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FX Strategy Trade Ideas

2 October 2012

Themes and trade ideas

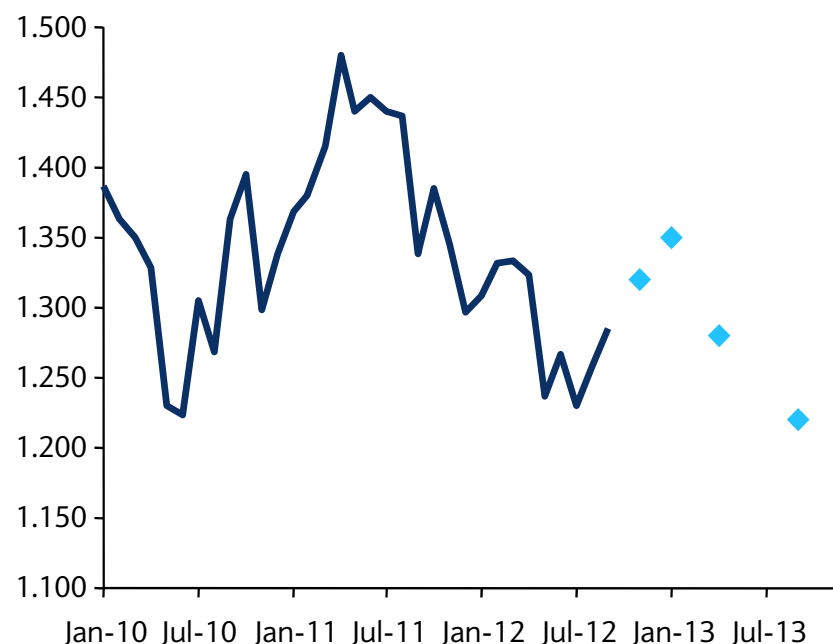
- 1. EUR/USD: near-term upside but remain bearish medium term.
- 2. Don't fight the Fed: Long EM FX with carry, cheap valuations and catch-up potential
 - Short USD/RUB
 - Short USD/MXN
 - Short JPY/INR
 - Short JPY/ZAR
- 3. G10 Vol curve too steep, expect long-end vol to continue to drop
 - Sell a 1y EUR/USD vol vs. buy 3m EUR/USD vol
- 4. JPY vulnerable to weak fundamentals, risk-on and BoJ intervention
 - Long USD/JPY through risk reversals

Theme 1: EUR/USD: near-term upside but remain bearish medium term

EUR/USD: near-term upside, medium-term downside

- ECB OMT in place means reduced downside for EUR.
- Open-ended QE by the Fed means USD to stay weak near term, especially if data weakens
- EUR/USD to rise to 1.32 in 1m and 1.35 in 3m
- EUR/USD downtrend to resume:
 - Weak EA growth and lingering periphery risks to keep monetary policy very loose.
 - US economy to do better than Europe over in 2013.
 - EUR/USD to fall to 1.22 in 12m
- Risks: Upside: EA stabilises, no ECB easing. Downside: Risk of breakup reemerges, US economy picks up more rapidly than expected.

