16 April 2014
Fixed Income Research
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FX Compass: The possibility of a euro ceiling

FX Strategy

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Recent dovish commentary from multiple ECB members, including President Draghi was the most attention grabbing macro development of the past few days, putting the euro on its back foot – as the potential for negative rates and even QE appear to be building. Our take is that President Draghi is trying to encourage the market to price for an effective ceiling on the trade-weighted euro – one which is adjustable in the event of surprises to growth or inflation.

Following the better-than-expected retail sales and CPI readings out of the US, the escalation of tensions in eastern Ukraine, and with US 10y yields stuck towards the bottom-end of their recent range, we are hesitant to continue chasing USD/EM lower in the near term.

Nonetheless, we maintain our view that in order for USD/EM to retest January highs, it will likely require a notable pick-up in US data, causing the market to bring forward their Fed policy expectations – either through an increase in the pace of taper or for an earlier “lift off” in rates. With expectations pretty well anchored for a constant $10bn/meeting taper, we continue to think the hurdle is high and remain biased for USD/EM downside on a carry-adjusted basis at better levels.

Focus: The possibility of a euro ceiling

We consider ways in which investors might seek to express the view that the ECB will indeed follow such an approach and introduce a policy of quantitative stimulus if necessary. Specifically, we consider the question from three angles:

- Rather than simply selling euro spot, what is the best risk/reward for expressing the view of a ceiling through the sale of EUR upside?
- To the extent that an investor is unable to gain exposure to the assets with most upside in the event of a programme of quantitative stimulus, what FX exposures are most attractive?
- From the perspective of a broad portfolio, what does limiting EUR upside change in driving positioning dynamics?

Trade recommendations

- We present different valuation metrics for selling EUR upside through options.
- We present three different dual digital option structures that combine exposure to USD upside vs. JPY, CAD, or AUD with limited EURUSD upside.

In this issue:

Macro View: Where to go?

EUR: Talking the talk vs. walking the walk

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Recent dovish commentary from multiple ECB members, including President Draghi was the most attention grabbing macro development of the past few days, putting the euro on its back foot – as the potential for negative rates and even QE appear to be building. President Draghi said that a strengthening of the euro "requires further monetary stimulus" and that that while the ECB does not have a target in mind for the euro, he stressed that its appreciation over the past year "was important for price stability".

Our take is that President Draghi is trying to encourage the market to price for an effective ceiling on the trade-weighted euro – one which is adjustable in the event of surprises to growth or inflation. In last week's *FX Compass*, we considered the implications for the euro of the apparent lowering of the bar for QE by the ECB.

While we think an ECB venture into asset purchases would be negative for the euro, especially against the dollar and growth-sensitive euro satellites, we also believe it is still not a likely near-term policy outcome. We believe it would likely require inflation outturns which reduce the medium-term inflation outlook. This implies increased market focus on upcoming data releases, especially the April flash HICP (30 April), which our economists expect to rise to 0.9%, reducing the near-term case for QE.

Market uncertainty could potentially last until the ECB produces its new inflation forecasts in June. Our economists argue that even if April's inflation disappoints, the ECB has other tools that it can employ first (refi and depo rate cuts or suspension of SMP drain).

Nonetheless, we believe the continued ECB focus on the euro's level might limit potential for euro upside in the near term, in our view. We suspect that part of the motivation for rolling out the QE option was to curtail potential further euro strength, hoping that an improvement in US data will eventually push EURUSD lower.

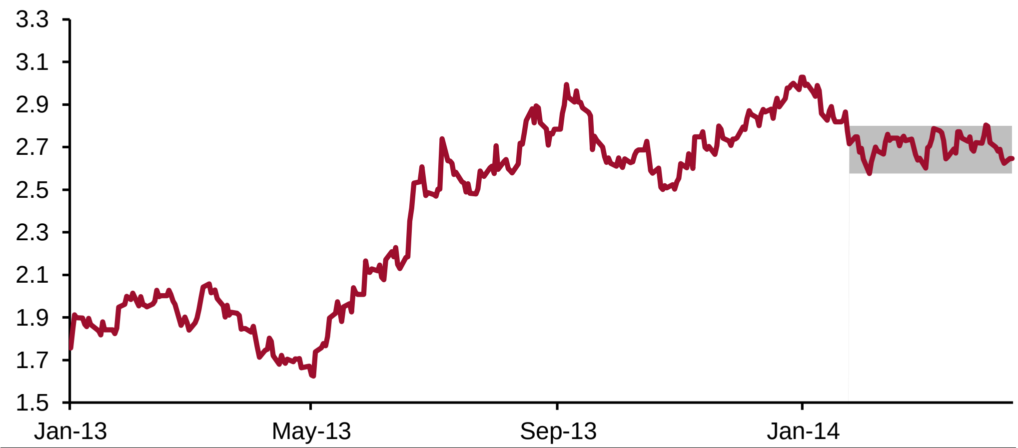
How much juice is left in EM?

Following the better-than-expected US retail sales and CPI readings data, the escalation of tensions in eastern Ukraine, and with US 10y yields stuck towards the bottom-end of their recent range (Exhibit 1), we are hesitant to continue chasing USD/EM lower in the near-term.

Nonetheless, we maintain our view that in order for USD/EM to retest their January highs, it will likely require a notable pick-up in US data, causing the market to bring forward their Fed policy expectations – either through an increase in the pace of taper or for an earlier "lift off" in rates. With expectations pretty well anchored for a constant $10bn/meeting taper, we continue to think the hurdle is high and remain biased for USD/EM downside on a carry-adjusted basis at better levels.

Exhibit 1: US yields have been in a tight range for most of 2014

US 10y yield (%)



Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

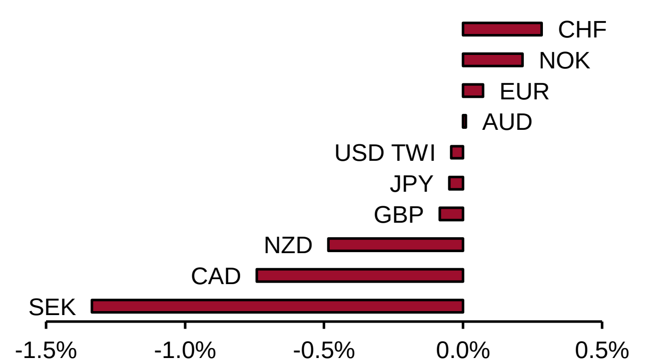
Weekly price action & positioning recap

USD TWI was little-changed on the week with SEK coming under pressure while NOK and CHF were the relative outperformers within G10. YTD, NZD and AUD remain the leaders, with USD TWI almost unchanged. Within EM, the complex was mostly weaker last week and remains mixed YTD to BRL leading the way while RUB lags.

Aggregate speculative positioning in the USD decreased 1pp and remains essentially flat. JPY speculative shorts increased, with net positioning decreasing 12pp, while AUD positioning continued to see shorts unwind, with net positioning in bullish territory for the first time since May 2013.

Exhibit 2: G10 five-day spot returns

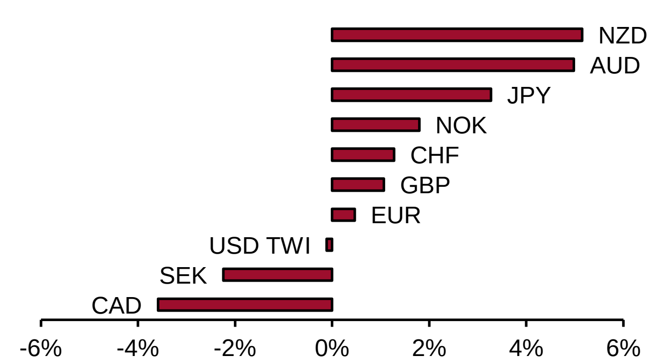
Percentage change versus USD



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Exhibit 3: G10 2014 spot returns

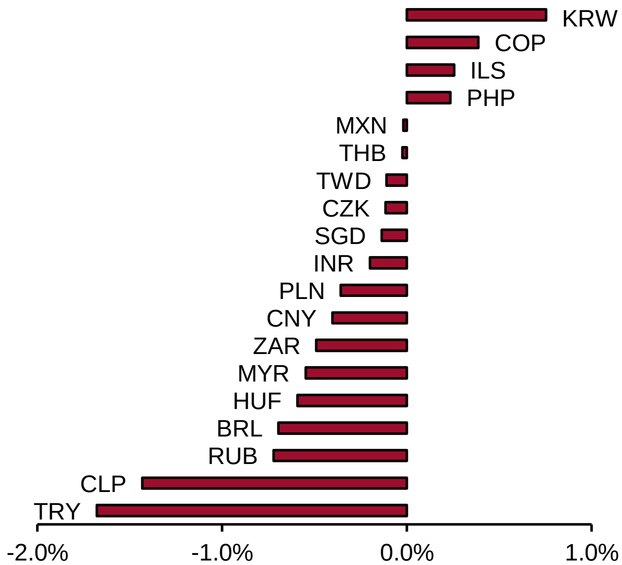
Percentage change versus USD



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Exhibit 4: EM five-day spot returns

