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Global FX Outlook

Foreign Exchange Strategy Team

October 2017

DISCLOSURE APPENDIX AT THE BACK OF THIS REPORT CONTAINS IMPORTANT DISCLOSURES, LEGAL ENTITY DISCLOSURE AND ANALYST CERTIFICATIONS.

Credit Suisse FX Forecasts as of 02 October 2017

		Spot	3-Month	12-Month
G10	EURUSD	1.20	1.22	1.25
	USDJPY	112	115	115
	EURCHF	1.16	1.16	1.18
	USDCHF	0.97	0.95	0.94
	GBPUSD	1.36	1.39	1.45
	USDCAD	1.23	1.20	1.15
	AUDUSD	0.79	0.81	0.82
	NZDUSD	0.73	0.74	0.75
	EURNOK	9.33	9.40	9.50
	EURSEK	9.53	9.40	9.15
EMEA	USDRUB	57.69	57.00	59.00
	USDTRY	3.49	3.40	3.75
	USDZAR	13.22	13.00	13.00
	EURPLN	4.27	4.27	4.27
	EURHUF	310	308	308
	EURCZK	26.08	26.00	25.50

		Spot	3-Month	12-Month
LATAM	USDBRL	3.14	3.05	3.00
	USDCLP	625	620	610
	USDCOP	2,916	2,850	2,800
	USDMXN	17.82	17.25	17.50
ASIA	USDCNY	6.59	6.45	6.50
	USDCNH	6.58	6.45	6.50
	USDIDR	13,321	13,000	12,800
	USDINR	64.92	63.00	62.00
	USDKRW	1,137	1,100	1,120
	USDMYR	4.20	4.10	4.00
	USDPHP	50.76	51.70	52.50
	USDSGD	1.35	1.34	1.34
	USDTHB	33.10	32.70	32.00
	USDTWD	30.19	29.50	29.20

Source: Credit Suisse

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USD: More downside, with political two way-risk

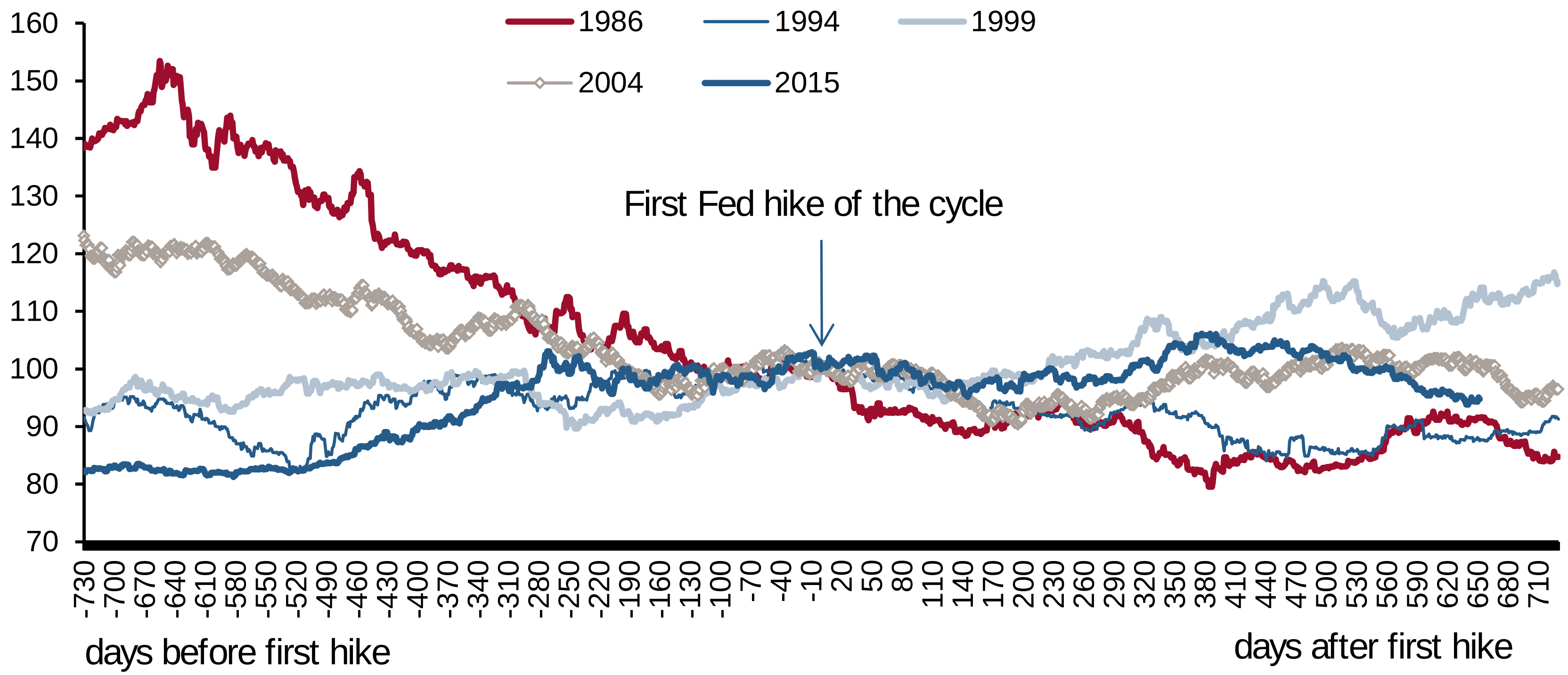
- Improvement in global growth momentum argues for further mild USD downside as CBs outside of the US shift hawkish
  - CS economists expect one more Fed hike in 2017, 2 in 2018. But they also expect strong economies outside the US, which limits scope for USD to benefit
  - Benign market response bodes well for currencies geared to global growth

