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## CURRENCY CONCERNS, FUTURE SOLUTIONS

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## Global Currency Outlook in 2011

- **US :** Quantitative Easing, Deficits & Sub trend Economic Growth
- **Euro:** Euro zone Debt issues, Deficits, Core vs. Peripheral countries
- **Currency Wars?:** Devaluation of currencies to spur economic growth
- **Emerging Market s:** China & other Asian Countries

## US growth continues, albeit at a slower pace

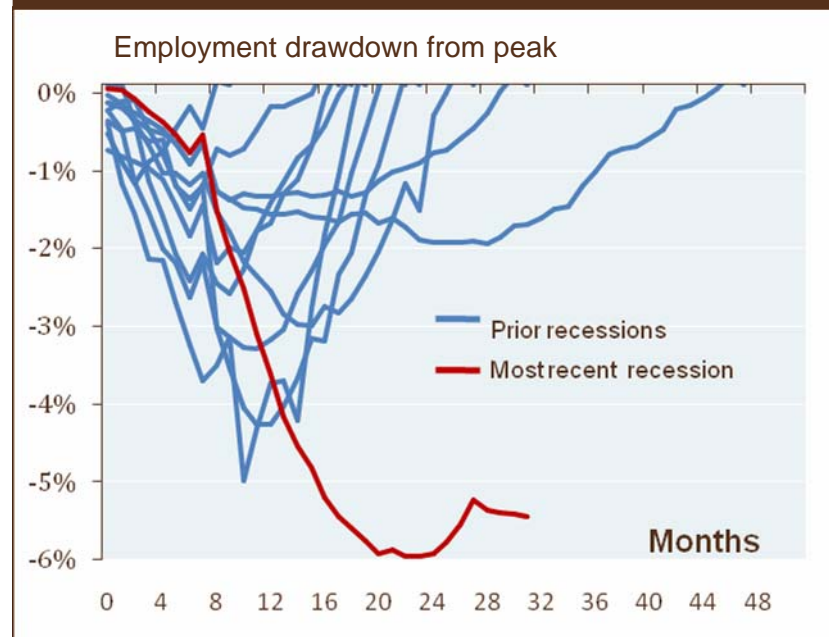
- Recovery in US private sector payrolls continues to be extremely weak.
- Pace and degree of job market improvement will dictate strength of the US economic recovery in 2011

### PMI indicators have continued to moderate



Source: J.P. Morgan Securities LLC Data as of 15/06/2010.

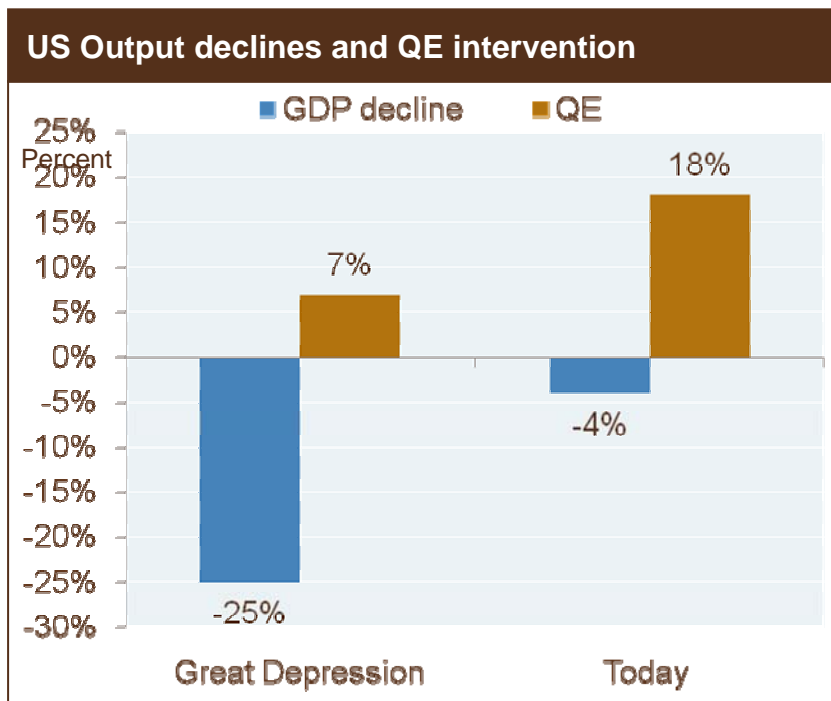
### Job losses in post WWII recessions



Source: Bureau of Labor Statistics. Data as of September 2010.

