



# G10 FX Outlook: GBP & USD are the Stars



**BNP PARIBAS**  
CORPORATE & INVESTMENT BANKING

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Frankfurt - January 2014

Steven Saywell  
Global Head of FX Strategy

# FX Themes



**USD:** Tapering should support a stronger USD against the other lower yielding G10 currencies. Long USD positioning has not fully recovered, which provides scope for upside despite for consensus for USD strength.



**EUR:** Further ECB policy easing is increasingly likely and we forecast a further rate cut in early 2014. EUR will suffer from this while current account support is also fading. We forecast 1.23 EURUSD by end-2014.



**Asia:** Growth in the region to remain robust, but Fed tapering expectation to impact USD vs Asia. Asian currencies may struggle in 2014.



**JPY:** USDJPY to rise as the BoJ remains committed to very loose policy, in contrast to a Fed that is heading towards the exit. Domestic investors to continue to be crowded out of the JGB market and allocating funds abroad. We forecast 118 USDJPY by end-2014.



**GBP:** The recovering in UK economy to continue to underpin the GBP. Market positioning is extreme long but it remains cheap vs long-term valuation. We forecast 0.78 EURGBP by end-2014.



**CHF:** EURCHF to rally as global growth recovers, but further ECB easing will provide a headwind. As the Swiss begin to recycle large current account surplus we forecast a gentle rise to 1.25 EURCHF by end-2014.



**AUD, NZD, CAD:** Pockets of EM resilience + local growth will be enough to shield commodity currencies strong as Chinese growth remains robust.. AUD & NZD now appear undervalued.

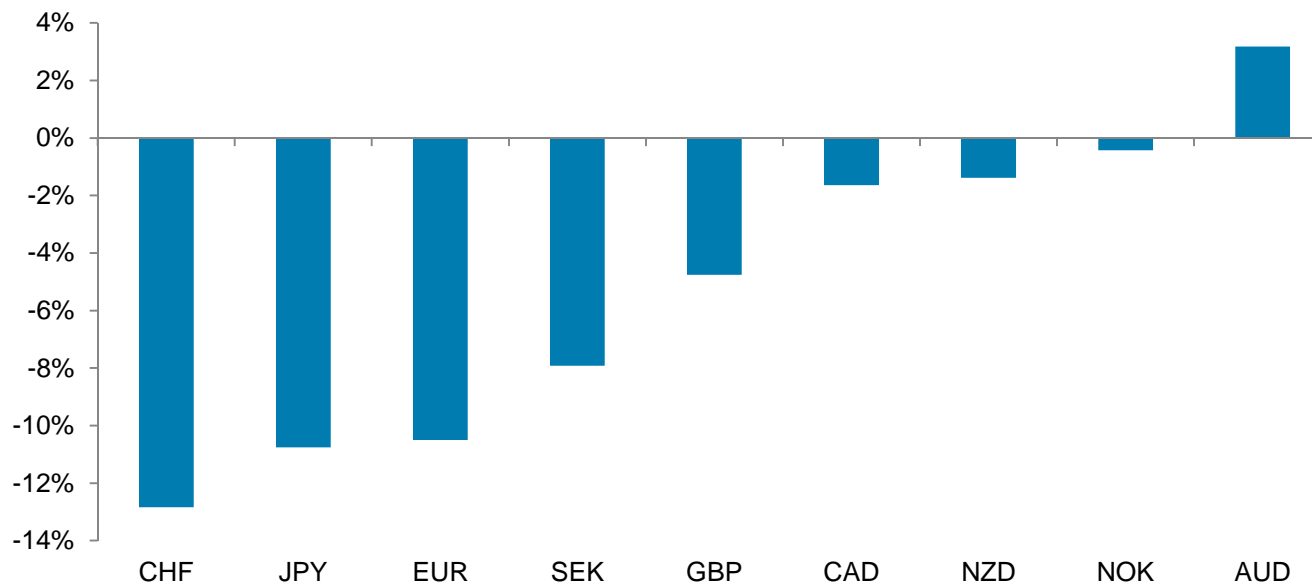


**NOK, SEK:** Scandinavian currencies appear oversold currently, in particular the NOK should recover against the SEK in 2014.



# We expect USD to gain broadly in 2014

Forecast percentage change vs. USD from 01-Jan-2014 to end 2014



Source : Ecowin Reuters, BNP Paribas



**Sharper USD gains are due in 2014 especially vs EUR, JPY & CHF**



# Fed Tapering agenda

## Current BNP Paribas Forecast: Monthly Pace of Purchases Expected at Future FOMC Meetings (USD bn)

		Tsy	chg	Agy MBS	chg	Total	chg
<b>2013</b>	<b>Dec 17-18*</b>	40		35		75	
	Jan 28-29	35	-5	30	-5	65	-10
	<b>Mar 18-19*</b>	30	-5	25	-5	55	-10
	Apr 29-30	25	-5	20	-5	45	-10
<b>2014</b>	<b>Jun 17-18*</b>	20	-5	15	-5	35	-10
	Jul 29-30	15	-5	10	-5	25	-10
	<b>Sep 16-17*</b>	10	-5	5	-5	15	-10
	Oct 28-29	5	-5	0	-5	5	-10
	<b>Dec 16-17*</b>	0	-5	0		0	-5

\* Indicates a meeting w/ SEP forecasts and a press conference

Source : BNP Paribas

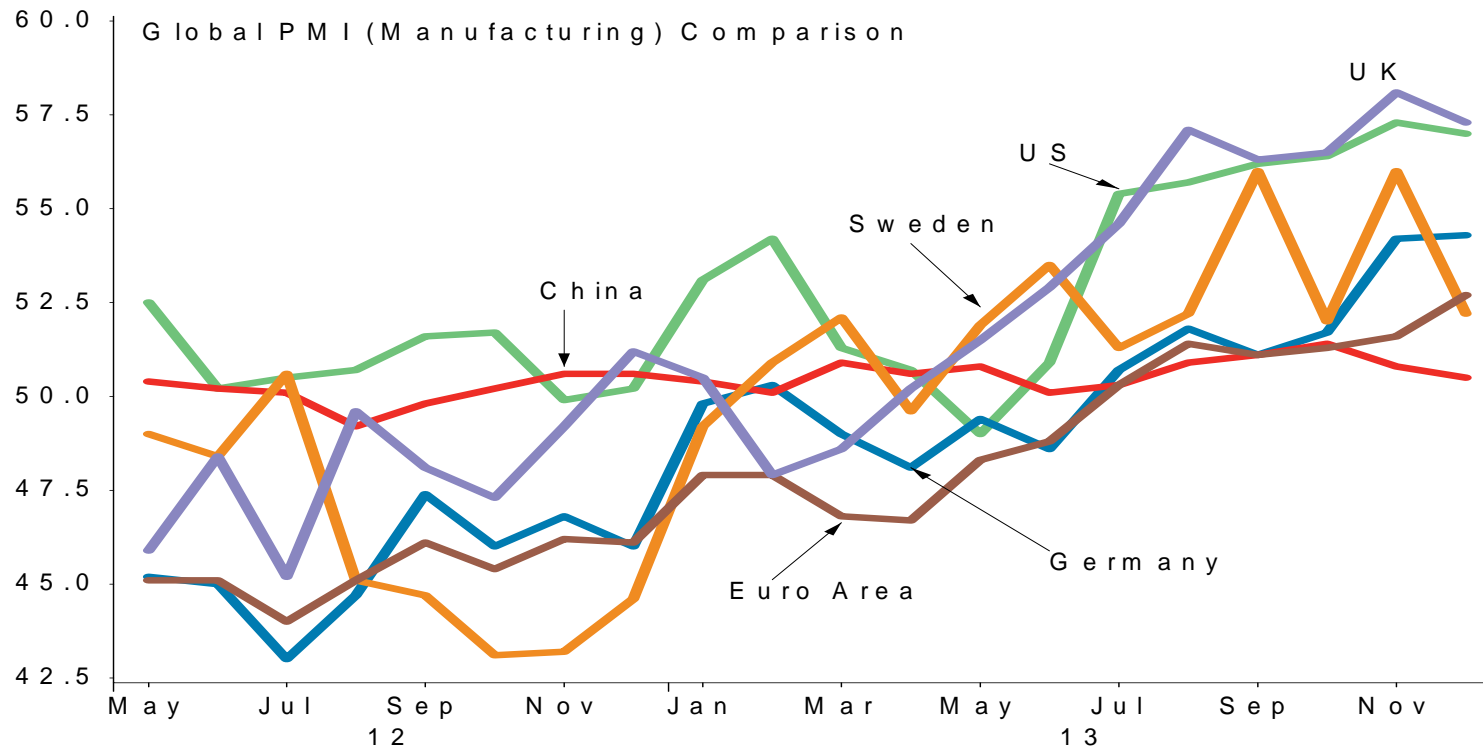


**Our basecase is in line with the agenda laid out by the Fed**



# US & UK move to the top of the pack

## Comparison of major countries PMI readings (Manufacturing)



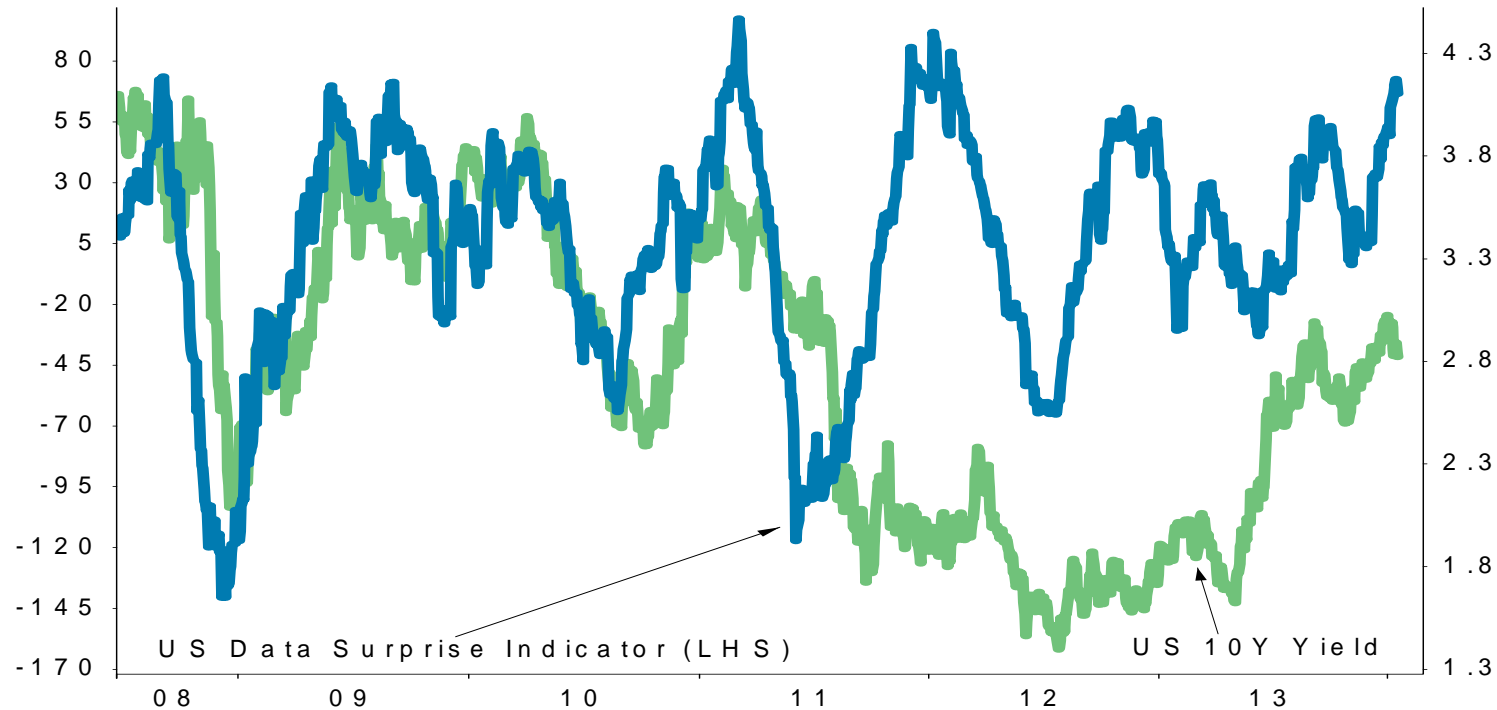
Source : Ecwin Reuters, Bloomberg, BNP Paribas

➤ **US and the UK outpace the rest, eurozone and China lag**



# US yields hit new highs recently

## US Data surprise index vs. 10 year yields



Source : US Federal Reserve, BNP Paribas

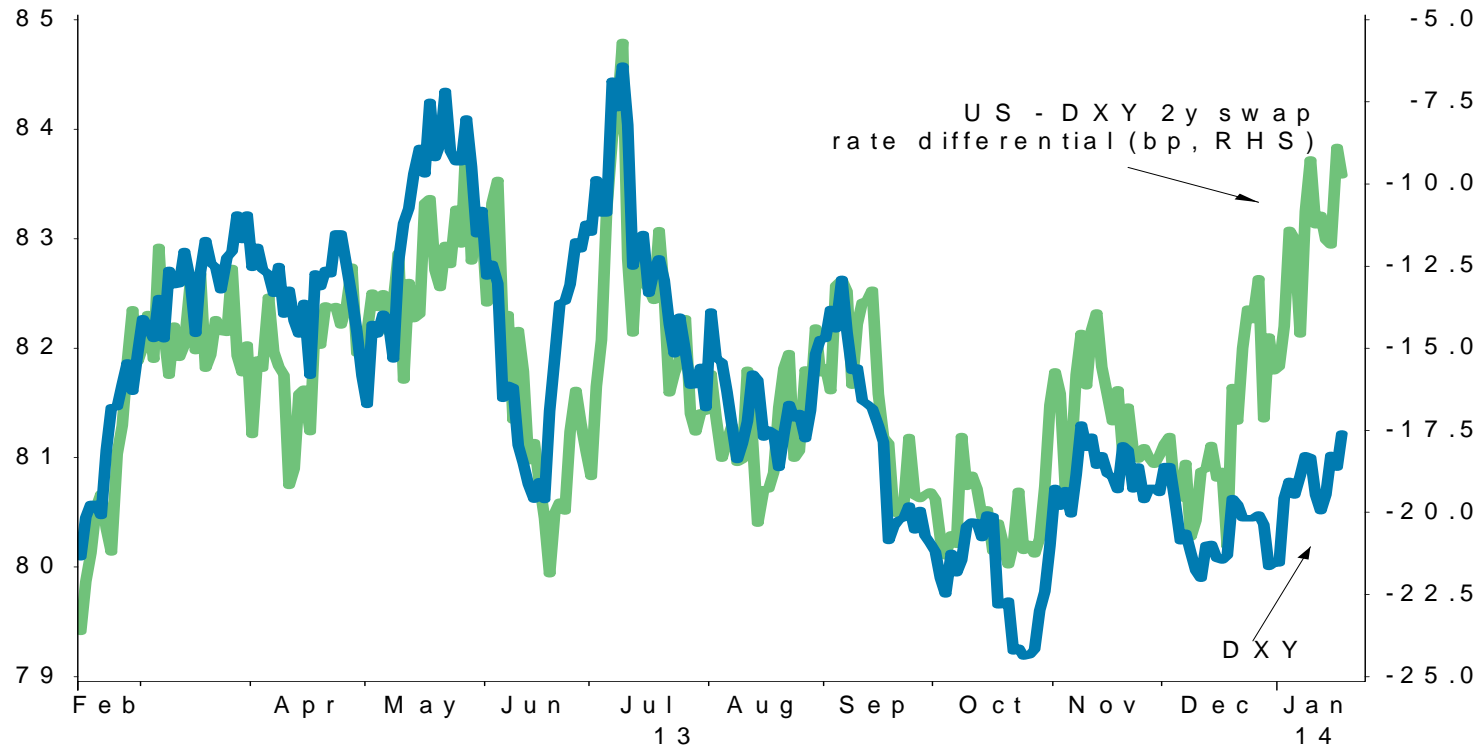


**Fed QE has kept yields subdued despite improving data...but yields are starting to relink.**



# The USD continues to takes its lead from US yield

## DXY (USD Index) vs US 2 yr swap spread - DXY components



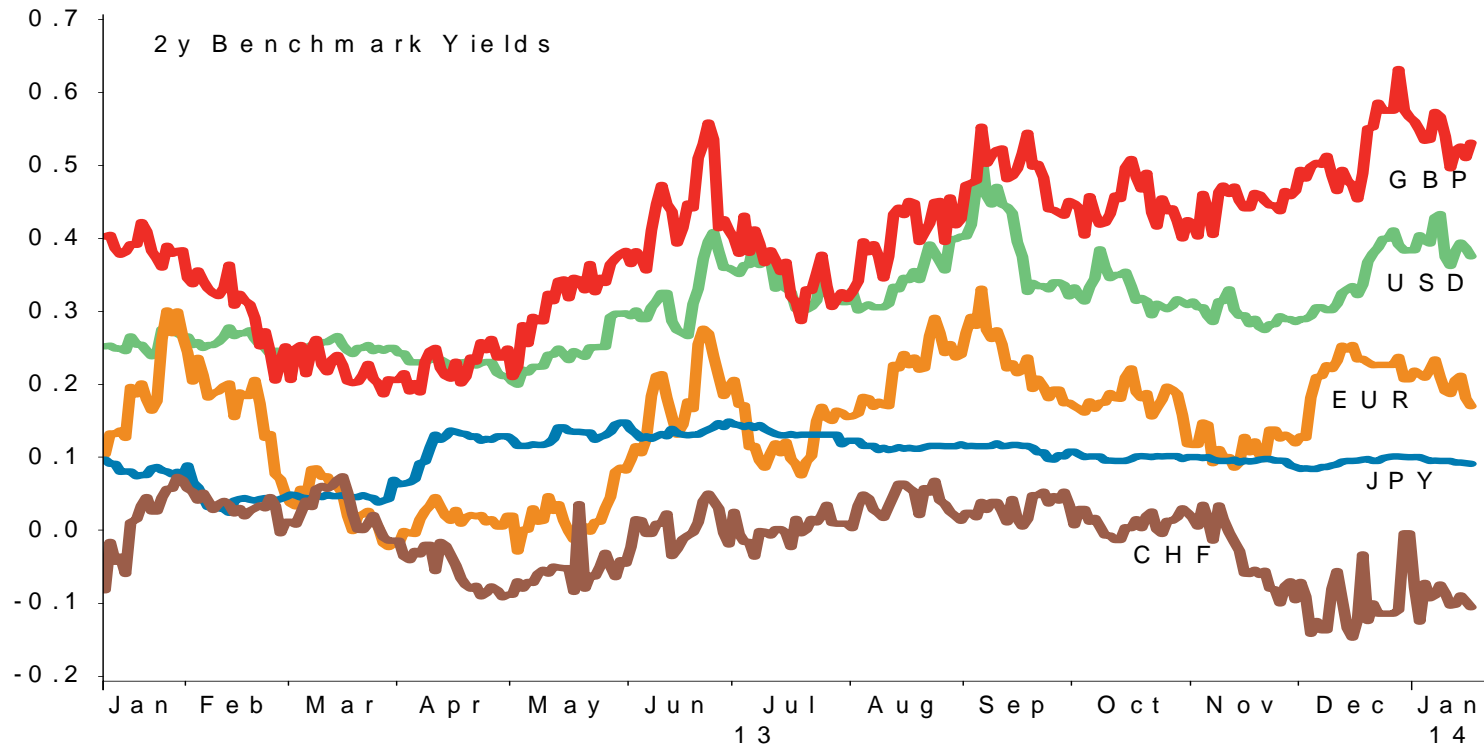
Source : Ecowin Reuters, BNP Paribas

➤ **The USD continues to takes its lead from yields. USD is now lagging the yield pick-up**



# USD is set to rise against the low-yielders

## 2Y Sovereign Benchmark yields (bp)



Source : Ecowin Reuters, BNP Paribas



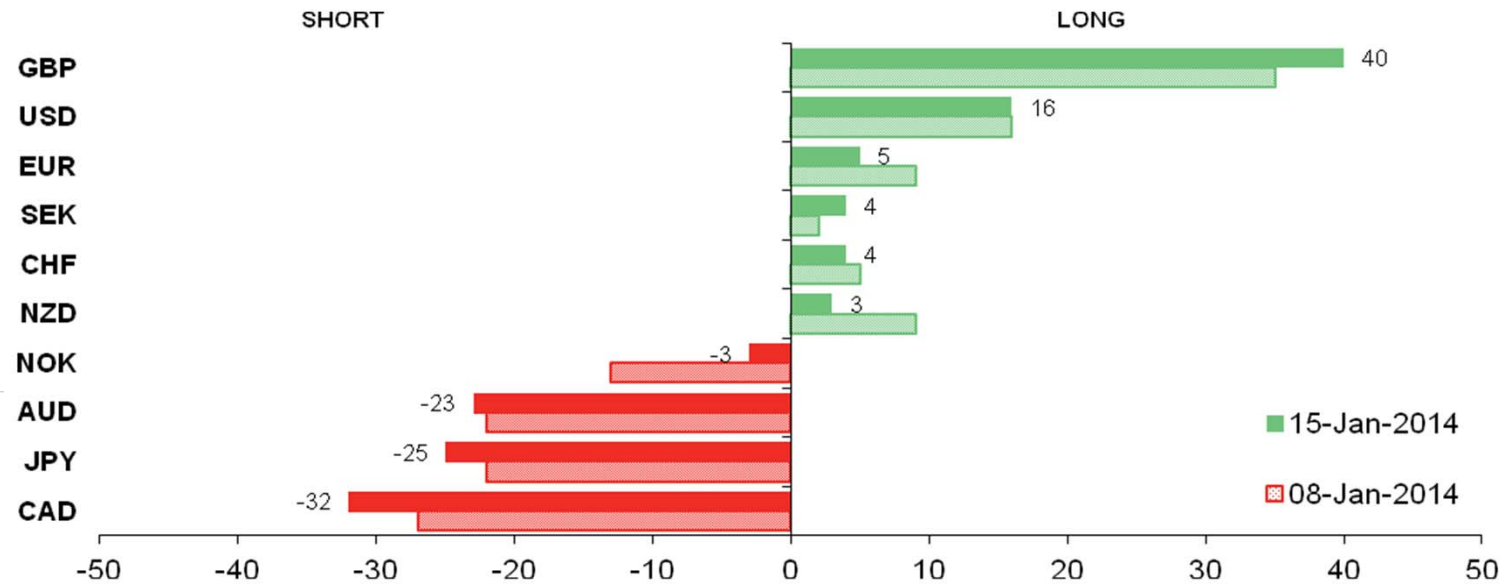
**EUR & GBP yields rise in tandem with USD,  
but JPY & CHF stay low**





# Largest FX market positions are long GBP & short CAD, JPY

## BNP Paribas Estimate of FX Market Positioning



Source : BNP Paribas

### Methodology

BNP Paribas FX Positioning Analysis is a broad gauge of positioning that combines the following factors:

- Client Exposure – Internal sales desks' estimate of FX investor exposure
- IMM – The Commitment of Traders (CFTC) is a widely used proxy for US-based hedge-fund/CTA activity.
- Risk reversals – Risk reversals indicate the relative price of calls relative to puts, and thus incorporate a option "market sentiment" function.
- Beta – Decomposition of the BTOP managed currency index.
- BNPP Trending Indicator. - A technical measure of the strength of a currencies momentum.