- US politics dictate two-way risk for the USD:
  - Limited market expectations of successful US tax reform suggest USD could rally significantly if Administration were to introduce significant policy changes
  - Ongoing Mueller investigation is a source of uncertainty, would likely be USD negative if were to yield evidence of foul play

- FOMC composition in 2018 is a major unknown
  - 5 members of the FOMC (including the Chair) are up for nomination

USD: The dollar tends to weaken as the Fed hikes

- This largely reflects faster policy tightening outside of the US, in response to stronger global GDP growth



DXY indexed at 100 on day of first Fed rate hike in tightening cycle

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

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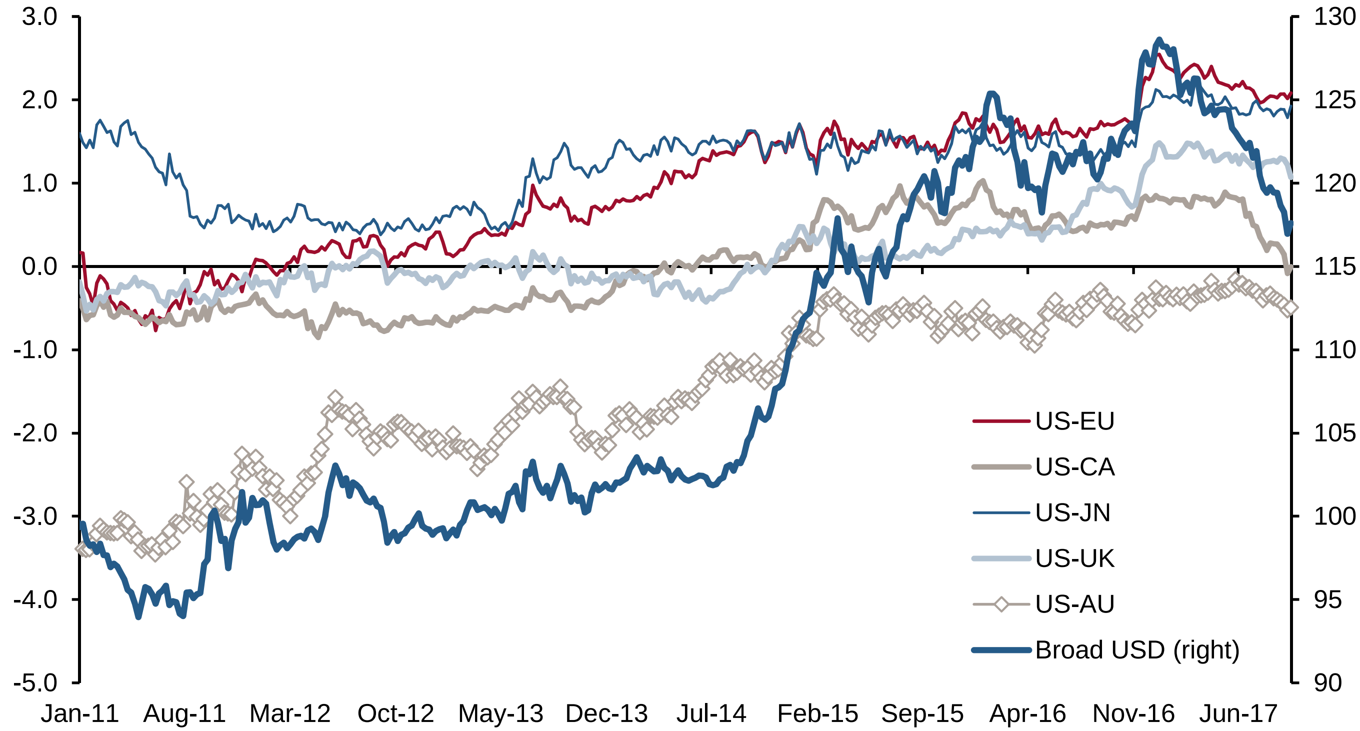
USD: The USD's rate advantage is eroding vs G10 FX