EUR/USD forecasts: 1.35 in 3m, 1.22 in 12m

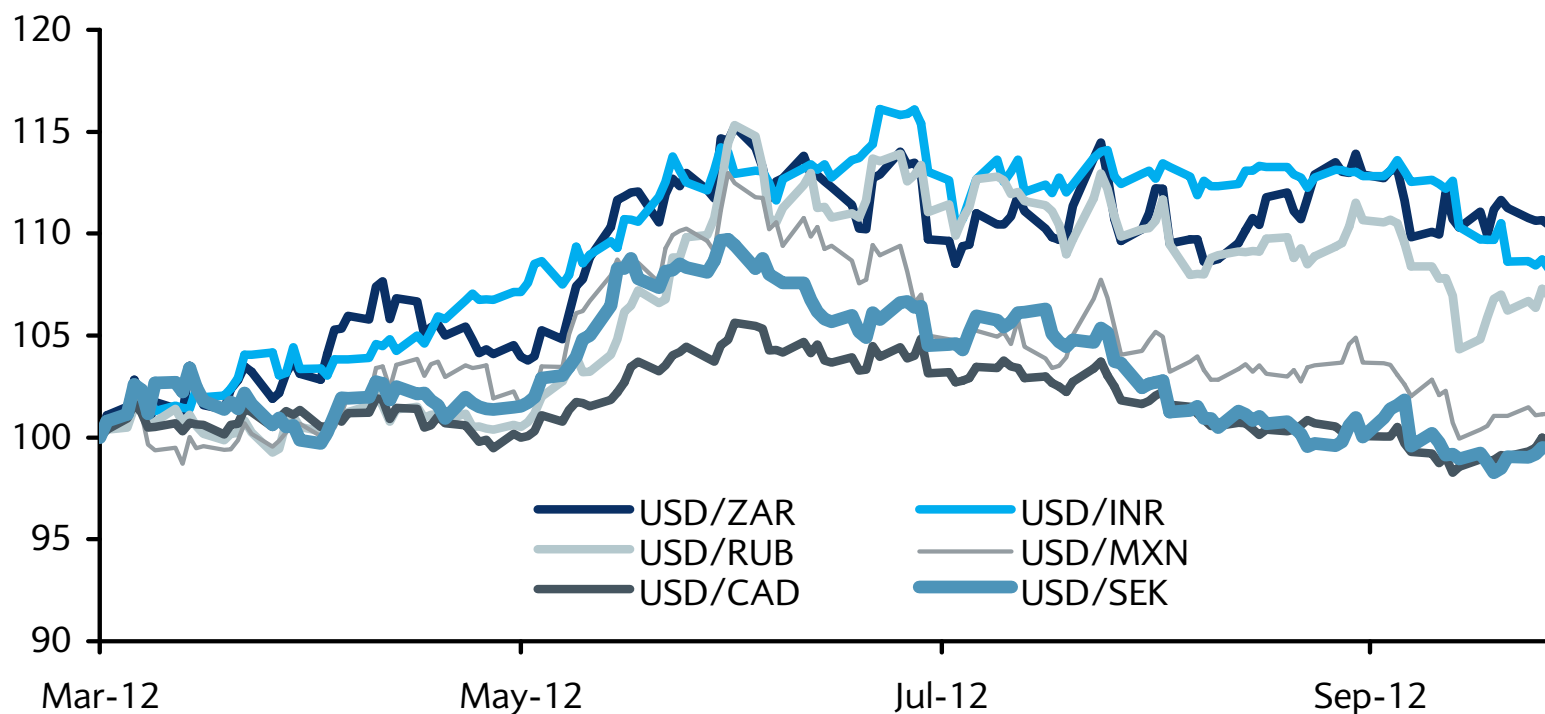


Source: Barclays Research

Theme 2: Don't fight the Fed: Long EM FX vs. USD

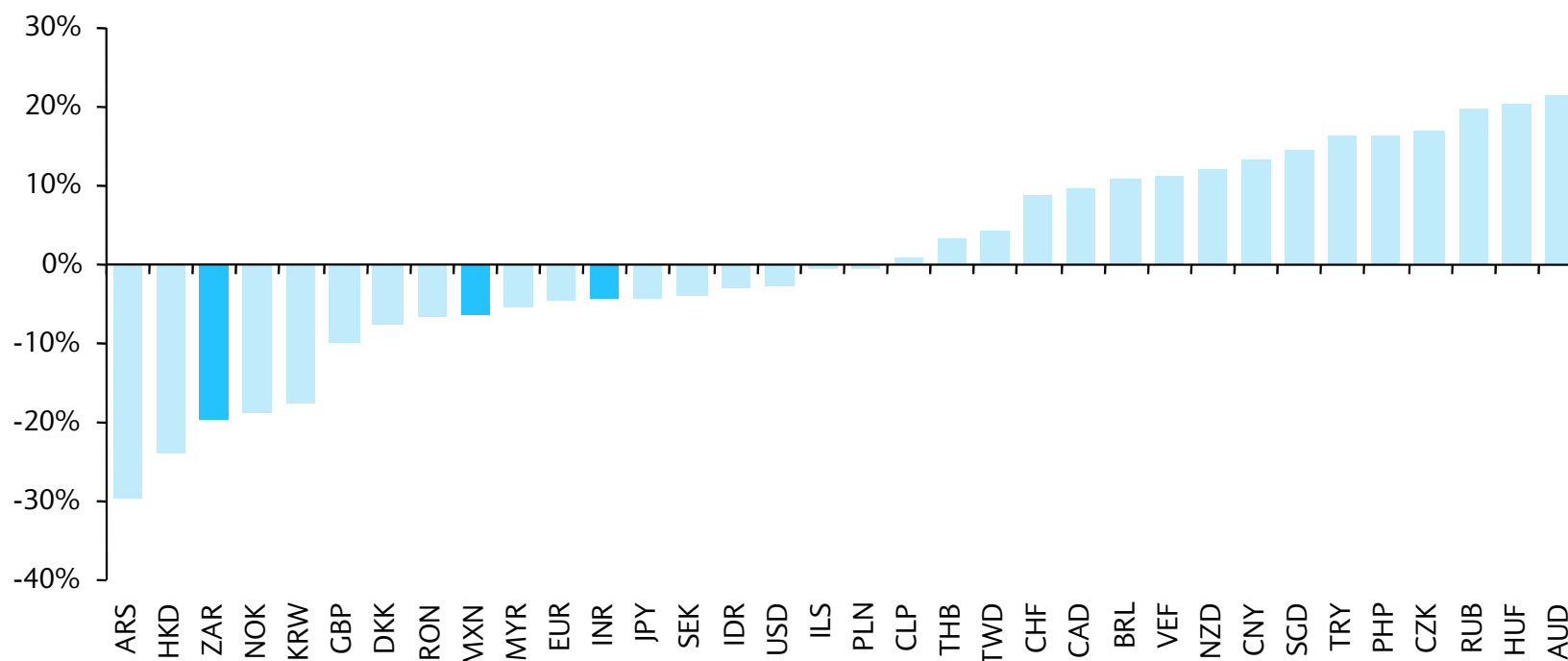
Long EM FX with carry, catch-up potential and cheap valuations