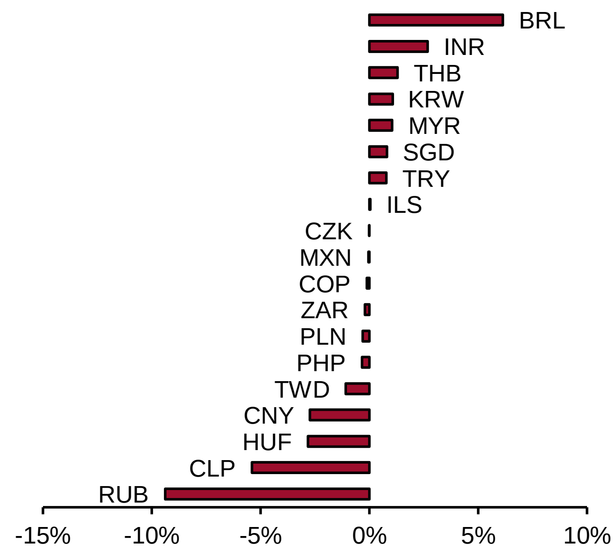
Percentage change versus USD



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Exhibit 5: EM 2014 spot returns

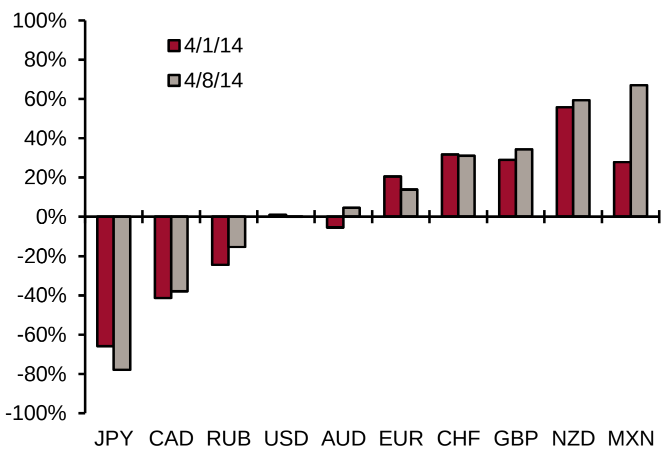
Percentage change versus USD



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Exhibit 6: Current positioning versus the prior week

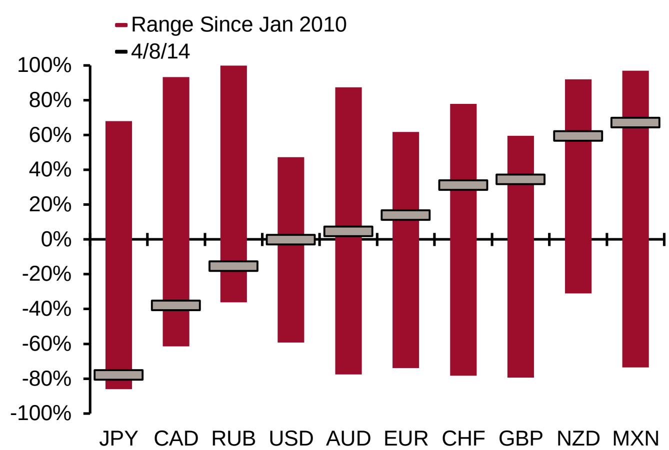
Net Speculative Positions as a % of Open Interest



Source: Credit Suisse, CFTC

Exhibit 7: Current positioning versus range since January 2010

Net Speculative Positions as a % of Open Interest



Source: Credit Suisse, CFTC

Focus: The possibility of a euro ceiling

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ECB President Draghi continues to encourage the market to price for an effective ceiling on the trade-weighted euro, albeit one which may prove to be adjustable in the event of surprises to growth or inflation.

In last week's *FX Compass*, we considered the implications for the euro of the apparent lowering of the bar for QE by the ECB, while in *Global Rates Atlas –The flight to normalcy*, our interest rate strategists consider some of the ways in which the ECB might seek to implement a programme of quantitative stimulus.

Below we consider ways in which investors might seek to express the view that the ECB will indeed follow such an approach and introduce a policy of quantitative stimulus if necessary. Specifically, we consider the question from three angles:

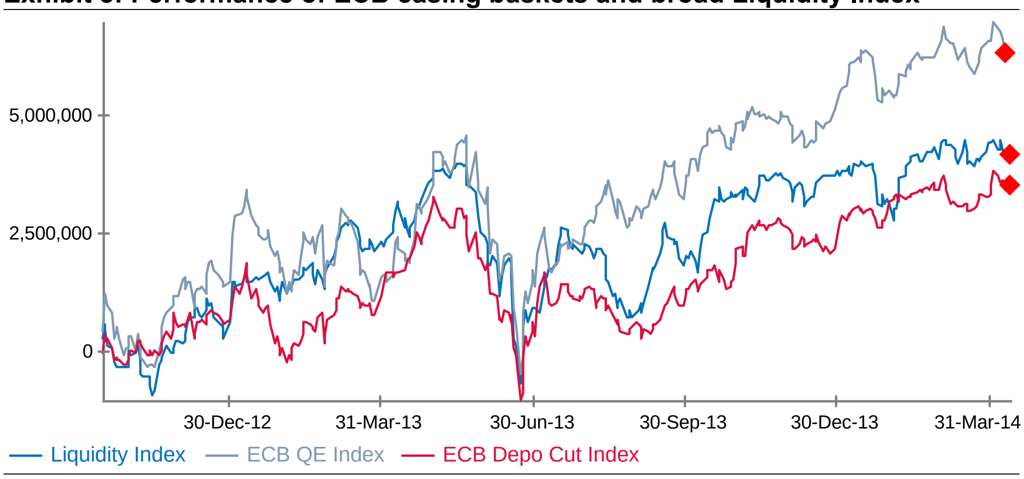
- Rather than simply selling euro spot, what is the best risk/reward for expressing the view of a ceiling through the sale of EUR upside?
- To the extent that an investor is unable to gain exposure to the assets with most upside in the event of a programme of quantitative stimulus, what FX exposures are most attractive?
- From the perspective of a broad portfolio, what does the limiting of EUR upside change in driving positioning dynamics?

The trading strategies that we consider include selling EUR/EM upside as well as a cash portfolio comprising EUR/EM shorts alongside EURCHF and EURJPY longs. However, the most attractive entry points are for strategies that seek to exploit what we expect to be an indirect effect of a credible EUR ceiling through the purchase of USD correlation. We detail these opportunities below.

Choosing FX exposure

In *Macro Tactics: Preparing for possible ECB next steps*, we outlined our attempt to construct baskets of trades that would offer exposure to ECB easing actions, presenting an ECB Depo Cut Index and an ECB QE Index. All of these are subject to the specific mechanism in which the ECB might execute its chosen strategy. However, in the context of recent developments, we believe that the ECB QE Index, consisting in steepening exposure in EUR rates, a long position in EUR inflation, short currency trades, as well as longs in bank equity, corporate credit and periphery bonds, would stand a very good chance of gains in value, having exposure to assets that the ECB could buy (such as corporate and peripheral bonds), as well as to those prices it would seek to influence (such as the euro and the inflation rate).

Exhibit 8: Performance of ECB easing baskets and broad Liquidity Index

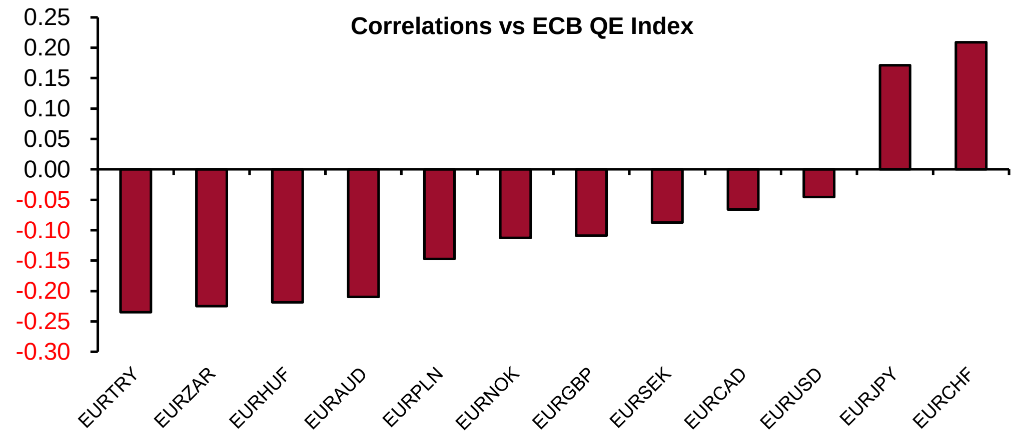


Source: Credit Suisse Locus

Acknowledging the inability of many portfolios to obtain exposure to the constituent assets of the ECB QE Index, we find it useful to examine the correlations of various EUR/G10 and EUR/EM FX pairs against the index, aiming to identify trades in FX space that could offer proxy exposure for the same view.