- The USD top in Jan '17 corresponds to peak US carry vs G10
- USD losing carry advantage as G10 central banks turn hawkish



5-year interest rate differentials (%)

Source: Credit Suisse, BEA, the BLOOMBERG PROFESSIONAL™ service

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EUR: Bullish

- **EURUSD forecast: 1.22 in 3m, 1.25 in 12m**

- EUR strength is likely preventing markets from pricing in aggressive ECB tightening, potentially allowing the ECB to taper asset purchases before hiking without excessive concern about market “tantrums”

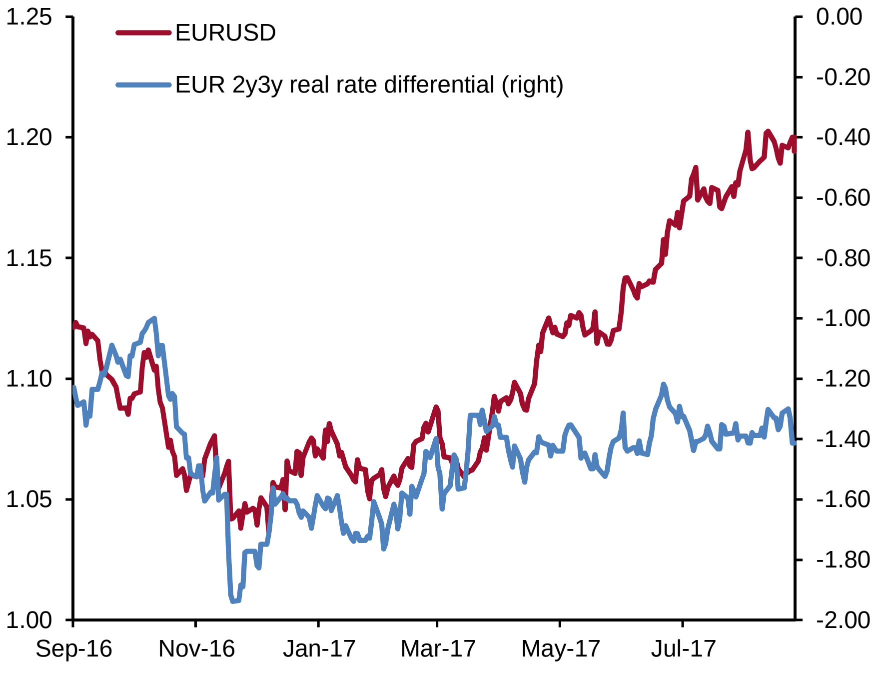
- Euro area growth appears to have entered a new phase of strong sustainable growth, inflation is still muted

- The BOP is still supportive and is likely to remain so in the long-term, especially as allocation to EUR by reserve managers remains low

- Italian elections remain a potential political tail risk, but less so in the light of the improvement in growth momentum

EUR: Diverging from rate differentials…and loving it!

- EURUSD has rallied above the level implied by rate differentials
- This reflects EUR strength hurting ECB tightening expectations,
- Is this a problem for EUR bulls? Not if the ECB approves of the mix of monetary conditions tightening this implies