RUB, INR and ZAR have lagged G10 currencies



Long EM FX with carry, catch-up potential and cheap valuations

ZAR, INR and NXN are cheap according to our behavioural real exchange rate model (BEER)



Barclays Research

EM FX trade ideas

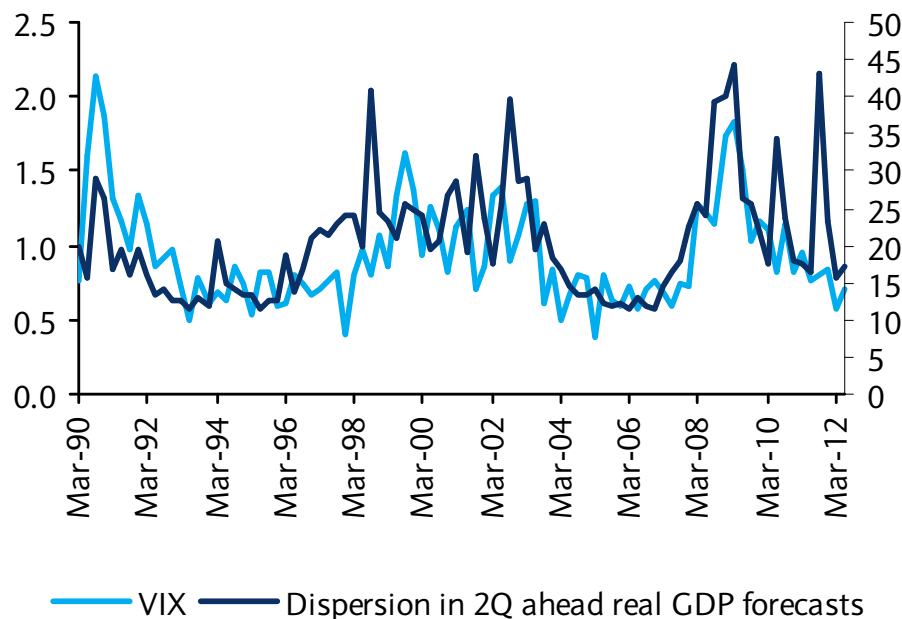
- MXN and RUB: High carry and central banks tolerate appreciation
 - Short USD/MXN at 12.83, target 12.40, stop loss 13.00 (entered 27 Sep)
 - Short USD/RUB at 31.0, target 29.0, stop loss 31.7 (entered 27 Sep)
- ZAR and INR: plenty of room for catch up, carry, hands-off central banks, and cheap valuations
- JPY is our favourite funding currency from a medium-term perspective
 - Go long ZAR/JPY at 9.42, target 10.50, stop loss 9.00 (entered 27 Sep)
 - Go long INR/JPY at 1.468, target 1.650, stop loss 1.440 (entered 27 Sep)

Theme 3: G10 Vol curve too steep, long-end vol to fall

FX Vols: Why so low?