Exhibit 9: EUR/EM pairs most negatively correlated with the ECB QE Index

Based on 12-month correlations of daily changes



Source: Credit Suisse

It follows from the correlations presented in Exhibit 9 that investors would maximize their exposure to the view through a combination of EURJPY or EURCHF longs, and short exposure in EUR/EM pairs with high Eurozone growth exposure such as EURPLN, EURHUF, and EURTRY.

Our primary concern with this as a portfolio is its exposure to upside surprises in inflation that both hurt risky assets and make the market question whether a currency ceiling is at all credible.

Selling EUR upside through options

Investors can position for the view that the ECB might impose an effective ceiling in the value of the single currency through the sale of EUR calls, thereby collecting option premium and taking the view that a significant pay-out to the buyer of the calls is unlikely given the possibility of ECB action that would limit any move higher in the exchange rate.

The relatively high current level of the euro against most currencies offers an attractive entry point for the sale of such call options, while investors would also achieve mark-to-market gains if policy action (or talk) suppresses implied call skew. By contrast, the depressed level of implied volatility across most FX pairs is a cautionary factor, suggesting the need for careful selection of entry points for the strategy.

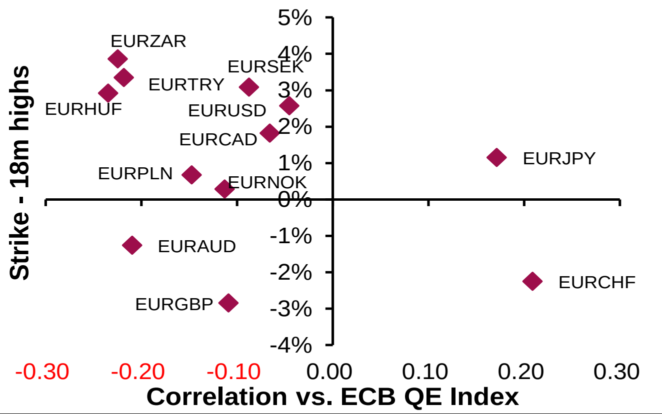
As explained above, our preference is for selling upside on those pairs that exhibit negative correlation against the ECB QE Index, i.e. exchange rates that would tend to move lower as the basket of pro-QE trades gains in value.

Exhibit 10 illustrates the risk/reward dynamics by incorporating both the level of correlation vs. the ECB QE Index and the distance between the 25-delta strike for 6-month EUR calls from the recent highs for the euro. The top-left quadrant contains the most attractive pairs on this basis, given their combination of negative correlations and reasonable “margin of safety” coming from a significant distance of strike from the euro highs.

Exhibit 11 provides an indication of the entry point for short call strategies from an implied skew perspective by illustrating the current percentiles for risk/reversals within their 12-month range. EURUSD, EURTRY, and EURSEK offer high skew entry points, while also sitting in the top-left of Exhibit 10 .

Exhibit 10: At expiry loss if we hit the highs

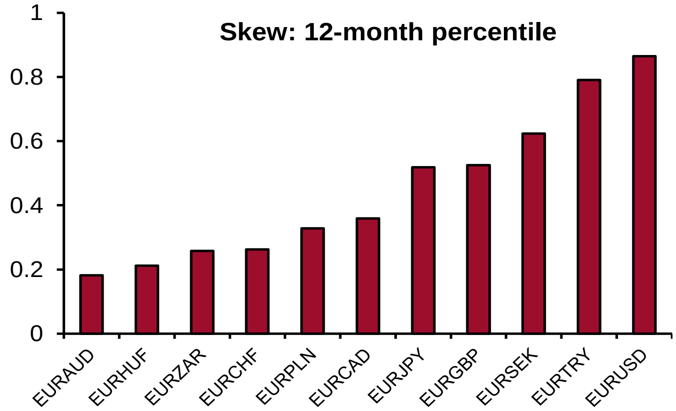
18-month high point for the euro used for each currency pair



Source: Credit Suisse

Exhibit 11: Level of skew

Percentile rank of 25d r/r versus 12-month history



Source: Credit Suisse

Stress testing the exposure

While selling upside through FX options is a strategy inherently exposed to potentially unlimited losses, we find it useful to get a sense of the potential losses for a scenario in which recent extremes are tested.

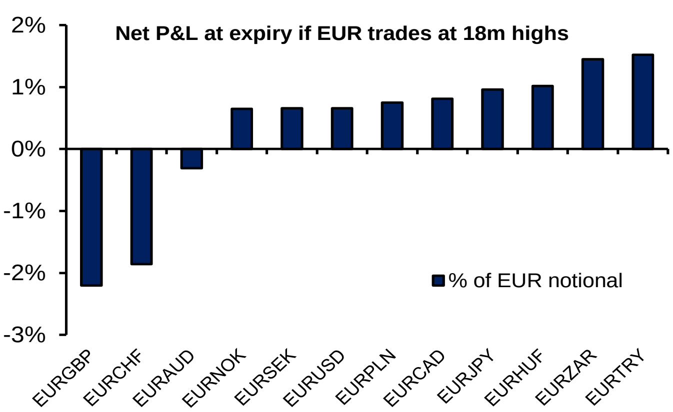
As discussed above, most trades offer a margin of safety with respect to spot moves given the distance between strike and recent highs: all-in P&L at expiry for most pairs is in the range of 0.5%-1.5% of notional (Exhibit 12), reflecting the fact that investors get to keep the entire premium in a scenario of not breaking those highs, having to make no payments as the sold calls expire out of the money.

From this standpoint, EURGBP and EURCHF present risks of sizeable losses (around 2% of notional), as the recent highs for these pairs (0.8766 and 1.2631) are sufficiently higher than the 25-delta strikes, so that a scenario of a bounce back to such levels would hurt the position materially.

Given the relatively long horizon for these trades, we also examine the possibility of losses generated by a spike in implied vol. Exhibit 13 shows the mark-to-market impact to the sold call positions in the event that vol rises to the highest levels of the last 18-month period. The impact is close to 40% of the premium received for most positions, but a lot higher for EURCHF and EURJPY, where vol has come down significantly from the highs.

Exhibit 12: Selling EURGBP or EURCHF upside would suffer sizeable losses if euro strengthened to the highs

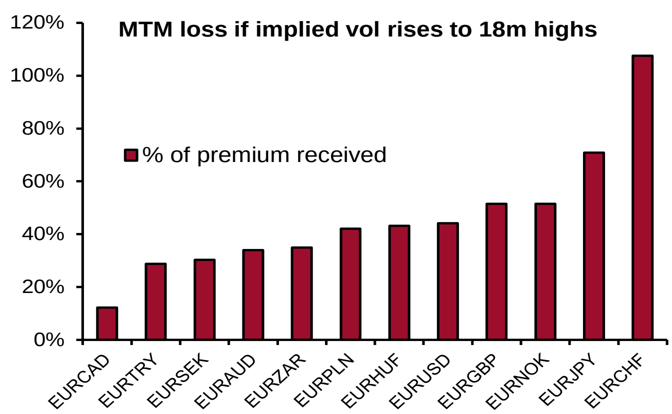
Includes premium collected. 18-month high point for EUR used for each ccy pair



Source: Credit Suisse

Exhibit 13: MTM losses in a vol spike towards recent highs would be most significant for EURCHF and EURJPY