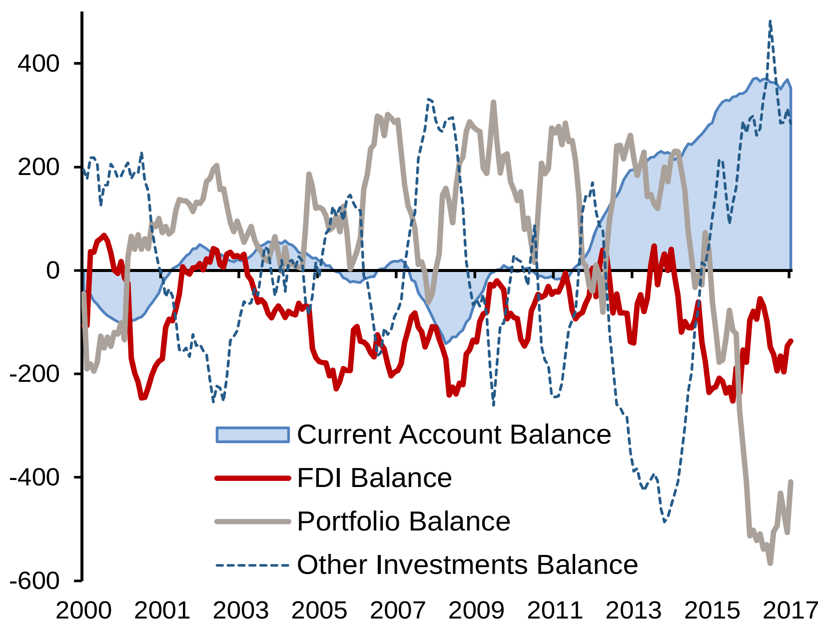
Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

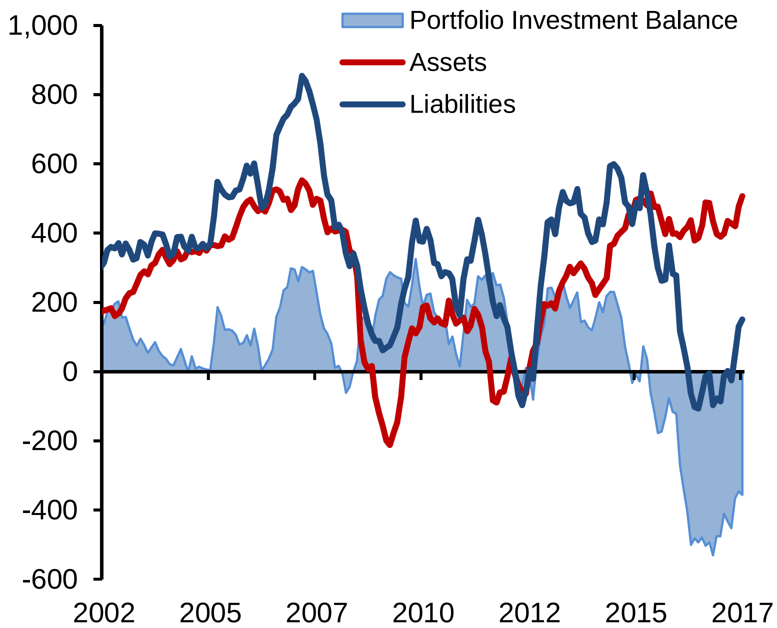
EUR: ECB set to chart monetary policy path in October

- Our economists expect the ECB to detail the future path of QE at their October 26 meeting, with a step down to 40bn EUR per month beginning in January 2018
- We then expect a move to 20bn by June 2018, a full taper by end-Q3 2018 followed by a rate hike in Q418 / Q119
- Our analysis shows that euro-area growth has become less sensitive to exchange rate fluctuations, and is increasingly driven by domestic demand
- We think that the ECB is relatively comfortable with the current exchange rate, and this “green-lights” further EUR gains

EUR: The BOP remains supportive

- Germany and northern European countries continue to drive a large trade surplus
- The recycling mechanism via portfolio flows is alive and well
- The rebound in portfolio liabilities is potentially very supportive