## Quantitative Easing: The US Federal Reserve's \$600 Billion QE2 program

- QE2 should support “risk” assets
- Fed has left the door wide open for additional Treasury purchases after June 2011



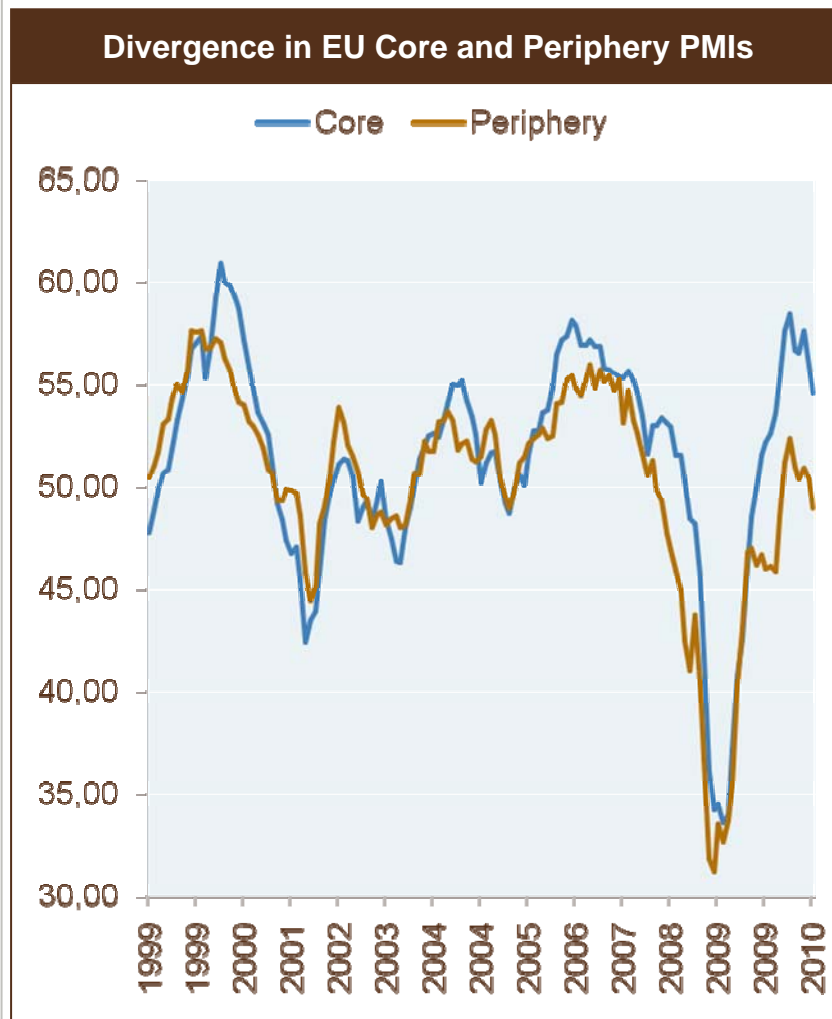
Source: J.P. Morgan PB, November 2010.

**Equities and metals have performed strongly since Bernanke's Jackson Hole speech**

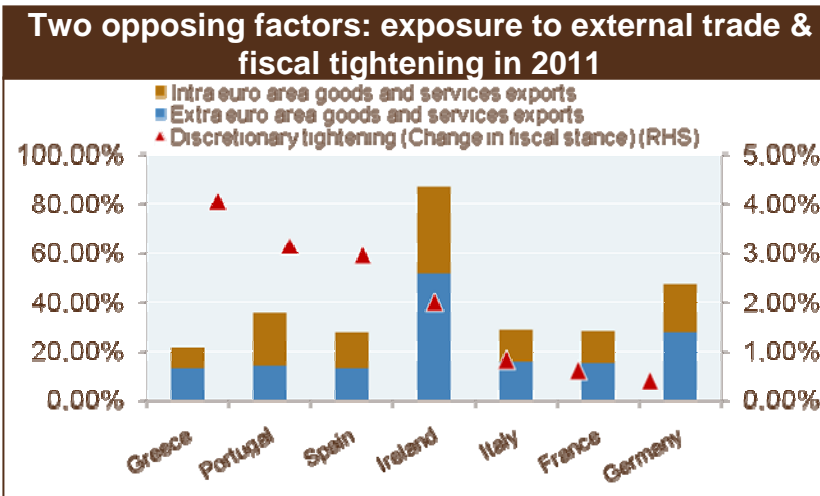
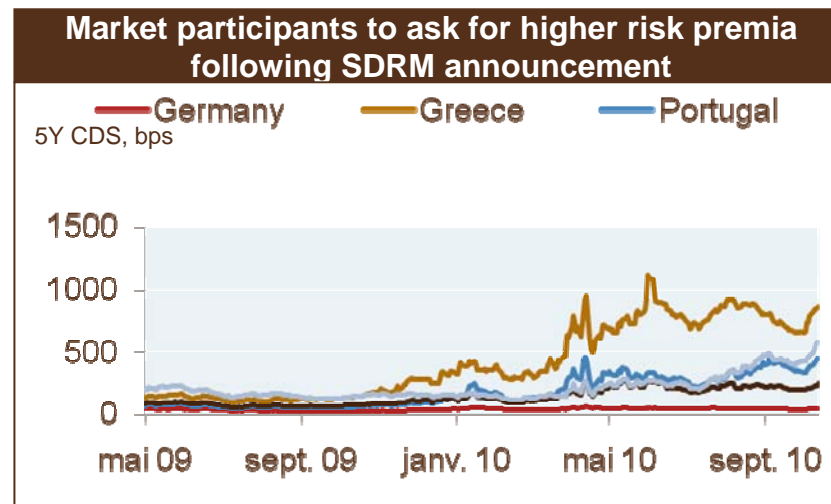
	27 Aug. 2010	5 Nov. 2010	Change
China Shanghai Comp.	2610.7	3129.5	19.9%
S&P 600 Small-Cap	330.2	391.2	18.5%
CRB Index	267.3	313.6	17.3%
S&P 400 Mid-Cap	734.3	861.1	17.3%
Copper	336.4	394.4	17.2%
<b>S&amp;P 500</b>	<b>1064.6</b>	<b>1225.9</b>	<b>15.2%</b>
Gold	1237.9	1380.6	11.5%
U.S. Dollar Index	82.9	76.5	-7.7%
U.S. 10-Year Yield	2.64%	2.53%	-11 bps
3-Month \$ LIBOR	30 bps	28 bps	-2 bps
3-Month EURIBOR	89 bps	105 bps	6 bps

