



When **insight matters.**<sup>TM</sup>

## THE EURO, BIS SURVEY & GOLD

CAMILLA SUTTON | CHIEF FX STRATEGIST | 416-866-5470 | [CAMILLA.SUTTON@SCOTIABANK.COM](mailto:CAMILLA.SUTTON@SCOTIABANK.COM)

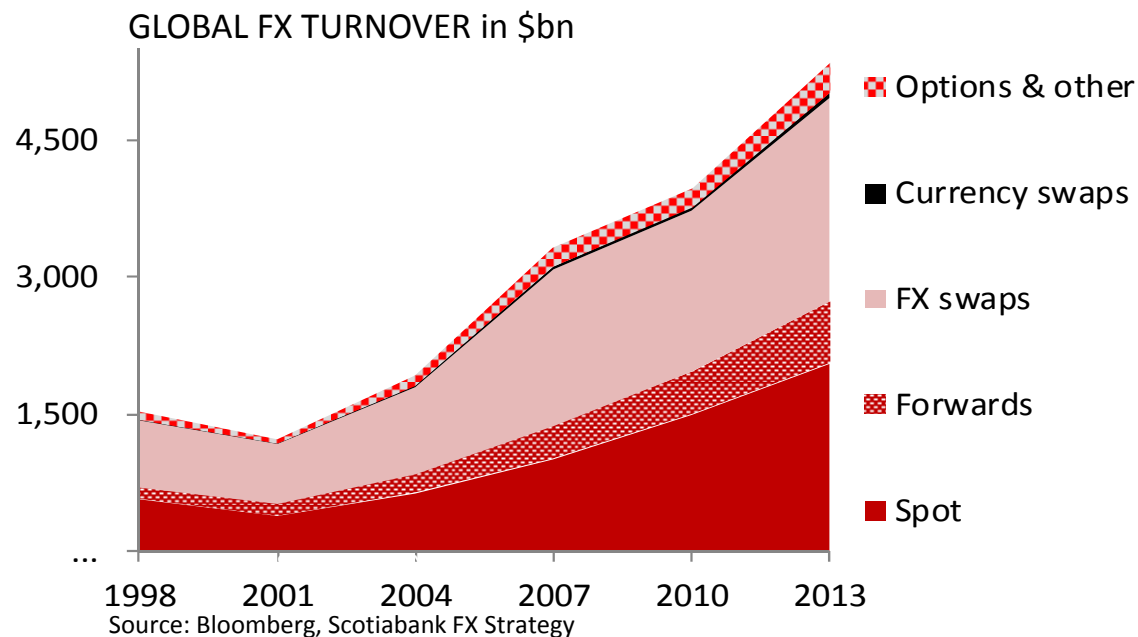
October 2013

## AGENDA – THREE TOPICS

---

1. Result of the latest BIS triennial central bank survey
2. Recent euro resilience against the US dollar
3. Overview of gold price developments

# BIS TRIENNIAL CENTRAL BANK SURVEY – TURNOVER



## GLOBAL FX DISTRIBUTION

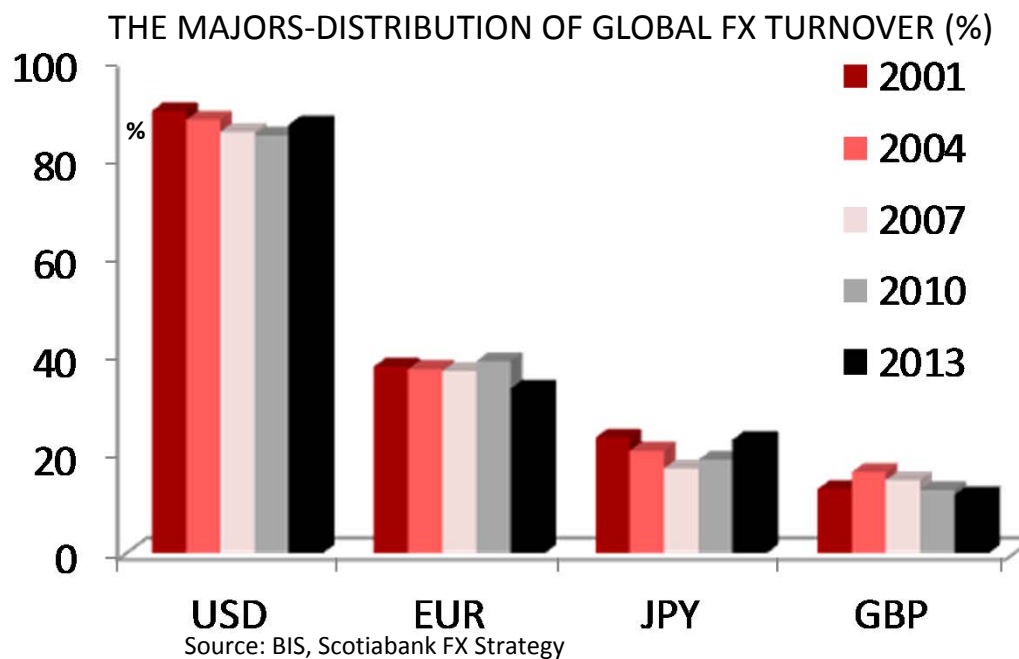
Currency	2013	
	Share	Rank
USD	87.0	1
EUR	33.4	2
JPY	23.0	3
GBP	11.8	4
AUD	8.6	5
CHF	5.2	6
CAD	4.6	7
MXN	2.5	8
CNY	2.2	9
NZD	2.0	10

Source: BIS

## FX TURNOVER - CORE THEMES

- Daily FX turnover increased to \$5.3trn in April 2013, from \$4.0trn in April 2010.
- Daily FX turnover is rising at a faster pace of 35%; outpacing the 2007/2010 growth rate of 19%.
  - USD is the dominant currency with an 87% share.
  - AUD is the 5<sup>th</sup> most actively traded currency, with a rising share.
- Share of turnover: importance of EM, with both MXN & CNY in top 10 most active.