12m sums, EUR bn

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

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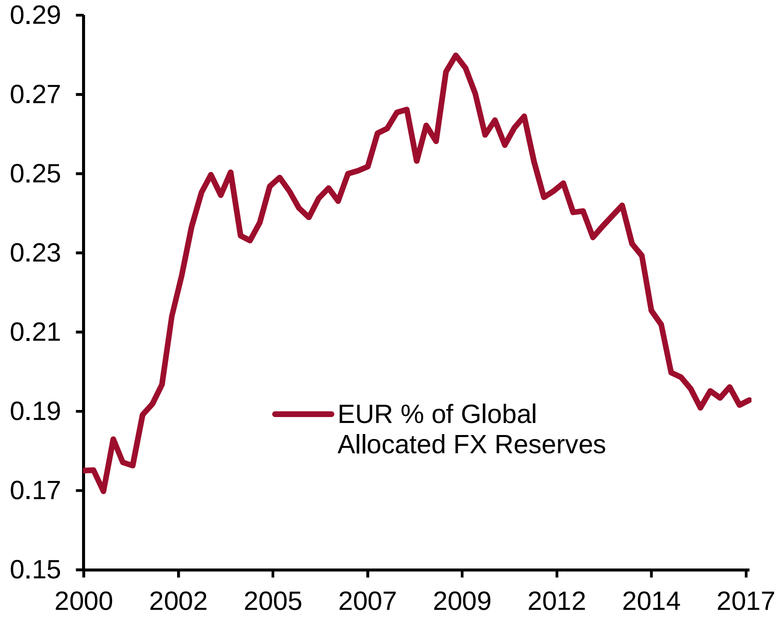
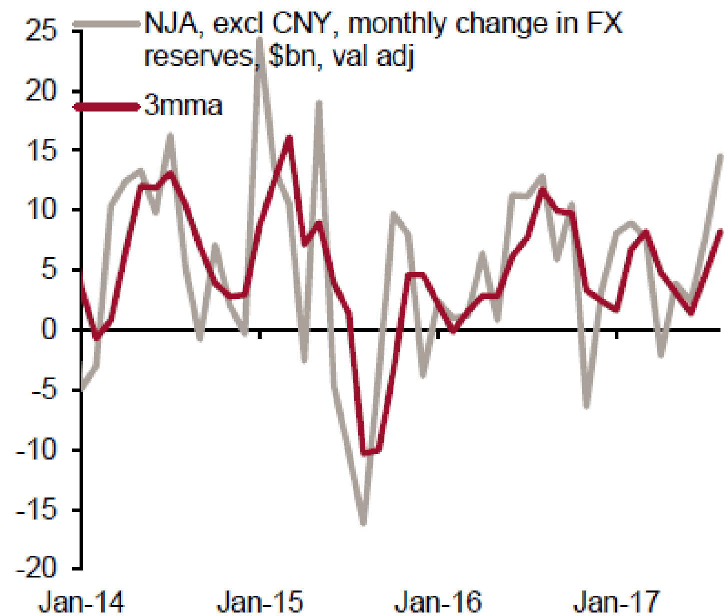
EUR: Under-owned by reserve managers

- EUR ownership by reserve managers never rebounded from the post Euro crisis dip
- The recent pick-up in global EM FX reserves is likely to provide an occasion to diversify into EUR assets





FX reserves change adjusted for valuation effects

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, IMF COFER

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GBP: Bullish

- **EURGBP forecast: 0.88 in 3m, 0.86 in 12m**
- **GBPUSD forecast: 1.386 in 3m, 1.454 in 12m**

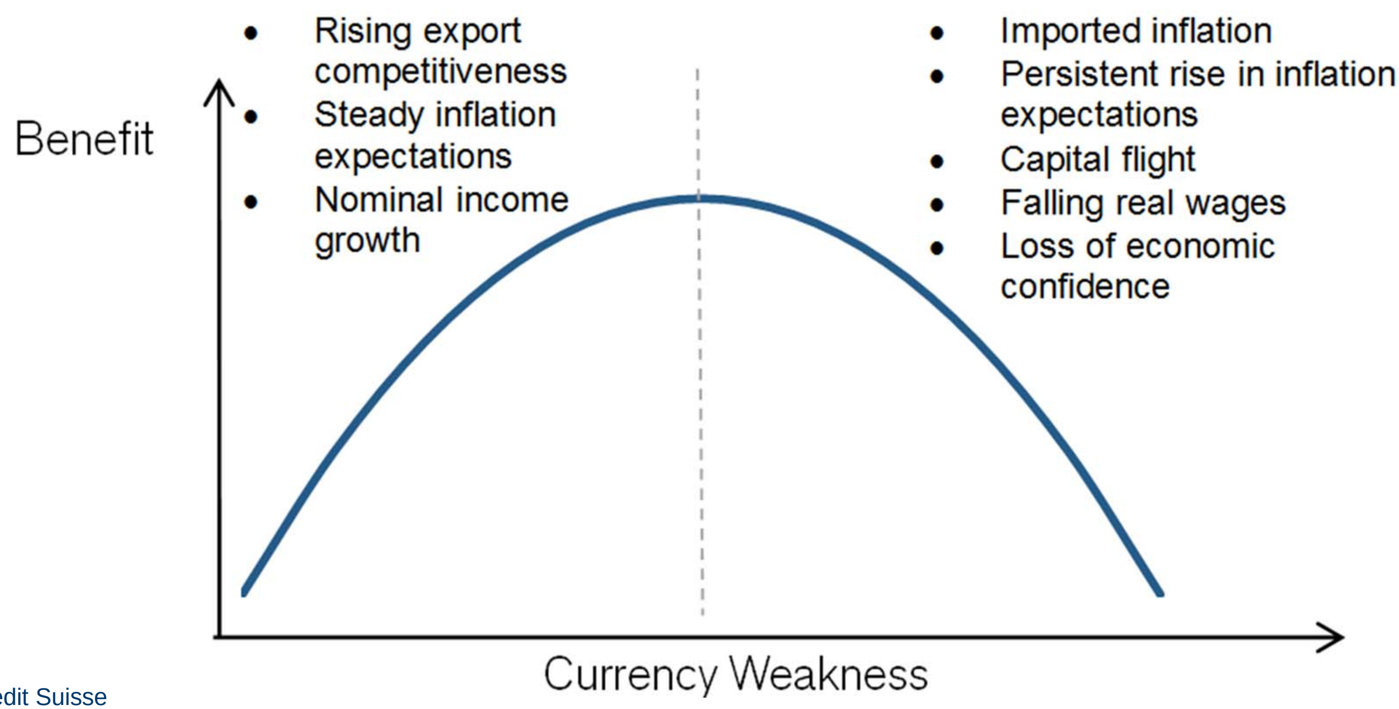
- The reorientation of the Bank of England's reaction function away from growth, wage, and Brexit risks in favour of targeting FX and supply-side induced inflation opens the way for further GBP strength