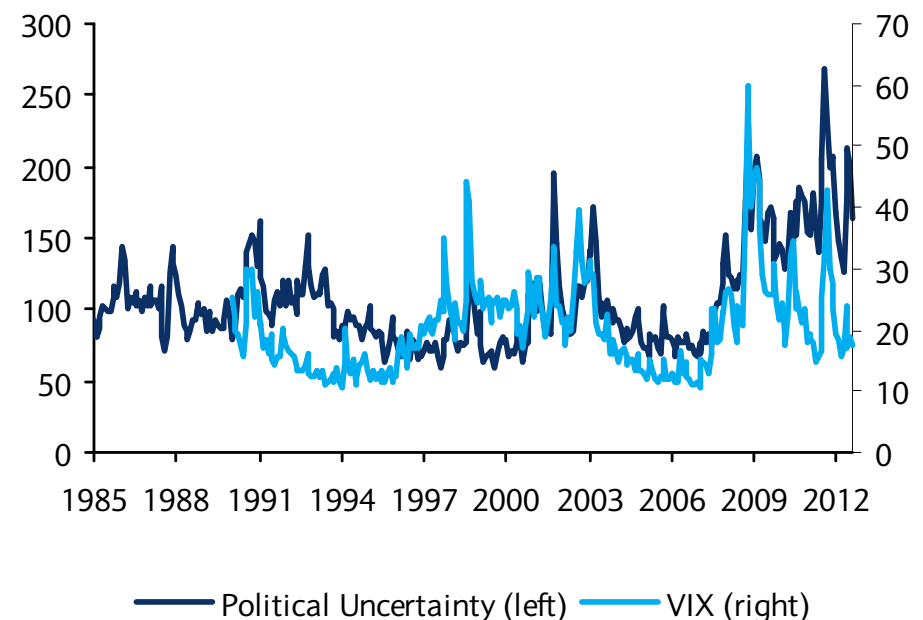
- Decline in macro uncertainty and central bank easing has anchored short-end vols
- But term structure remains steep due to political uncertainty
- Subdued macro risks and market-friendly resolution of political risks should bring long-term vols lower
- Sell 1y EUR/USD vol and buy 3m vol