Source: J.P. Morgan PB, Strategas, November 2010.

## Europe: Core Europe is doing well, while the Periphery is still lagging



Source: Markit, BofA Merrill Lynch Global Research. September 2010.



Source for the top graph: J. P. Morgan PB, Bloomberg. November 2010.  
Source for the lower graph: Barclays, IMF, Eurostat. 2010.

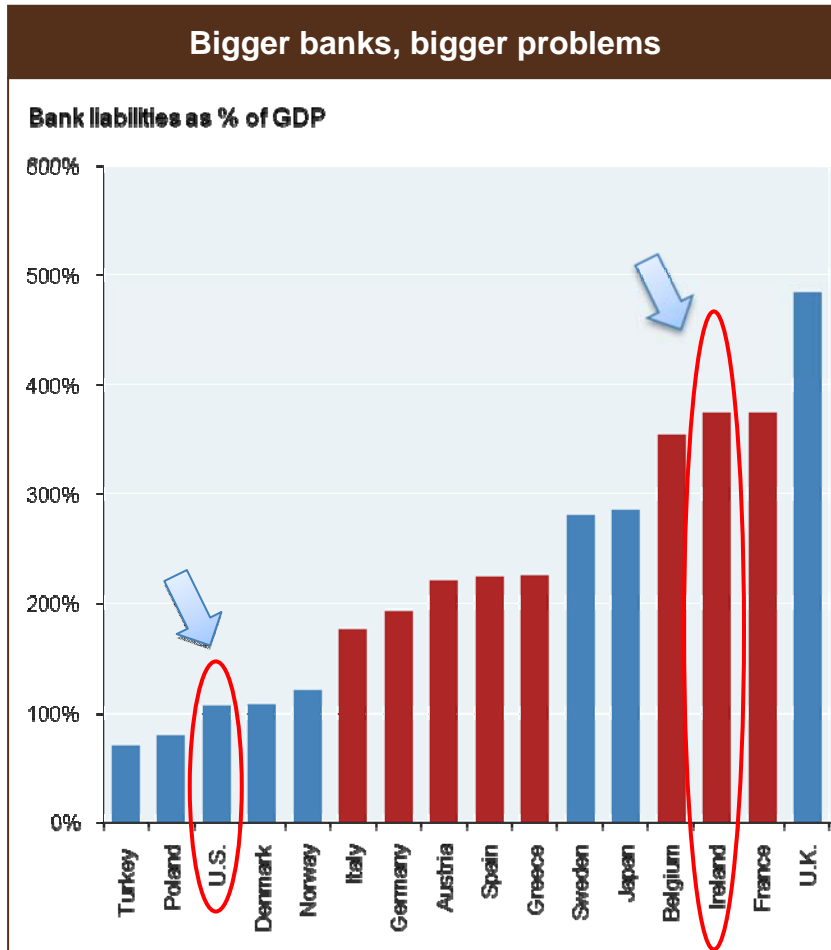
## Euro zone debt crisis back in the limelight:

