July 2017

FX market outlook

Currencies

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2. Significant uptick in G10 yields

Initially led by Trump and US-led reflation hopes

Now led by Europe and ECB taper talk

Source: Bloomberg, HSBC
3. But not because of inflation expectations
4. Inflation actually lower than expected

Source: Bloomberg, HSBC
5. Global cyclical rebound could be fading

Survey data stronger than expected

Hard data weaker than expected

Source: Bloomberg, HSBC
6. EUR to follow the USD’s path when the Fed went towards “normalisation”
7. ECB normalisation to lead to EUR strength

Source: Bloomberg, HSBC
8. EUR is not as widely held as before

World reserves total around USD10trn: a rise in EUR holdings back to 25% could translate to USD500bn of demand for the single currency

Source: Bloomberg, HSBC
9. GBP: less cyclical, more political

Source: Bloomberg, HSBC
## 10. Politics: massive uncertainty on a deal

<table>
<thead>
<tr>
<th></th>
<th>EU</th>
<th>EEA</th>
<th>&quot;Britzerland&quot;</th>
<th>Customs Union</th>
<th>New FTA</th>
<th>No deal</th>
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<tr>
<td>Single Market</td>
<td>✔️</td>
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<td>❓</td>
<td>✗</td>
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<tr>
<td>Free trade in goods/services</td>
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<td>FTAs with 3rd parties</td>
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<td>Free movement of people</td>
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</tbody>
</table>

✔️ = yes  
*= no  
◊ = grey area / mixed  
Source: HSBC
11. Cyclical: rate hikes would be misguided

Market confuses cyclical and structural

- Faster growth
- Inflation rises
- BoE hikes
- GBP rallies

Current account deficit in focus
- GBP depreciates
- Inflation rises

Is the adjustment big enough?
- Yes: GBP stabilizes
- No: Real incomes squeezed
  - Growth slows & imports fall

Source: HSBC
12. Cyclical: higher inflation solely FX-led

8. In our forecast, sterling effects are the only drivers of above-target (core) inflation

Source: ONS, HSBC
13. Structural: limited external rebalancing

Source: Bloomberg, HSBC
14. EM FX is not cheap

Source: Bloomberg, HSBC
15. Disclosure appendix

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