- The costs of currency depreciation now appear to exceed its benefits, with the BOE unlikely to stand in the way of further gains.

- We expect the probability of a negotiated transition period and soft Brexit over the medium term to rise, allowing the GBP to reverse some of its post-referendum undervaluation as underweight positions are unwound

GBP: A weaker pound is forcing the BOE's hand

- In the early stages of depreciation, policymakers may be unconcerned or welcoming, as this assists exports and reduces disinflationary tendencies.
- But eventually, a persistently weak currency can boost inflation expectations too far (as was the case in Mexico and Russia).

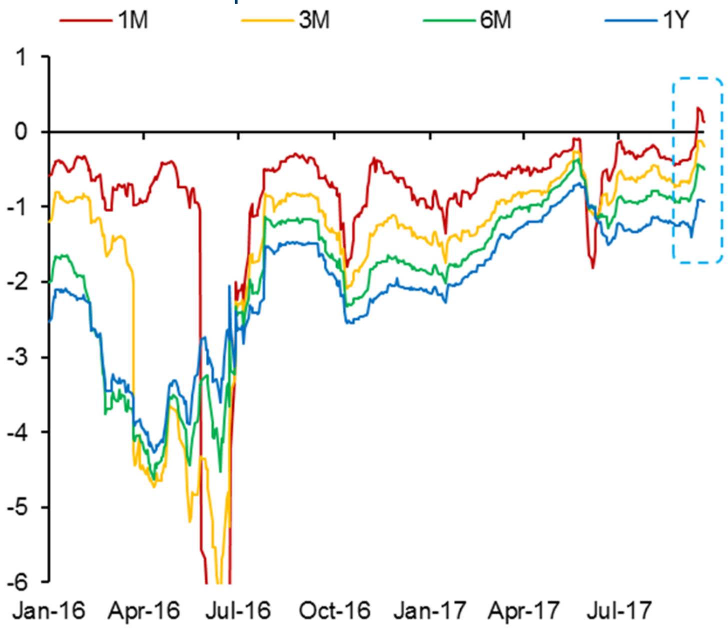


Source: Credit Suisse

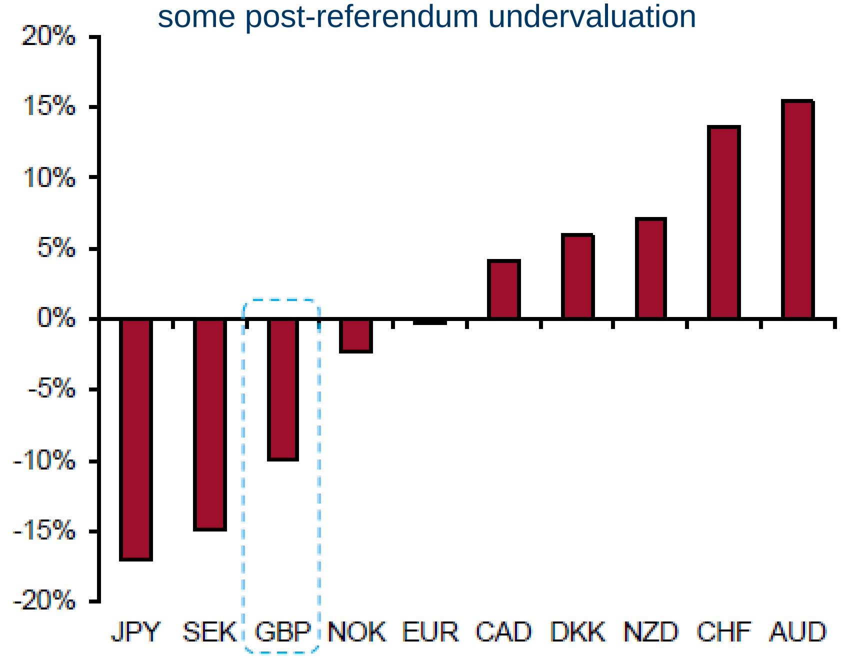
GBP: Softer Brexit to reverse undervaluation