As percentage of the premium collected

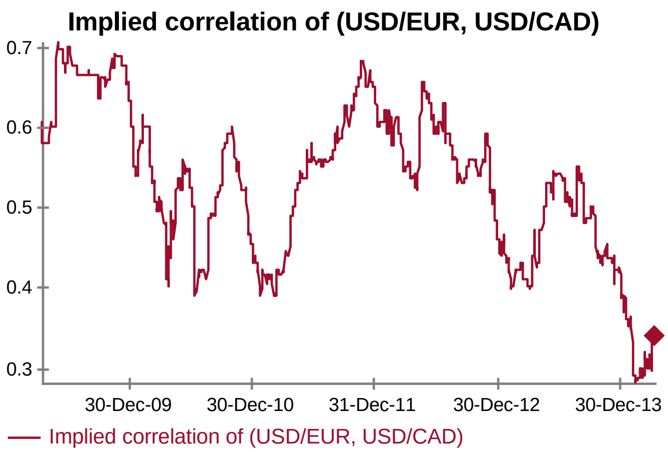


Source: Credit Suisse

Trading the theme through correlation structures

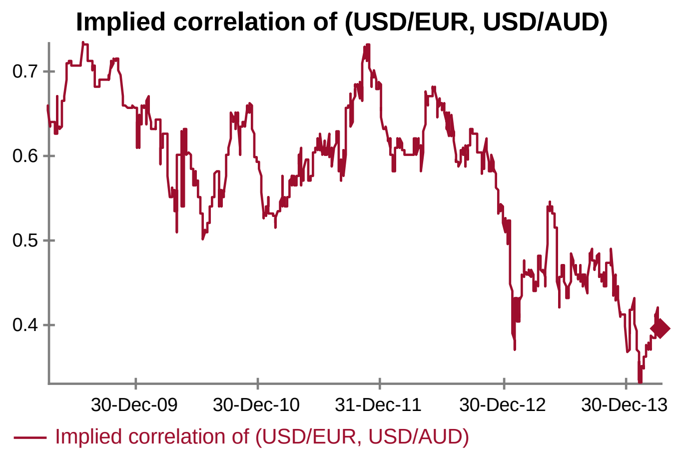
The final strategy that we consider is based on an expectation that a credible ceiling for the euro would reduce the euro's portfolio value to investors. With reduced ability to diversify away from the dollar, we would expect dollar implied correlation to rise from what are historically depressed levels. See Exhibit 14 - 16 .

Exhibit 14: USDEUR / USDCAD correlation has cheapened…



Source: Credit Suisse Locus

Exhibit 15: … as has USDEUR - USDAUD



Source: Credit Suisse

As an expression of this view, we consider a range of dual digital structures that pay out if EURUSD falls at the same time as the dollar rallies versus selected other pairs. Exhibit Exhibit 16 shows the implied correlations across the grid for the major FX pairs.

Exhibit 16: Implied correlation grid

Color grid sensitivities based on 12-month history

	USD/EUR	USD/CHF	USD/JPY	USD/GBP	USD/CAD	USD/AUD	USD/NZD
USD/EUR		0.90	0.23	0.55	0.34	0.39	0.41
USD/CHF	0.90		0.46	0.54	0.35	0.35	0.38
USD/JPY	0.23	0.46		0.27	0.24	0.25	0.26
USD/GBP	0.55	0.54	0.27		0.30	0.39	0.38
USD/CAD	0.34	0.35	0.24	0.30		0.51	0.49
USD/AUD	0.39	0.35	0.25	0.39	0.51		0.72
USD/NZD	0.41	0.38	0.26	0.38	0.49	0.72	

Implied Correlation, Tenor: 6M, Trader Quotation

Cheap (-2) Rich (2)

Source: Credit Suisse Locus

Source: Credit Suisse

Given the above, we present three different dual digital option structures that combine exposure to USD upside vs. JPY, CAD, or AUD with limited EURUSD upside:

- **Buy 6m EURUSD < 3% OTMS, USDJPY > 3% OTMS dual digital for 14%** of USD notional. Individual digitals cost 27% and 32.5% respectively.
- **Buy 6m EURUSD < 3% OTMS, USDCAD > 3% OTMS dual digital for 15%**. Individual digitals: 27% and 30.3%.
- **EURUSD < 3% OTMS, AUDUSD < 3% OTMS, offer 17%.** Individual digitals: 27% and 26% respectively.

The risk to these trades is limited to the premium paid.

AUD: Inflation prospects key

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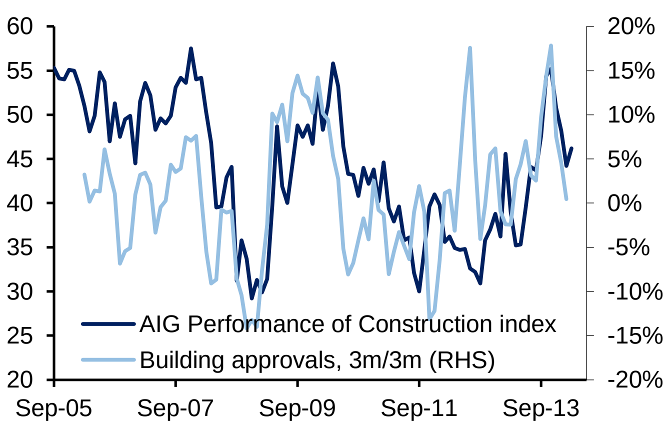
We revise up our forecasts for AUDUSD to 0.91 and 0.82 in 3 and 12 months respectively, from 0.85 and 0.75 previously.

Quite simply, we have gotten AUD wrong recently. Following the RBA's initial move to a less dovish stance in February, we shifted our AUD forecasts up and argued that there could be a near-term bounce above 90 (see here). But we underestimated the extent and persistence of AUD strength, as the RBA has proven less averse to AUD strength than we expected, Australian data has surprised to the upside, and the Chinese government has announced near-term stimulus aimed at supporting China's growth.

The RBA probably still ultimately wants a lower AUD – Governor Stevens continues to argue that the prospective terms of trade decline is AUD-negative. But for now the RBA is constrained by concerns about inflation and, to some extent, the strong Australian property market. Stevens has passed on a number of opportunities to talk down the Aussie, instead expressing optimism about the tentative signs of the handover from mining to other sectors. Notably, the April monetary policy statement argued that the exchange rate can assist economic rebalancing even though AUD was then at a similar level to in December 2013 when they thought that it "remained uncomfortably high and a lower level would likely be needed to achieve balanced growth".

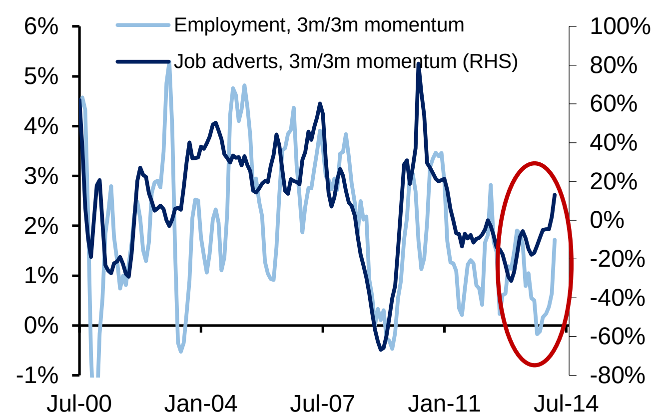
The less dovish RBA tone has interacted with better Australian cyclical data, although the mining investment outlook remains dire. The RBA has been focusing on a prospective residential construction boom as easing the handover from mining. While the level of building approvals is high, their momentum has eased recently (Exhibit 17).

Exhibit 17: Surveys suggest potential for construction improvement, although momentum has slowed



Source: the BLOOMBERG PROFESSIONAL™ service

Exhibit 18: Potential further near-term employment strength



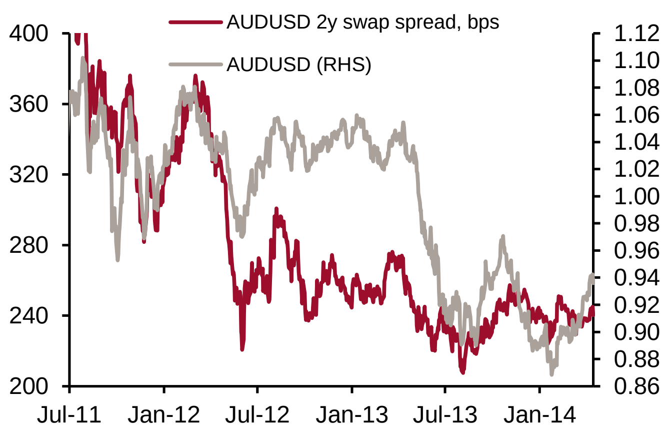
Source: the BLOOMBERG PROFESSIONAL™ service

In particular, the apparent employment improvement has also captured investors' imagination[1]. February's exceptionally-strong headline employment rise was statistically-inflated. March's decent number represented a cleaner read, although it was dominated by rising part-time employment and the surprise unemployment rate fall reflected lower participation. But recent buoyant job adverts and hours worked suggests **potential further near-term employment improvements (Exhibit 18), with the associated risk of near-term AUDUSD upside** (although it has recently shown signs of turning).

[1] Stronger retail sales have also attracted attention, although they run counter the falling consumer confidence and weak wages.