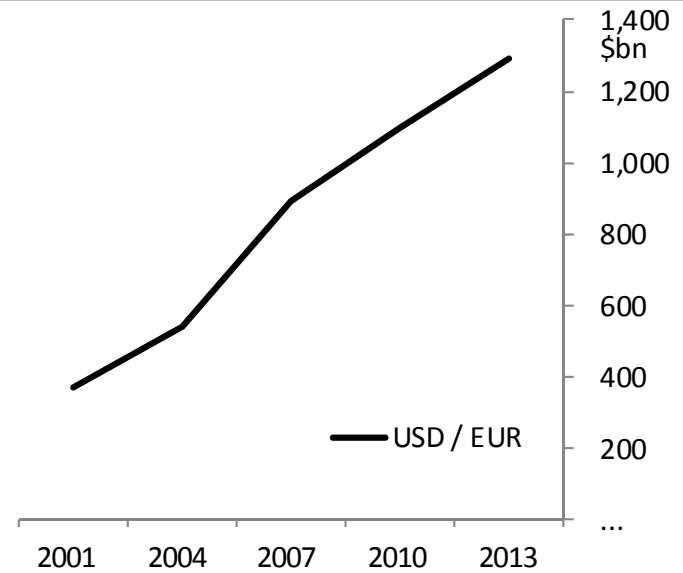
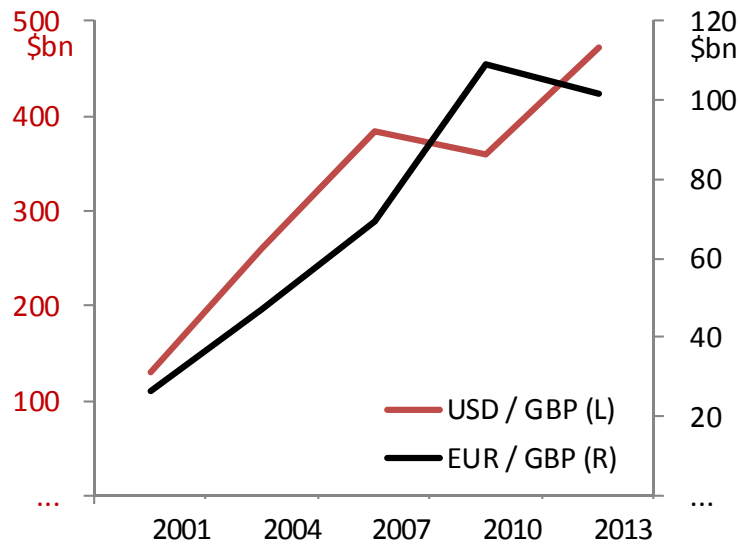
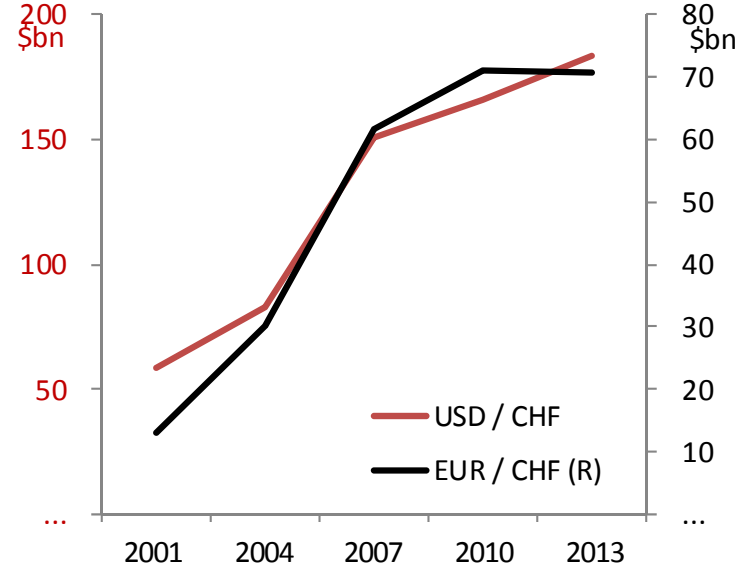
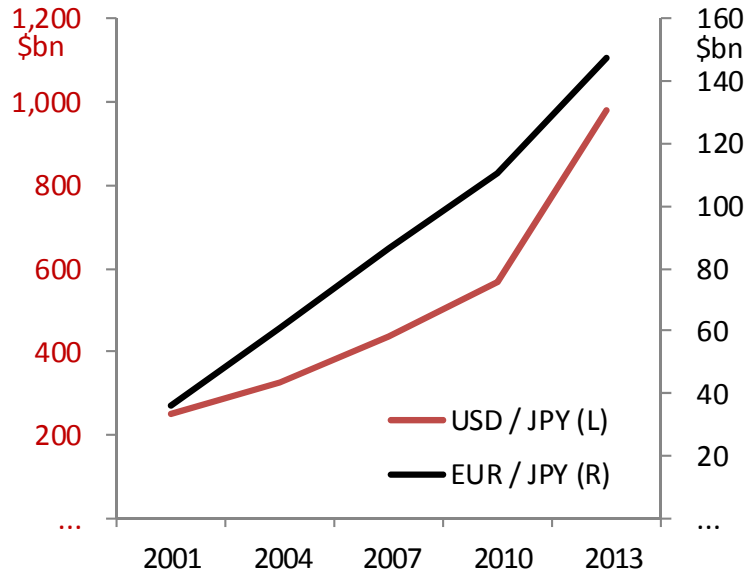
## BIS – THE MAJORS' SHIFTING TURNOVER



### DISTRIBUTION OF GLOBAL FX TURNOVER

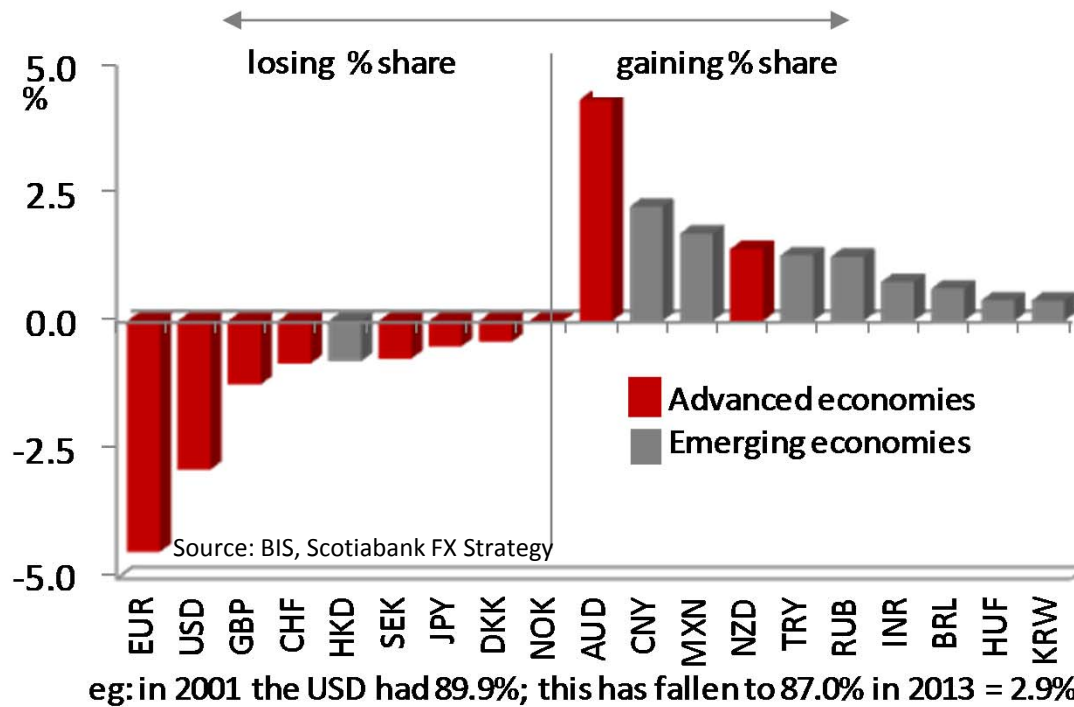
- USD is dominant and reclaiming share.
- EUR's share is falling - accounts for 33% of all turnover.
- EUR – 2010 volumes were likely impacted by the EURCHF floor.
- JPY is reclaiming lost share – but also story of the year.

# BIS – TURNOVER BY EUR PAIR (\$) VS SAME USD PAIR



# BIS – G10 CURRENCIES LOSE SHARE TO EMERGING MARKETS & OCEANIA

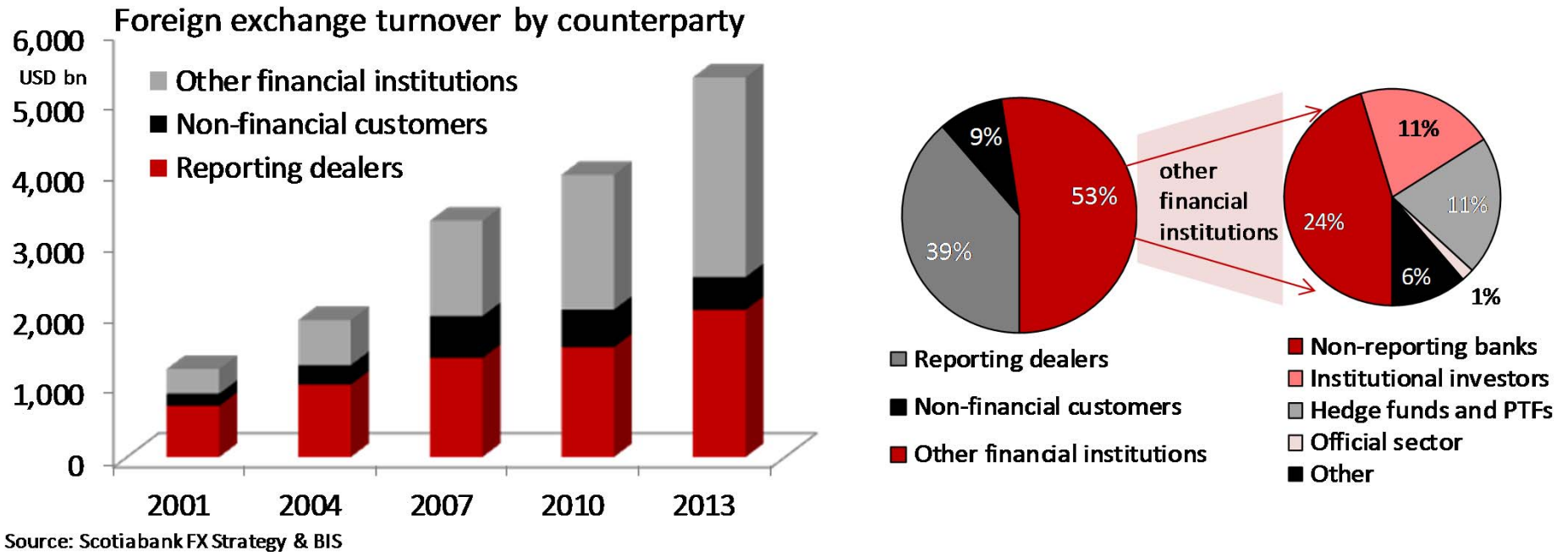
SINCE 2001 THE ADVANCED ECONOMIES ARE LOSING SHARE TO EM  
Percentage point change in share 2001 to 2013



## GEOGRAPHICAL DISTRIBUTION OF GLOBAL FX TURNOVER

- Drop in EUR share is a shift from G10 to EM (Europe, Latam & Asia) & Oceania.
- This is a G10 and less a EUR story.