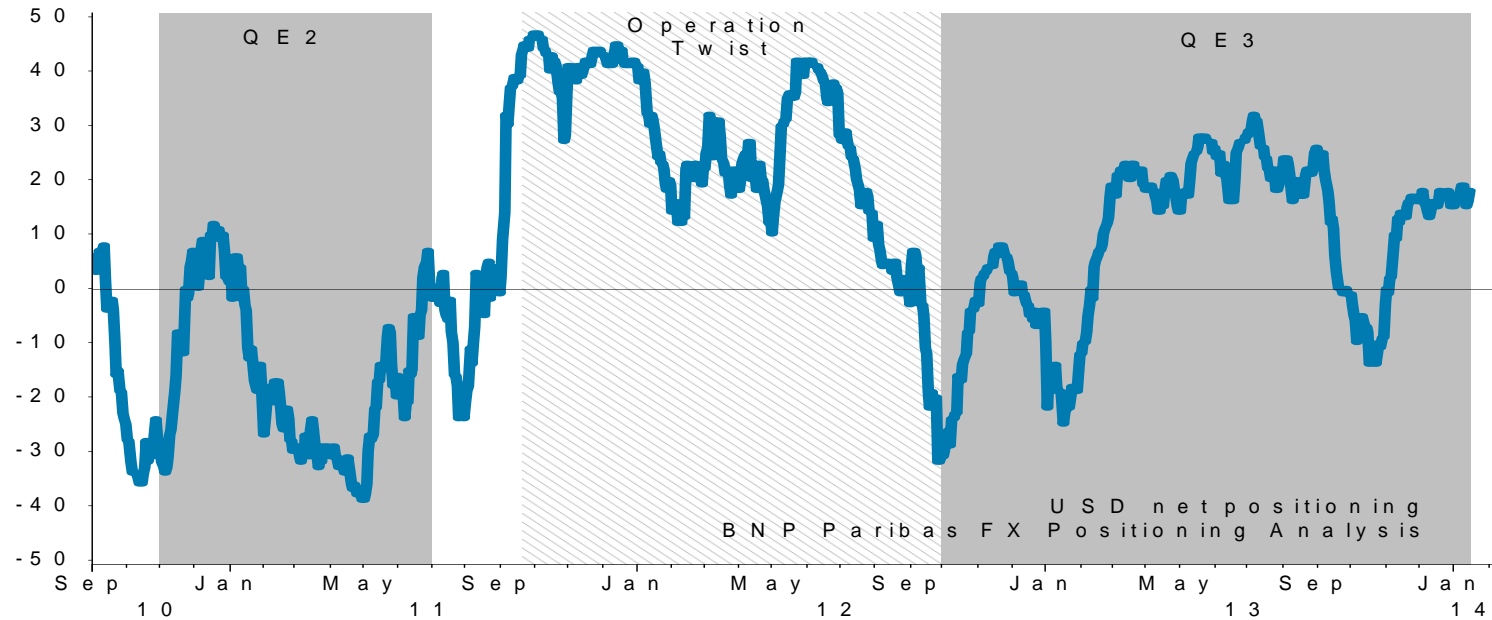
The overall currency score is then calculated as the equally weighted sum of the components

➤ CAD shorts have overtaken AUD & JPY, while GBP is the largest long positioning



# FX participants shift to a net long USD exposure

## BNP Paribas Estimate of FX Market Positioning for USD



Source : Ecowin Reuters, BNP Paribas

### Methodology

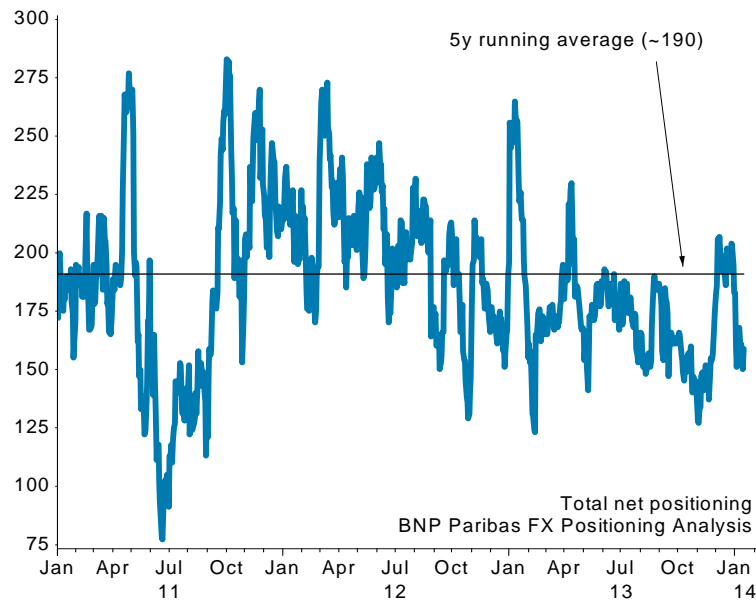
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➔ **FX investors generally establish USD shorts during QE. But the more data contingent nature of QE3 has made markets less comfortable funding in USDs.**

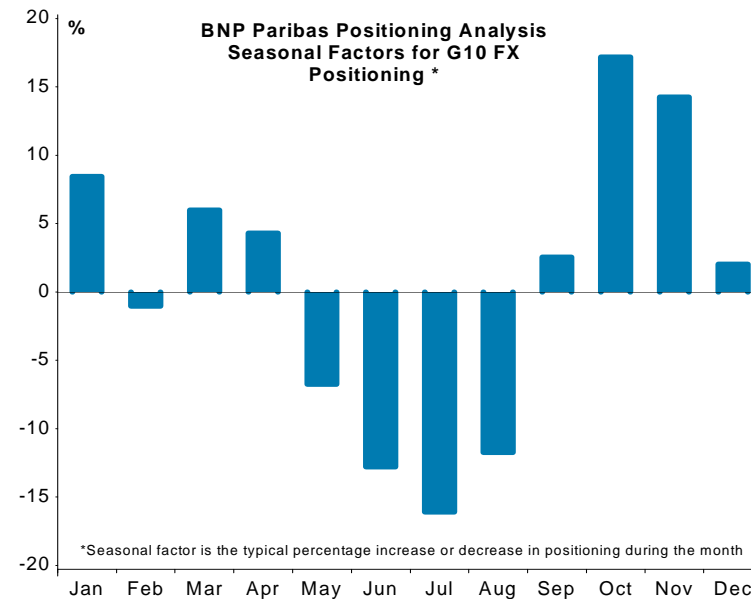


# Overall FX positioning is low

Total G10 positions



Positions typically build in Oct. and Nov.



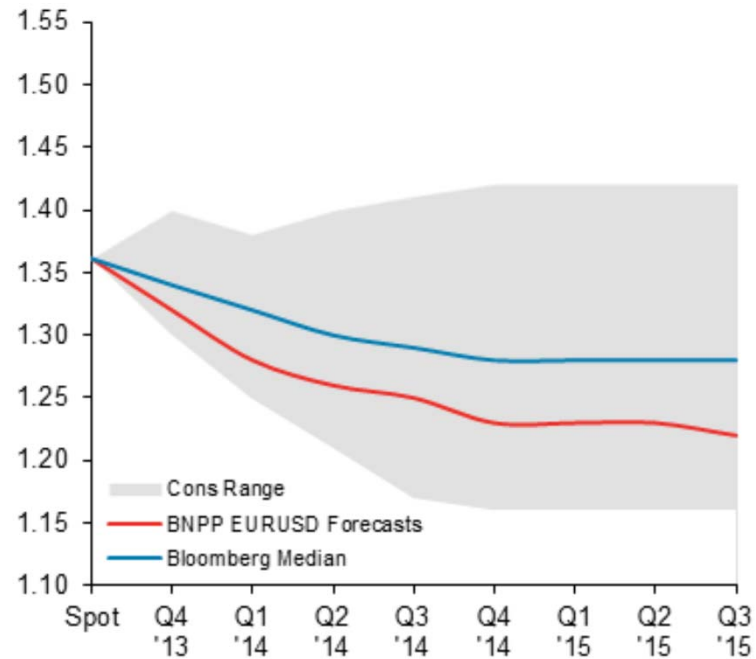
Source : Ecowin Reuters, BNP Paribas

➤ **Seasonal analysis shows that October and November are when FX positioning is usually highest**

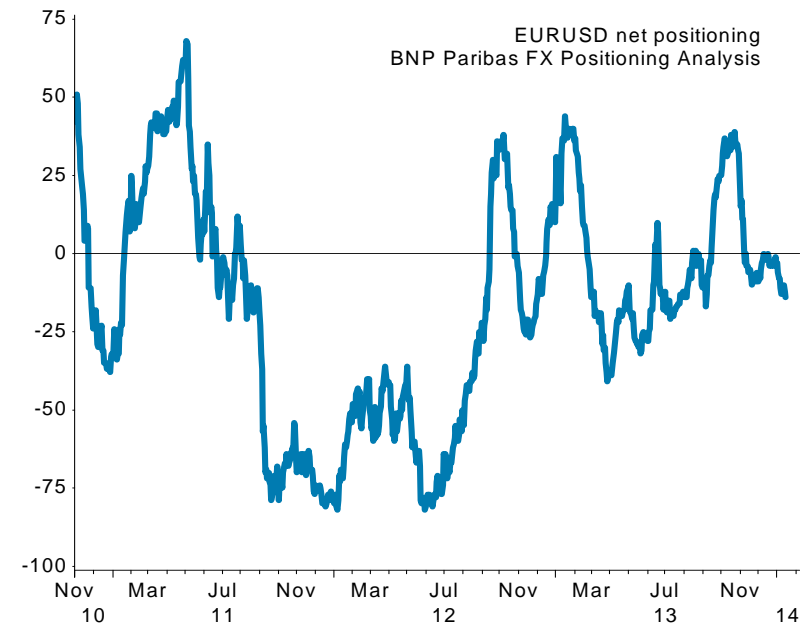


# Dislocation between market views and positioning

## BNP Paribas Forecasts vs Consensus



## EURUSD Implied Positioning



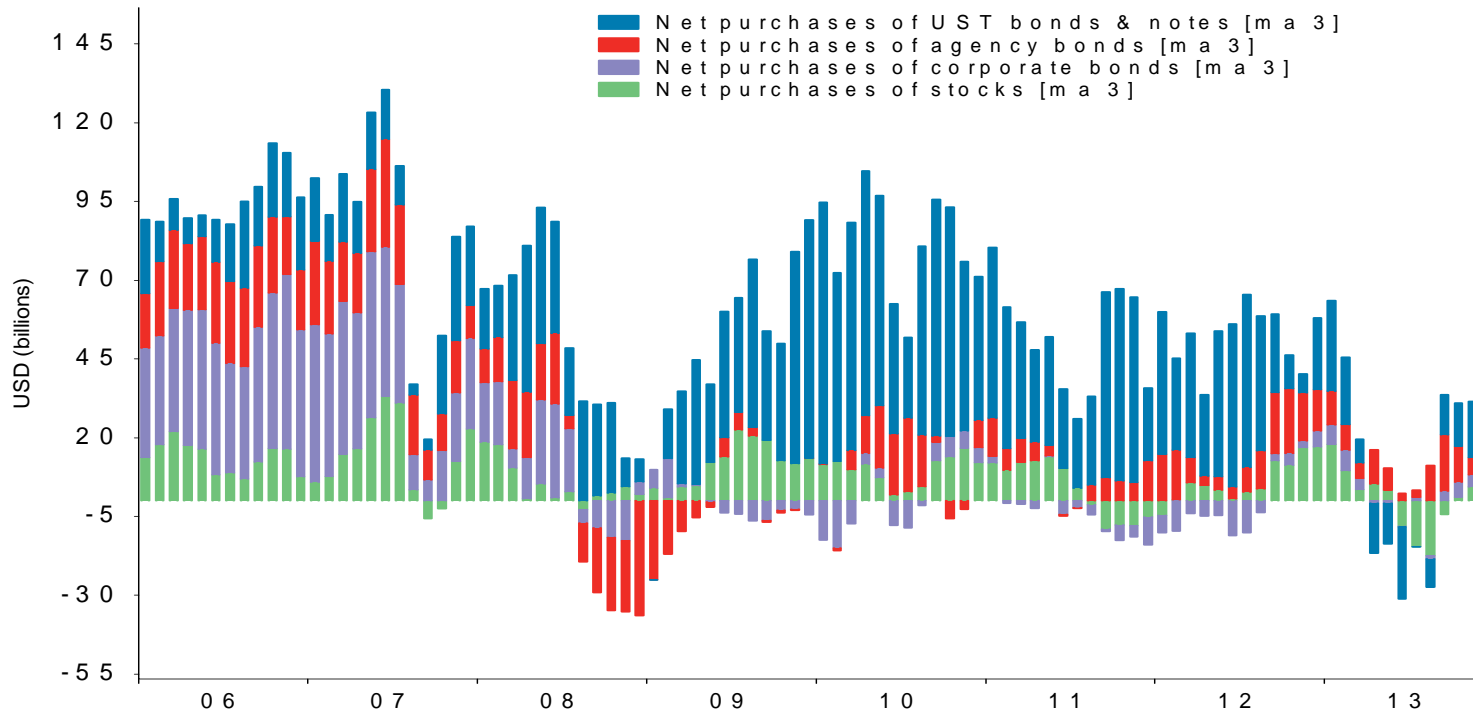
Source : Ecowin Reuters, BNP Paribas

➤ **Market consensus is bullish USD, but investors have only started to put on the position**



# US TIC capital flow data

## US TIC capital flow data broken down by asset type



**Inflows into US Treasuries and Agency debt have returned**





EUR strength is starting to wane:  
EURUSD is set to fall

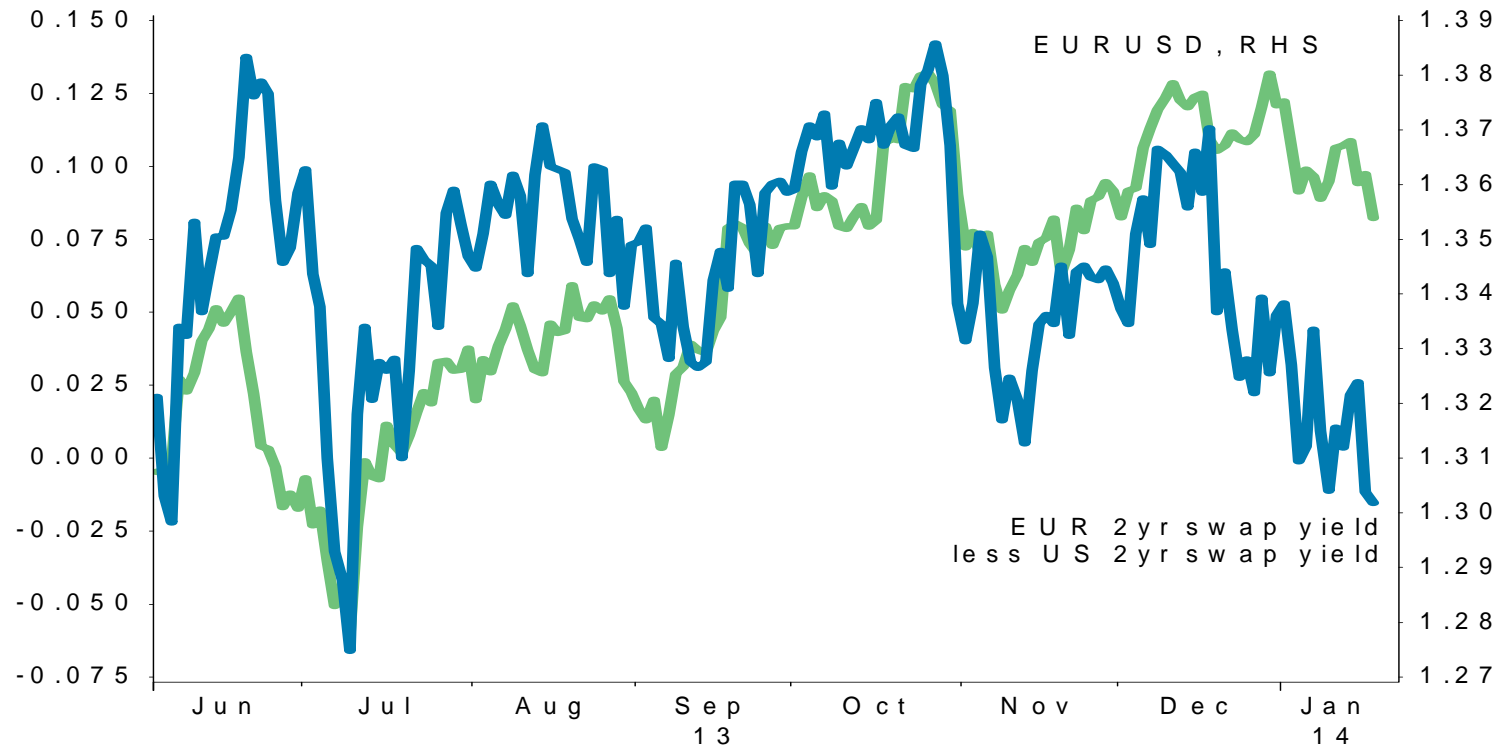


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# EURUSD has now diverged from interest rate spreads