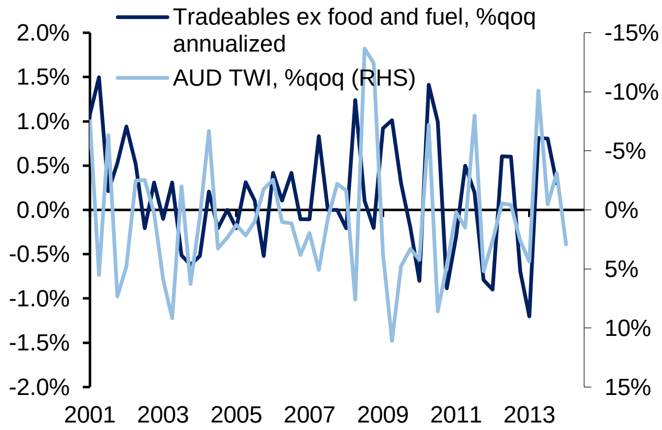
Nonetheless, we note that the Aussie's rise has not been supported by rising interest rate differentials (Exhibit 19). Rather, it seems to have been the unwinding of short AUD positions, which we previously cautioned about, which has driven the rally. But with CFTC data showing positions now around neutral, it may be tougher for positive data to support the Aussie.

Exhibit 19: Recent Aussie strength has not reflected interest rate differentials



Source: the BLOOMBERG PROFESSIONAL™ service

Exhibit 20: Recent AUD strength should pull down tradeables inflation



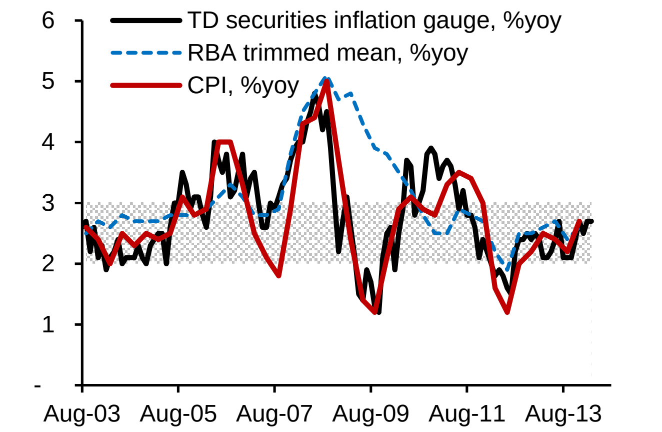
Source: the BLOOMBERG PROFESSIONAL™ service

Likely change in RBA tone after Q2 inflation data

Looking forward, how inflation evolves is likely to be key to how the AUD trades. The upside surprise to Q4 inflation, driven in large part by AUD weakness, was the core driver of the RBA's shift away from dovishness,

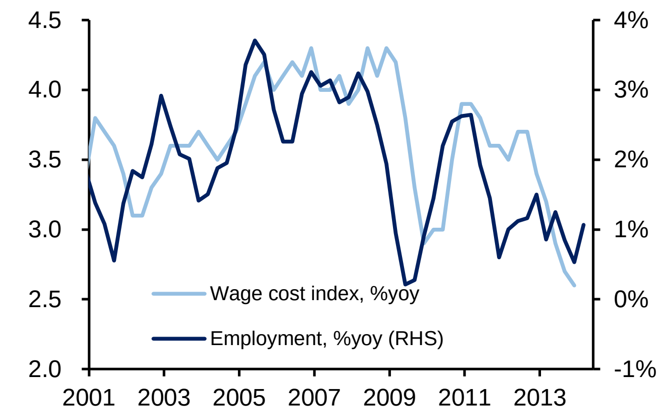
We expect inflation to moderate to close to 0.6%qoq on a trimmed mean basis over the next couple of quarters. Exhibit 20 suggests the recent AUD TWI appreciation should pull down tradeables inflation. We agree with the RBA that the weakest wage growth in over a decade should gradually moderate non-tradeables inflation. As evidence, the TD securities inflation gauge suggests inflation has already begun softening (Exhibit 21)

Exhibit 21: TD securities measure suggest moderating inflation



Source: the BLOOMBERG PROFESSIONAL™ service

Exhibit 22: While employment situation has improved, wage growth is slowing



Source: the BLOOMBERG PROFESSIONAL™ service

We doubt that the full extent of this moderation in price pressure will come through in the Q1 CPI inflation data scheduled for release on 23 April. We expect some softening in inflation and the RBA's tone, but the May meeting is probably too soon to expect a significant shift in rhetoric[2]. Nonetheless, a below-consensus number would help reduce current market pricing for a rate hike in June of next year .

In contrast, Q2 inflation should slow more significantly, prompting the RBA to return to a more aggressive stance on the AUD. By then we expect that the RBA will have two quarters evidence of tradeables inflation being under control and non-tradeables inflation moderating more significantly. We expect market expectations of this to grow over time, pricing out expectations of RBA rate hikes. Combined with the rise in US yields we expect in response to stronger US data, this outlook for the RBA drives our three-month 0.91 AUDUSD forecast.

To be sure, some tentative signs of RBA concern about the AUD have emerged. The April monetary policy statement noted that the Aussie's recent strength equated to less support for economic rebalancing. And the comment that the Aussie remains high by historical standards reappeared in the March statement after being dropped in February.

A potential risk to this view, however, is RBA concerns about strong house prices intensifying, forestalling a dovish turn. Governor Stevens recently noted that the RBA is watching the trend in dwelling prices closely, that a further big step-up in household debt to income ratios would be "asking for trouble" and that the 8-9% yoy growth in credit to households for investment in housing is "probably fast enough". That said, there have also been recent signs of the RBA's previous skepticism about macro-prudential policies easing a little.

Further AUD falls at longer horizons

Our 12-month 0.82 AUDUSD forecast is keyed off our structural model for AUDUSD, where the 2-year Australian-US swap spread and Australian commodity prices are the main drivers. On the former we feed in our interest rate strategists views that US 2-year rates are set to rise to 1.35% by 2015 Q1 (see Global Rates Atlas) and an unwind of the recent rise in Australian 2y rates. On the latter we incorporate the 20% fall in iron ore prices forecast by our commodities strategists (see here).

Two supplementary arguments support this view. First, even though recent PBoC stimulus has provided near-term support for Chinese growth, helping account for account for our recent forecast error, the risks seem skewed towards further Chinese growth slowdown over the next year. Second, the negative impact of the lower Australian terms of trade will have had longer to work its way through the economy. But, to be clear, we think that the projected AUDUSD fall will key off the RBA rather than these factors.

[2] Base effects mean that the yoy print will likely be strong but the market and the RBA should focus more on the qoq number.

NZD: Weak 1Q inflation – what' s next?

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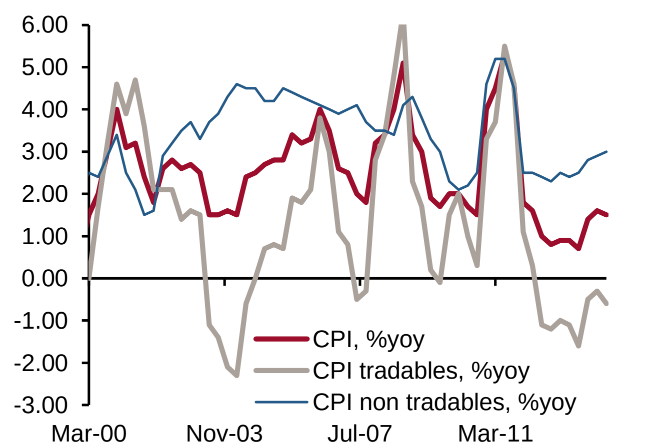
New Zealand inflation surprised to the downside at 0.3%qoq versus the RBNZ and Bloomberg median expectation of 0.5%qoq. Annual inflation moderated to 1.5% from 1.6% in 4Q. This outcome is in line with our expectation highlighted in last week's *FX Compass*. We had positioned for a NZD correction via NZDCAD downside and continue to see value holding onto this position. Additionally, for those looking for USD strength near term, we think short-term NZDUSD put RKO for instance offers good values.

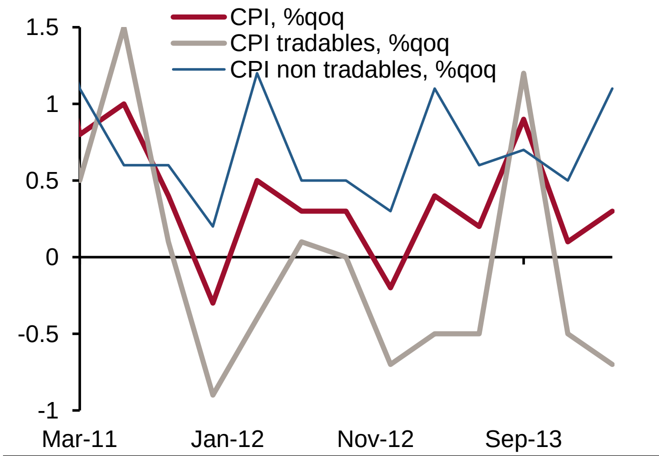
Strength in NZD once again contributed to depressing tradable inflation. Tradable CPI fell 0.7%qoq in 1Q following a 0.5%qoq fall in 4Q. On the contrary, non-tradable inflation accelerated to 1.1%qoq from 0.5%qoq, with housing-related costs leading gains (Exhibits 23 & 24).