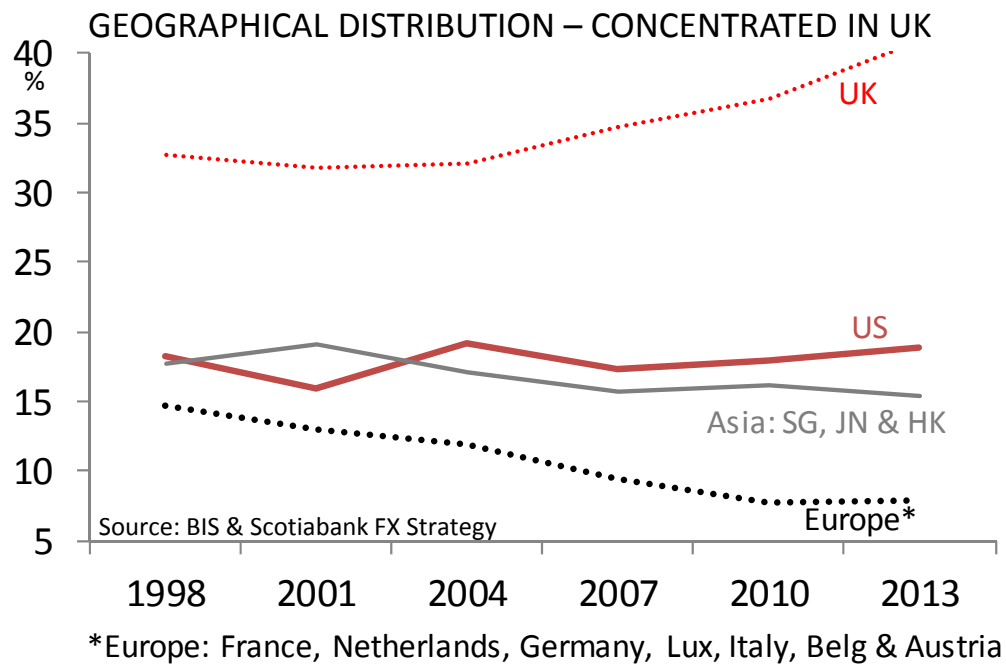
## BIS – CONCENTRATION IN ‘OTHER FINANCIAL INSTITUTIONS’



### TURNOVER BY COUNTERPARTY HIGHLIGHTS IMPORTANT SHIFT TO HFT

- Most of growth in other financial institutions.
- High frequency trading proves to be important component.
  - Rising volumes do not equate to increased liquidity.
- Misunderstanding rising volumes could leave markets vulnerable when they need liquidity the most.

## BIS – CONCENTRATION OF GEOGRAPHY



### DISTRIBUTION OF GLOBAL FX TURNOVER

- Trading is increasingly concentrated in the major centers, particularly the UK.
  - European trading centers are losing share.



## BIS TRIENNIAL CENTRAL BANK SURVEY – CORE THEMES

---

1. Turnover increased to \$5.3trn but does not necessarily equate to higher liquidity.
2. Rising concentration in geography of trading activity.
3. Shifting importance of counterparties.
4. Increasing importance of high frequency and algorithmic trading.
5. EUR is losing share; but 2010 vs 2013 data magnifies overall trends.
6. G10 is losing share to EM and Oceania.
7. EM is gaining share with MXN & CNY in top 10 for the first time.