### Outlook for the Euro area periphery - Long-term fiscal efforts cannot be ignored

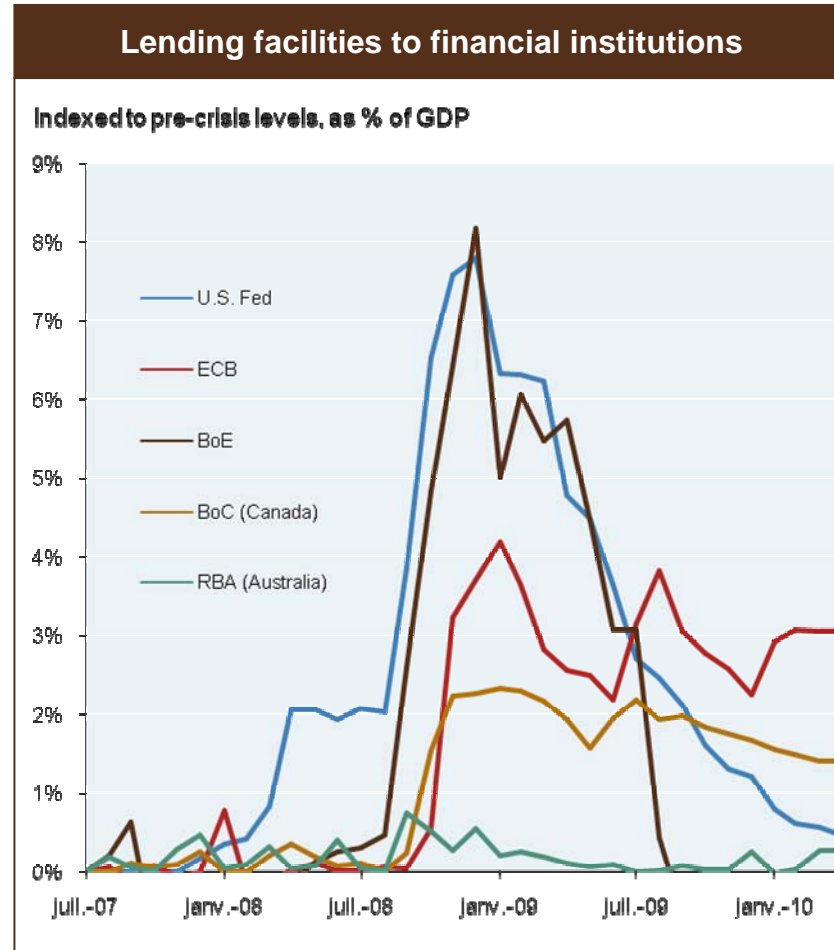
% oya for GDP and CPI, % of GDP for deficits and debt					
	2010	2011	2012	2013	2014
<b>Greece</b>					
GDP	-4.0	-2.6	1.1	2.1	2.1
CPI	4.6	2.2	0.5	0.7	0.9
Deficit	-9.4	-7.6	-6.5	-4.9	-2.6
Debt	144.0	153.0	158.0	158.0	153.0
<b>Ireland</b>					
GDP	0.3	1.8	3.3	3.0	2.8
CPI	-1.5	0.8	1.0	1.8	1.8
Deficit	-32.0	-9.4	-7.0	-5.4	-2.9
Debt	98.5	105.0	106.0	105.0	101.0
<b>Portugal</b>					
GDP	1.3	0.2	1.3	1.7	na
CPI	1.3	2.2	1.9	2.0	na
Deficit	-7.3	-4.6	-3.0	-2.0	na
Debt	82.1	86.6	86.6	85.5	na
<b>Spain</b>					
GDP	-0.3	1.3	2.5	2.7	na
CPI	1.7	1.8	2.0	2.0	na
Deficit	-9.3	-6.0	-4.4	-3.0	na
Debt	62.8	68.7	70.2	70.0	na

Sources: J.P. Morgan Securities LLC

The absolute size of banks in Europe has been a challenge and they remain heavily reliant on the ECB...



