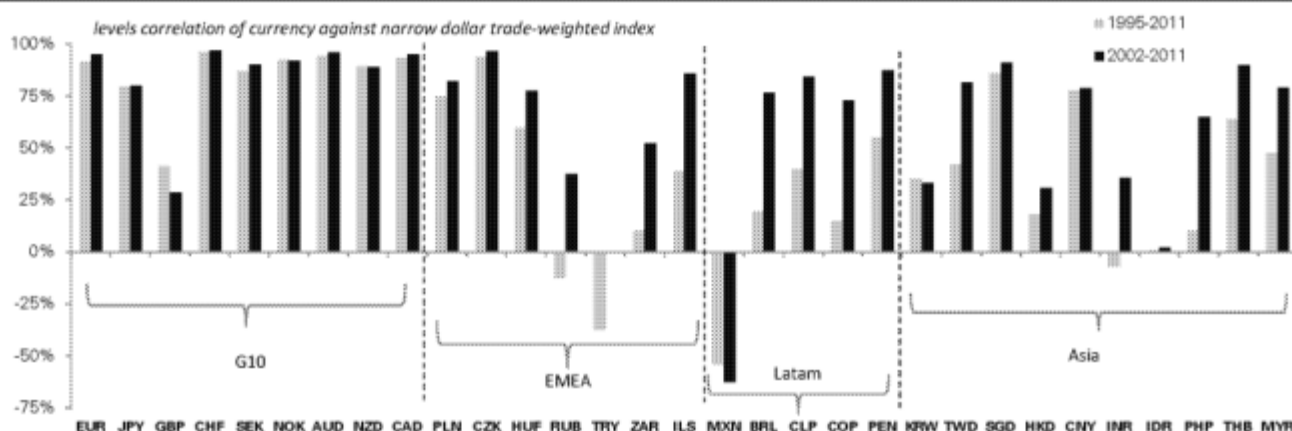


Figure 21: Almost All FX Weaken When Dollar Strengthens.

Source: Deutsche Bank, EcoWin.

We only expect modest CNY appreciation against the dollar. One measure of valuation points to only modest undervaluation (see Figure 20). Moreover, the decline in China's current account has been quite sharp. If China wishes to see a return of the current account balance back to its recent average, then the CNY would have to weaken (see Figure 20).

Importantly, we expect the China-linked currencies such as AUD to weaken to 0.85 by 2015 (and 1.00 by year-end, 0.90 by end-2014). The risks around switching from an investment-led growth model to a consumption-based model, that is, China rebalancing, suggests the risks for these currencies are to the downside.

Other currencies should broadly follow the dollar. Indeed, past correlations suggest that most EM currencies follow the narrow dollar trend (see Figure 21). The main exception is the Mexican peso which has tended to strengthen with dollar strength. Some of the high-yielding currencies such as TRY, INR, IDR and RUB have tended not to see their spot move with the dollar trend.

Through all of these individual currency forecasts, the most important point is that the 9-10 years of dollar weakness is now behind us, and the beginning of a multi-year uptrend is unfolding.

Bilal Hafeez, London, +44 20 7547 1489