- We expect post-referendum fears of “terms of trade” shock to GBP to ease as the path to soft Brexit becomes clear
- Longer term undervaluation of the GBP is then unjustified
- Risk reversals may then begin pricing more premium for GBP calls

GBPUSD risk reversals have begun pricing GBP calls at a premium over some tenors



Lifting of hard Brexit risks should allow GBP to recover some post-referendum undervaluation



Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

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CHF: Bearish, with further downside risks

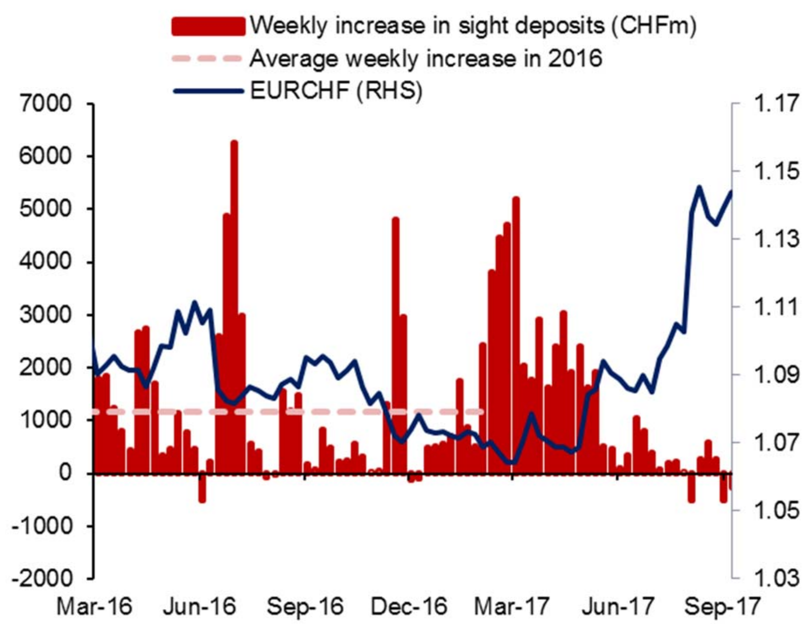
- **EURCHF forecast: 1.16 in 3m, 1.18 in 12m**
- **USDCHF forecast: 0.951 in 3m, 0.944 in 12m**

- Despite YTD depreciation, the CHF remains fundamentally overvalued
- The expected path of core inflation remains weak, with disinflationary effects from sub-groups outweighing exchange rate pass-through
- Strengthening global growth outlook increases the opportunity cost of holding CHF, as global rates accelerate higher
- Accumulated stocks of foreign assets in Switzerland risk an acceleration in capital outflows