## EURUSD vs. 2-yr euro-US swap spread



Source : Ecowin Reuters, BNP Paribas

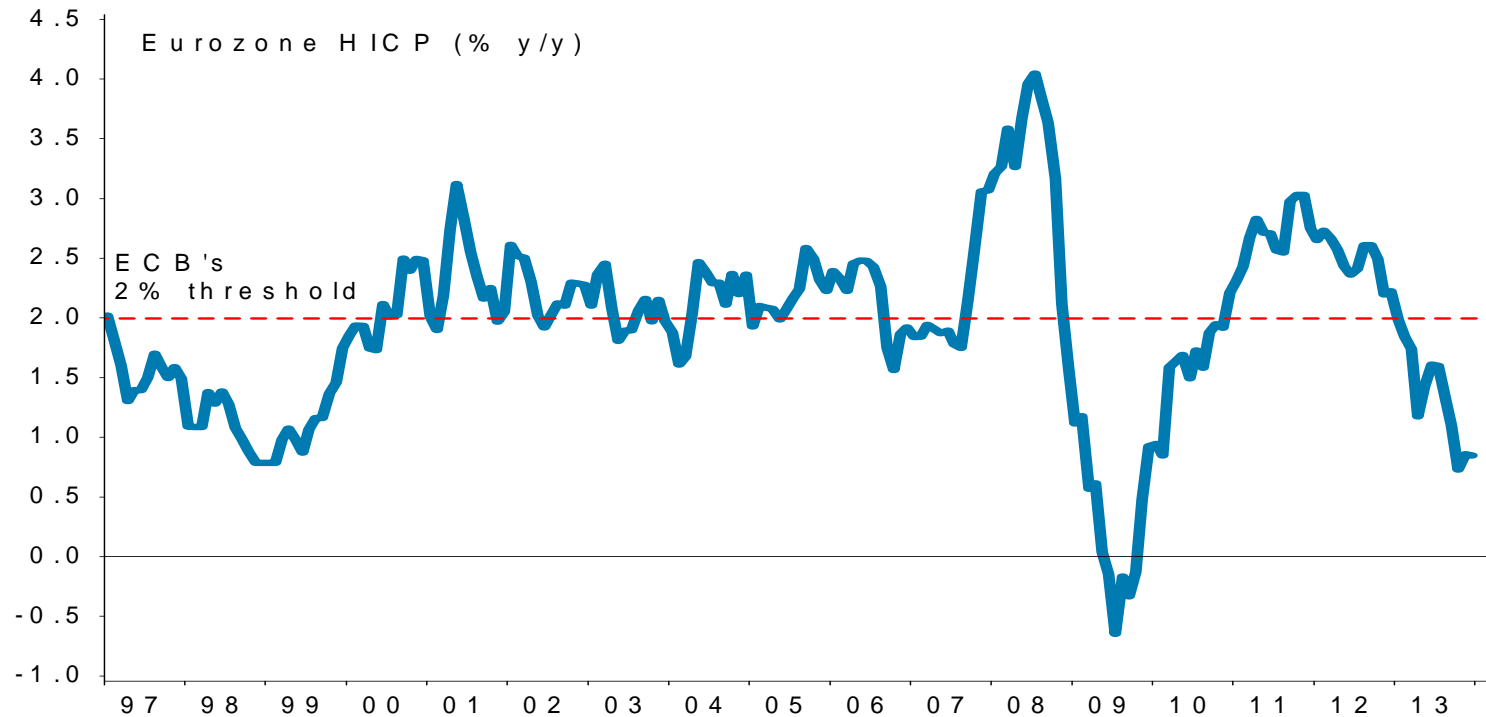


**US fiscal stress has pushed EURUSD way beyond fundamentals**



# Eurozone inflation undershoots sharply

## Eurozone Inflation CPI (HICP) y/y % change



Source : Ecowin Reuters, BNP Paribas

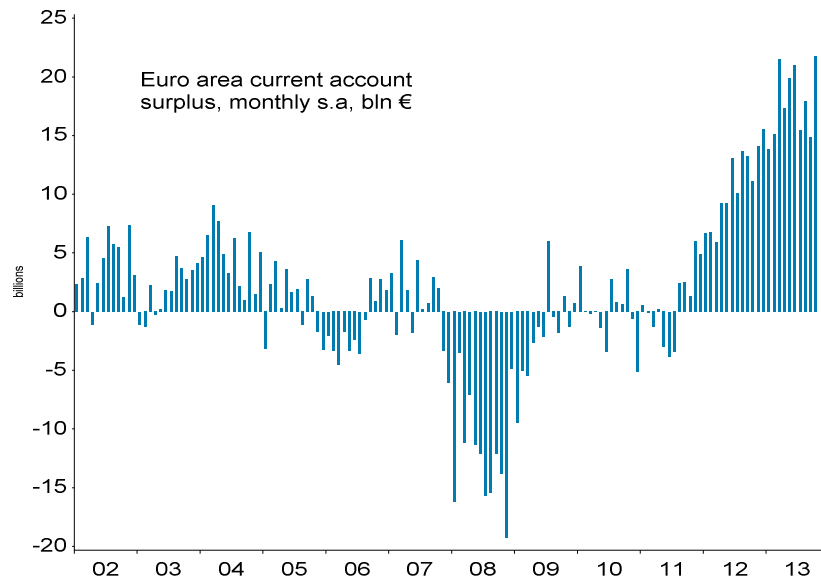
➤ The sharp undershoot in inflation increases prospects for ECB easing. We forecast a refi rate cut in December



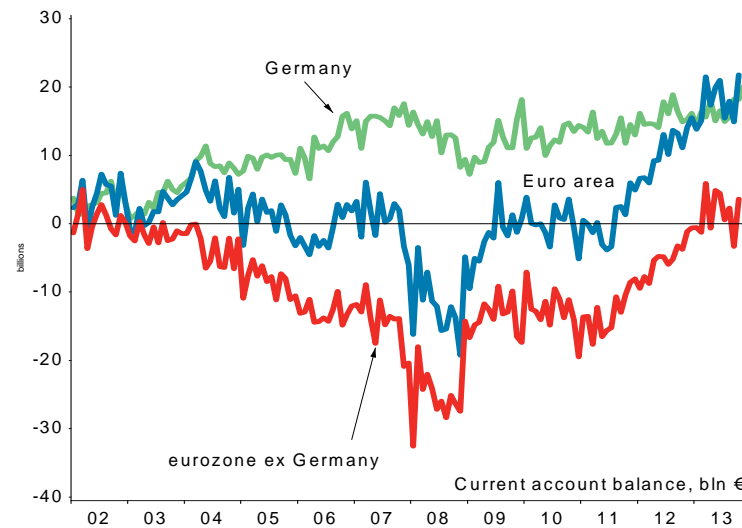


# Support from the current account is fading

## C/A surplus appears to have peaked



## Periphery has driven the deterioration



Source : Ecwin Reuters, BNP Paribas

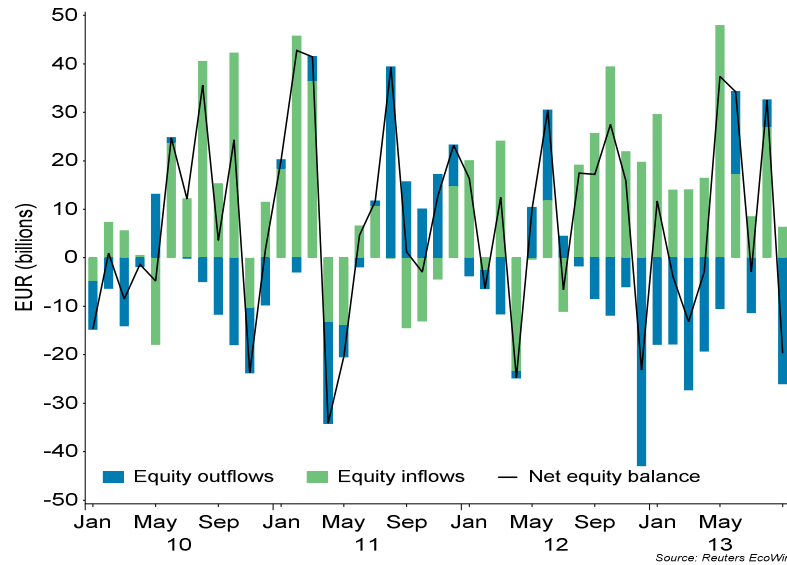


**Eurozone current account suggest greater EUR vulnerability**



# Eurozone Financial Account Breakdown

Equity balance turned negative in Sep.



Stock market yield suggests lower inflows



Source : Ecowin Reuters, BNP Paribas

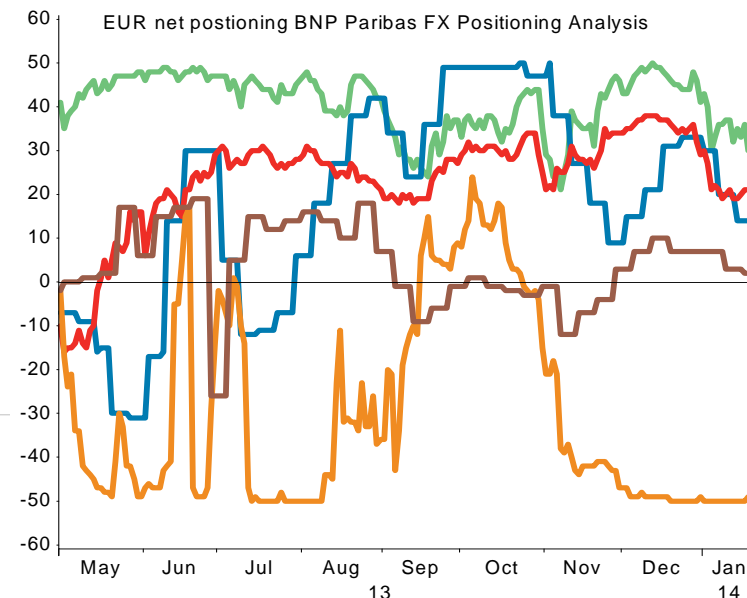
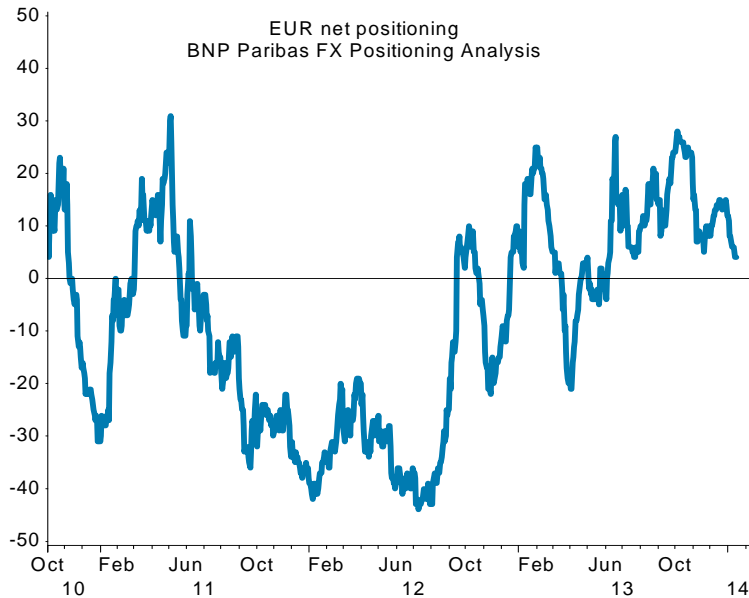


**Portfolio flow data show the EUR surplus is being recycled more efficiently now**



# Market Positioning remains Long EUR

## EUR Market Positioning



Trending Indicator    FX Funds  
Risk Reversals    IMM    Clients

Source : BNP Paribas

### Methodology

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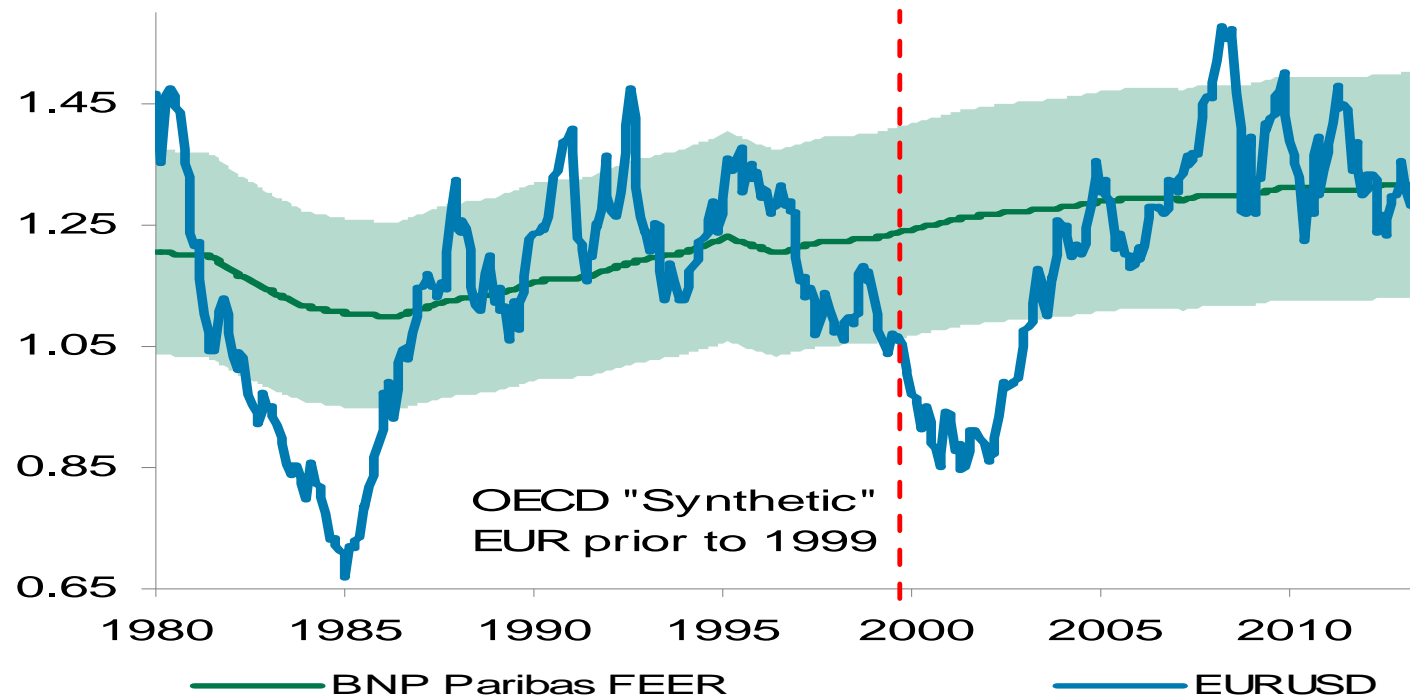
The market remains long EUR despite dovish ECB rhetoric



# EURUSD trades very close to its fair value

## BNP Paribas FEER for EURUSD

BNPP FEER (Fundamental Equilibrium Exchange Rate) is the value of an exchange rate when an economy is operating with an internal balance (i.e. output in line with potential output, full employment and inflation in line with central bank's target) and a sustainable current account balance.



Source : BNP Paribas



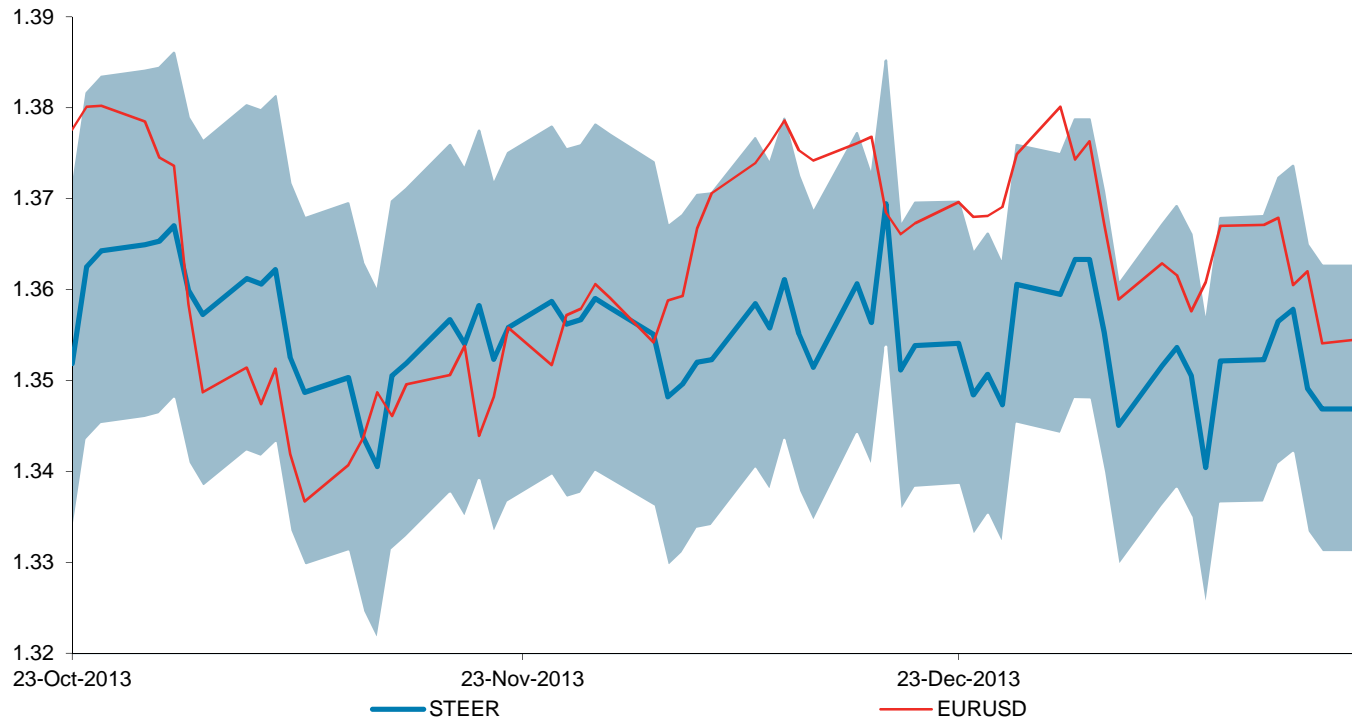
**EURUSD FEER is estimated at 1.32, so EURUSD is not overvalued despite Fed QE3**



# Our STEER model signals EURUSD is trading above fair value

## BNP Paribas STEER™\* fair value model EURUSD

\*BNPP STEERs are regression based short-term fair-values based on relationships between exchange rates, interest rate markets, equity markets and commodity markets.



Source : BNP Paribas

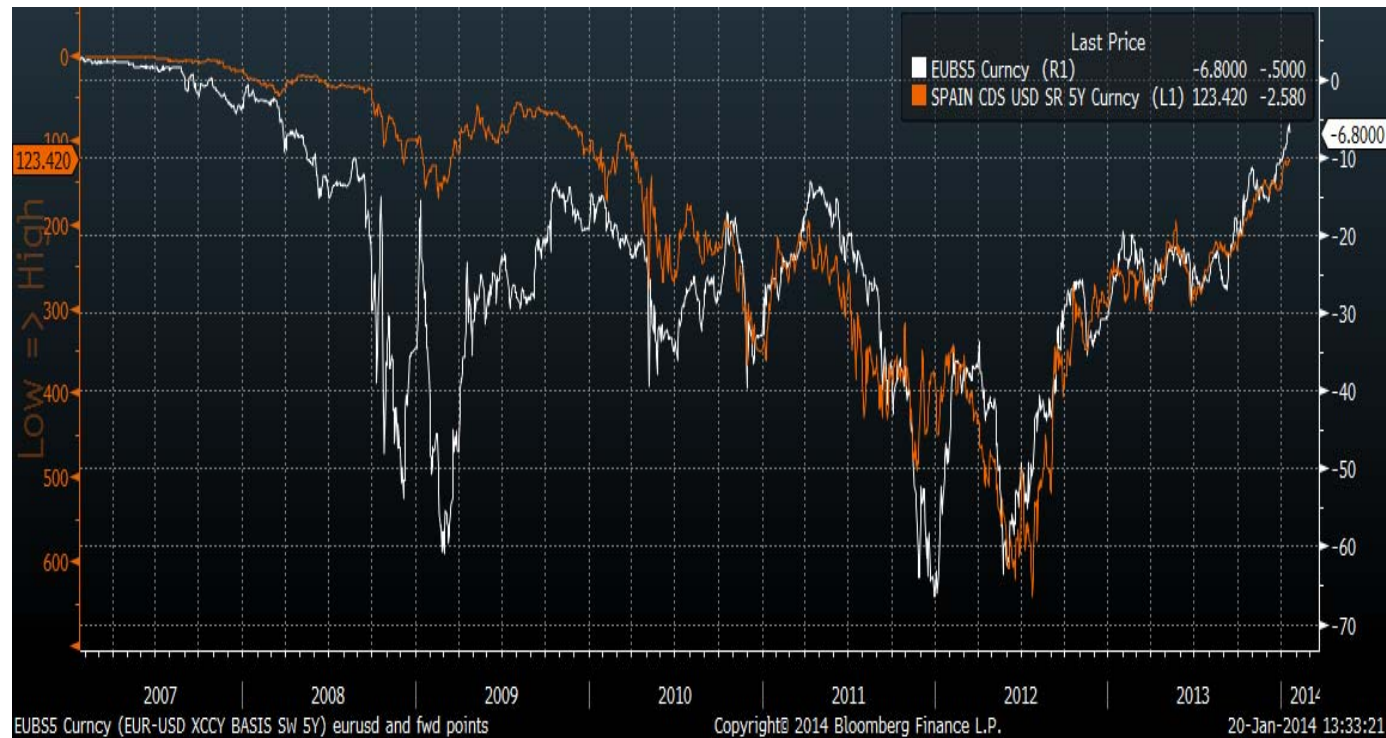


**EURUSD trades inside of its corridor**



# Relaxation in Eurozone stress normalizes euro basis

## Spanish 5 Year CDS vs Euro Basis 5 year swap



➤ Euro basis normalization creates opportunities for some corporates





JPY to be driven higher by  
“Abenomics.”