# EUR: RECENT RESILIENCE AGAINST THE USD

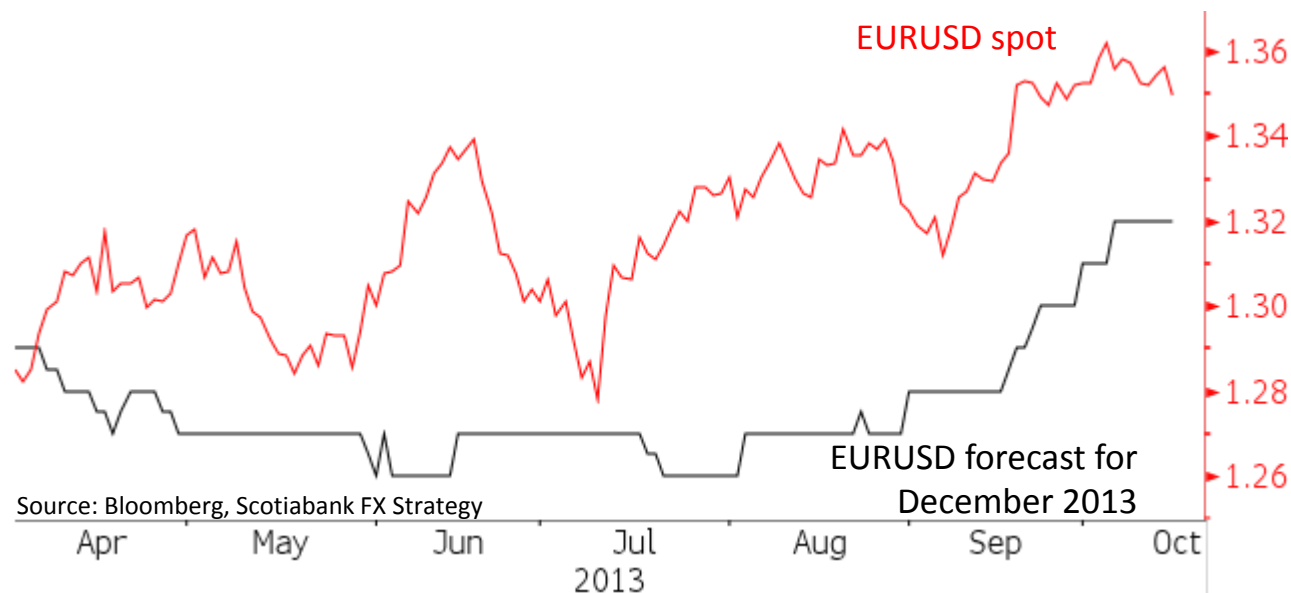
---

## GETTING LOST IN THE NOISE



## EUR RESILIENCE – ACTUAL VERSUS FORECAST

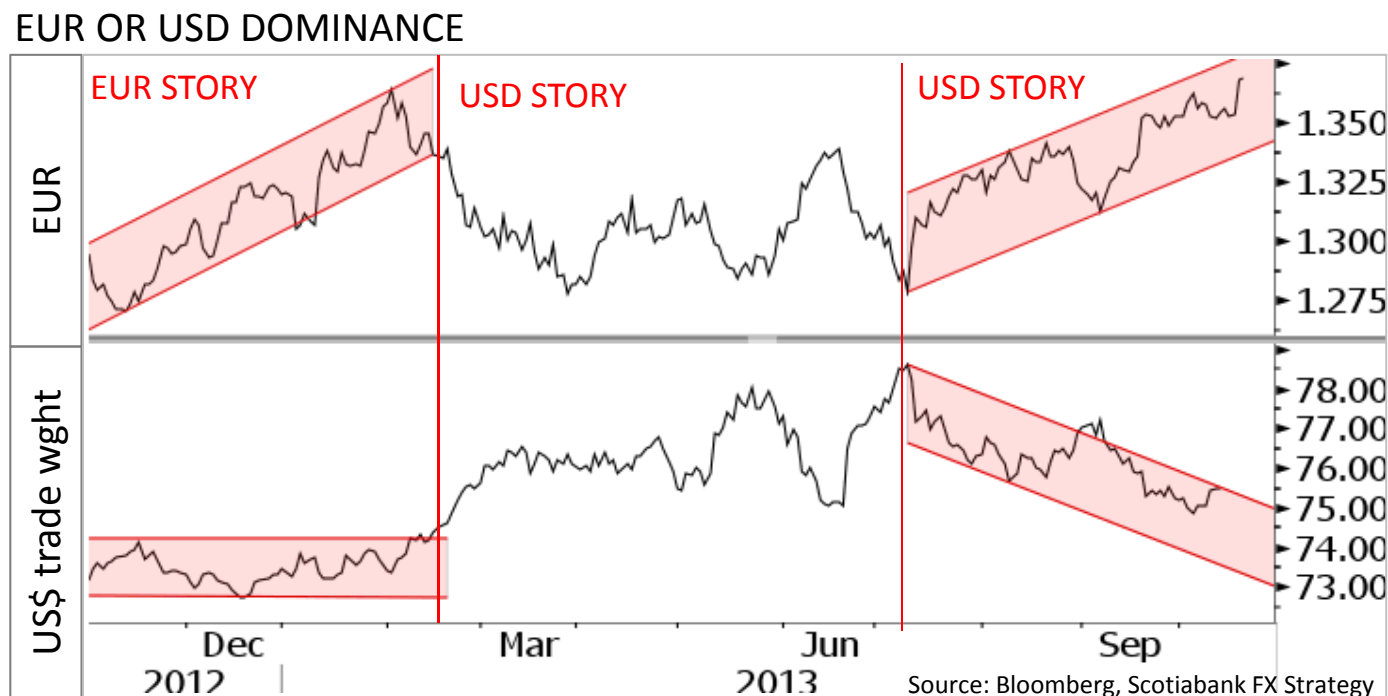
EUR SPOT VERSUS DECEMBER 2013 CONSENSUS FORECASTS



### EUR RALLIES - DEFYING BEARISH OUTLOOK

- EUR defies bearish forecasts and rallies 4.5% ytd (to October 22, 2013).
- As of Dec 2012, consensus forecast was for EUR to close Dec 2013 at 1.27 (a 4% depreciation).
  - Forecasters did not waver in bearish outlook, even as spot rallied.
- Forecasters focused on EUR side of equation; but it was USD side that drove EUR in first three quarters.

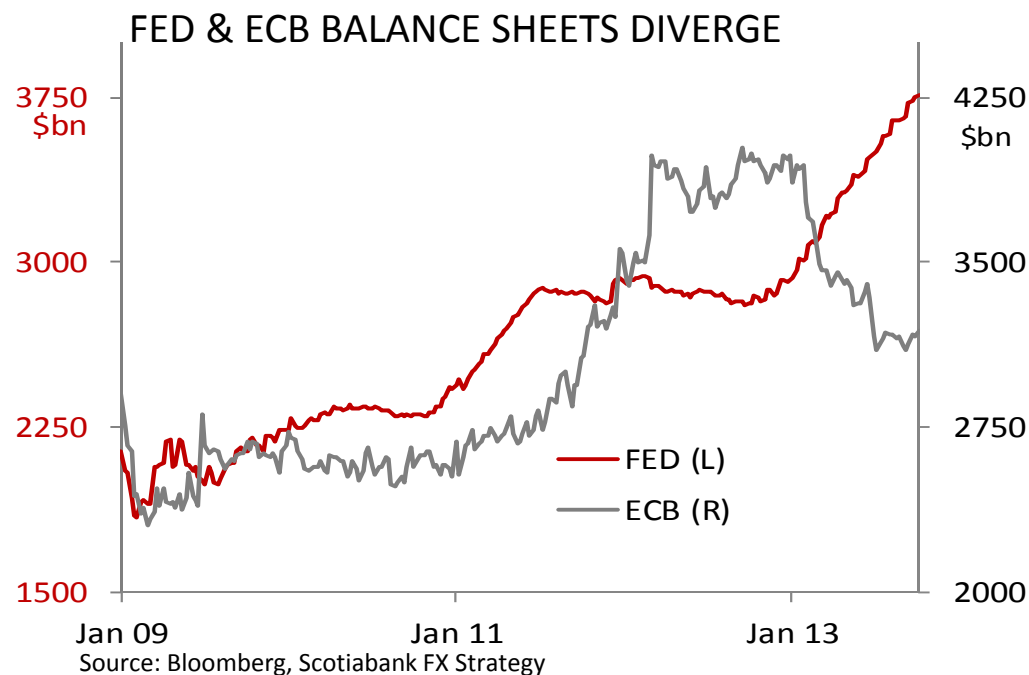
## EUR RESILIENCE – ACTUAL VERSUS FORECAST



### USD, NOT EUR, PROVES DRIVER OF EURUSD IN 2013

- EUR drove rally in late 2012 and early 2013.
- USD has driven EUR rally in summer and fall of 2013:
  - Central bank policy, the growth outlook and politics have all weighed on USD.
    - The bearish EUR side has been ignored.

## EUR RESILIENCE – RELATIVE CENTRAL BANK POLICY

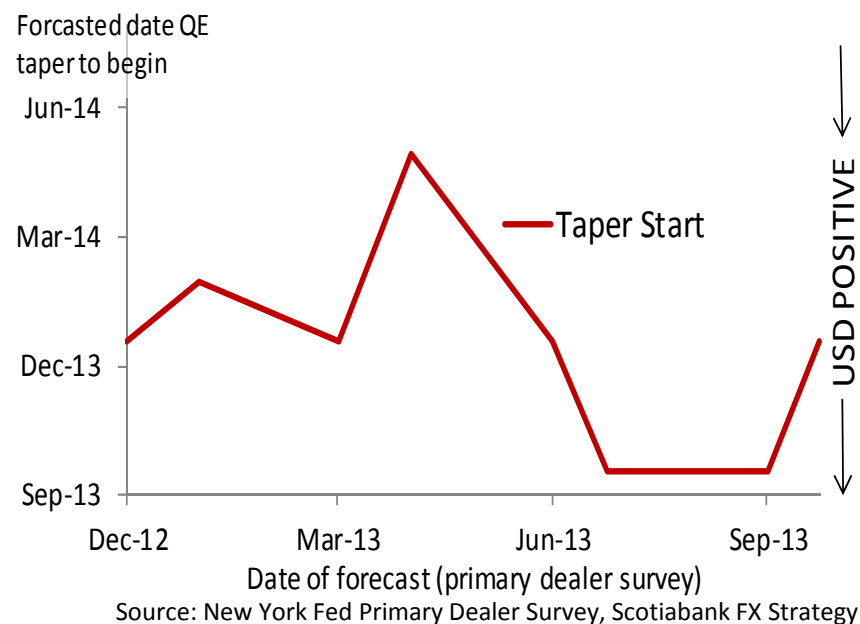


### RELATIVE MONETARY POLICY

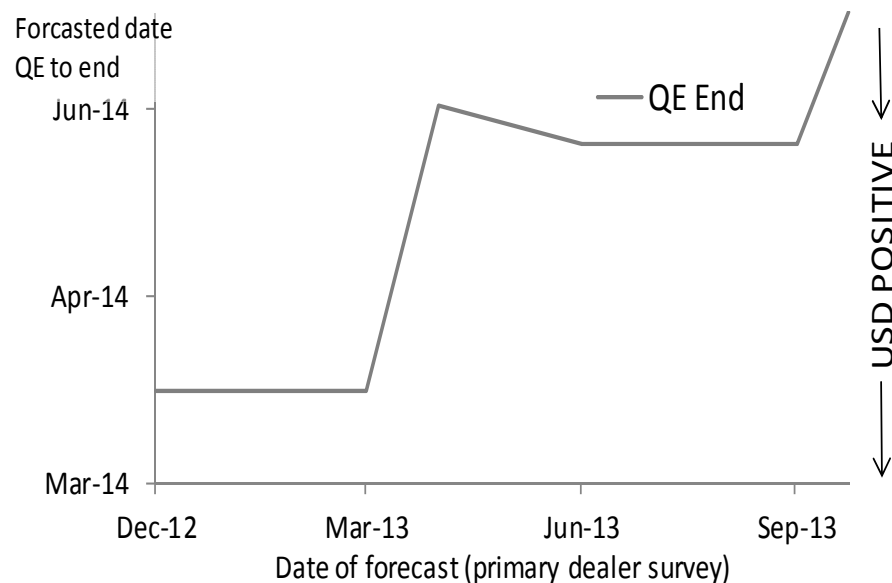
- ECB – as data improved, ECB tone was stable, rising EUR is not perceived as a threat (yet).
  - ECB – balance sheet declines on LTRO repayments.
  - FED – aggressive balance sheet growth continues.
    - Flows have supported EUR side.