Exhibit 23: Inflation remains benign…



Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

Exhibit 24:…largely depressed by tradable inflation



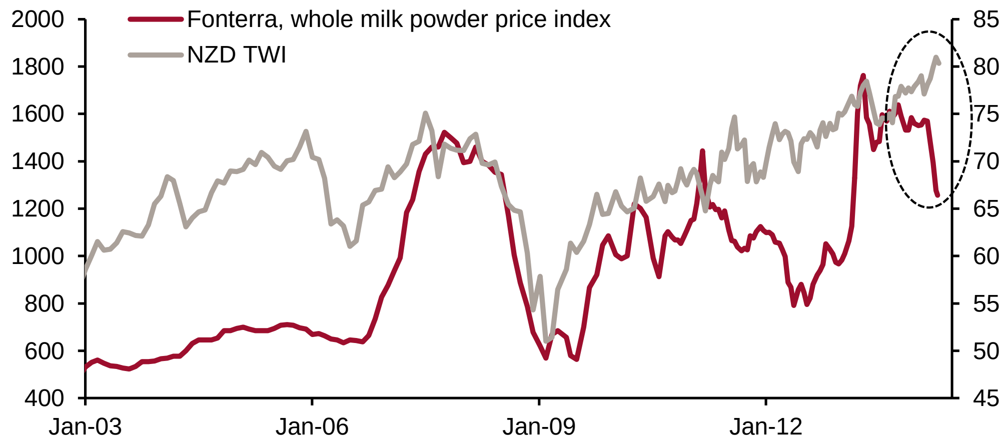
Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

We don't think one data point is enough to change the RBNZ's tightening path and continue to expect the central bank to deliver a 25bp hike each in April and June. NZ rates reflected this view, with front-end rates holding up well post the inflation disappointment.

Our bigger concern is on the currency as we think the NZD has been stronger than both rates and commodity drivers would suggest, even taking into account today's fall. Dairy prices have continued to decline in recent Fonterra auctions. Whole milk powder prices dropped 1.6% overnight and have declined 15% since the RBNZ's March meeting, and 23% from the peak in October last year.

The RBNZ has turned more accepting of NZD strength this year, in large part because the currency was backed by a 40-year high terms of trade. The recent decline in Fonterra dairy auctions puts this support at risk. We wouldn't be surprised if the RBNZ stepped up their rhetoric against NZD again in their April meeting, similar to what they did when we saw a significant divergence between NZD and commodity prices back in 2012, early 2013 (Exhibit 25). This combined with still crowded NZD long positioning suggests to us that the NZD correction has yet fully run its course.

Exhibit 25: NZD has significantly overshot dairy prices



Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

CNY: still squeezing

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In last week's *Compass*, we argued for beginning to dip into CNH shorts. We recognized the risk that we were too early, and, well, we were. The government has raised the USDCNY fix from 6.14907 to 6.1589 over the past week, driving USDCNH 0.5% higher. Clearly, the PBoC's squeeze on speculative positions is still on. We maintain our long USDCNH put recommendation despite the current P&L hit, but would avoid cash positions for now.

We recognize that a longstanding rule in trading China is to do what the government tells you to do. However, we also note that geopolitical pressure on China has clearly risen with the latest US Treasury report on foreign exchange. Several points stand out, in our view:

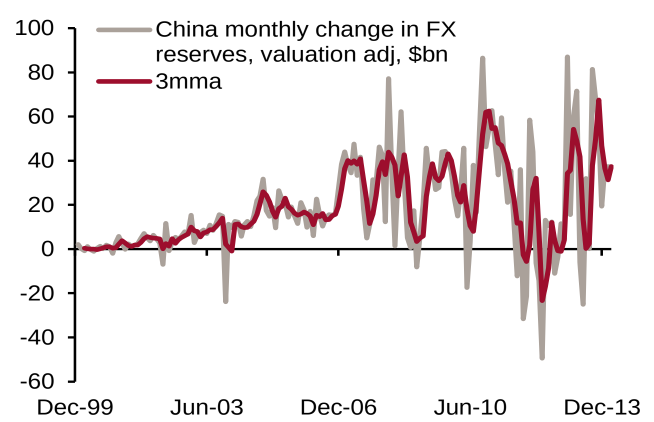
- The prompt timing of the release of the report in April and the day after China released its Q1 reserve accumulation was probably an intentional signal of US disapproval for China's intervention.
- The tone of the criticism of China's intervention seems more aggressive than in recent reports, particularly "…recent developments in the RMB exchange rate raise particularly serious concerns…"
- This came even as the discussion in the text recognized that China's recent action seems to be aimed at squeezing speculative flows and increasing two-way volatility.
- The US is unambiguous that it views the CNY as still significantly undervalued and that China has committed to "reforming" its exchange rate system, which is political code for appreciation.

This US criticism, combined with the pace of China's FX reserve accumulation, seems unsustainable to us. We estimate China's reserves rose $112bn in Q1 after adjusting for valuation and interest income (Exhibits 26 and 27). The increasing success of the PBoC's squeeze on the market is driving some speculators to buy back USD and has probably stopped speculative inflows recently.

Exhibit 26: FX reserve accumulation has reaccelerated

Source: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service

Exhibit 27: FX reserve accumulation has reaccelerated



Source: Credit Suisse

However, the continuing slowing in Chinese investment and industrial output growth in Q1 and March imply that China's current account surplus should rise, offsetting much of this reduction of speculative inflows. China's trade surplus in March was its largest in five years and the Q1 surplus was the largest in six years if the clearly distorted Q1 2013 data are discounted (see FX Strategist).

Technical Analysis

Nikkei tops, will USDJPY follow?

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We have been concerned about the potential for equity tops in Japan from mid-March following the rally by the **Nikkei** to its secular downtrend, which then capped, and weakness last week finally saw these tops confirmed. Although our long-term outlook stays bullish (for an eventual move to 19115), a phase of weakness is expected first.

The Nikkei and TOPIX have both completed price tops

Below 13995 has seen key "neckline" price and moving average support removed, and we look for weakness to extend to 13750 initially, the October 2013 low, ahead of 13235 – the 38.2% retracement of the June-12/December-13 rally. With the August 2013 low just below at 13185, we would expect this to hold at first for a rebound. However, our bias would be for a break below 13185 in due course also to target 12760/50 next – the 38.2% retracement of the entire 2008/2013 rally. It should be noted the measured target from the top is actually seen set much lower at 11745.

A not unsurprising similar story for the **TOPIX**, which has finally removed its key price support from the October 2013 and February 2014 lows at 1140/38. This has seen the expected top finally complete, and we look for further weakness to emerge to 1073 initially – the 38.2% retracement of the entire 2012/2014 bull trend.

The JPY and equity market have maintained a strong relationship

There remains a strong relationship between the JPY and equity market and, in reality, equity strength has in our view only emerged as a result of JPY weakness. This leaves the behavior of the JPY slightly strange, as USDJPY actually strengthened as equities fell. Unless we are witnessing a decoupling of this relationship, which we do not think is the case, or the equity market's move lower is false, which again we think unlikely, (especially given the corresponding tops in US equities), we see the immediate risk to USDJPY as lower, even if the long-term trend is up.

Only below 100.75 sees a top for USDJPY

Key support remains seen from its recent lows, uptrend and 200-day average at 101.20/100.75. Only a break below here would see a top for USDJPY, warning of a potentially aggressive sell-off and a move to 99.64 initially, then 98.25/00. Bigger picture, we would see scope for 97/96.50, and potentially as far as 94.65 – the 38.2% retracement of the entire rally from the September 2012 low.

While 100.75 holds, despite the equity break, UDJPY can stay in an uptrend.

Nikkei 225 – Weekly

Source: CQG, Credit Suisse

USDJPY - Weekly

Source: CQG, Credit Suisse

Cash Portfolio Update

Exhibit 28: Positions in cash recommendations portfolio

- We close our long SGD basket position. The catalysts for further NEER appreciation seem to have run their course.