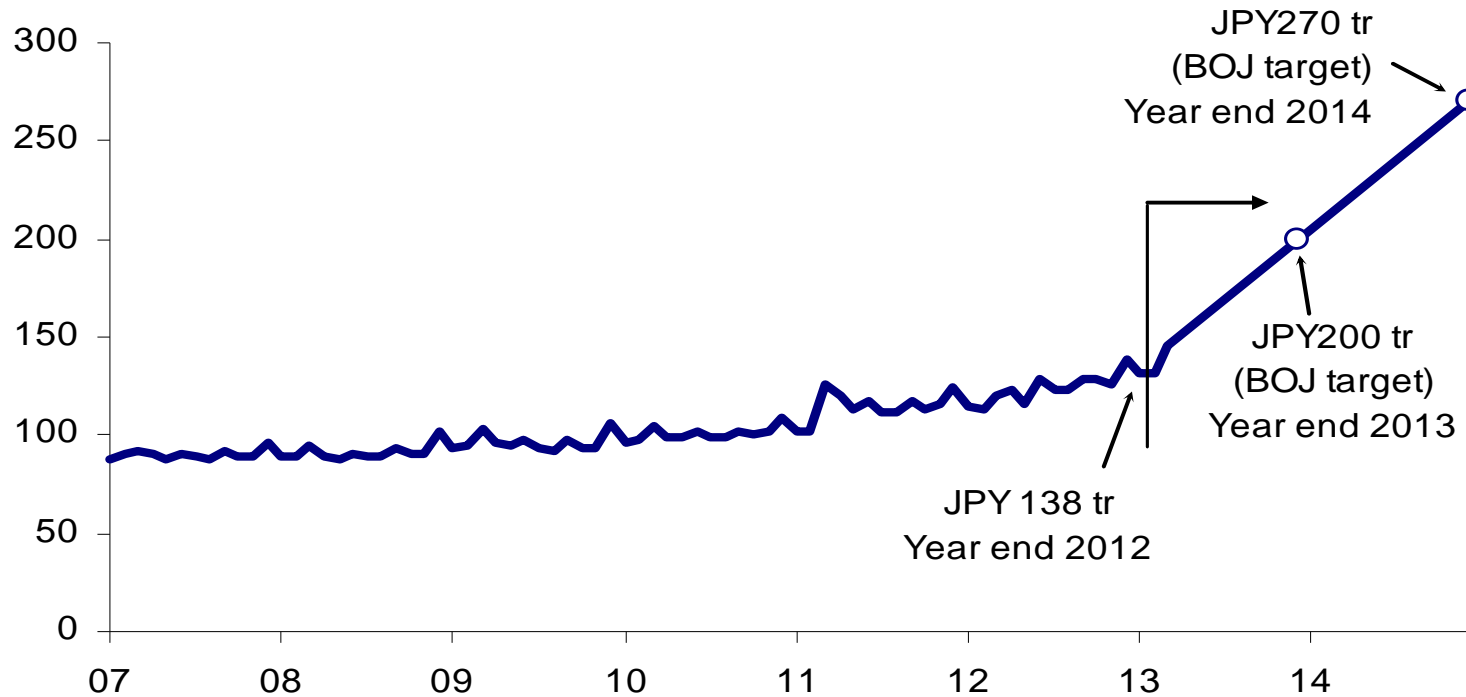


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# The BOJ undertakes a dramatic increase in policy

Japanese monetary base projections (JPY trillions)



Source : BoJ, BNP Paribas



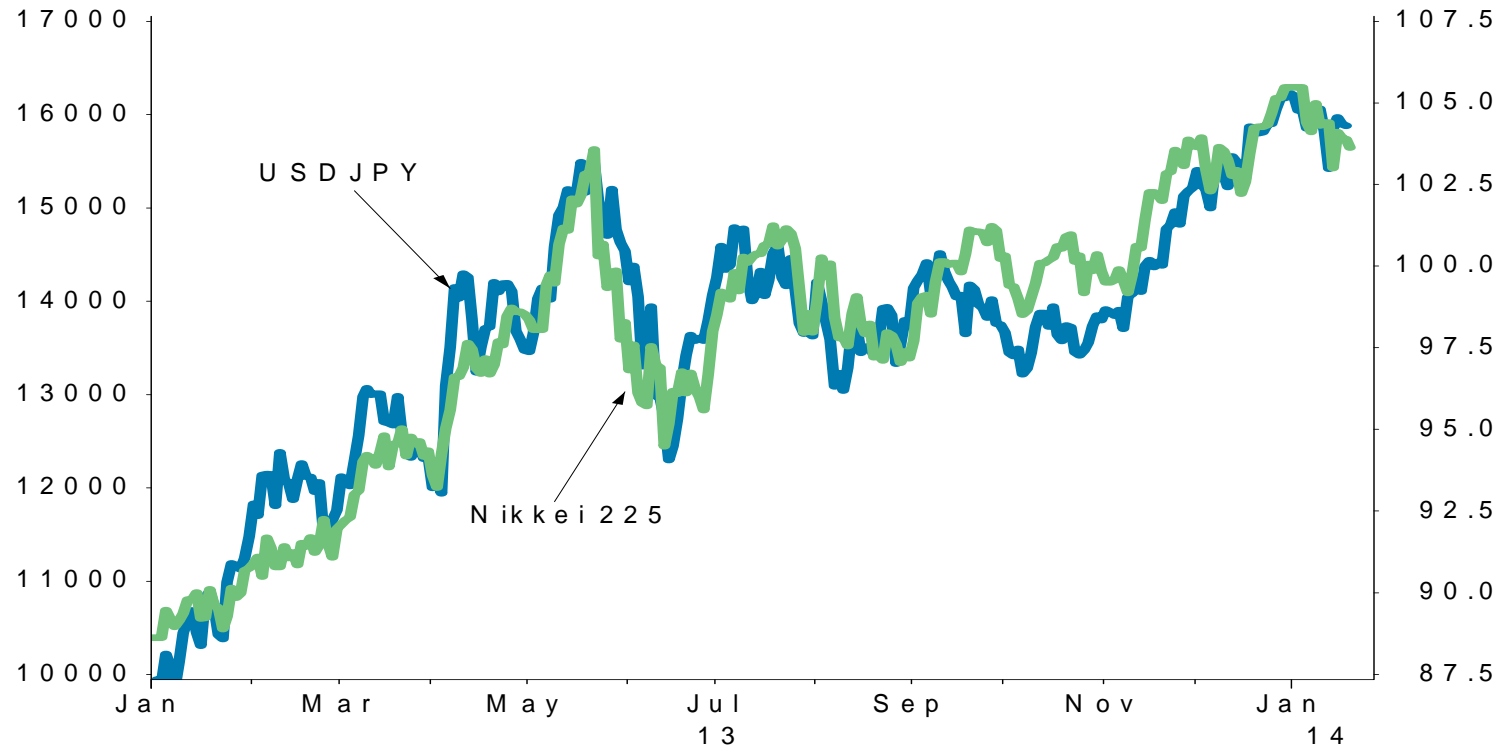
**The policy shift under Governor Kuroda is dramatic**





# USDJPY is highly correlated to Nikkei 225

## USDJPY vs. Nikkei 225



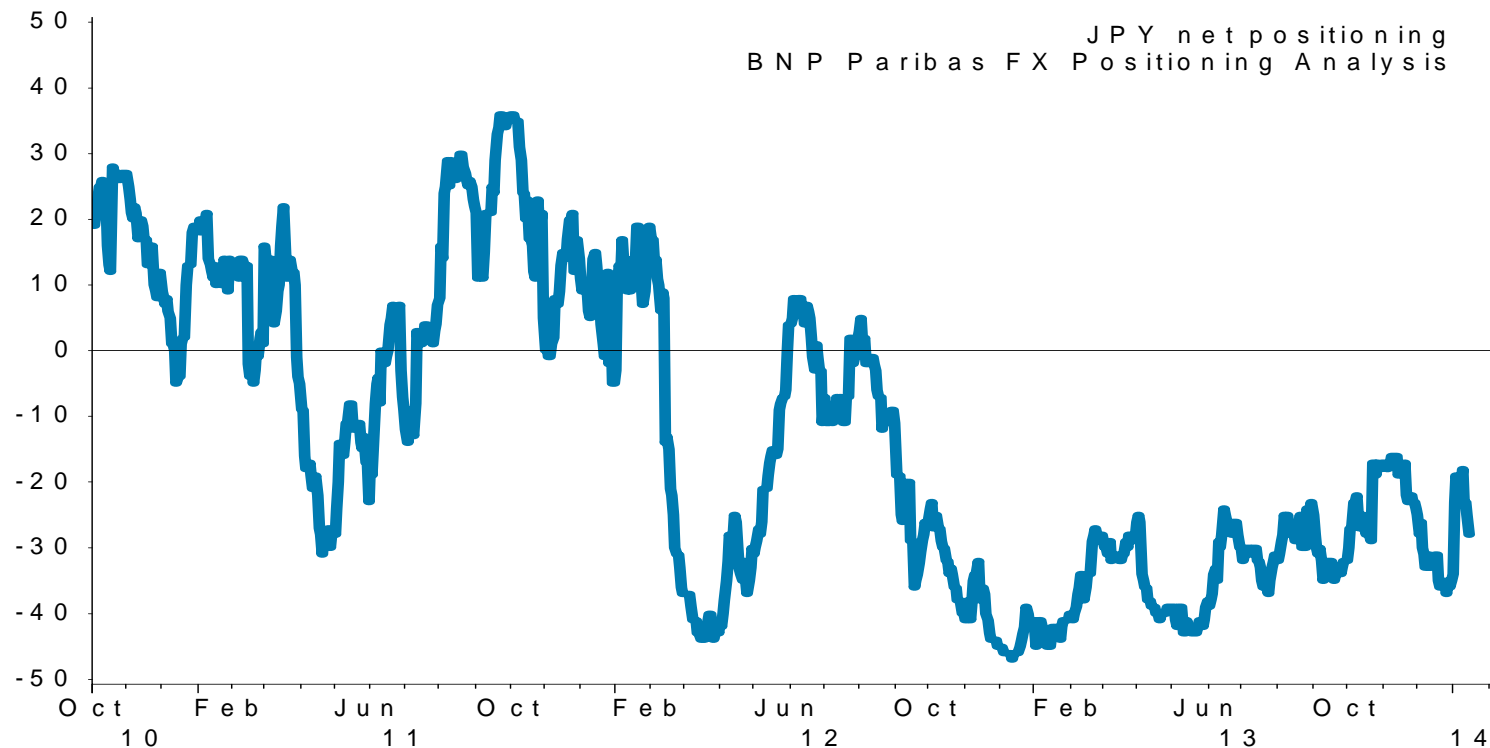
Source : Ecowin Reuters, BNP Paribas

➤ The close link between Japanese equities and the JPY is policy driven by “Abenomics”



# JPY short exposure had fallen to just -16...

## BNP Paribas FX Positioning Analysis (JPY)



Source : BNP Paribas

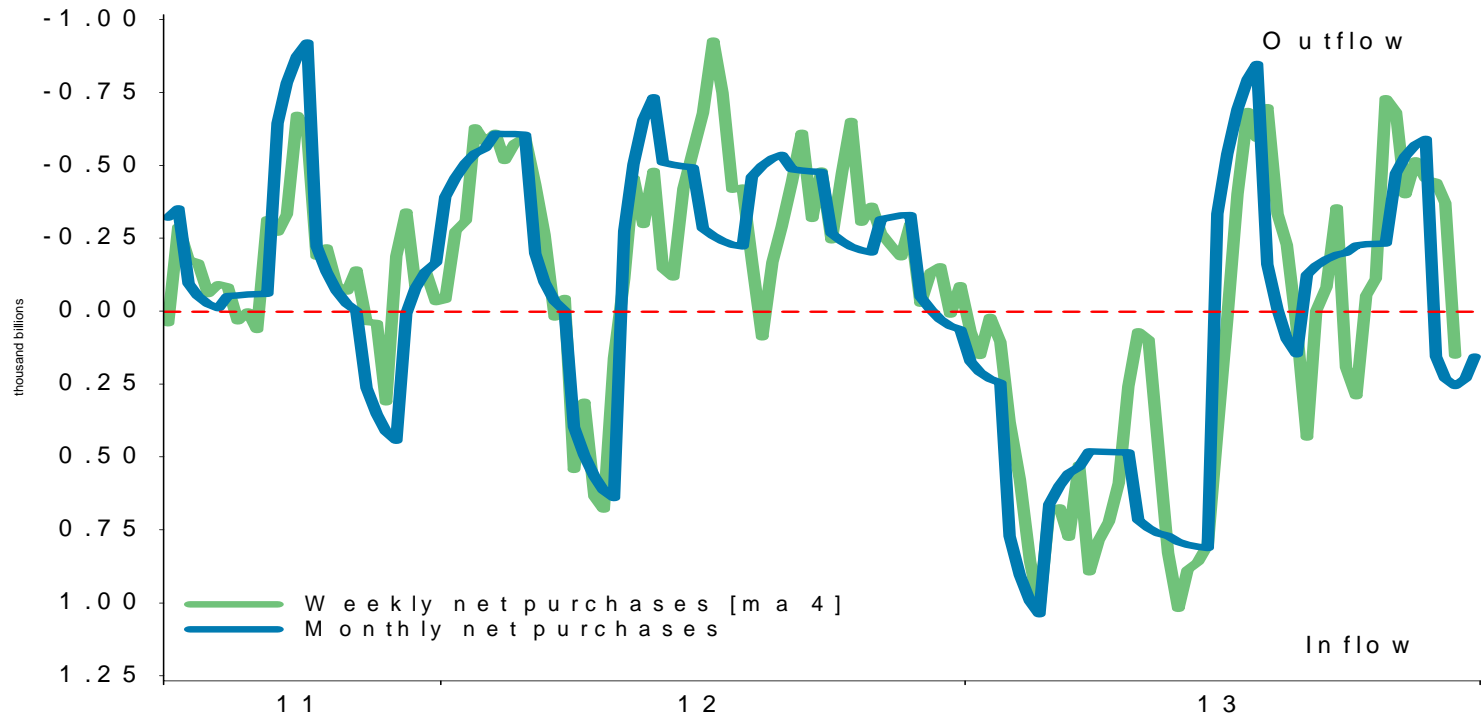


**BNP Paribas JPY positioning indicator signals that investors' short JPY exposure is the smallest this year.**



# ...but domestic investors are not yet short JPY

## Japanese investors' net purchases of foreign assets



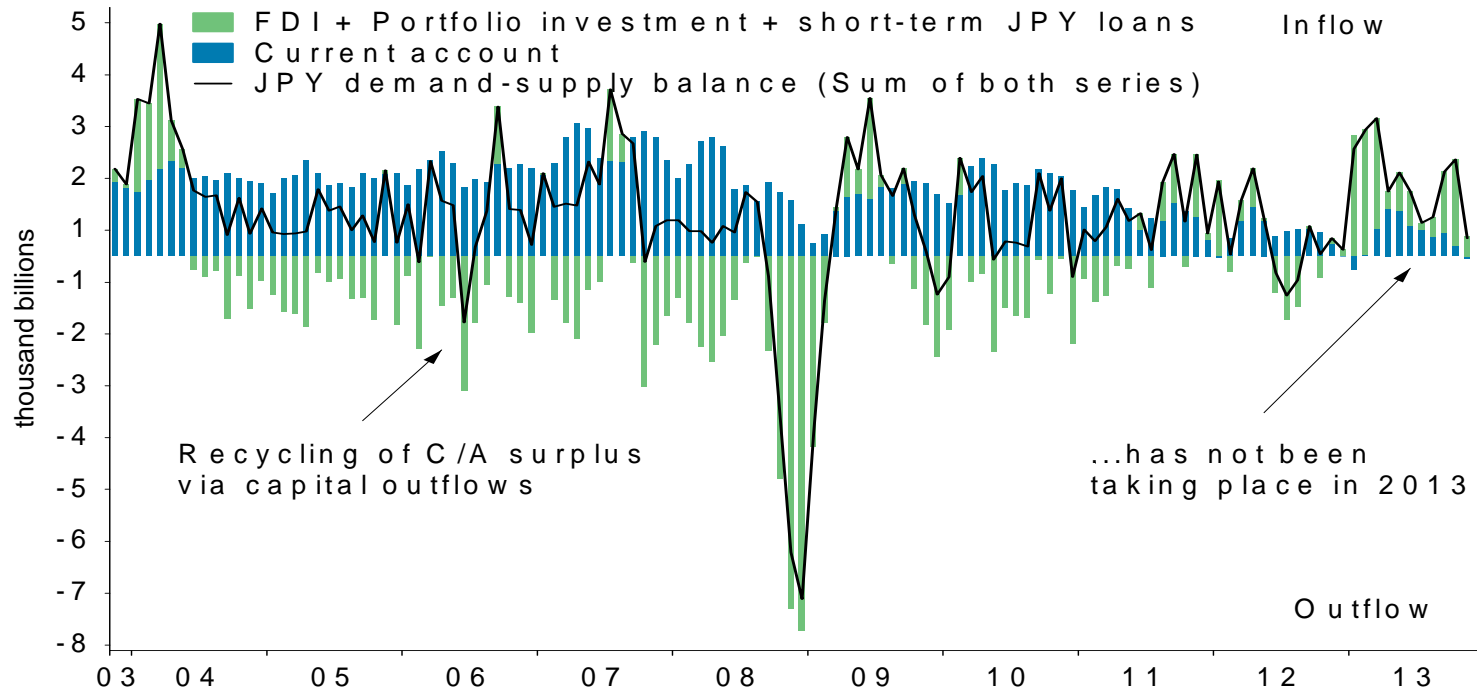
Source : Ecwin Reuters, BNP Paribas



**Japanese investors have turned net long JPY over Q1.  
Most of this is driven by repatriation.**



# Aggregate demand-supply balance for JPY



Source: Reuters EcoWin

Source: Ecwin Reuters, BNP Paribas

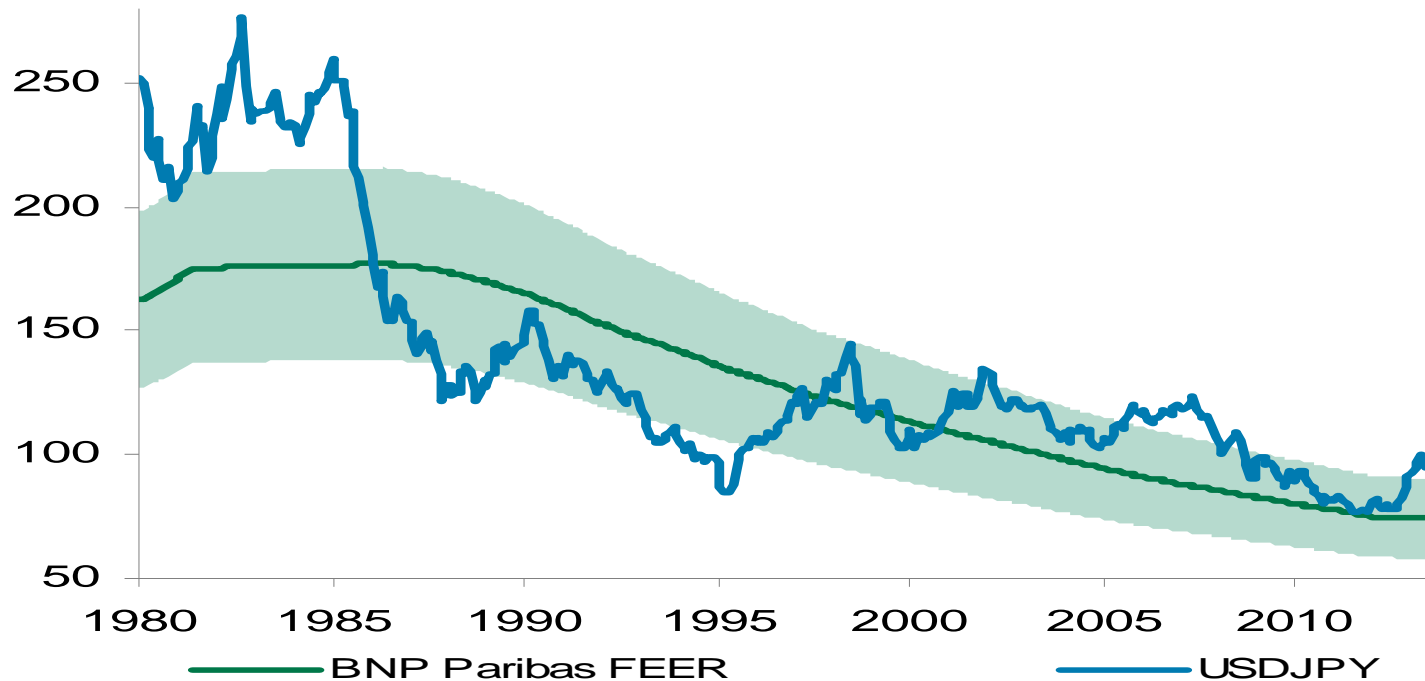
**Evidence has yet to emerge of large-scale JPY outflows but the net inflows are falling**



# USDJPY long-term fair value is now 74

## BNP Paribas FEER for USDJPY

BNPP FEER (Fundamental Equilibrium Exchange Rate) is the value of an exchange rate when an economy is operating with an internal balance (i.e. output in line with potential output, full employment and inflation in line with central bank's target) and a sustainable current account balance.



