways arrow (→) indicates that the currency is expected to be at a similar level to the spot price stated in the report by the end of the last forecast period. **Note:** The direction of the arrow is dictated by the difference between the spot price and the furthest forecast stated in the forecast table. Within that timeframe, it is quite possible that the currency is expected to move in an opposing direction. This is depicted both by the forecast 'dots' shown on the charts as well as in the forecast table.

Disclosure appendix

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