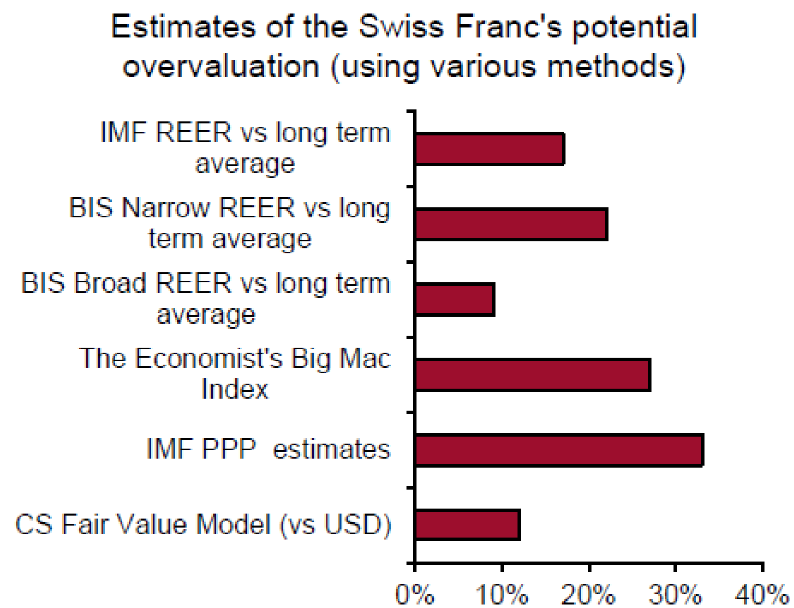
CHF: Bulls bereft of support

- Domestic stakeholders (SNB, exporters, residents holding foreign assets) are aligned in their opposition to a stronger CHF
- Fundamental overvaluation persists, despite YTD depreciation vs the EUR

SNB's need for intervention has fallen



The CHF remains fundamentally overvalued

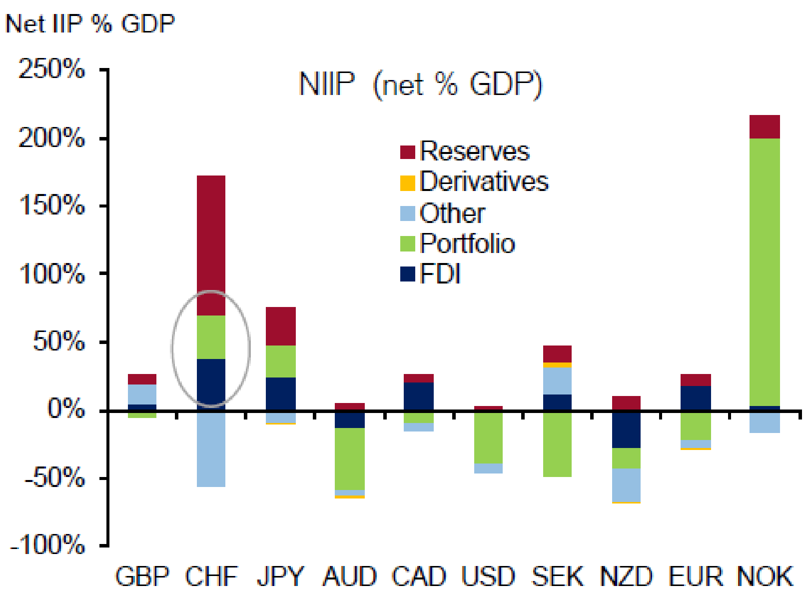


Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, Swiss National Bank

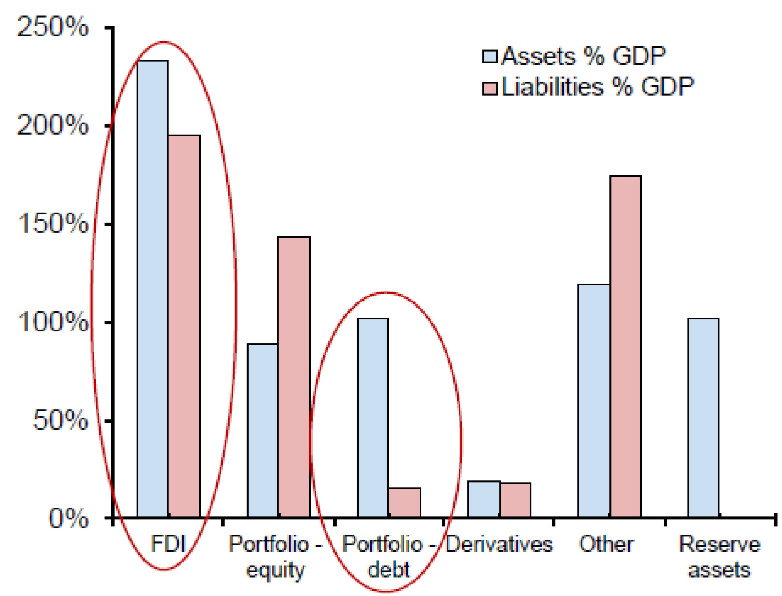
CHF: Capital outflows may have only just begun

- Rapid CHF depreciation suggests an unwinding of Swiss hedges on overseas assets
- Gross NIIP balances suggest more unwinding can come, counteracting a persistent current account surplus

Accumulated Swiss assets may see hedge shifts depreciation expectations



Gross foreign investments are sizeable compared to GDP



Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, Datastream

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