Source : BNP Paribas

➤ **Our estimate of long-term fair value (BNP Paribas FEER) continues to fall and now stands at 74**





# GBP: Economic recovery to provide on going support

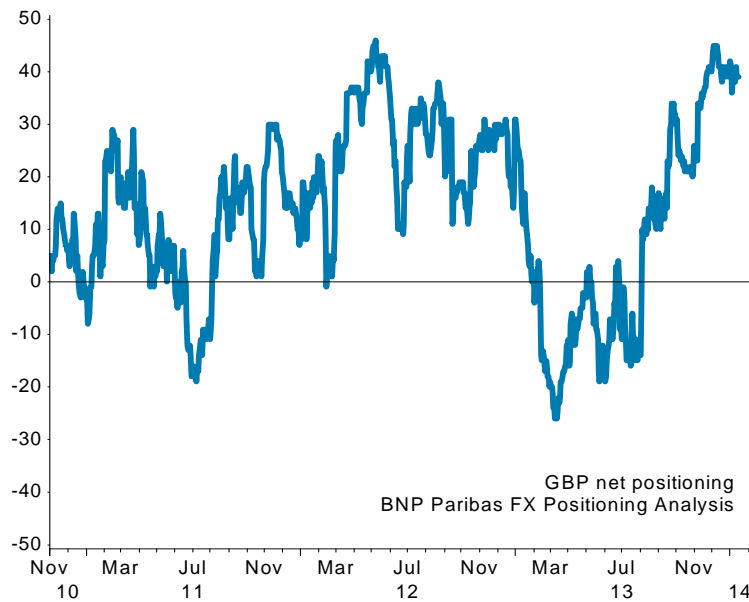


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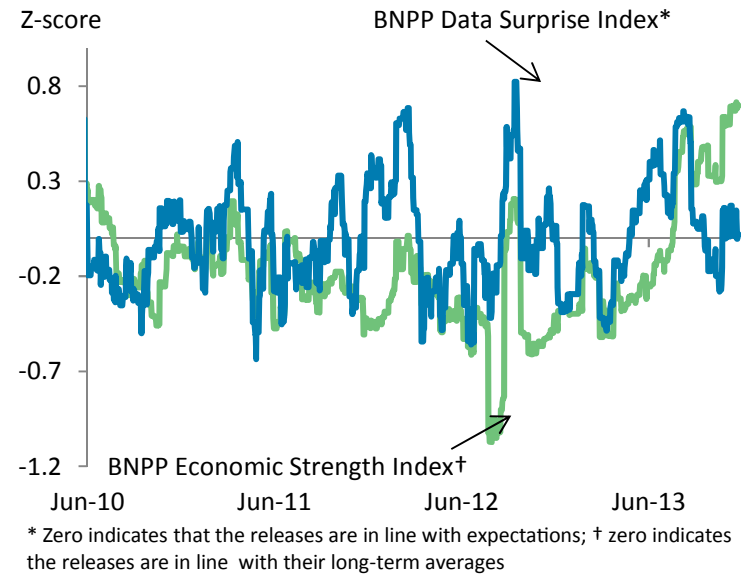
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# Recovery in UK Data is Different This Time

## BNP Paribas Positioning Analysis



## UK economic dataflow



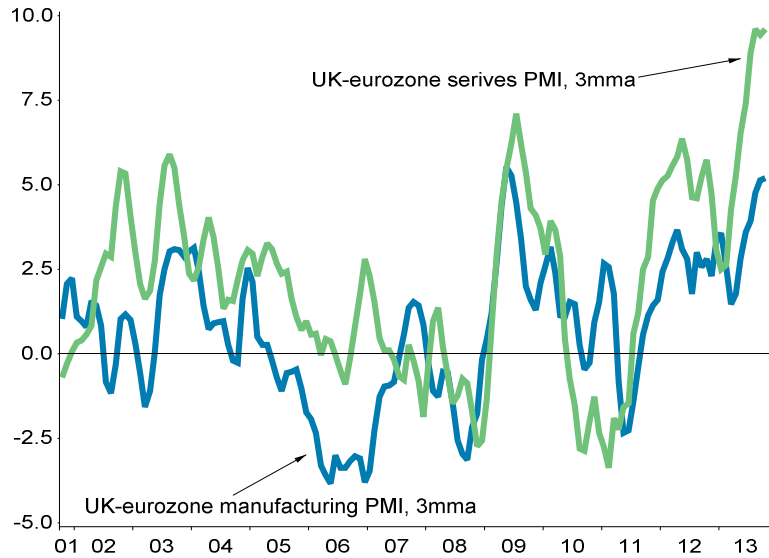
Source : BNP Paribas

**Economic data is finally strong enough for the output gap to start to narrow**

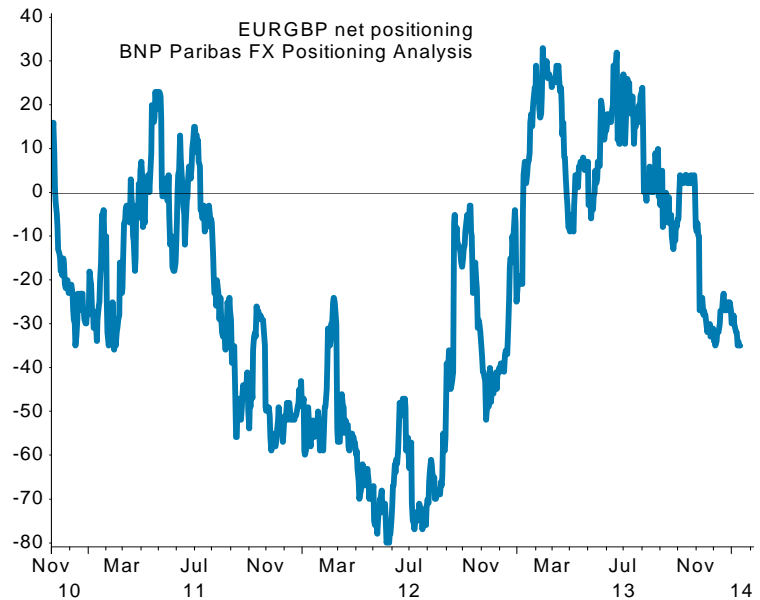


# We favour EURGBP downside

## UK growing much faster than eurozone



## EURGBP shorts far from extreme level



Source : Ecowin Reuters, BNP Paribas

**▶ We expect the GBP to recover against the EUR, targeting 0.81 EURGBP**

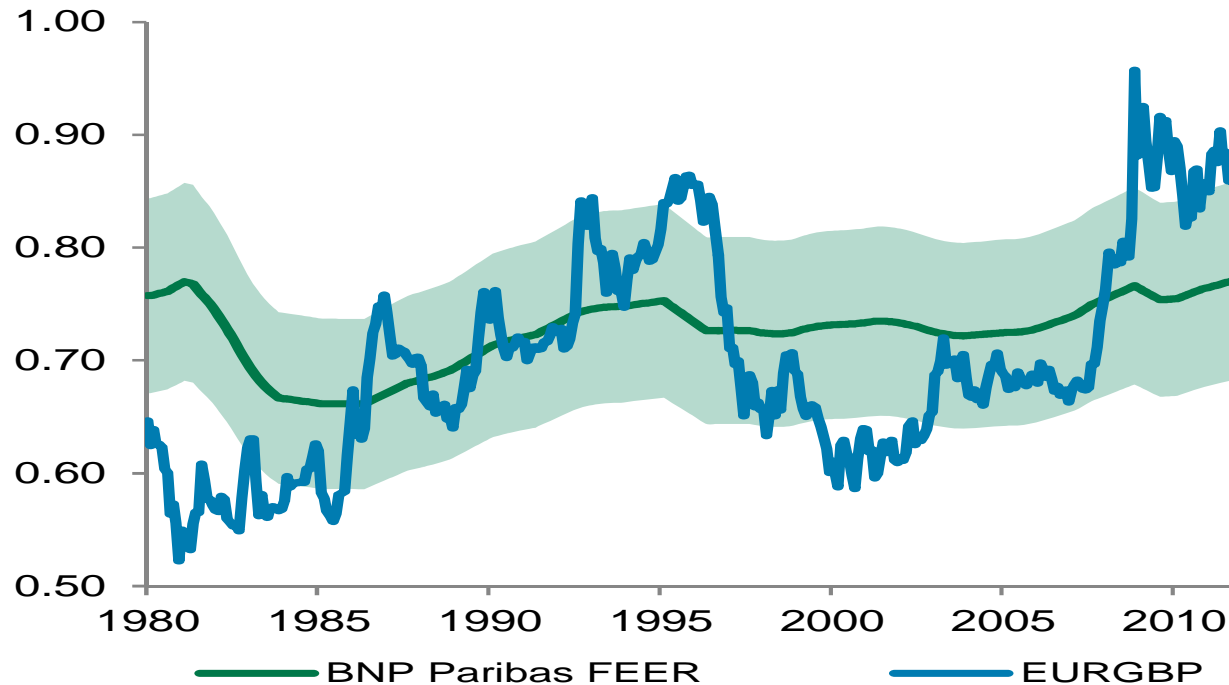




# EURGBP is significantly above long-term fair value estimates

## BNP Paribas FEER for EURGBP

BNPP FEER (Fundamental Equilibrium Exchange Rate) is the value of an exchange rate when an economy is operating with an internal balance (i.e. output in line with potential output, full employment and inflation in line with central bank's target) and a sustainable current account balance.



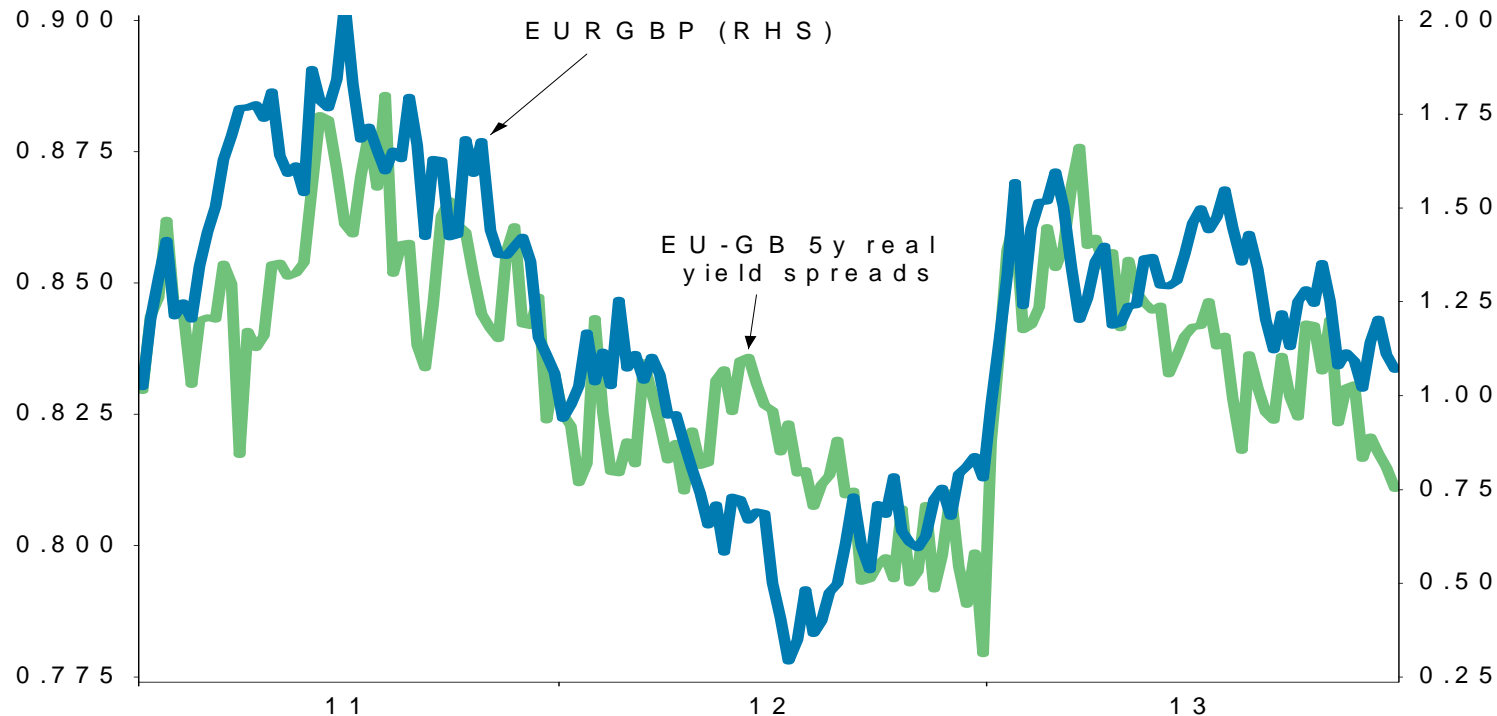
Source: BNP Paribas

➤ **EURGBP overvalued on longer term valuation estimates and has plenty of scope to decline**



# EURGBP tracking real yield differentials instead

## EURGBP vs. 5 year yield spreads



Source : Ecowin Reuters, BNP Paribas

▶ Real rates maybe a better indicator as central bank policy is now impacting FX through the inflation expectations channel.





# Easing of eurozone stress now suggests durable Swiss Franc reversal

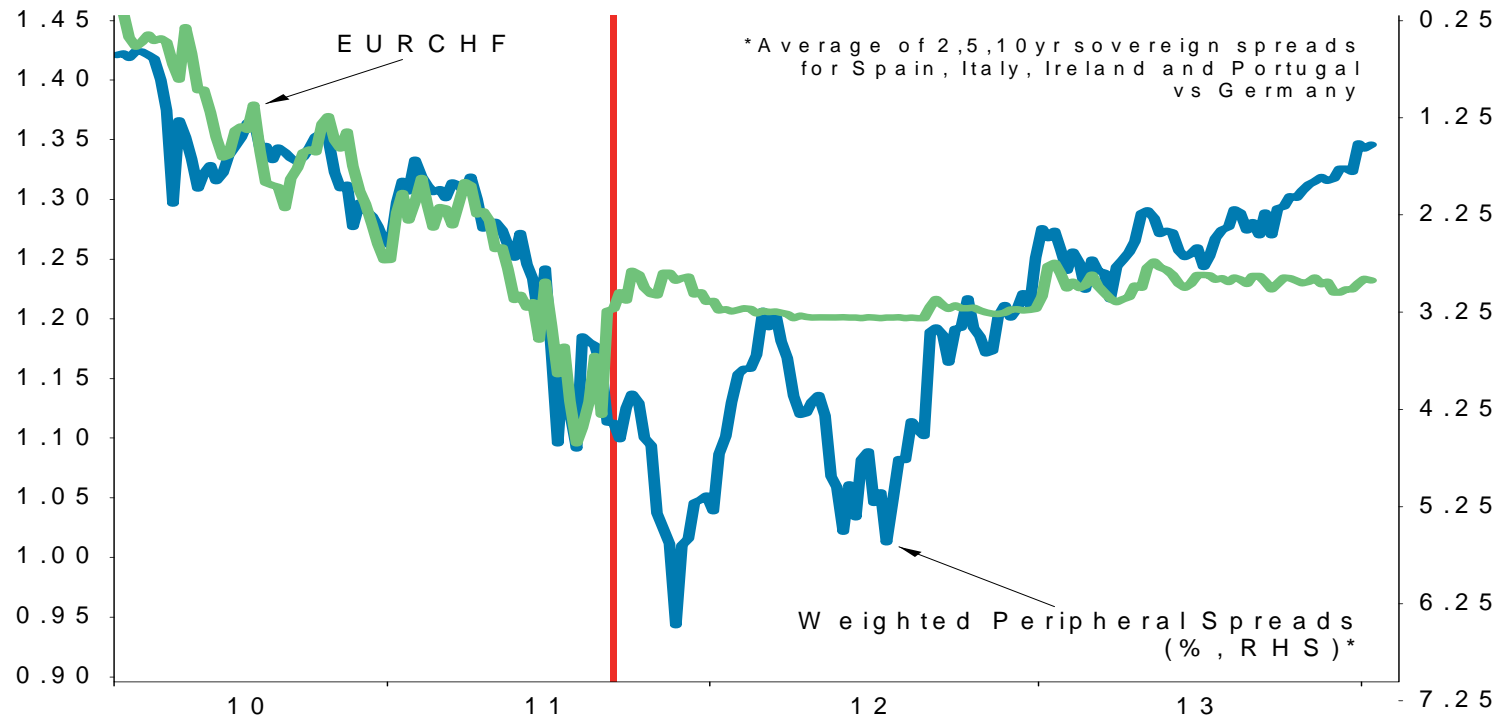


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# Easing of eurozone stress key for durable Swiss Franc reversal