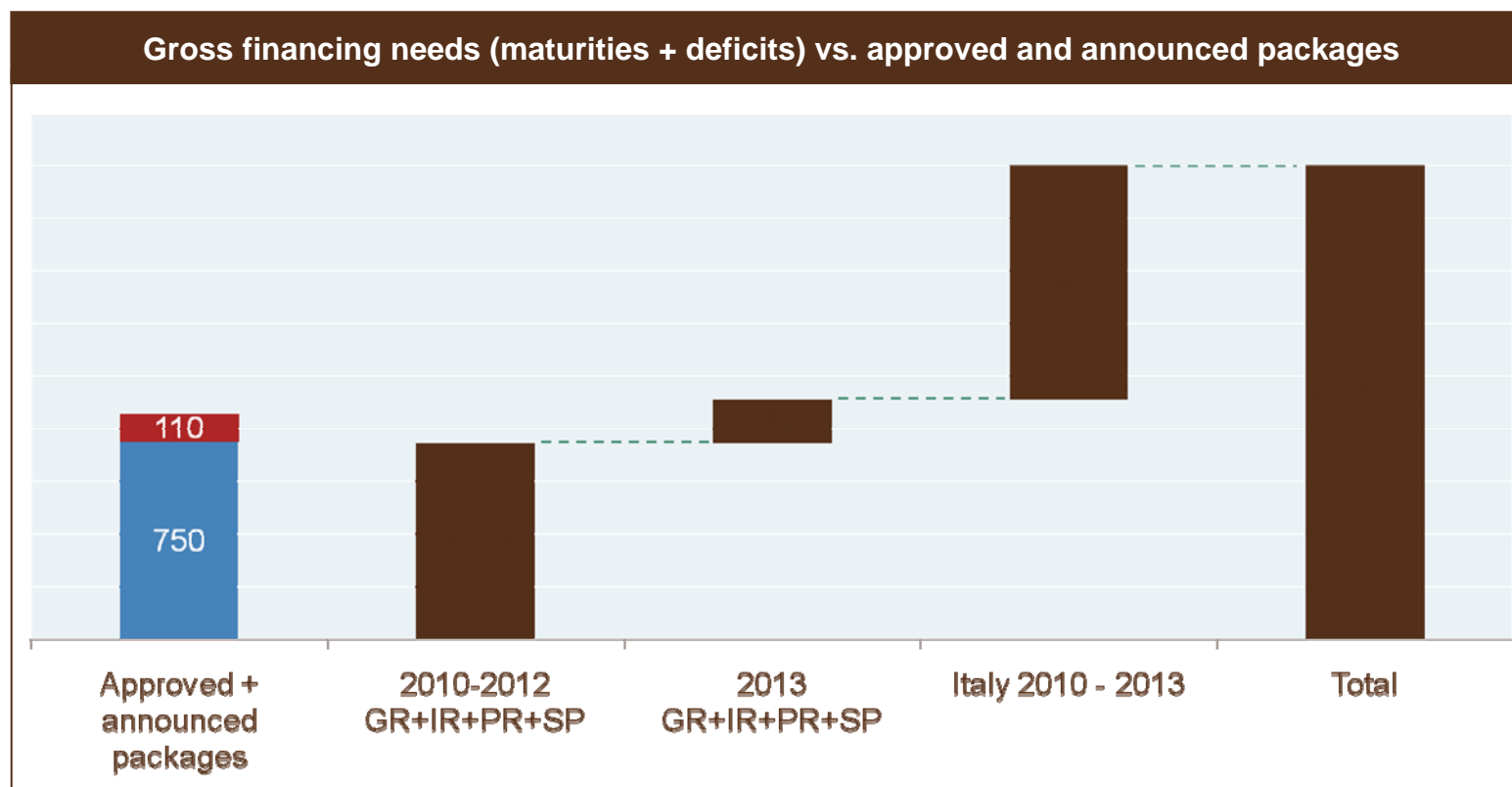
Source: Central Banks, Data as of December 2009.



Source: Federal Reserve, Bank of England, European Central Bank, Royal Bank of Australia, Bank of Canada, Data as of April 2010.

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## The IMF and the Eurozone have announced a massive credit facility for European sovereigns...



Source: Eurostat, Bloomberg, Ministries of Finance, Barclays. Data as of June 2010.

- In addition to lending facilities for participating member states, the ECB has begun buying sovereign bonds (specifically in Ireland, Greece and Portugal)

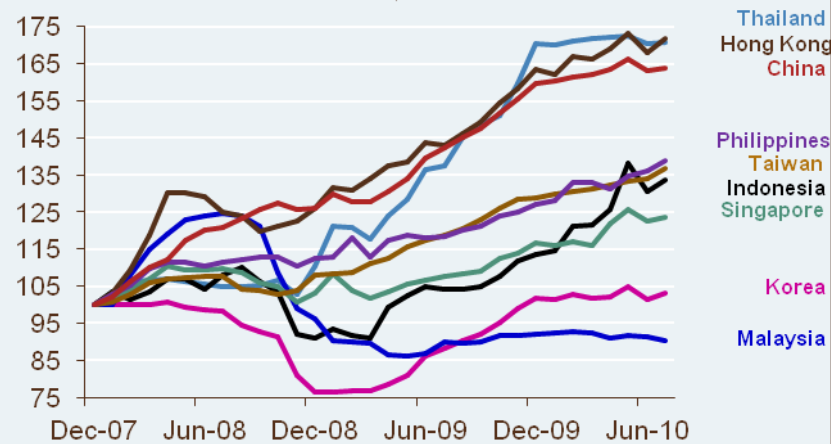


## Global Currency wars ?

- **Currency wars:** Nations attempting to devalue their currencies to support domestic growth
- Developed nations : **easier monetary policy** to revive economies and mitigate deflation risks
- Emerging economies: intervening in global currency markets to slow their currency appreciation