2Q ahead forecasts have been decreasing, leading to lower market vol



Source: Bloomberg, Barclays Research

Political uncertainty remains elevated



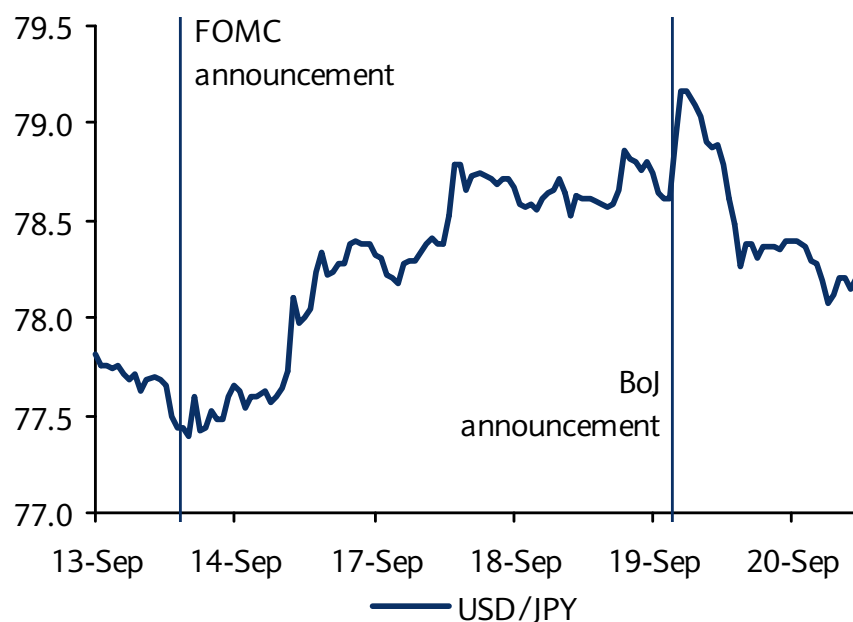
Source: Bloomberg, Barclays Research

Theme 4: JPY vulnerable to weak fundamentals, risk on and BoJ intervention

Pressure on the JPY is increasing

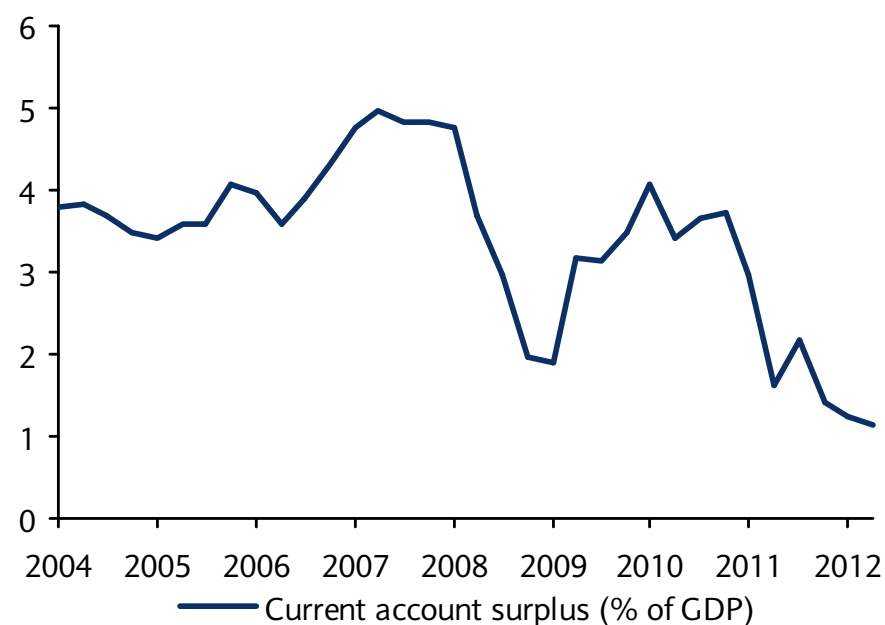
- USD/JPY response to FOMC and BoJ was the opposite of what would be expected
 - Weak USD is dominating, but risk-on and intervention risk limits the downside
- Longer-term Japan-specific issues are gaining importance
 - Current account balances, growth differentials, relative monetary policy
 - Similar to what we saw in Q1 12

USD/JPY response to policy actions opposite to what we expected



Source: Bloomberg, Barclays Research

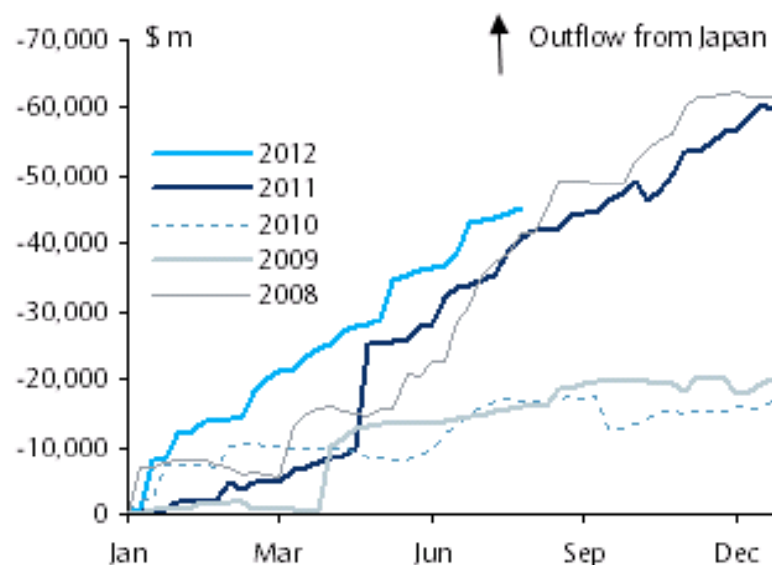
Current account balance deteriorating



Source: Bloomberg, Barclays Research

Long USD/JPY through risk reversals

Continued outflow from Japan through overseas M&A by Japanese firms



Source: Bloomberg, Barclays Research

BoJ keeps expanding its balance sheet even without additional easing (CB balance sheets as % GDP)



Source: Barclays Research

Trade: long USD/JPY through a 3m 78-81.40 USD/JPY risk reversal which is zero premium (Spot. ref. 79.65)
Entered: 20 Aug 2012