## EURCHF vs. Weighted Peripheral Spreads



Source : Ecowin Reuters, BNP Paribas



Easing eurozone stress now signals EURCHF upside



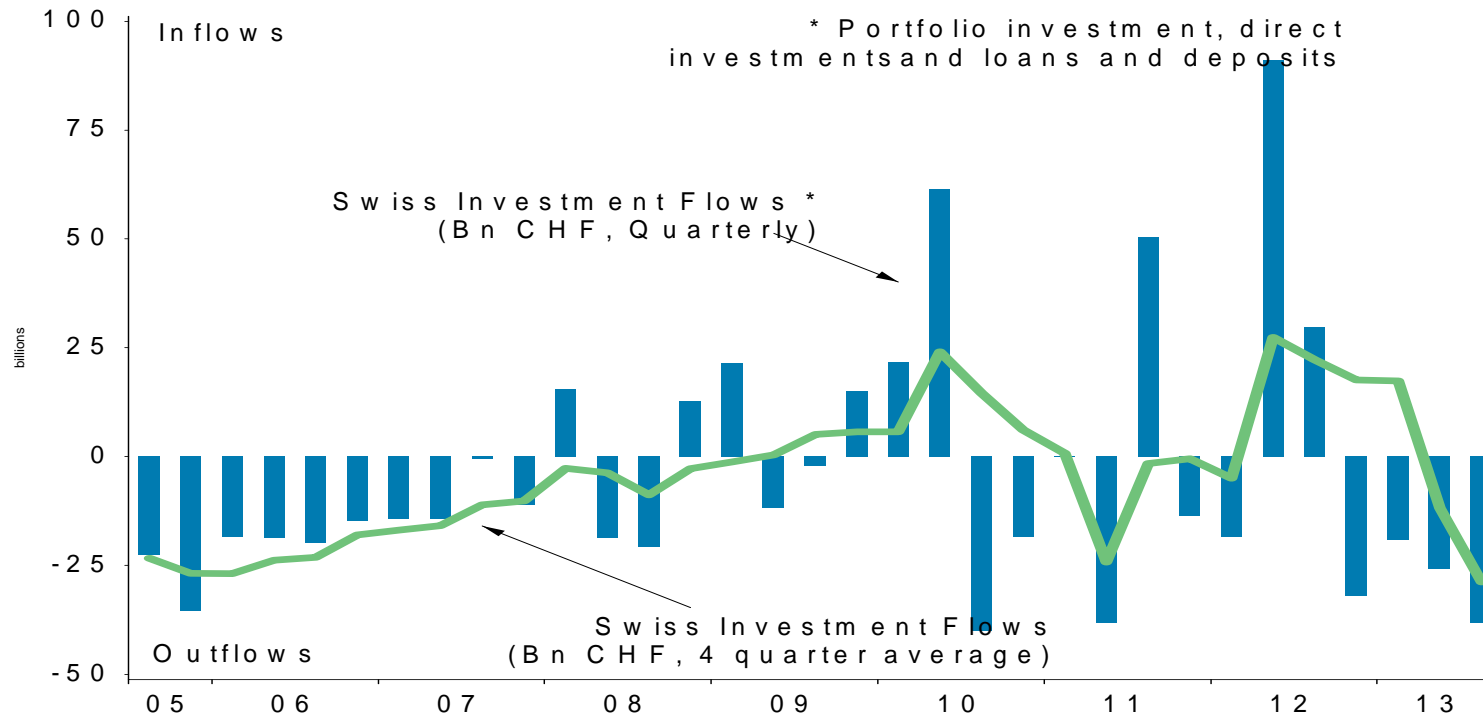
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# Swiss investment outflows

## Financial account moves from inflow to outflow



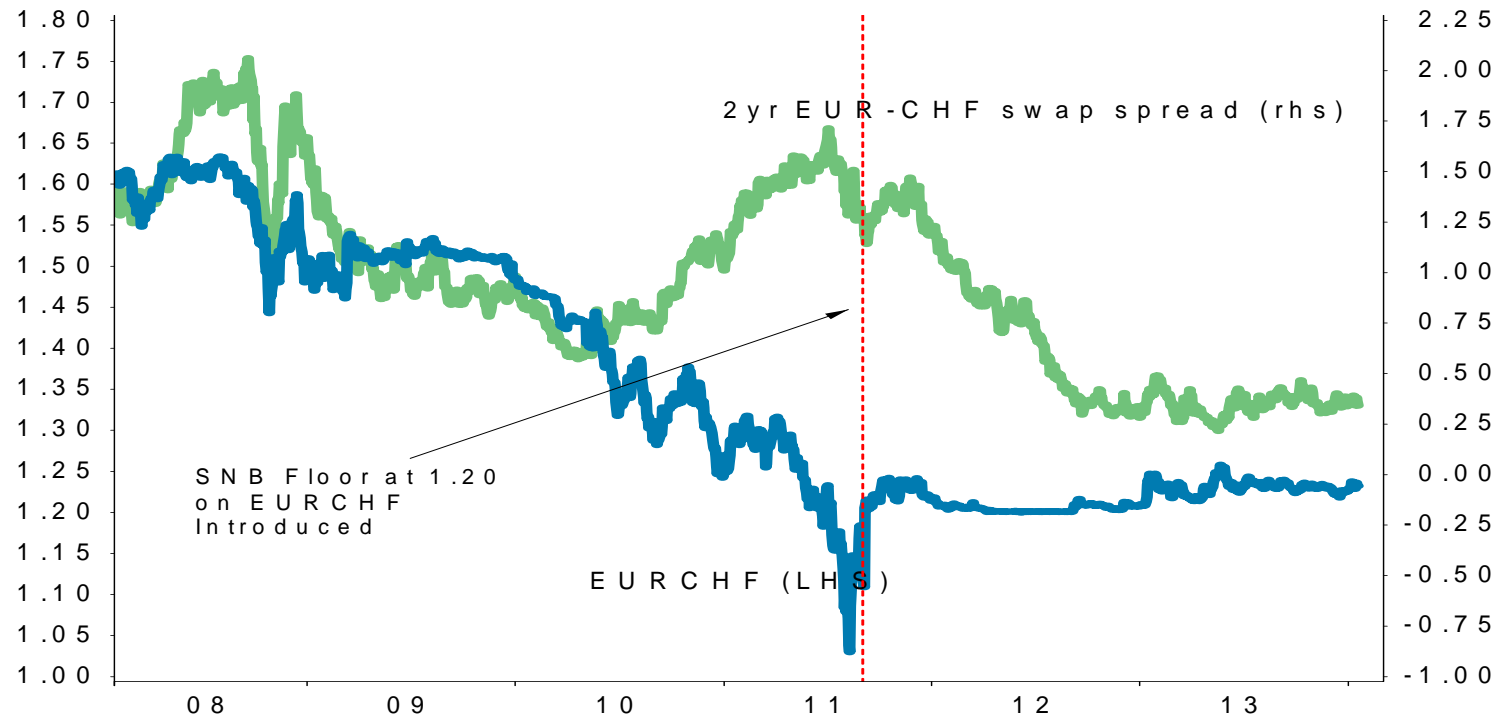
Source : Ecwin Reuters, BNP Paribas

➤ **Total net financial inflows peaked in Q2 2012 at the same time eurozone stress peaked. Outflows are now taking off.**



# Easing of Eurozone stress key for durable Swiss Franc reversal

## EURCHF v. 2-year swap spread



Source : Ecowin Reuters, BNP Paribas



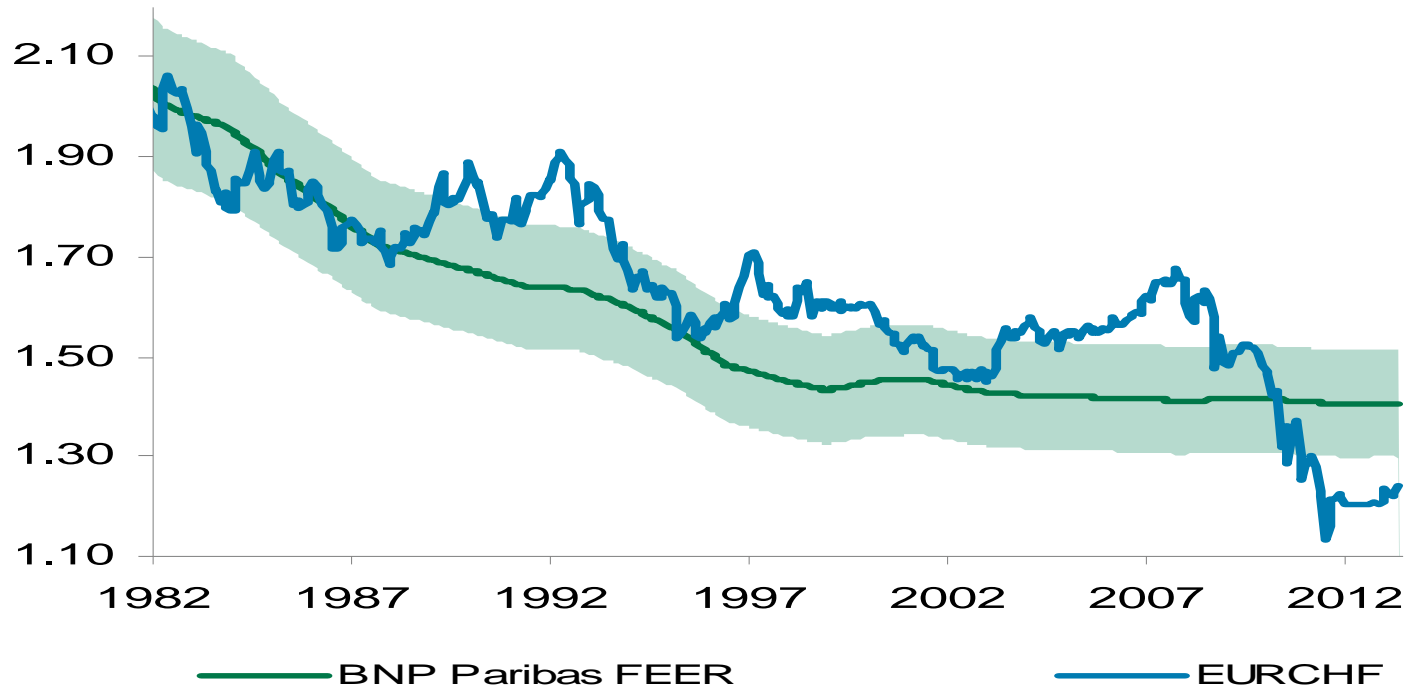
**CHF appears extremely overvalued vs relative interest rates**



# EURCHF is undervalued relative to its long term fair value

## BNP Paribas FEER for EURCHF

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Source : BNP Paribas

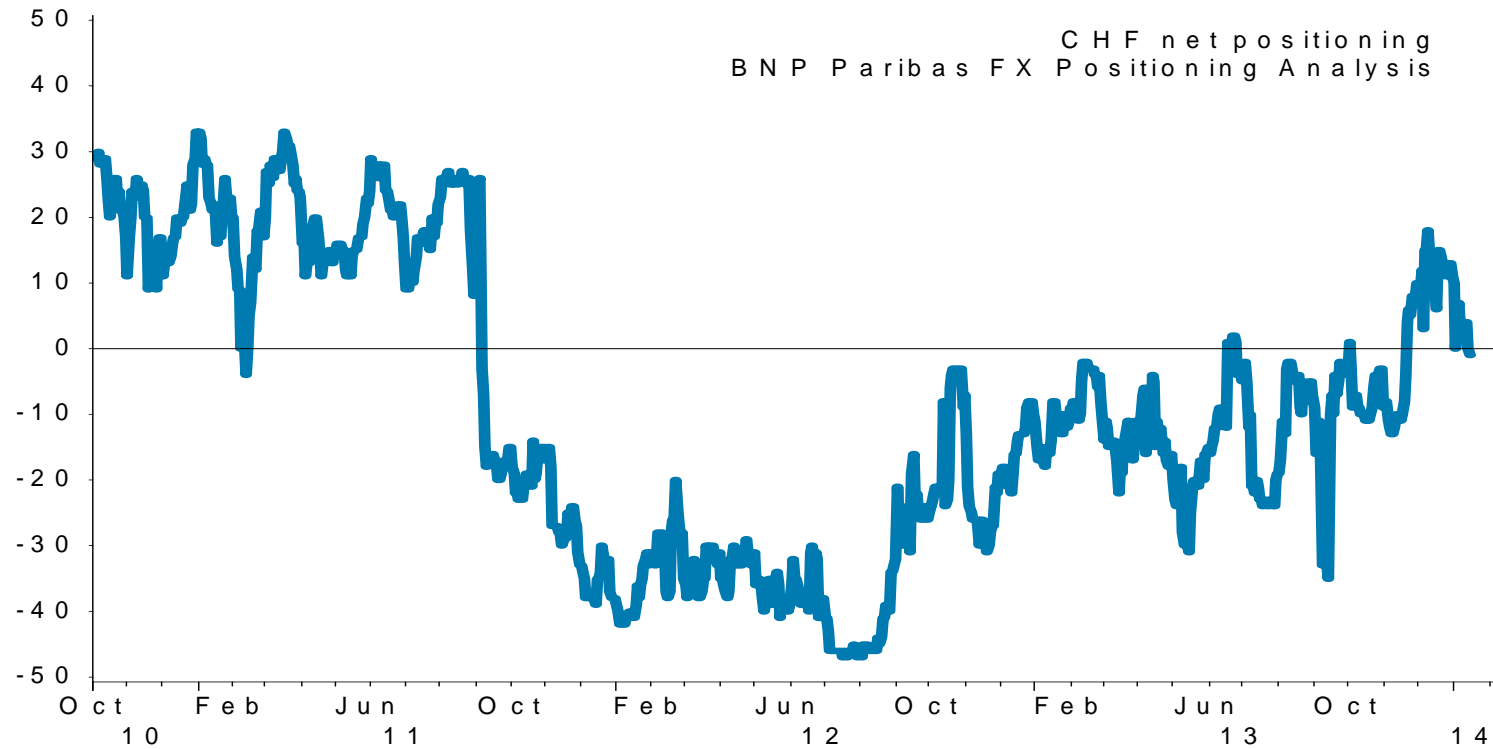


**EURCHF trades significantly below its FEER of 1.40**



# Market positioned neutral CHF

## EURCHF



Source : BNP Paribas

➤ **Market positioning has turned long CHF for the first time since the floor was introduced**







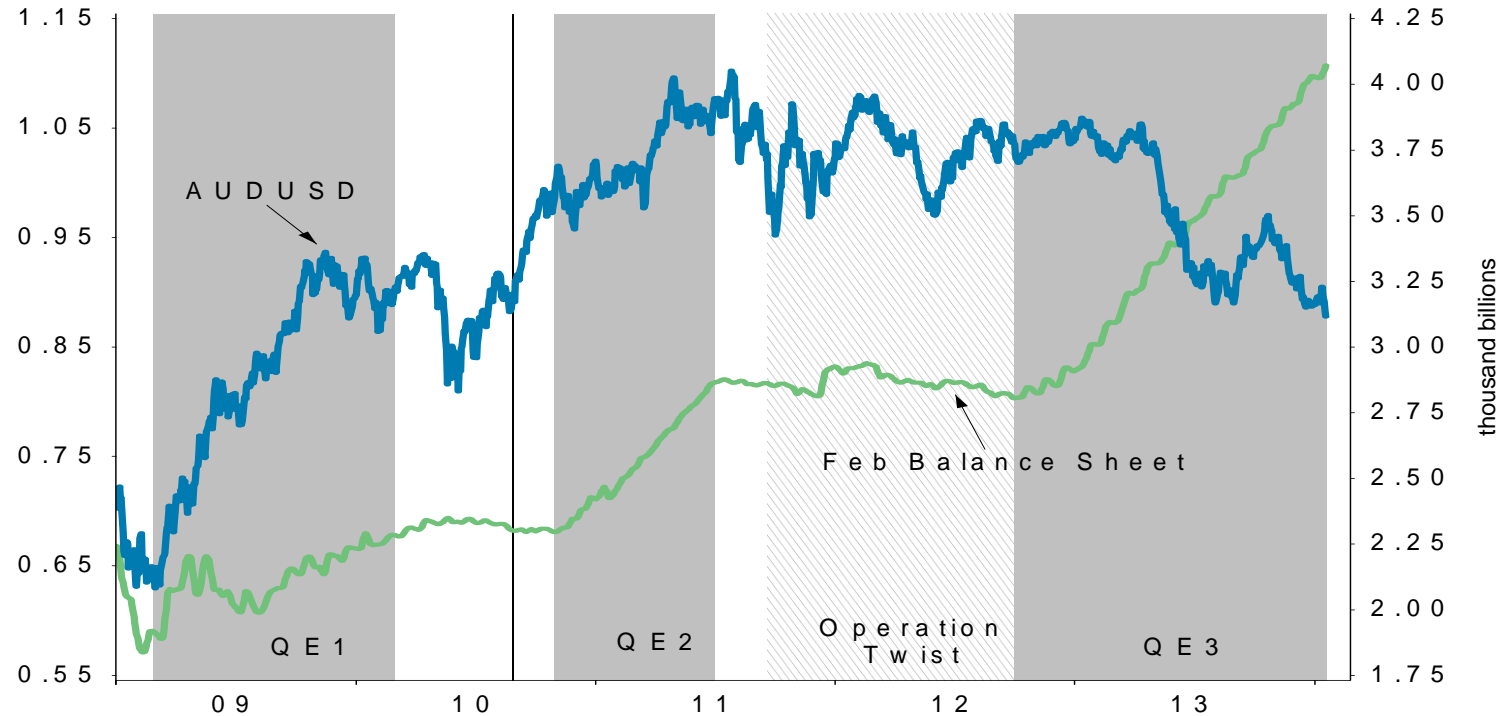
# Commodity currencies; A surprisingly positive outlook



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# Fed tapering has been negative for commodity currencies