Date Opened	Trade Details	Notional Units	Spot Reference	Forward	Take Profit	Spot Loss	%Gain	P&L in USD
11-Mar-14	Short EURPLN	1	4.22	4.24	4.10	4.26	1.43%	142,567
11-Mar-14	Long PLNHUF	1	74.10	74.13	76.00	73.00	-1.51%	(151,070)

Closed Positions

Date Opened	Trade Details	Notional Units	Date Closed	Fwd at Open	Fwd at Close	P&L (%)	P&L ($)	Rationale
12-Nov-13	Long USDTRY	1	07-Jan-14	2.0918	2.1803	4.06%	405,880	Hit target
07-Jan-14	Short CLPCOP	1	30-Jan-14	3.6190	3.6697	-1.34%	(133,764)	Stop loss
09-Oct-13	Long GBPNOK	1	11-Feb-14	9.6502	10.0917	4.52%	451,614	Closed
05-Nov-13	Long GBPSEK	1	11-Feb-14	10.4916	10.6034	1.08%	108,180	Closed
21-Jan-14	Short AUDUSD	1	11-Feb-14	0.8747	0.9001	-2.82%	(281,800)	Closed
25-Sep-13	Long USDPHP 3m NDF	1	11-Feb-14	43.0000	44.9370	4.31%	431,048	Closed
07-Jan-14	Long USDTHB	1	14-Feb-14	33.4911	32.4546	-3.19%	(319,369)	Stop loss
04-Dec-13	Long INRIDR	1	17-Feb-14	192.64	186.81	-3.13%	(312,931)	Stop loss
11-Mar-14	Long COPBRL	1	08-Apr-14	0.1146	0.1150	0.37%	36,796	Stop loss
15-Mar-14	Long SGD basket	1	16-Apr-14	1.2691	1.2531	0.68%	67,761	Closed
	(*spot ref based on USDSGD)							

Unrealised P&L:	**14,345**
Realized P&L:	**453,415**
Total P&L 2014:	**467,759**
Hit Rate:	**58%**

Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information, opinions and estimates contained in this report reflect a judgment at the original date of publication by CS and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. The value of securities and financial instruments may be subject to exchange rate fluctuation that may have a positive or adverse effect on the price or income of such securities or financial instruments. The P&L results shown do not include relevant costs, such as commissions, interest charges, or other applicable expenses. (*) Spot ref based on USDSGD.
Source: Credit Suisse

Derivative Portfolio Update

Exhibit 29: Positions in derivative recommendations portfolio

- We closed our long 3m EURGBP 1x1.5 RKI put spread, losing the 0.38% premium.

Date Opened	Trade Details	Entry Cost	Current Value	P&L (as % of Notional)	Notional (in USD)	P&L (in USD)
8-Apr-14	Buy 3m USDCNH put	0.30%	0.20%	-0.10%	100,000,000	-100,000
8-Apr-14	Buy 2m USDCAD 1x1.5 put spread	0.49%	0.34%	-0.15%	100,000,000	-150,000
25-Mar-14	Buy 3m AUDCAD RKO digital put	10.00%	7.00%	-3.00%	1,000,000	-30,738
10-Mar-14	Buy 2m USDRUB RKO call	0.42%	0.31%	-0.12%	100,000,000	-115,000
18-Feb-14	Buy 2m USDRUB 1x1.5 call spread	0.44%	0.54%	0.10%	100,000,000	95,000
4-Feb-14	Buy 3m USDJPY RKI risk reversal	0.11%	-0.02%	-0.13%	100,000,000	-130,000
14-Jan-14	Buy 6m AUDNZD digital put	12.50%	2.04%	-10.47%	1,000,000	-109,603
26-Nov-13	Buy 1y USDBRL seagull	0.30%	-1.39%	-1.69%	100,000,000	-1,685,000
26-Nov-13	Buy 1y1y USDRUB FVA	12.00%	13.63%	1.63%	10,000	16,300
9-Apr-13	Buy 2y USDJPY call	1.83%	0.22%	-1.62%	100,000,000	-1,615,000
9-Apr-13	Buy 2y zero cost USDJPY RKI risk reversal	0.00%	-0.04%	-0.04%	100,000,000	-35,000

Closed Positions

Date Closed	Trade Details	Entry Cost	Date Opened	P&L (as % of Notional)	Notional (in USD)	P&L (in USD)
14-Apr-14	Buy 3m EURGBP 1x1.5 RKI put spread	0.38%	14-Jan-14	-0.38%	100,000,000	-383,409
8-Apr-14	Buy 3m AUDUSD RKO digital put	11.00%	11-Mar-14	-8.25%	1,000,000	-85,913
8-Apr-14	Buy 6m AUDUSD digital put	15.00%	23-Oct-13	-13.40%	1,000,000	-130,202
8-Apr-14	Buy 6m USDCAD seagull	0.41%	14-Jan-14	-0.41%	100,000,000	-405,000
8-Apr-14	Buy 3m USDCAD RKO call	0.24%	11-Feb-14	-0.05%	100,000,000	-52,000
8-Apr-14	Sell 2m USDCAD call, buy 1y Canadian OIS	0.53%	11-Mar-14	-0.03%	100,000,000	-34,567
8-Apr-14	Buy 3m USDZAR KI call	1.40%	10-Mar-14	-0.47%	100,000,000	-470,000
8-Apr-14	Buy 6m USDZAR 1x1.5 call spread	0.20%	21-Jan-14	0.17%	100,000,000	170,000
4-Apr-14	Buy 2m EURUSD 1x1 put spread	0.36%	4-Feb-14	-0.36%	100,000,000	-364,884
18-Mar-14	Buy 1m EURGBP RKO put	0.20%	18-Feb-14	-0.20%	100,000,000	-202,085
18-Mar-14	Buy 3m CADMXN RKO put	0.35%	19-Dec-13	-0.29%	100,000,000	-281,953
30-Jan-14	Buy 3m CADMXN 1x2 put spread	0.64%	30-Oct-13	2.01%	100,000,000	1,887,003
3-Feb-14	Buy 2m USDRUB 1x1.5 call spread	0.26%	3-Dec-13	0.10%	100,000,000	97,617
27-Jan-14	Buy 3m USDTRY RKO call	0.41%	7-Jan-14	-0.41%	100,000,000	-410,000
26-Jan-14	Buy 2m USDJPY call	0.45%	26-Nov-13	-0.45%	100,000,000	-450,000
21-Jan-14	Buy 2m USDZAR RKO call	0.60%	17-Dec-13	0.55%	100,000,000	548,750
16-Jan-14	Buy 2m USDTRY RKO call	0.45%	17-Dec-13	-0.45%	100,000,000	-450,000
20-Jan-14	Buy 1m USDSGD call	0.23%	17-Dec-13	0.26%	100,000,000	260,000

Please see the Structured Securities, Derivatives, and Options Disclaimer.
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Source: Credit Suisse

FX Forecast Summary

Major Currencies[3]	vs.	Spot	Forecasts 3m	Forecasts 12m	
US Dollar by market convention	TWI	86.40	87.66	94.06	**Bullish.** As the Fed continues to taper, we expect many EM currencies to remain under pressure, as excesses of the unprecedented period of record low US interest rates begin to reveal themselves.
	EUR	1.382	1.360	1.320	
	JPY	101.5	106.0	120.0	
	GBP	1.673	1.669	1.650	
	CHF	0.880	0.904	0.924	
	AUD	0.935	0.910	0.820	
	CAD	1.098	1.080	1.160	
	SEK	6.577	6.360	6.970	
Euro foreign currency units per euro	TWI	97.0	96.3	97.08	**Moderately bearish.** The ECB's dovish rhetoric on potential QE will likely make the euro sensitive to data and ECB comments, but implementation faces barriers. EURUSD prospects will be determined by the evolution short-term real interest rate differentials and flow-based factors, where we see scope for the euro support to diminish a little.
	USD	1.382	1.360	1.320	
	JPY	140.3	144.2	158.4	
	GBP	0.826	0.815	0.800	
	CHF	1.215	1.230	1.220	
	AUD	1.478	1.495	1.610	
	CAD	1.517	1.469	1.531	
	SEK	9.088	8.650	9.200	
Japanese Yen yen per unit foreign currency	TWI	137.1	132.0	118.5	**Bearish.** In the next month or so, lower US yields in response to the slowing in the US are likely to keep USDJPY languishing around 102. However, we expect the US economy and yields to bounce up in the late spring. The ongoing deterioration in Japan's current account deficit, combined with our outlook for US yields to rise later this year, should keep USDJPY trending slightly higher.
	USD	101.5	106.0	120.0	
	EUR	140.3	144.2	158.4	
	GBP	169.8	176.9	198.0	
	CHF	115.41	117.20	129.84	
	AUD	94.89	96.46	98.40	
	CAD	92.4	98.1	103.45	
	SEK	15.43	16.67	17.22	
UK Sterling foreign currency units per pound	TWI	85.57	86.53	88.66	**Bullish.** Strong UK activity prospects, with the recovery broadening, together with the BoE's move to a looser forward guidance policy underpin our bullish sterling view, with the UK's substantial current account deficit playing second fiddle.
	USD	1.673	1.669	1.650	
	EUR	1.210	1.227	1.250	
	JPY	169.8	176.9	198.0	
	CHF	1.471	1.509	1.525	
	AUD	1.789	1.834	2.012	
	CAD	1.837	1.802	1.914	
	SEK	11.00	10.61	11.50	
Swiss Franc francs per unit foreign currency (per 100 units for JPY and SEK)	TWI	147.2	145.1	146.9	**Neutral to bearish.** EURCHF looks set to remain near-term range-bound as Switzerland's superior growth prospects are counterbalanced by the SNB's continued dovish focus of the 1.20 floor given low inflation, while other bilaterals look set to rise. Risks relate to the potential unwinding of crisis-related flows and CHF becoming a funding currency.
	USD	0.880	0.904	0.924	
	EUR	1.215	1.230	1.220	
	JPY	0.867	0.853	0.770	
	GBP	1.471	1.509	1.525	
	AUD	0.822	0.823	0.758	
	CAD	0.801	0.837	0.797	
	SEK	13.37	14.22	13.26	

[3] Major currencies, defined and ranked by order of their reported foreign exchange market turnover from the BIS 2004 Triennial Central Bank Survey.