## EUR RESILIENCE – RELATIVE CENTRAL BANK POLICY

### EXPECTATIONS FOR QE TAPERING



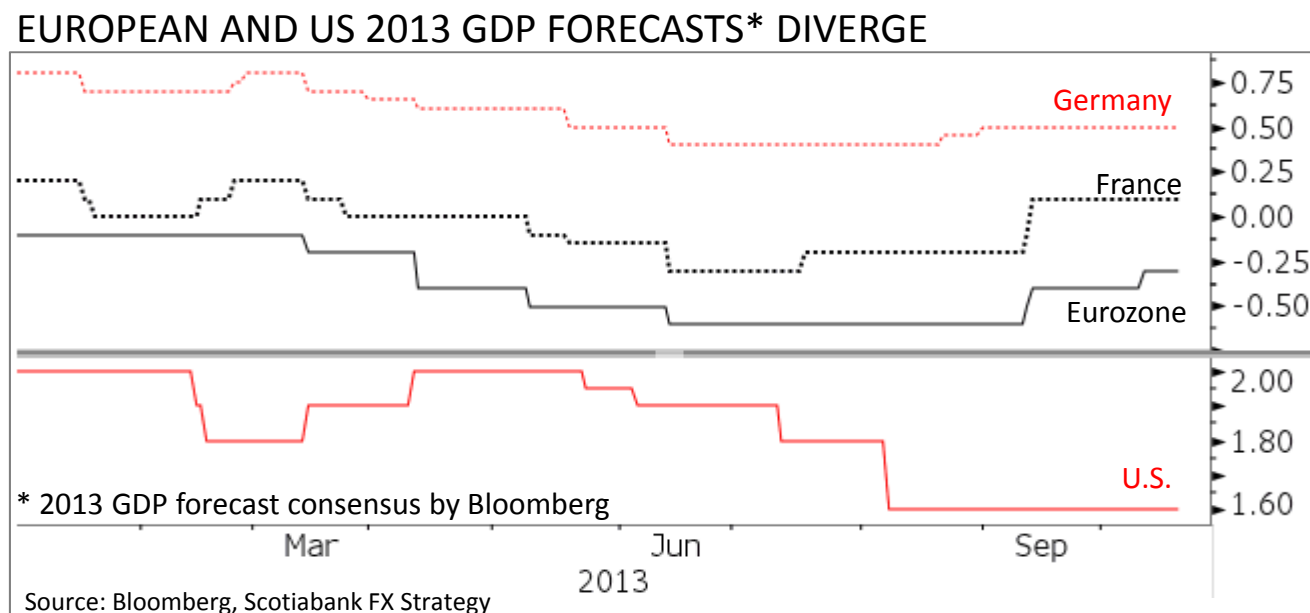
### EXPECTATIONS FOR QE COMPLETION



## US FED POLICY PROVES USD NEGATIVE

- Fed expectations and how they have changed over the year.
- QE tapering – volatile during year, at times supporting the USD and vice versa.
  - QE completion – was pushed out, weighing on USD.

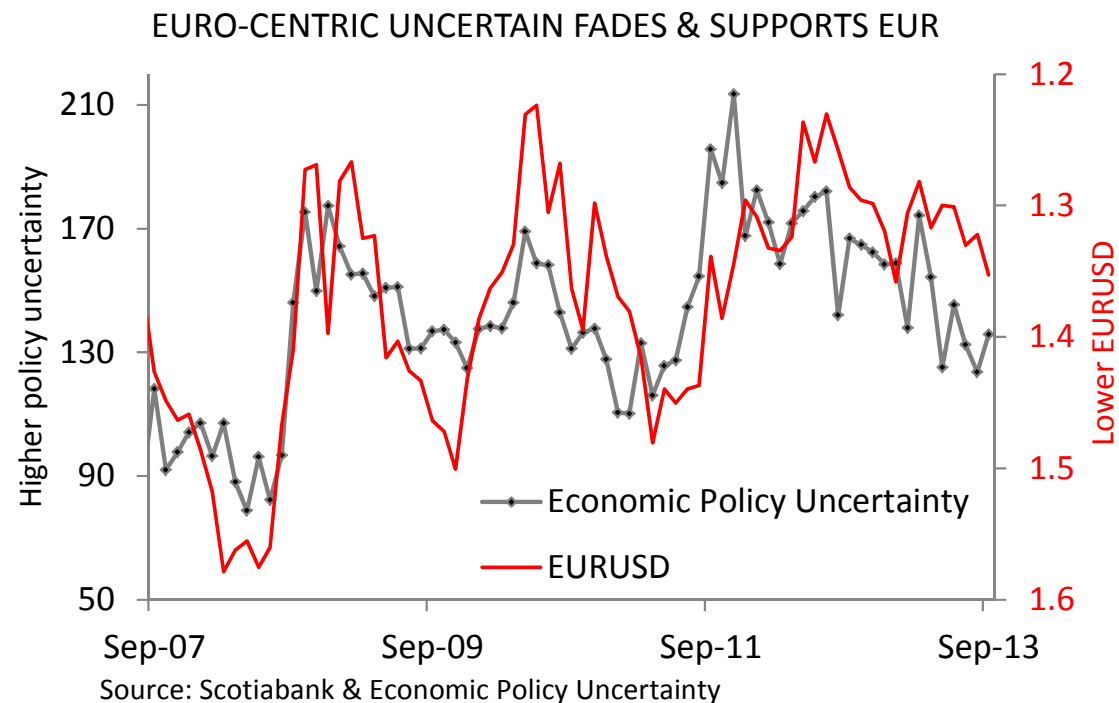
## EUR RESILIENCE - GROWTH



### GROWTH FORECASTS SHIFT IN EUROPE'S FAVOUR

- Eurozone - in the early summer growth outlook undergoes positive shift.
  - US – in early summer growth outlook is still be revised lower.
  - Diverging growth outlooks play into currency sentiment.

## EUR RESILIENCE – FROM CRISIS TO STABILITY



### EUROZONE UNCERTAIN FADES

- Economic policy uncertainty is an important market driver.

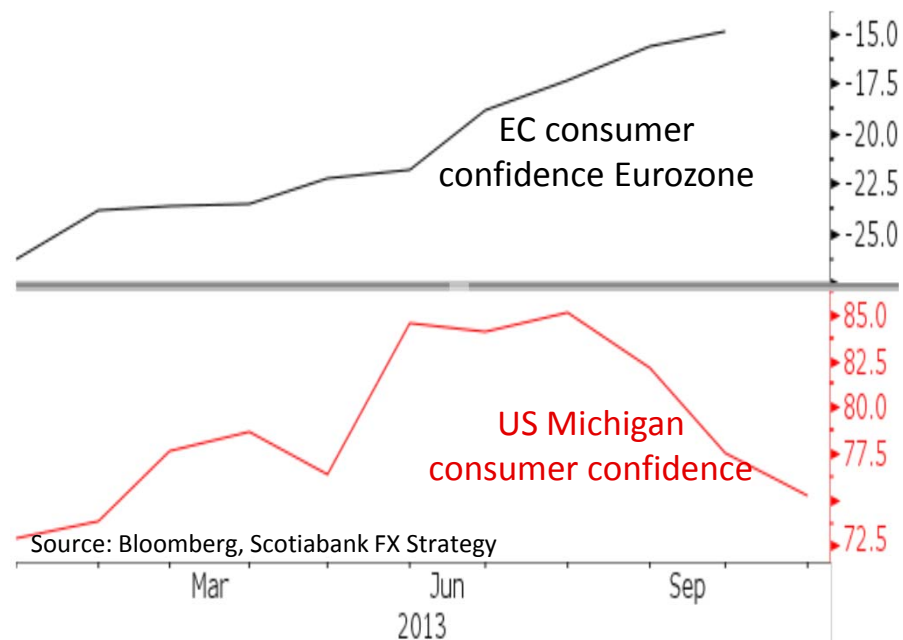
Index:

- Newspaper coverage of policy related economic uncertainty.
- Disagreement among economic forecasters as a proxy for uncertainty.