Source : Ecowin Reuters, BNP Paribas

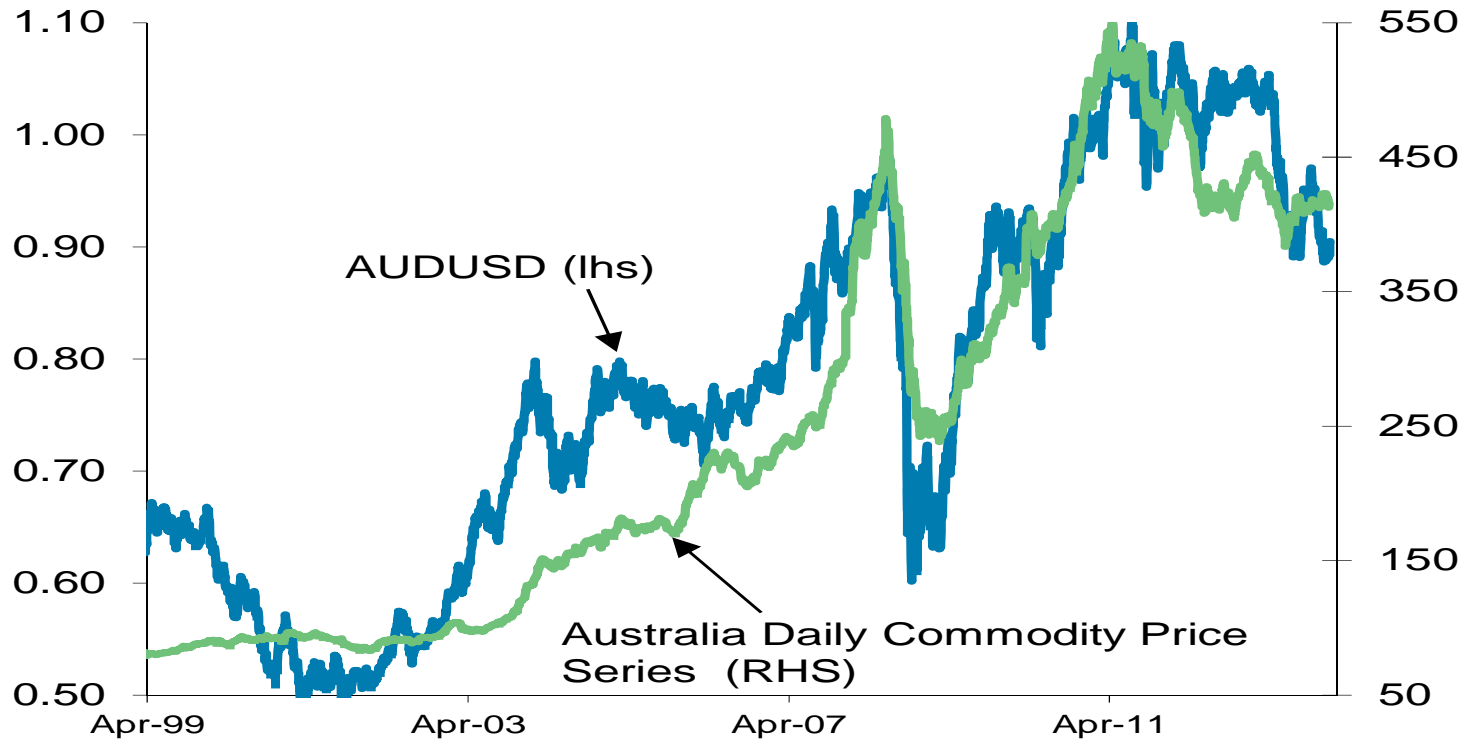


Expectations of Fed tapering is negative for the commodity currencies



# AUDUSD not trading rich vs commodity prices

## AUDUSD vs. AUD exporter commodity prices



Source : Ecowin Reuters, BNP Paribas

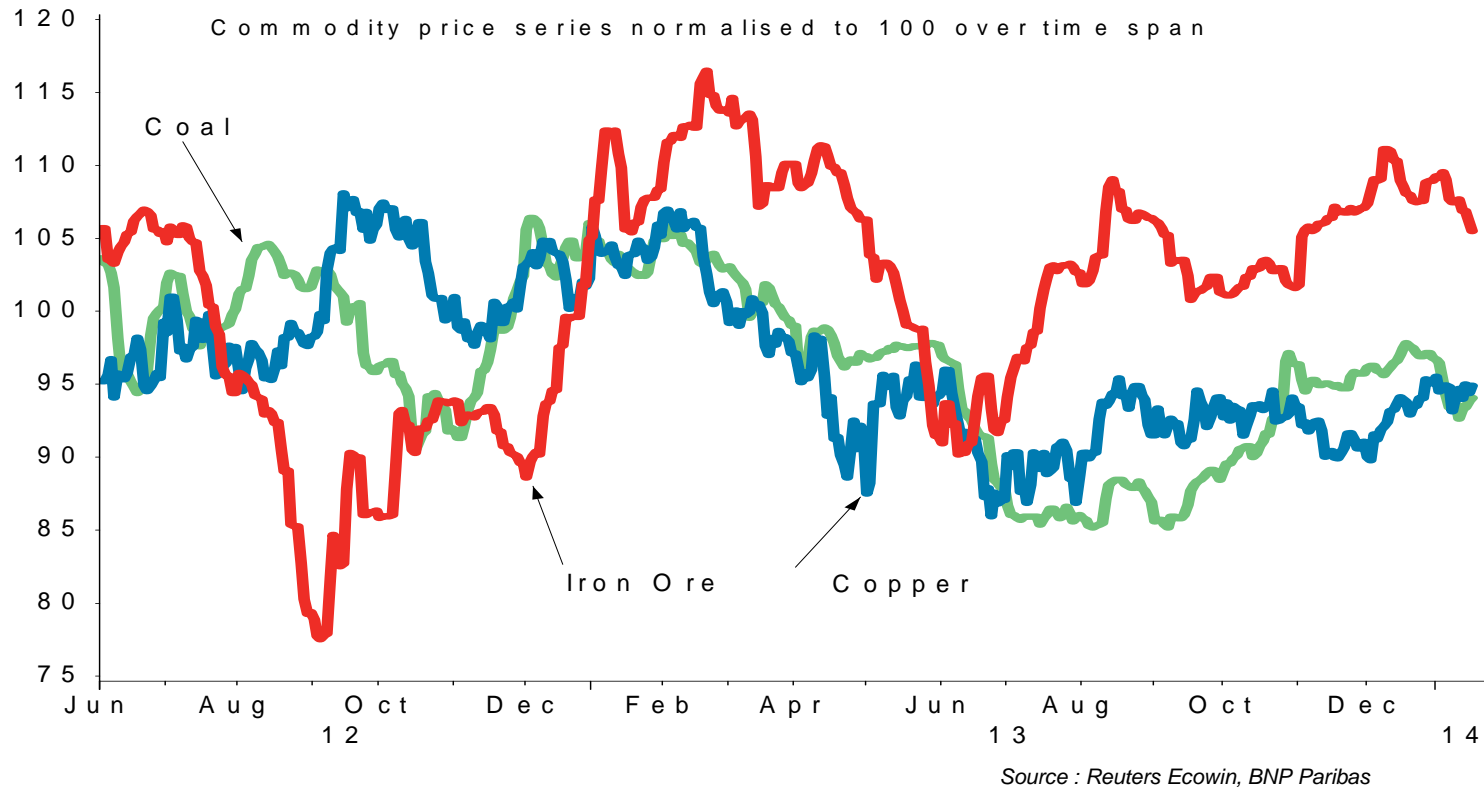


**AUDUSD is not trading that rich against underlying export commodity prices**



# Australian commodity prices stable in 2013

## AUD commodity prices relatively stable

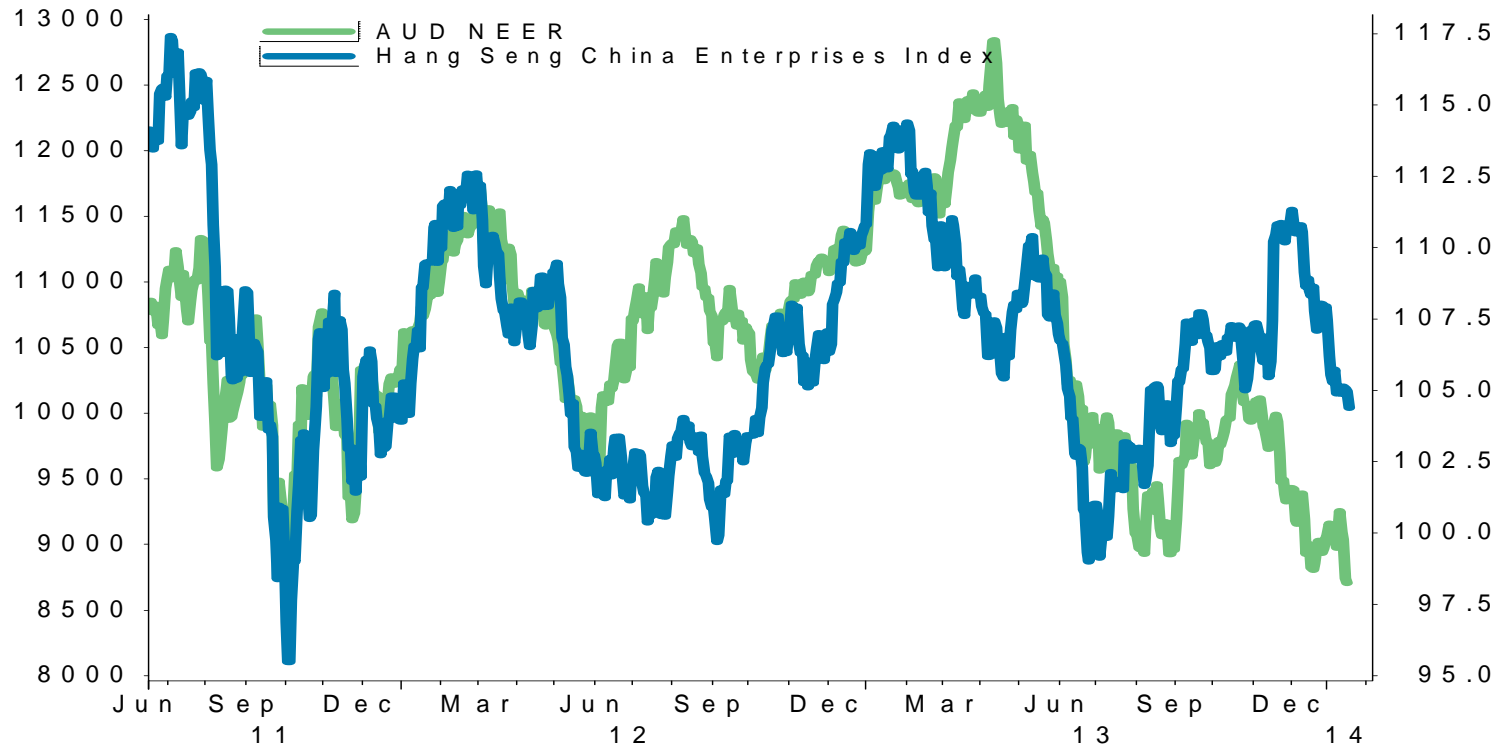


**AUD commodity prices have stabilised in 2013, at odds with notion of a severe terms of trade shock**



# China now providing positive signal

## AUD NEER vs. Hang Seng China Enterprises index



Source : Ecowin Reuters, BNP Paribas



Chinese stocks signals AUD upside

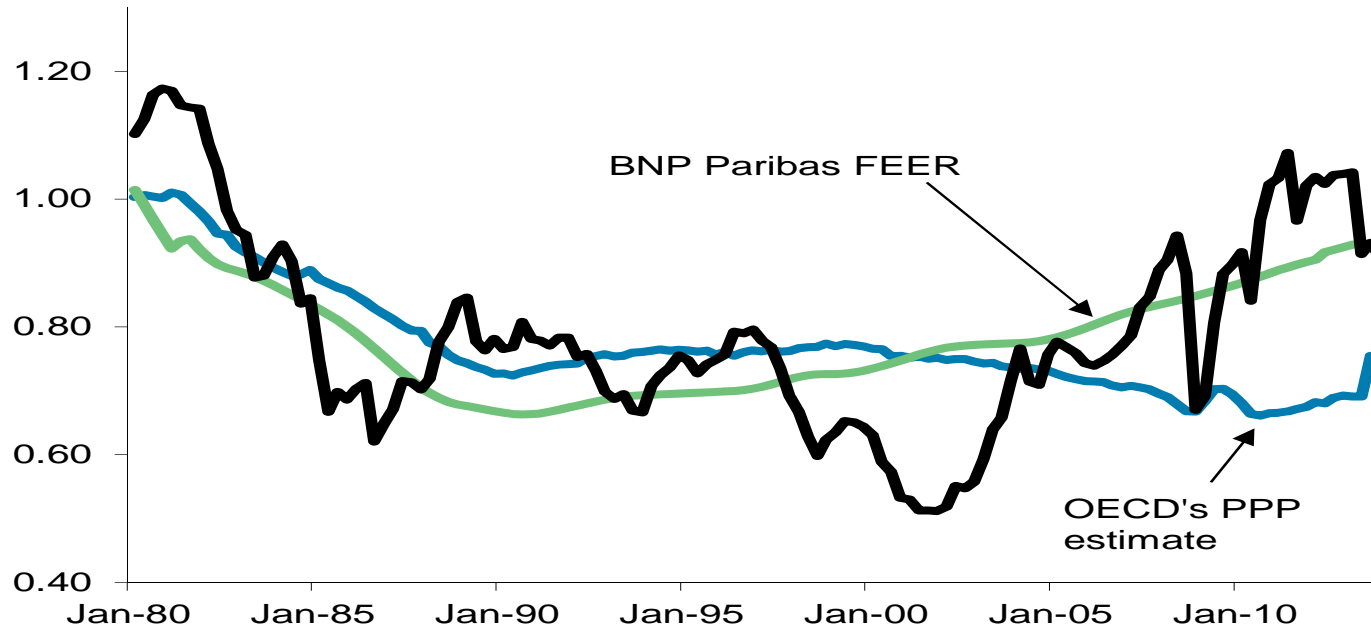


# BNP Paribas FEER AUDUSD vs AUD PPP

## BNP Paribas FEER for AUDUSD

BNPP FEER (Fundamental Equilibrium Exchange Rate) is the value of an exchange rate when an economy is operating with an internal balance (i.e. output in line with potential output, full employment and inflation in line with central bank's target) and a sustainable current account balance.

AUDUSD



Source : BNP Paribas

▶ We believe that BNP Paribas FEER is more useful than PPP and indicates that AUDUSD is not overvalued





# Scandinavia; Appreciation but NOK outperforms

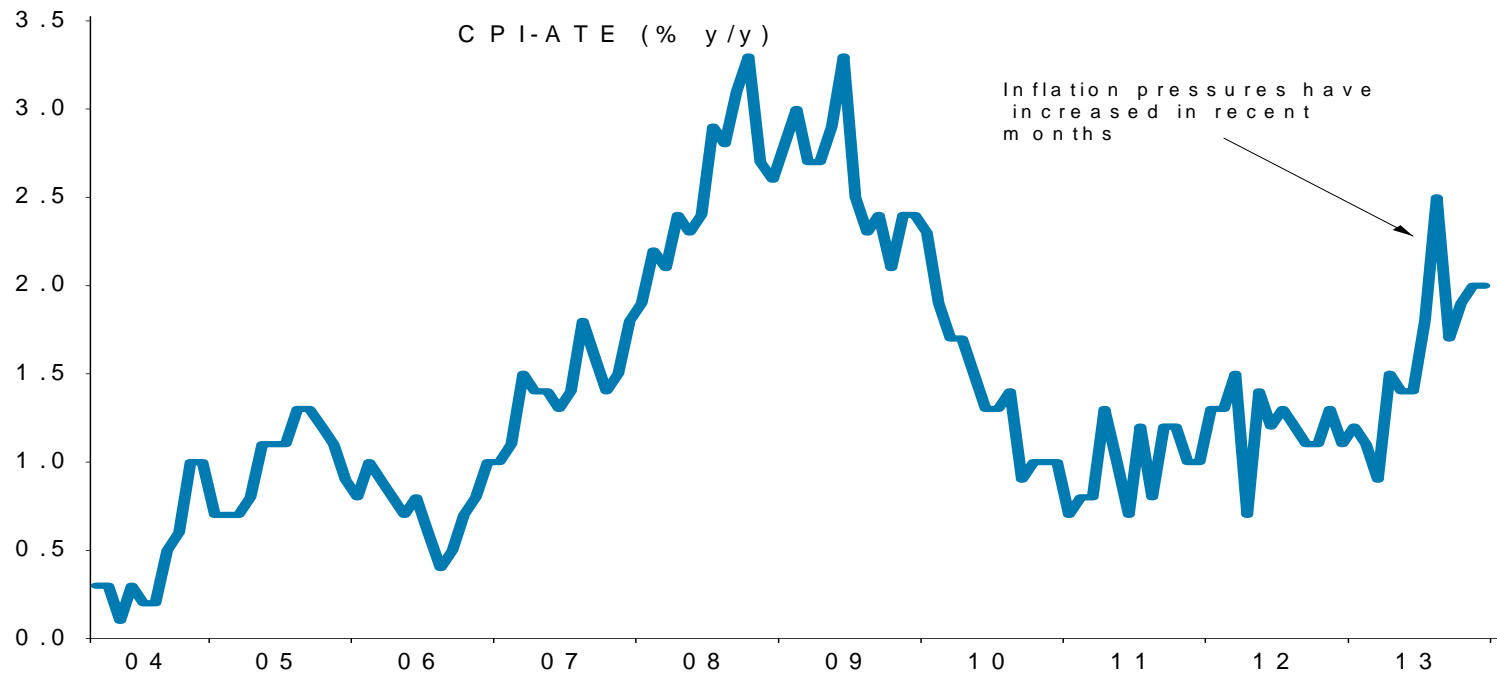


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# Norwegian inflation pressures have increased in recent months

## Norwegian CPI-ATE (% y/y)



Source : Ecwin Reuters, BNP Paribas



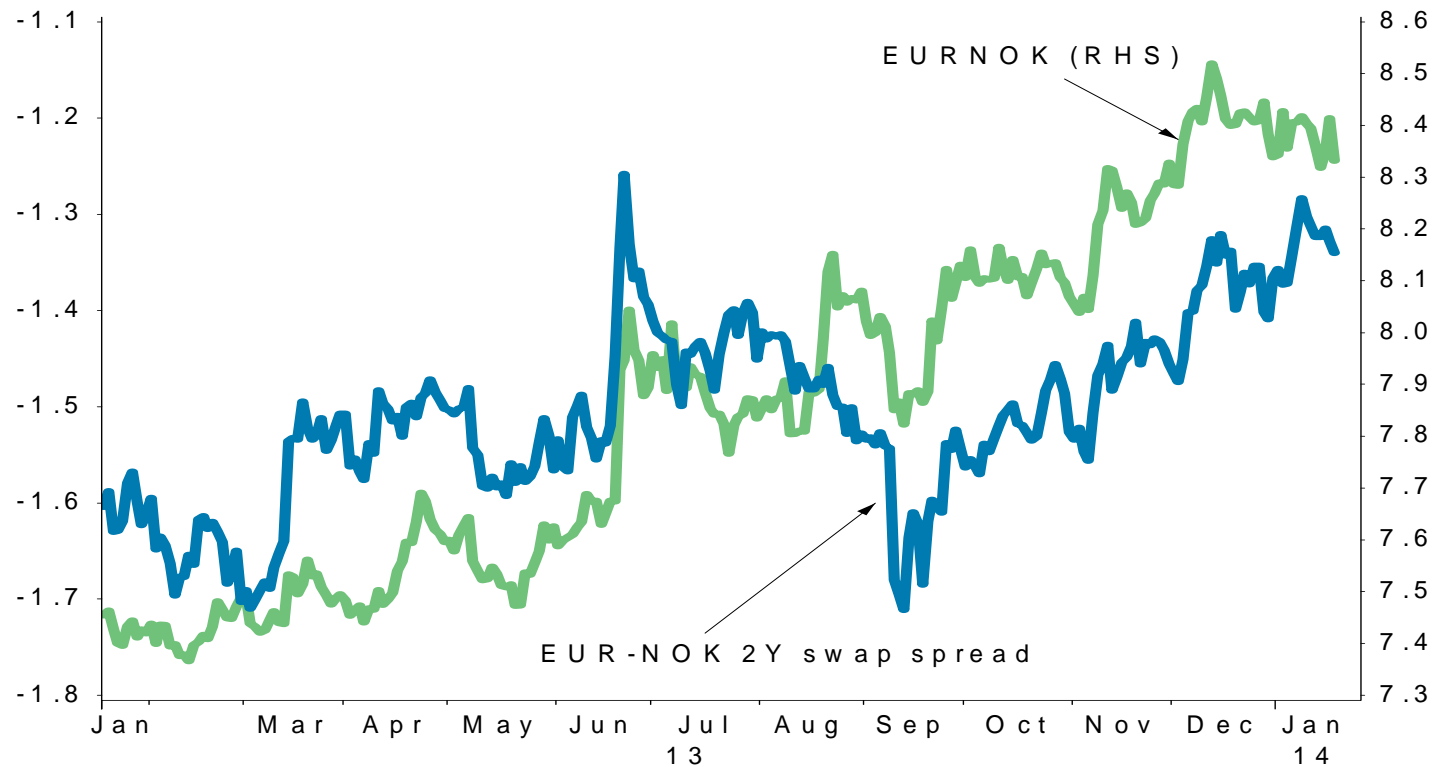
**Inflation has picked up in Norway in recent months**