G10 FX forecasts

	Spot	1 Month	Forecasts 3 Month	6 Month	1 Year	Forecast vs Outright Forward			
						1 Month	3 Month	6 Month	1 Year
EUR/USD	1.29	1.32	1.35	1.28	1.22	2.6%	4.5%	-0.7%	-5.5%
USD/JPY	77.7	81	83	84	86	4.3%	7.0%	8.4%	11.3%
GBP/USD	1.62	1.63	1.65	1.60	1.56	0.5%	1.8%	-1.3%	-3.6%
USD/CHF	0.94	0.92	0.91	0.98	1.02	-2.0%	-3.0%	4.7%	9.4%
USD/CAD	0.98	0.97	0.96	0.95	0.94	-2.0%	-2.6%	-3.8%	-5.3%
AUD/USD	1.04	1.06	1.05	1.04	1.04	2.1%	1.6%	1.4%	2.7%
NZD/USD	0.83	0.84	0.83	0.82	0.82	1.5%	0.7%	0.1%	1.3%
EUR/JPY	100	107	112	108	105	7.1%	12.1%	8.1%	5.2%
EUR/GBP	0.79	0.81	0.82	0.80	0.78	2.1%	2.6%	0.6%	-2.2%
EUR/CHF	1.21	1.22	1.22	1.25	1.25	1.0%	1.1%	3.6%	3.8%
EUR/SEK	8.43	8.70	8.80	8.40	8.20	3.1%	4.0%	-1.0%	-4.0%
EUR/NOK	7.37	7.55	7.60	7.30	7.15	2.3%	2.7%	-1.8%	-4.7%

Source: Barclays Research

EM FX forecasts

	EMERGING MARKETS FX FORECASTS					Forecast vs Outright Forward			
	Spot	1 Month	3 Month	6 Month	1 Year	1 Month	3 Month	6 Month	1 Year
USD/CNY	6.30	6.29	6.30	6.30	6.26	-0.9%	-0.9%	-1.2%	-2.5%
USD/HKD	7.75	7.75	7.76	7.76	7.76	-0.1%	0.1%	0.1%	0.1%
USD/INR	53.02	53.50	53.00	52.00	52.00	0.6%	-1.2%	-4.4%	-6.8%
USD/IDR	9598	9550	9600	9800	10000	-0.7%	-1.0%	-0.1%	-0.7%
USD/KRW	1116	1105	1105	1100	1050	-1.1%	-1.4%	-2.3%	-7.2%
USD/MYR	3.07	3.01	3.00	3.05	2.98	-2.1%	-2.7%	-1.6%	-4.5%
USD/PHP	41.83	41.00	41.50	41.50	41.00	-2.0%	-0.8%	-0.9%	-2.2%
USD/SGD	1.23	1.22	1.22	1.21	1.20	-0.7%	-0.7%	-1.5%	-2.2%
USD/THB	30.92	30.60	30.40	30.20	30.00	-1.2%	-2.2%	-3.2%	-4.7%
USD/TWD	29.35	29.20	29.20	28.75	28.50	-0.5%	-0.3%	-1.6%	-1.8%
USD/ARS	4.69	4.72	4.82	5.04	5.54	-1.0%	-2.8%	-5.0%	-7.6%
USD/BRL	2.03	2.00	2.00	2.00	1.95	-2.0%	-2.7%	-3.7%	-8.5%
USD/COP	1796	1810	1820	1820	1810	0.4%	0.2%	-0.6%	-2.6%
USD/CLP	470	470	475	475	480	-0.4%	-0.2%	-1.4%	-2.2%
USD/MXN	12.86	12.70	13.00	12.65	12.50	-1.5%	0.2%	-3.3%	-6.1%
USD/PEN	2.59	2.60	2.57	2.57	2.56	0.2%	-1.2%	-1.6%	-2.7%
EUR/CZK	25.10	24.70	25.00	25.00	24.50	-1.6%	-0.4%	-0.4%	-2.4%
EUR/HUF	285	278	285	290	295	-2.9%	-1.2%	-0.5%	-0.7%
EUR/PLN	4.15	4.10	4.10	4.15	4.15	-1.6%	-2.3%	-2.1%	-3.7%
EUR/RON	4.52	4.50	4.50	4.45	4.40	-0.7%	-1.5%	-3.7%	-6.9%
USD/RUB	31.09	30.00	30.50	30.00	30.00	-4.0%	-3.4%	-6.3%	-9.1%
BSK/RUB	35.10	34.32	35.24	33.78	32.97	-2.9%	-1.4%	-6.6%	-11.4%
USD/TRY	1.79	1.80	1.80	1.85	1.85	0.2%	-0.6%	0.9%	-1.8%
USD/ZAR	8.18	7.95	8.30	8.05	7.85	-3.2%	0.2%	-3.9%	-8.4%
USD/ILS	3.92	3.88	3.80	3.77	3.75	-1.0%	-3.2%	-4.3%	-5.3%
USD/EGP	6.09	6.20	6.50	7.00	7.00	1.2%	4.3%	9.7%	2.6%

Source: Barclays Research

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