### EM Asia resisting further currency appreciation

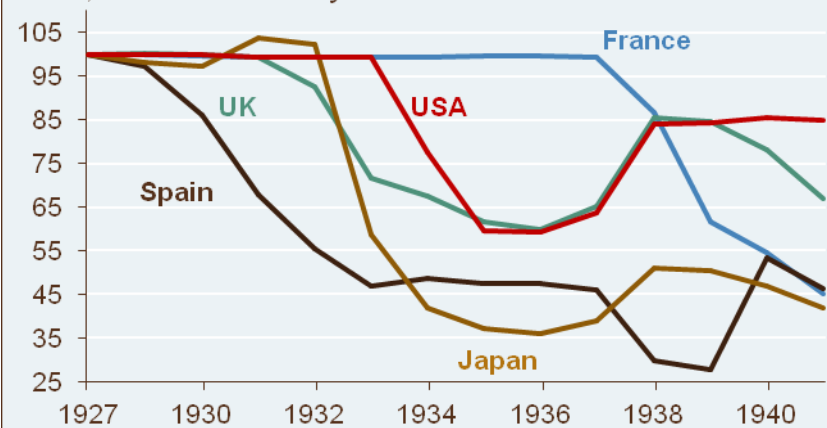
FX reserve accumulation - Index, December 2007 = 100



Source: International Monetary Fund. Data as of 7/31/2010.

### Competitive devaluation could strike again

Index, 100 = 1927 currency value vs. the Swiss franc



Source: "Exchange Rates Between the United States Dollar and Forty-one Currencies", Measuring Worth, 2009.

## Currencies War and Monetary Policy, four armies to consider..



### EASERS

- Pursuing easier monetary policy to support growth/fight deflation risks
- Includes **U.S.**, **Japan**, and maybe **U.K.**
- U.S. currently “winning” the battle with “QE-2” (\$600 Billion Quantitative Easing)

### CHINA

- Similar to the tighteners, but with one key difference
- Intervention to limit Chinese Yuan gains come despite currency already being undervalued (in contrast to tightener currencies which tend to be overvalued)



### TIGHTENERS

- High and/or rising interest rates to limit inflation risk, BUT ALSO steps (intervention) to limit pace of local currency gains
- Includes **Brazil**, **Mexico**, **Chile**, **Israel**, most of **emerging Asia**

### OTHERS

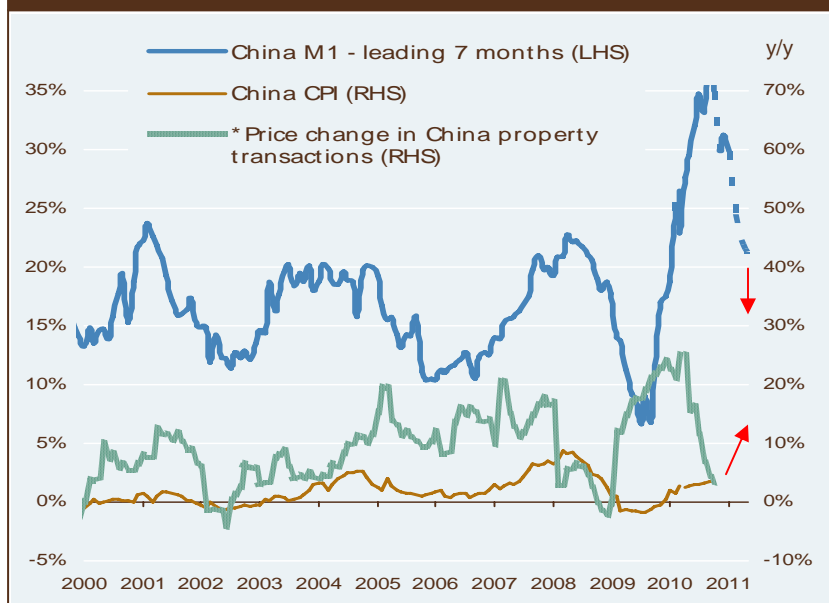
- Currencies that are not actively pursuing a policy which directly or indirectly strongly influences the local currency
- **Euro area** could be considered in this camp to a degree; some policymakers there feel they are “victims” of this so-called war