# Interest rate differentials suggest scope for EURNOK decline

## 2-year euro-Norwegian swap spread (bps)



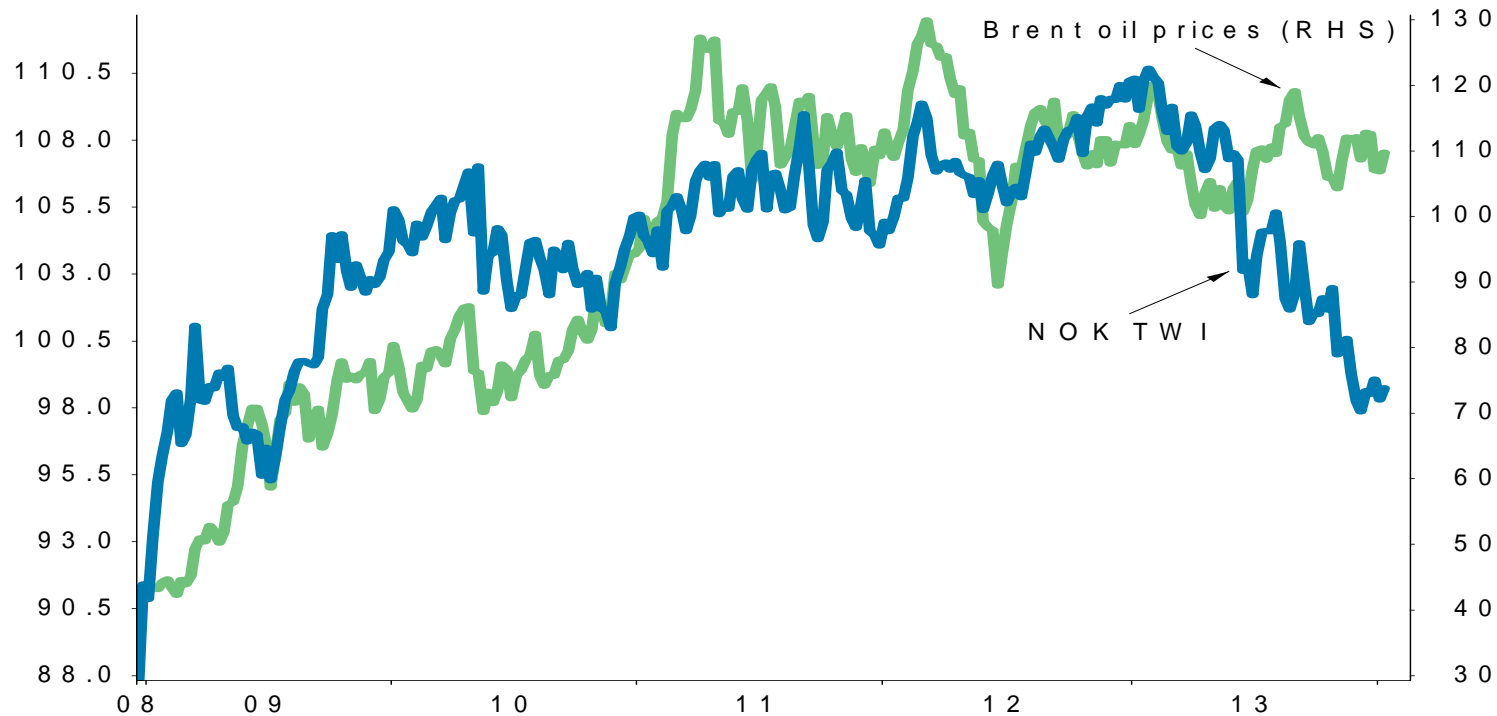
Source : Ecowin Reuters, BNP Paribas



**NOK is trading far weaker than signalled by the rates market**



# NOK appears undervalued relative to oil prices



Source : Ecowin Reuters, BNP Paribas

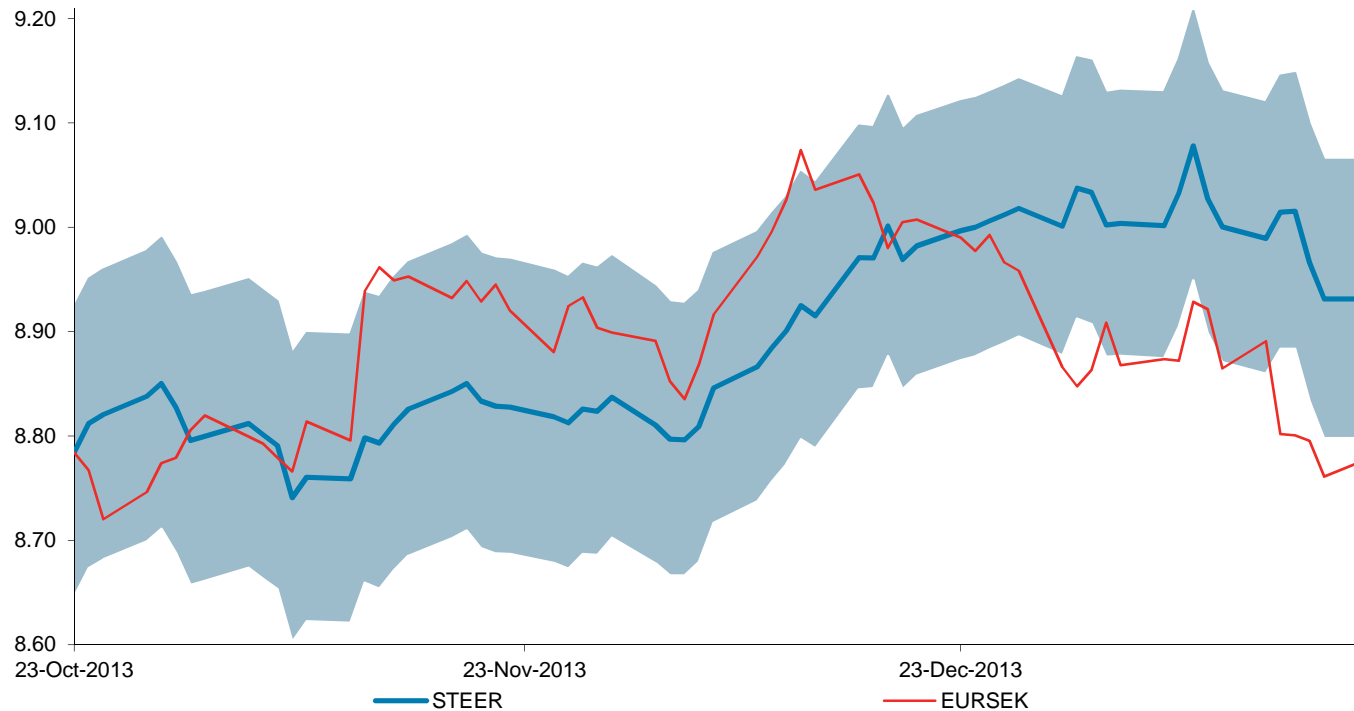
➤ **NOK has weakened relative to oil prices. Our commodity strategists target Brent at \$115 per barrel**



# Our STEER model signals EURSEK is undervalued

## BNP Paribas STEER™\* fair value model EURSEK

BNPP STEERs are regression based short-term fair-values based on relationships between exchange rates, interest rate markets, equity markets and commodity markets.



Source : BNP Paribas

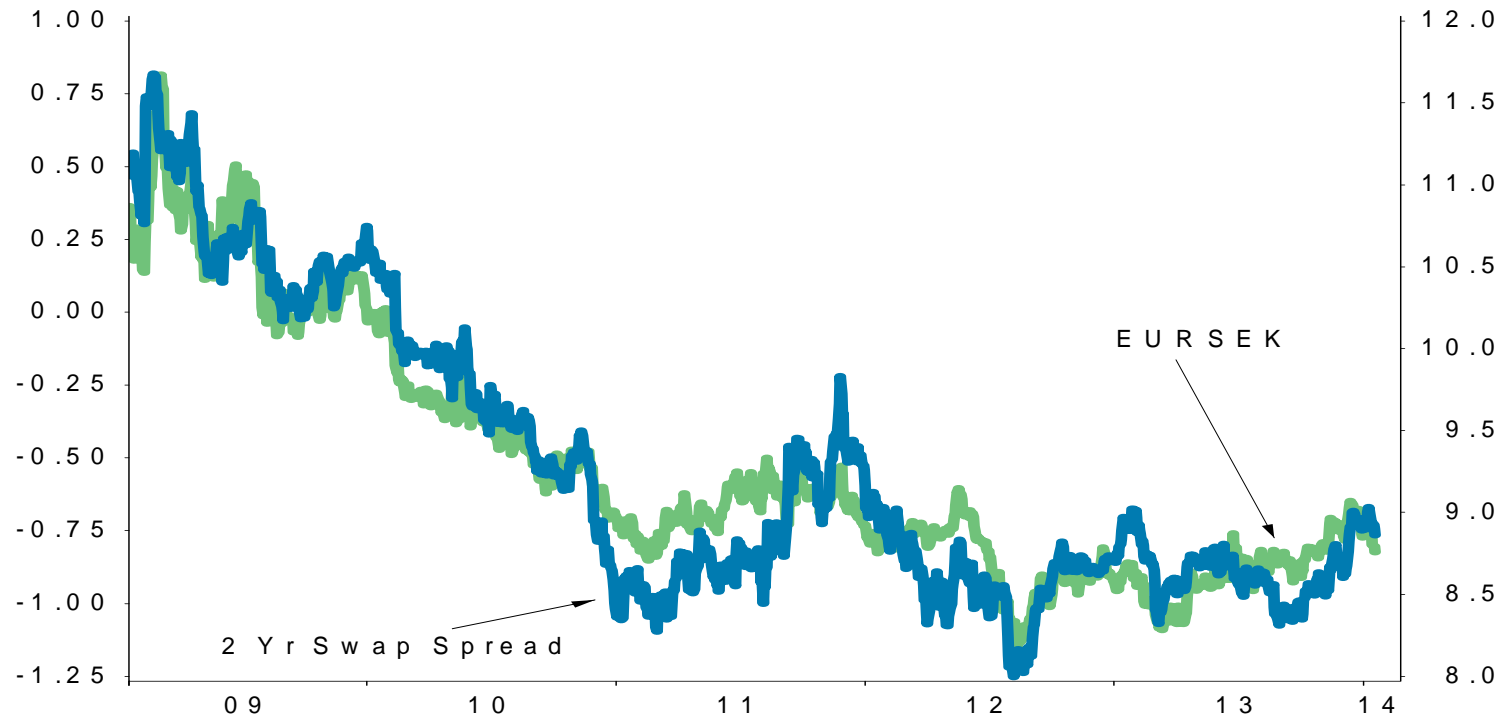


**EURSEK appears undervalued according to STEER**



# Short-term rates are the principal driver of EURSEK

## EURSEK vs 2 year Swap Differential



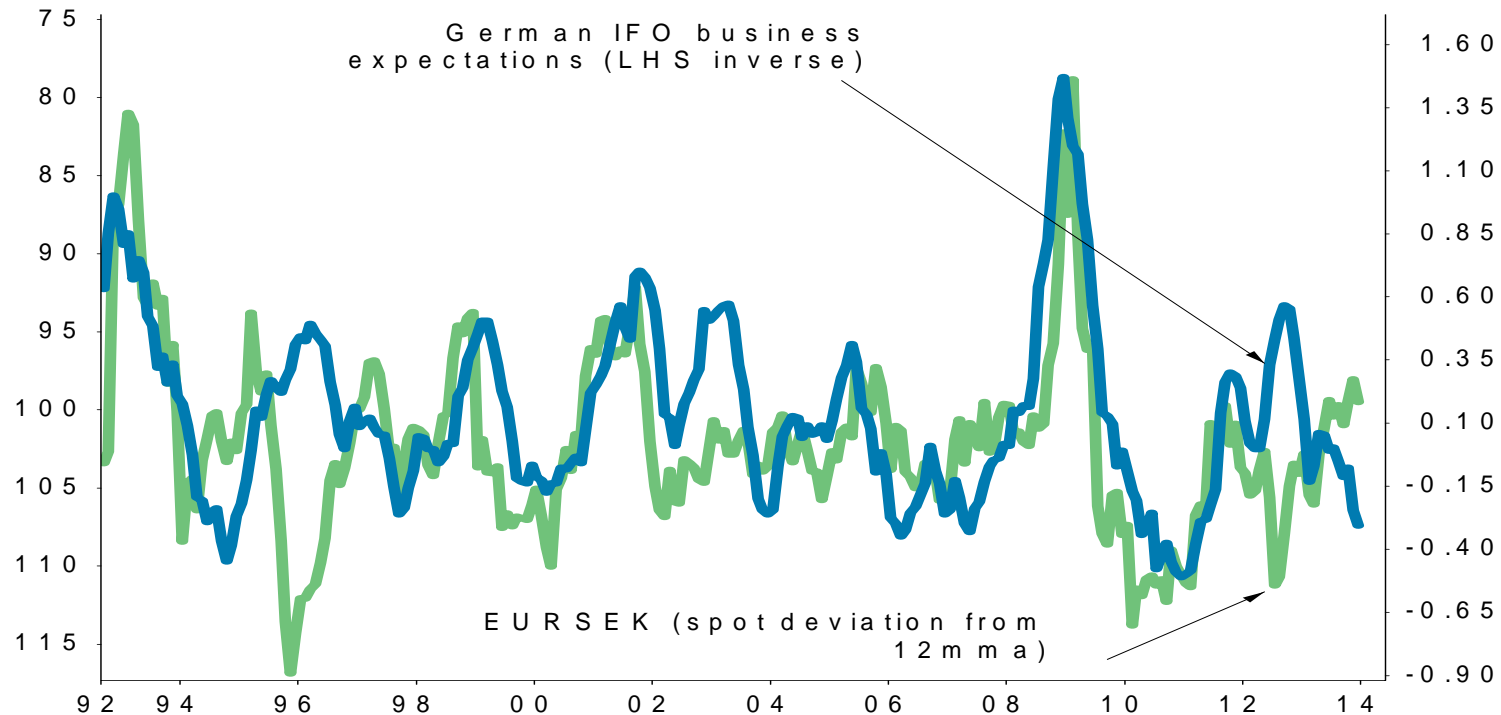
Source : Ecowin Reuters, BNP Paribas

▶ We believe the Riksbank will hike rates at least 12 months ahead of the ECB. The downward trend will continue.



# EURSEK is strongly linked to the EZ business cycle

## German IFO Expectations vs EURSEK deviation from 12 month average



Source : Ecowin Reuters, BNP Paribas



**SEK should appreciate as the EZ business cycle improves**



# Top FX Trade Ideas for 2014

## 1. Short EURUSD – target 1.25

One of our strongest themes for 2014 is the widening of US short-term yield spreads versus those in the eurozone. This widening trend should produce a sharp fall in EURUSD despite the recent market focus on the zone's robust current account surplus.

## 2. Long USDJPY – target 118

As the USD rebounds in 2014, we forecast it to make its largest gains against the currencies with the loosest monetary policy. The BoJ is likely to ensure that policy is loosest in Japan and that JGB yields remain low.

## 3. Long NAFTA basket: Long USD, MXN and CAD vs short CHF and JPY

The improvement in US growth will boost economic activity in Canada and Mexico, providing support to the CAD and MXN. Meanwhile, the ultra-low yielding CHF and JPY remain our funding currencies of choice

## 4. Short EURGBP – target 0.78

The UK economy should continue to grow strongly in 2014 causing markets to price in higher yields, especially relative to the eurozone. In addition, the GBP remains very cheap according to our longer-term BNP Paribas FEER model.

## 5. Long NOKSEK – target 1.1460

Macroeconomic favour Norway over Sweden in 2014. Both the Norges Bank and the Riksbank are likely to keep interest rates on hold throughout most or all of 2014, but we expect a strong Norwegian economy to support a rebound in NOKSEK.



# Top FX Trade Ideas for 2014

## 6. Position for taper stress via GBPUSD put spreads and FVAs

We recommend going long forward volatility in a carry-efficient manner, to position for an intensification of stress related to Fed tapering.

## 7. Long GBPSEK targeting 11.20 – Play the relative housing cycle

We think a number of currencies like GBP, NZD, NOK and SEK are being increasingly driven by trends in their housing markets. The UK housing market is growing at a fast pace, in contrast in Sweden the housing market is slowing modestly.

## 8. Positioning for limited upside in EURCHF

To position for modest upside in EURCHF, while exploiting expensive topside vols relative to higher delta topside and the SNB's floor at 1.20 EURCHF, we propose entering long EURCHF spot and selling a 12m 2x1 1.26/1.3125 ratio call spread

## 9. Long AUDNZD – target 1.2000

The relative pricing of rate hike expectations between the RBA and the RBNZ appears extreme. 125bp of rate hikes from the RBNZ are expected by mid-2014. In contrast, there is scope for RBA rate expectation to rebound.

## 10. Prepare for ECB QE via long EUR forward vols

To position for a weaker EUR we favour purchasing forward volatility in EUR crosses taking advantage of very low base vols in the entire EUR complex, coupled with flat curves, resulting in a very mild decay profile for the entire EUR complex.



# Forecasts

<b>USD Bloc</b>	<b>Spot</b>	<b>Q1 '14</b>	<b>Q2 '14</b>	<b>Q3 '14</b>	<b>Q4 '14</b>	<b>Q1 '15</b>	<b>Q2 '15</b>	<b>Q3 '15</b>	<b>Q4 '15</b>
EUR/USD	1.36	1.28	1.26	1.25	1.23	1.23	1.23	1.22	1.25
USD/JPY	104	108	112	114	118	120	120	120	120
USD/CHF	0.91	0.96	0.98	1.00	1.02	1.06	1.07	1.11	1.08
GBP/USD	1.64	1.54	1.56	1.56	1.58	1.60	1.62	1.63	1.64
USD/CAD	1.10	1.10	1.10	1.09	1.08	1.08	1.08	1.09	1.10
AUD/USD	0.88	0.88	0.88	0.90	0.92	0.93	0.93	0.92	0.90
NZD/USD	0.83	0.79	0.79	0.80	0.81	0.82	0.82	0.81	0.80
USD/SEK	6.48	6.88	6.90	6.96	6.99	6.91	6.83	6.89	6.64
USD/NOK	6.19	6.17	6.19	6.08	6.10	6.02	5.93	5.98	5.76
<b>EUR Bloc</b>	<b>Spot</b>	<b>Q1 '14</b>	<b>Q2 '14</b>	<b>Q3 '14</b>	<b>Q4 '14</b>	<b>Q1 '15</b>	<b>Q2 '15</b>	<b>Q3 '15</b>	<b>Q4 '15</b>
EUR/JPY	141	138	141	143	145	148	148	146	150
EUR/GBP	0.82	0.83	0.81	0.80	0.78	0.77	0.76	0.75	0.76
EUR/CHF	1.23	1.23	1.24	1.25	1.25	1.30	1.32	1.35	1.35
EUR/SEK	8.79	8.80	8.70	8.70	8.60	8.50	8.40	8.40	8.30
EUR/NOK	8.39	7.90	7.80	7.60	7.50	7.40	7.30	7.30	7.20
EUR/DKK	7.46	7.46	7.46	7.46	7.46	7.46	7.46	7.46	7.46
<b>CEEMEA</b>	<b>Spot</b>	<b>Q1 '14</b>	<b>Q2 '14</b>	<b>Q3 '14</b>	<b>Q4 '14</b>	<b>Q1 '15</b>	<b>Q2 '15</b>	<b>Q3 '15</b>	<b>Q4 '15</b>
EUR/CZK	27.5	27.0	27.0	27.0	27.0	26.5	26.0	25.5	25.0
EUR/HUF	302	300	295	295	300	290	285	285	285
USD/ZAR	10.8	10.50	10.30	9.90	10.00	10.20	10.20	10.50	10.70
USD/TRY	2.24	2.25	2.20	2.22	2.20	2.22	2.25	2.24	2.22
EUR/RON	4.54	4.35	4.40	4.25	4.42	4.30	4.30	4.39	4.42
USD/RUB	33.77	34.01	34.24	33.26	33.50	33.50	34.00	33.75	34.80
EUR/PLN	4.16	4.00	3.90	3.95	4.15	4.10	4.16	4.16	4.18
USD/ILS	3.49	3.60	3.65	3.62	3.60	3.75	3.83	3.79	3.76
<b>Asia Bloc</b>	<b>Spot</b>	<b>Q1 '14</b>	<b>Q2 '14</b>	<b>Q3 '14</b>	<b>Q4 '14</b>	<b>Q1 '15</b>	<b>Q2 '15</b>	<b>Q3 '15</b>	<b>Q4 '15</b>
USD/SGD	1.28	1.28	1.30	1.28	1.30	1.32	1.35	1.35	1.40
USD/MYR	3.20	3.30	3.32	3.35	3.40	3.40	3.42	3.45	3.50
USD/IDR	9053	12300	12500	12800	13000	13000	13200	13300	13500
USD/THB	32.9	33.80	33.80	33.50	34.00	34.00	34.50	35.00	35.50
USD/PHP	46.3	45.20	45.80	45.20	45.00	45.00	45.50	45.00	46.00
USD/HKD	7.76	7.80	7.80	7.80	7.80	7.80	7.80	7.80	7.80
USD/RMB	6.05	6.02	5.93	6.00	5.89	-----	-----	-----	5.95
USD/TWD	30.1	30.30	30.50	30.30	30.00	30.00	29.70	29.70	29.50
USD/KRW	1064	1080	1040	1020	1020	1020	1000	970	980
USD/INR	61.6	63.00	65.00	66.00	66.00	67.00	69.00	68.00	69.00
USD/VND	19100	21300	21400	21400	21400	21500	21500	21500	21500
<b>LATAM Bloc</b>	<b>Spot</b>	<b>Q1 '14</b>	<b>Q2 '14</b>	<b>Q3 '14</b>	<b>Q4 '14</b>	<b>Q1 '15</b>	<b>Q2 '15</b>	<b>Q3 '15</b>	<b>Q4 '15</b>
USD/ARS	6.80	7.13	7.52	8.35	9.27	9.83	10.42	11.04	11.70
USD/BRL	2.34	2.50	2.55	2.75	2.60	2.57	2.55	2.50	2.45
USD/CLP	541	510	515	520	520	510	500	490	500
USD/MXN	13.2	13.15	12.90	12.70	12.60	12.30	12.10	12.00	12.20
USD/COP	1969	1930	1920	1890	1890	1900	1880	1850	1850
USD/VEF	6.29	7.50	7.50	7.50	7.50	7.50	7.50	7.50	7.50
USD/PEN	2.81	2.79	2.79	2.78	2.78	2.77	2.76	2.75	2.75
<b>Others</b>	<b>Spot</b>	<b>Q1 '14</b>	<b>Q2 '14</b>	<b>Q3 '14</b>	<b>Q4 '14</b>	<b>Q1 '15</b>	<b>Q2 '15</b>	<b>Q3 '15</b>	<b>Q4 '15</b>
USD Index	81.11	85.30	86.50	87.07	88.19	88.34	88.21	88.77	87.29

\*End Quarter





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