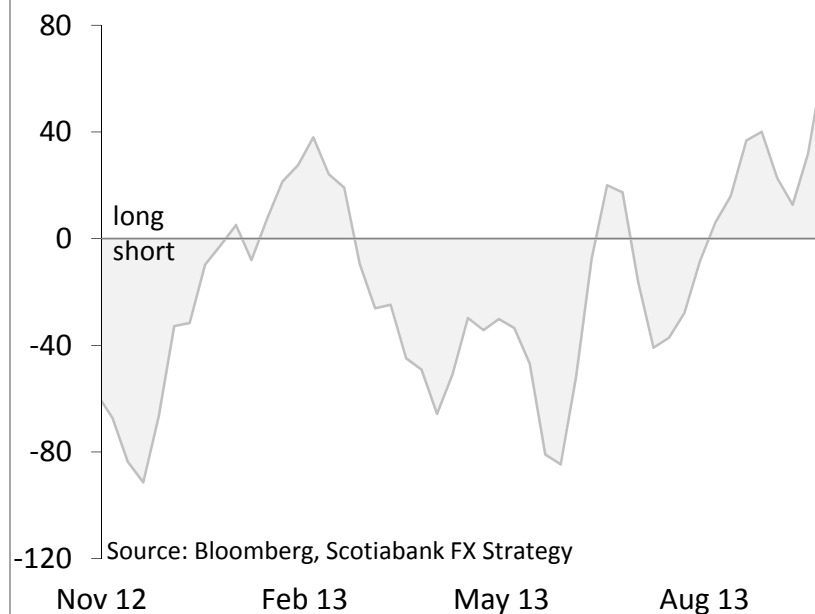


# EUR RESILIENCE – CONFIDENCE & SENTIMENT

## CONSUMER CONFIDENCE DIVERGES



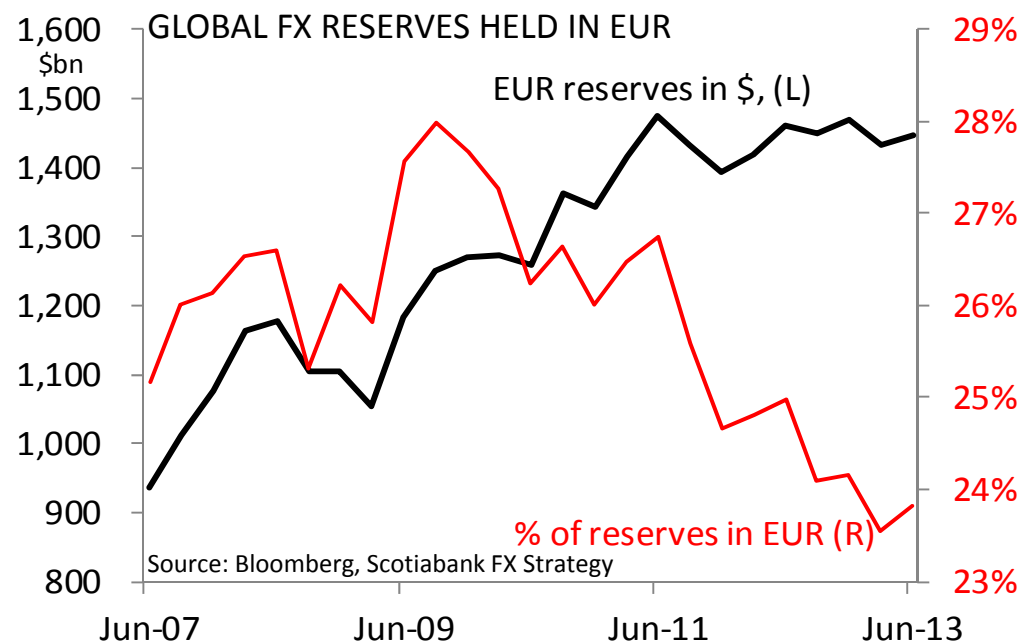
## EUR NET POSITION - SHIFTING



## DIVERGING CONSUMER CONFIDENCE

- Consumer confidence diverges in Europe and the US.
- EUR sentiment shifts increasingly bullish in the spring.
  - Powerful near-term drivers.

## EUR RESILIENCE – FX RESERVES



### FX RESERVE MANAGERS MAKE IMPORTANT BUYER OF EUR

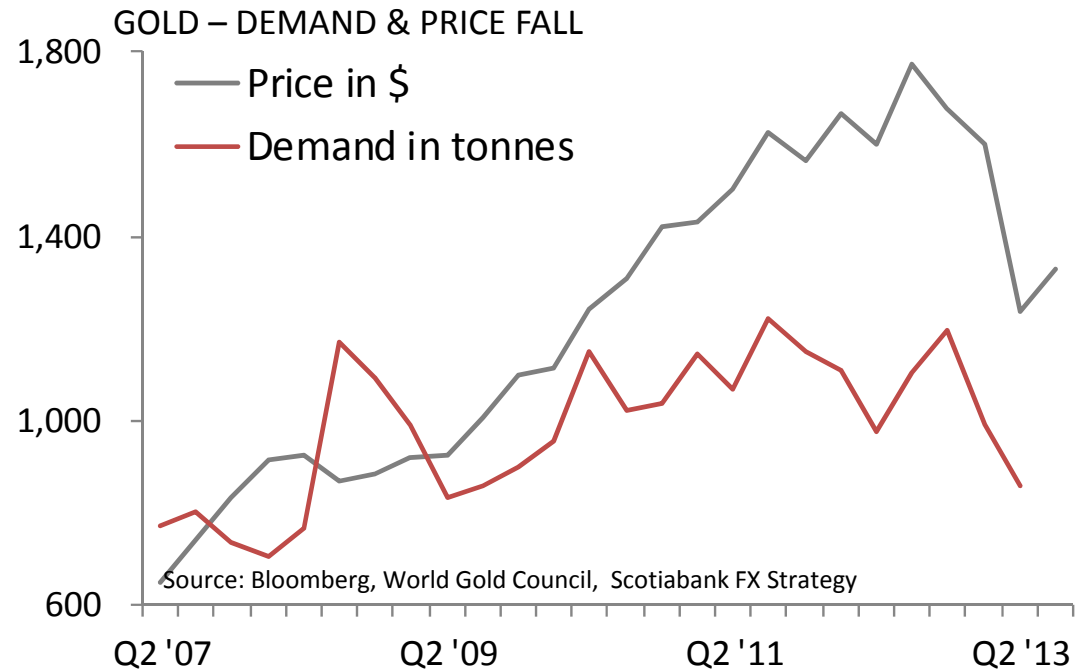
- EUR allocations in \$ are constant – even as percentage falls.
  - EUR percentage of reserves – likely bottoming.
- Diversification of reserves is an important short-term driver.

## EUR: RECENT RESILIENCE AGAINST THE USD – CORE THEMES

---

1. A lot of noise clouds the outlook.
2. Drivers of EUR:
  - Relative central bank policy
  - Growth outlook and changes in outlook
  - Politics
  - Level of uncertainty
  - Sentiment
3. Market focused on USD side of equation.