## China's growth is moderating, but the threat of inflation has re-emerged

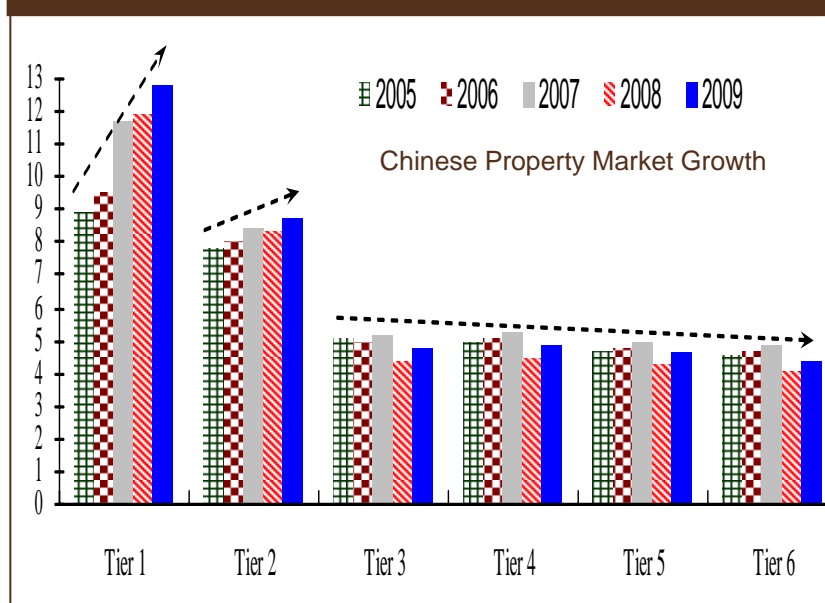
- Headline CPI has continues to show marginal increases (mostly due to **higher food prices**)
- **Property prices** in 70 mainland cities also rose half a percent in September
- PBoC **recently hiked interest rates** by a quarter of a point in response to higher inflationary pressures

The liquidity wave is over. Inflation to moderate.



Source: J.P. Morgan Securities LLC Data as of 6/30/2010.

Where's the bubble? Most cities fine.



Source: CEBM Research. October 2010.

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# We see secular and cyclical drivers for China and India domestic consumption

**Favorable demographics and rapid urbanization**

- India and China will account for 40% of urban population growth from 2005 to 2025

**Under-penetration of consumer goods**

- China's population is ~20% of the global population, but its private consumption only makes up ~5-6% of world consumption

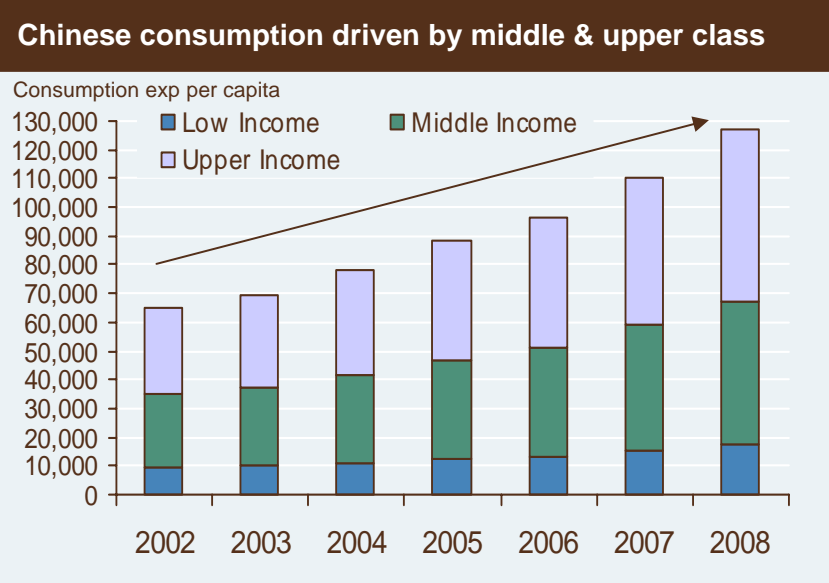
**Supportive government policies**

- RMB 4Trillion stimulus policy to boost consumption through job creation and income growth
- China's GDP, consumer confidence and retail sales bottomed in 2H09

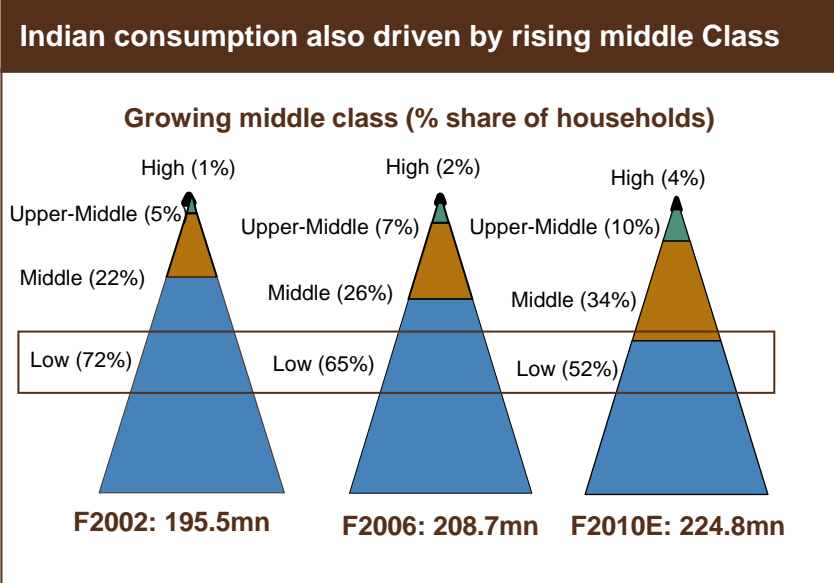
**Recovering economy**

- Interest rates remain at historical lows – this continues to reduce incentive to save

Source: McKinsey, United Nations, World Bank.