Regional Currencies	vs.	Spot	Forecasts 3m	Forecasts 12m	Comments
Americas					
Brazilian Real	USD	2.239	2.400	2.580	**Bearish.** The deterioration in fiscal accounts exposes credit to a downgrade risk. Furthermore, BRL remains vulnerable to Fed tapering, and political risk should rise ahead of the October election. Limited easing from the Chinese authorities and an unimpressive recovery from Europe should also hurt exports.
Canadian Dollar	TWI	103.5	105.7	99.5	**Bearish.** We think the Bank of Canada will turn more dovish in H1. In the absence of offsetting flows from reserve managers demand, we think this will help push the CAD towards a less expensive valuation level.
	USD	1.098	1.080	1.160	
Mexican Peso	USD	13.12	13.50	13.00	**Long-Term Bullish.** The recent stream of negative growth surprises in Mexico reinforces our bias for a weak peso in the near term, with limited impact on MXN's long-term prospects. In the aftermath of the ambitious reform agenda of late 2013, the focus has shifted to the softer tone emerging from recent data.
Colombian Peso	USD	1935	1955	1985	**Neutral.** Within LatAm, Colombia continues to have the strongest macro fundamentals. Colombia's sovereign credit rating should be stable, and the prospect of rates rising in a context of strong growth should be mostly constructive.
Chilean Peso	USD	556.0	570.0	575.0	**Bearish.** We remain of the view that monetary accommodation and an extended slowdown in mining FDI will weigh on CLP in coming months.
Pacific					
Australian Dollar	USD*	0.935	0.910	0.820	**Long-term bearish.** The RBA seems likely to turn more dovish after the Q2 inflation print, with declining yield spreads and falling commodity prices pulling AUD down further out.
	JPY*	94.89	96.46	98.40	
	NZD*	1.082	1.060	1.020	
NZ Dollar	USD*	0.864	0.858	0.804	**Mixed.** We expect NZD to outperform AUD but lose ground against USD in a broad USD strength environment. We look for monetary and economic divergence between Australia and New Zealand to continue driving AUDNZD lower in 2014.
	JPY*	87.68	91.00	96.47	
Scandinavia					
Swedish Krona	EUR	9.088	8.650	9.200	**Bearish.** The recovery is underway, but slowly. Low price pressures and macroprudential measures should keep the Riksbank dovish for an extended period. Weaker FX would be welcome but the current account surplus is high and flow support may delay such an adjustment.
	USD	6.577	6.360	6.970	
Norwegian Krone	EUR	8.236	8.200	8.600	**Bearish.** The outlook for weaker investment growth, cooling household consumption and falling house prices are key concerns. Reliance on non-core exports may require further currency depreciation. Meanwhile, Norges Bank is likely to remain dovish for a prolonged period.
	USD	5.961	6.029	6.515	
	SEK*	1.104	1.055	1.070	
Emerging Europe, Middle East and Africa					
Czech Koruna	EUR	27.46	27.30	27.30	**Neutral.** Low inflationary pressure should support the credibility of the floor while negative carry suggests the koruna can play the role of a funding currency for the region. In the medium term, we believe the inflation dynamic will prove crucial in determining the exit strategy from the current policy.
Hungarian Forint	EUR	309.2	315.0	320.0	**Bearish.** The dovish central bank remains our key concern. Yet, our base case is for only moderate depreciation pressure. With a still-high basic balance surplus, acceptable growth and a reasonable fiscal position, we do not envisage any serious difficulty in meeting the external financing needs.
Polish Zloty	EUR	4.19	4.10	4.05	**Bullish.** Poland's economy is rebounding, its credit profile is solid and real yields are positive. We suspect that most of the negative impact on bond flows from the pension reform has already passed. Poor EM risk appetite and Ukraine tensions are risks, but PLN should remain relatively resilient.
Israeli Shekel	USD	3.47	3.53	3.55	**Moderately bearish.** Strong opposition to ILS strength from Bank of Israel essentially eliminates room for Shekel to appreciate much beyond 3.45, in our view. FX interventions remain high, yields continue to move against the currency, and trade exports recently showed a very heavy mom decline.

Regional Currencies	vs.	Spot	Forecasts 3m	Forecasts 12m	Comments
Russian Rouble	Basket	42.4	43.5	43.0	**Moderately bearish.** The economy and current account remain weak, and Ukraine tensions could have important negative implications for asset prices and growth. However, the CBR has delivered an aggressive response and, unlike previously, the authorities now appear to see further RUB weakness as undesirable.
Rouble versus basket:	USD	36.2	37.4	37.6	
.55*USD+.45*EUR	EUR	50.0	50.9	49.6	
South African Rand	USD	10.59	11.20	11.50	**Bearish.** We expect further deterioration in domestic fundamentals to combine with higher US Treasury yields to weaken the rand. However, short-term factors may keep the rand temporarily supported over the next few weeks.
	EUR	14.63	15.23	15.18	
Turkish Lira	Basket	2.55	2.67	2.75	**Bearish.** Recent tightening appears sufficient for now to placate markets and constrain domestic demand. However, the current account deficit should remain too large to protect against pressures on EMs from rising US yields. Political risks are elevated and central bank credibility remains to be tested.
Lira versus basket:	USD	2.14	2.26	2.37	
.50*USD+.50*EUR	EUR	2.96	3.08	3.13	
Asia					
Chinese Renminbi	USD	6.22	6.10	6.07	**Bullish.** The recent rise in the USDCNY fix and resulting rally in the onshore spot and USDCNH are likely to be temporary. China's BoP surplus has risen sharply and its trade surplus with the US has hit a record level. We continue to expect the authority to resume trend CNY appreciation in the coming months.
Indian Rupee	USD	60.2	61.0	62.5	**Bullish vs. forwards.** India's seasonal current account deterioration and the April elections are the near-term risks but real yields should gradually rise, increasing support for the INR.
Indonesian Rupiah	USD	11428	11500	11800	**Neutral near term.** Real yield is likely to improve as we project inflation to ease gradually. However, the challenge near term is a likely reversion of recent strong inflows and the upcoming JPM GBI EM rebalancing.
Korean Won	USD	1041	1045	1055	**Bullish.** The current account will enter a period of positive seasonality through to September and the Korea's recent improved export performance should reduce concerns about a negative yen impact.
Malaysian Ringgit	USD	3.24	3.33	3.38	**Bearish.** Positive currency seasonality due to the dividend season could drive USDMYR towards 3.20-3.25 in April, but we think it would represent a good buying opportunity. We expect US yields to rebound into the summer and bond outflows to resume. Malaysia's current account surplus will likely narrow as robust investment boosts imports.
Philippines Peso	USD	44.5	45.5	45.8	**Bearish.** Carry remains low and the BSP is unlikely to turn sufficiently hawkish to support PHP. Narrowing yield advantage to the US will likely trigger outflows.
Singapore Dollar	USD	1.253	1.270	1.280	**Neutral.** We expect Singapore's central bank (MAS) to maintain the current appreciation path for the SGD nominal effective exchange rate. We estimate the appreciation slope to be 2%pa with +/-2% bandwidth.
Taiwan Dollar	USD	30.17	29.80	29.90	**Neutral.** Taiwan's central bank should continue to manage volatility on both sides. In the very near term, the Chinese government's change in direction for the USDCNY fix might spur some outflows from the now sizable USDCNT deposit base in Taiwan, back into TWD.
Thai Baht	USD	32.33	33.50	33.50	**Bearish.** Negative current account seasonality and a potential escalation of political stress in March-April could be the catalysts for the next leg higher in USDTHB. We expect capital outflows to continue although the composition may shift from foreign to domestic.

Exchange rates are home currency per foreign currency unit, unless indicated by * (= inverse quotation).
Source: Credit Suisse

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