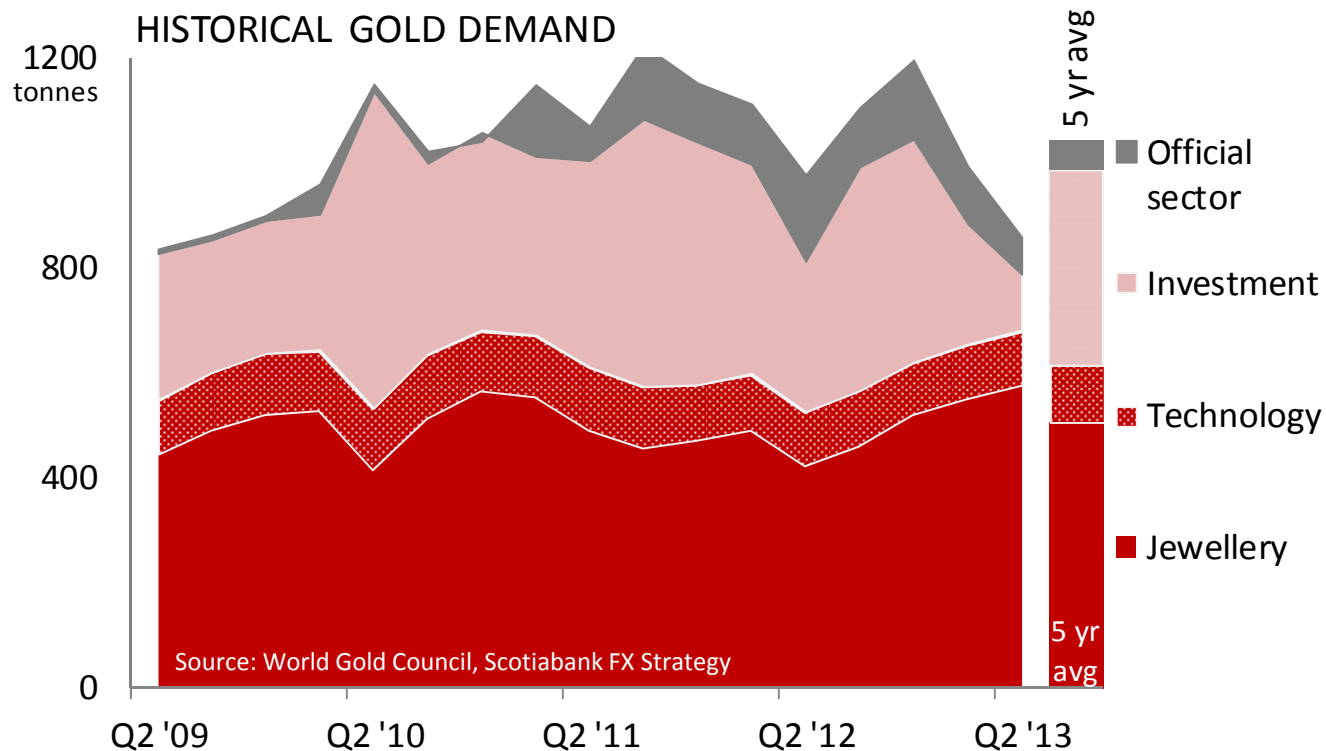
## GOLD: A DECLINE IN DEMAND, SUPPLY AND PRICES



### GOLD PRICES LOSE THEIR SHINE

- Gold peak: \$1,921 on September 6, 2011.
- Gold (mid October at \$1325) is down 32% from its peak.
- Demand has been trending lower since Q3 2012.

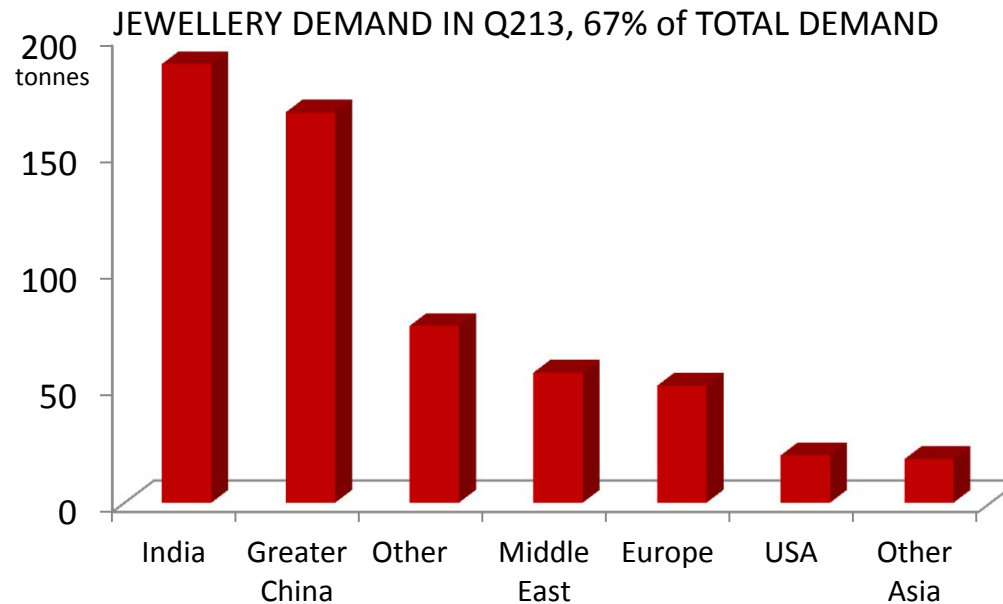
## GOLD DEMAND – SHIFTING DEMAND TRENDS



### BROAD DEMAND THEMES

- Largest demand: jewellery.
- Largest fall in demand: investment.
- Steady demand: technology (& official sector to lesser extent).

# GOLD DEMAND – JEWELLERY, THE IMPORTANCE OF INDIA & CHINA

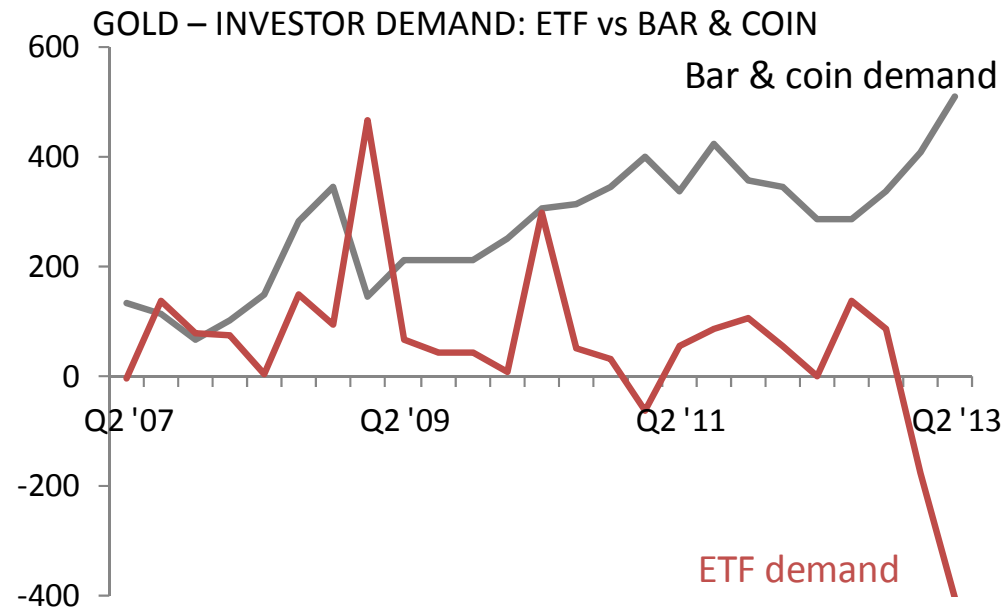


Source: World Gold Council, Scotiabank FX Strategy

## BROAD DEMAND THEMES

- Jewellery demand is rising as prices fall.
- China & India jewellery demand in Q213 accounted for 60% of total gold demand.
- Risks: India imposes gold import duties of 10% - creating confusion & weighing on demand.
- Risks: China's demand has been strong, fears building that they are overstocked.

## GOLD DEMAND – INVESTORS DIVERGE



Source: World Gold Council, Scotiabank FX Strategy

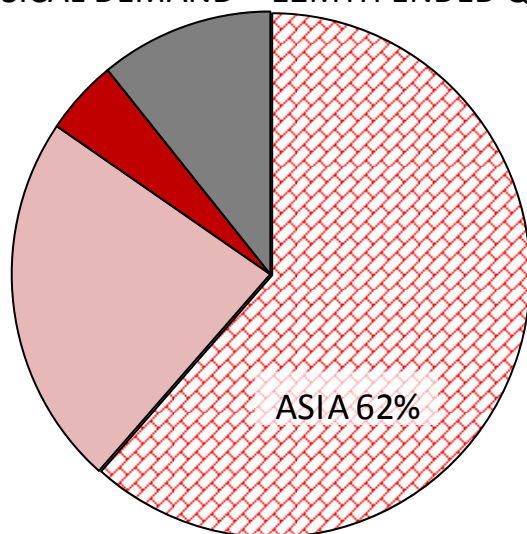
### GEOGRAPHY OF GOLD & DIVERGING DEMAND

- ETF – before crisis demand positively linked with bar/coin demand.
- NA & Europe: shift to other assets on changing safe haven demand, Fed policy & commodity super-cycle.
  - Asia: Gold as form of protection against currency depreciation.