Source: CEIC, J.P. Morgan Securities LLC Data as of 2008.



Source: J.P. Morgan Securities LLC Data as of Jan 2010.

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## In Summary - the G10 currency world in 2011

### Euro stronger in first half(H1), but we expect a downward trend later in second half(H2) of 2011

- US reflationary policies will weigh on the US dollar.
- **Possible softer EUR/USD later in second half of 2011**
- Increased downside risks to 2011 Euro area growth, on back of fiscal tightening
- Euro zone debt problems will not be solved for a few more years. Expect **Volatility**.

### Dollar Yen has found strong support close to 80.00 but bulls have to be patient

- We maintain a bullish **medium-term** Dollar Yen outlook, though not likely till late 2011
- Japanese domestic fundamentals unfavourable, but dollar upside very limited, as long as US rate expectations stay low.

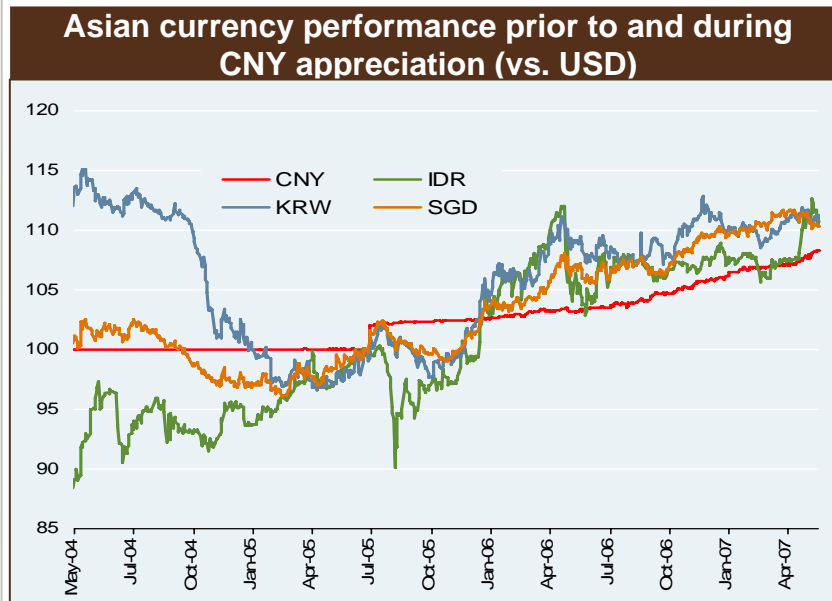
### Swiss Franc will stay bid, UK Pound could surprise to the upside

- We are **mildly bullish** on the Swiss franc into early 2011. Swiss economic climate has deteriorated notably recently.
- Markets remain excessively bearish on the UK economy and on the UK Pound – could see a bounce

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## In Summary – Continued strength for Asian Emerging Market currencies

- With low short-term US interest rates, investors are likely to seek better yields/returns in Asian markets
- Stronger Yuan can help rebalance China economy and overcome inflationary pressure. Slow appreciation.
- Since July 2005, all Asian EM currencies broadly appreciating, and actually strengthening faster than the Yuan (below left chart)



**Emerging Asia: Macro Snapshot**

Country	Key Currency Pair	Current Account (Deficit/Surplus)	Valuation (Over/Under/Fair) Local FX / USD	J.P.Morgan PB End-2010 Fair Value
China	USD/CNY	Surplus	Under	6.50
India	USD/INR	Deficit	Fair	42
Indonesia	USD/IDR	Small Surplus	Under/Fair	8800
Singapore	USD/SGD	Surplus	Under/Fair	1.33-1.35
South Korea	USD/KRW	Surplus	Under	1100

Source: Bloomberg, 2010.

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# Currencies: What we like and don't like for 2011

**Emerging Asian FX (Singapore, Indonesia, Malaysia, India, South Korea, Taiwan, China)**  
 Relatively strong growth, current-account and fiscal balances, relatively attractive yields, central banks focused on limiting volatility

**EMEA FX (Turkey, and Poland)** High yields, healthy fundamentals

**G-3 (USD, Euro, Yen) + UK Pound to some extent:** Slow growth and central banks (to different degrees) providing unusual liquidity to support markets and fight disinflation/deflation;

**Buy into 2011**

**Sell into 2011**

**Latam FX (Mexico & Columbia)**  
 Relatively attractive yields and ties to commodities; careful on valuations (especially for BRL).  
 Caution on BRL.

**“Scandis” (Sweden & Norway)**  
 Current-account and fiscal balances; rising interest rates; Norway has commodity ties

**Australia and Canada**  
 Rising yields and commodity ties offsetting other drags

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