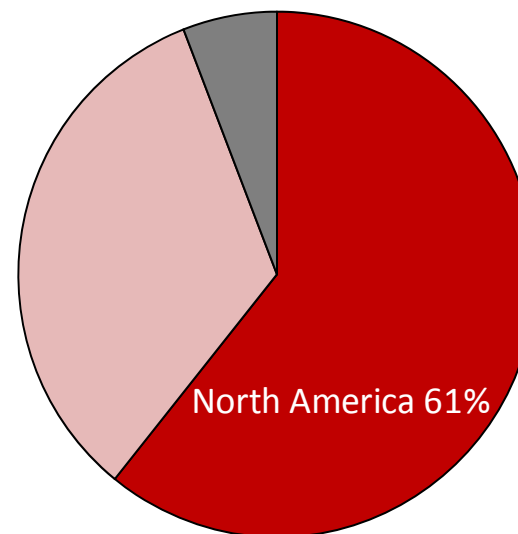
# GOLD DEMAND - THE GEOGRAPHICAL SHIFT

## GEOGRAPHY OF PHYSICAL vs ETF DEMAND

PHYSICAL DEMAND – 12MTH ENDED Q2 13



ETF HOLDINGS AS OF Q1 13



- ASIA
- EUROPE
- US / NA
- OTHER

Source: World Gold Council, Scotiabank FX Strategy

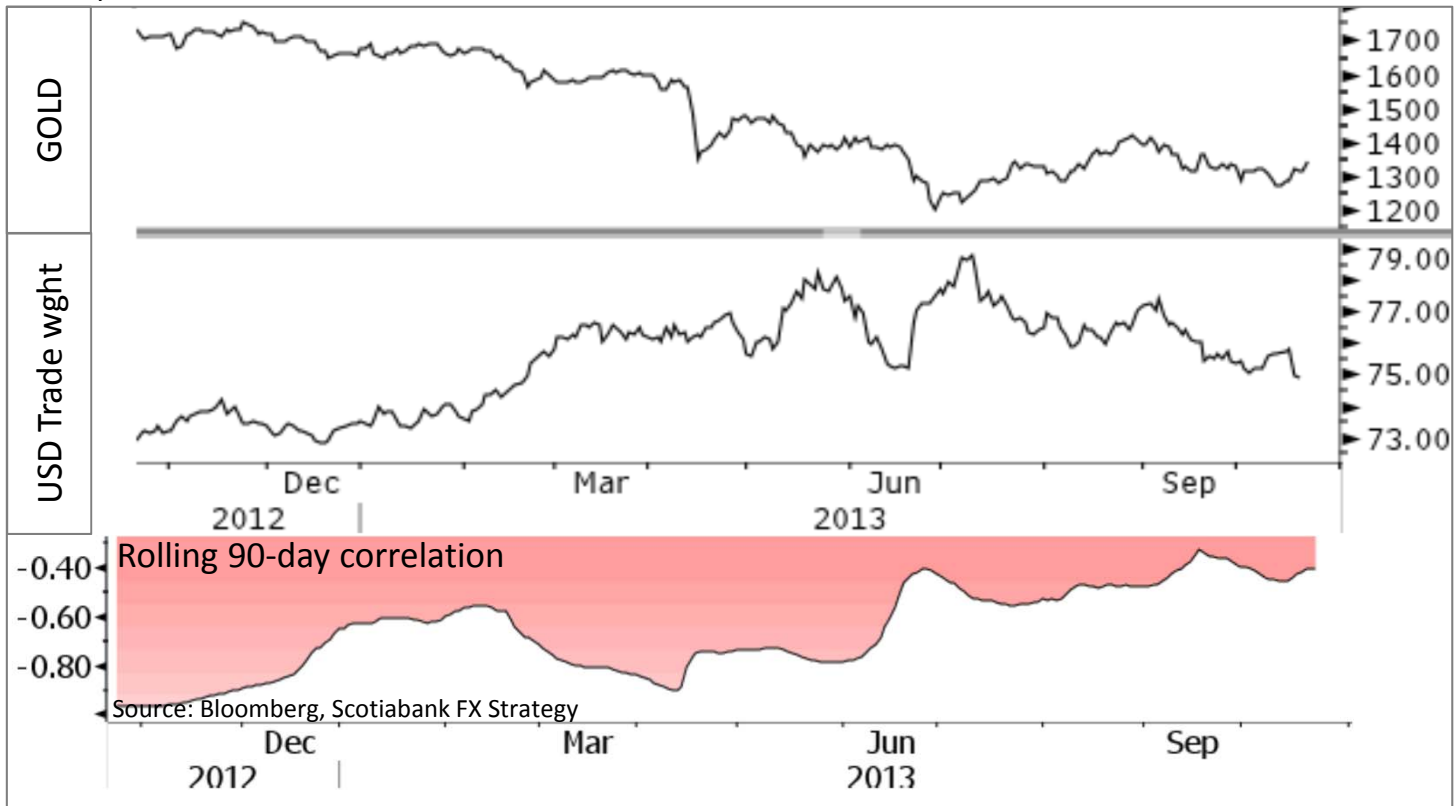
## GEOGRAPHY & GOLD MARKETS

- Asia: physical demand is significant; ETF market less developed.
- North America (NA) & Europe – well developed ETF markets.



# GOLD – FAILS TO RALLY WITH USD WEAKNESS

USD, GOLD AND CORRELATIONS



## GOLD AND THE USD – CORRELATION BREAKS DOWN

- USD trending lower

# GOLD PRICE DEVELOPMENTS

---

## General Drivers

- Safe haven demand
- Inflation fears
- Central bank policy - unconventional
- The US dollar / currency devaluation
- Portfolio diversification into commodities

## Supply Drivers

- Official sector – sales expected to remain well below their ceiling
- Mine production – uncertain

## Demand Drivers

- Jewellery – trend is positive but at risk
- Investment – dependent on unconventional policy developments
- Official & technology demand stable

# DISCLAIMER

---

**DISCLAIMER:** This report is prepared by The Bank of Nova Scotia (Scotiabank) as a resource for clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness and neither the information nor the forecast shall be taken as a representation for which The Bank or its affiliates or any of their employees incur any responsibility. Neither Scotiabank or its affiliates accept any liability whatsoever for any loss arising from any use of this report or its contents. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any of the currencies referred to in this report. Scotiabank, its affiliates and/or their respective officers, directors or employees may from time to time take positions in the currencies mentioned herein as principal or agent. Directors, officers or employees of Scotiabank and its affiliates may serve as directors of corporations referred to herein. Scotiabank and/or its affiliates may have acted as financial advisor and/or underwriter for certain of the corporations mentioned herein and may have received and may receive remuneration for same. This report may include forward-looking statements about the objectives and strategies of members of the Scotiabank Group. Such forward-looking statements are inherently subject to uncertainties beyond the control of the members of the Scotiabank Group including but not limited to economic and financial conditions globally, regulatory development in Canada and elsewhere, technological developments and competition. The reader is cautioned that the member's actual performance could differ materially from such forward-looking statements. You should note that the manner in which you implement any of strategies set out in this report may expose you to significant risk and you should carefully consider your ability to bear such risks through consultation with your legal, accounting and other advisors. Information in this report regarding services and products of Scotiabank is applicable only in jurisdictions where such services and products may lawfully be offered for sale and is void where prohibited by law. If you access this report from outside of Canada, you are responsible for compliance with local, national and international laws. Not all products and services are available across Canada or in all countries. All Scotiabank products and services are subject to the terms of applicable agreements. This research and all information, opinions and conclusions contained in it are protected by copyright. This report may not be reproduced in whole or in part, or referred to in any manner whatsoever nor may the information, opinions and conclusions contained in it be referred to without in each case the prior express consent of Scotiabank. Scotiabank is a Canadian chartered bank. TM Trademark of The Bank of Nova Scotia. Used under license, where applicable. Scotiabank, together with "Global Banking and Markets", is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including, Scotia Capital Inc. and Scotia Capital (USA) Inc. - all members of the Scotiabank Group.

**Dodd-Frank Act Disclaimer:** This material has been prepared and distributed by The Bank of Nova Scotia for informational and marketing purposes only and should not be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap. The general transaction, financial, educational and market information contained herein is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a "call to action" or suggestion that you enter into a swap or trading strategy involving a swap. You need to exercise independent judgment in evaluating this material, and you should consult with your own independent financial, legal, accounting, tax and other professional advisors as to whether any swap or trading strategy involving a swap is suitable or advisable for you.

## APPENDIX: EUR RESILIENCE – BUT OUTLOOK IS STILL WEAK

ISSUE	DEVELOPMENTS TO DATE	STILL NEEDED	CHANGE IN TAIL RISK	REMAINING TAIL RISK
Bank Solvency / Fragmentation	1. LTRO - provided liquidity 2. Banking union plans	SSM, SRM & deposit insurance fund	increasing	high
Euro exit / bail outs	1. OMT 2. Ireland, Portugal & Greece	A framework for a closer fiscal union	decreased	medium
Politics	Italy, Germany, France	Solid political base across Europe	stable	medium
Government debt	Austerity	Balance between growth & austerity	stable	medium
Growth	Improving growth outlook	Balance between growth & austerity	stable	low

### UPCOMING KNOWN RISKS

- Q1 2014 risks: AQR, parliament approval of SRM, Ireland program concludes.
- Q2 2014 risks: Council to approve SRM, EBA stress tests.
- Q3 2014: ECB & SSM, Portuguese program concludes.
- Q4 2014: Greece program concludes.