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FOREX MARKETS 2015/16: ANNUAL REVIEW & OUTLOOK

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Overview:
What will follow the year of the dollar?

By all accounts, 2015 was the year of the dollar as the greenback surged against its major counterparts. The dollar was up around 10% versus a basket of trade-weighted currencies, with some of its strongest gains registered versus commodity currencies such as the Canadian dollar and the Australian dollar, while it also gained around 10% versus the euro on policy divergence. Interestingly, the dollar's gains were not evenly distributed throughout the year as the dollar index surged to a fresh 12½-year high in mid-March but then spent the rest of the year trying to overcome those gains and correcting from those highs. The dollar index came close to overcoming those levels during November and December – mainly on euro weakness – but the March highs nevertheless held.

Most of the dollar's ups and downs had to do with the speculation of when US interest rates would finally rise for the first time in 9 years. Coming into 2015, many analysts expected the Federal Reserve to raise rates from zero as early as June. However some soft data regarding the economy's performance during the first quarter of the year, delayed the hike. September was the other time where a rate hike was expected; however worries about the slowdown in China and emerging markets and some financial market turbulence in August following the devaluation of the Chinese yuan in August forced the Fed to put off the rate hike. After the decision not to hike in September, speculation started to mount that the Fed would not hike at all during 2015. This forced the Chair and other board members of the Fed to come out strongly in favor of a rate hike soon and the October meeting prepared the ground for a December hike, which eventually became reality.

The US economy did relatively well in 2015; with a growth rate around 2.5% and unemployment down to the 5% area, but inflation was weak due to low energy prices. The focus for financial markets now shifts to how many rate hikes the Fed will deliver during 2016. The dollar is still favored by most investors as central banks that are tightening policy are relatively rare in the global economy. Fed policymakers expect to hike four times in 2016, the markets expect about two more rate hikes – so it will be interesting to watch the economic data unfold and what their effect on monetary policy will be.

The euro on the other hand was one of the weaker currencies of 2015, as the ECB started a policy of quantitative easing in March. As inflation did not appear to be getting a lift from either the weak euro or the economic recovery, there was speculation that the ECB might be forced to do more. In the end the ECB's additional measures failed to meet up to market expectations and this helped the euro finish the year well off its worse levels. This also helped to reverse some of the ultra-bearish sentiment concerning the euro as well as bring about the realization that the ECB Governing Council might be deeply divided on the issue of aggressively expanding stimulus. That may provide support for the euro and prevent it from falling too far in 2016.

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Another story that gripped the attention of the markets regarding the euro was the Greek debt crisis. Particularly starting from late spring until mid-summer, there was intense uncertainty about Greece's continued membership of the Eurozone. In the end there was a deal regarding a new Greek bailout program and the ruling party also managed to survive the September elections. Political uncertainty was also evident in Portugal where the ruling party did not manage to win the elections by a sufficient margin in order to form a majority government; a scenario that was also repeated in Spain's election at the end of the year. Political uncertainty could be a theme that may affect the euro in 2016.

In Japan, while the market was very bearish regarding the yen when the year started, by the end of the year, the currency ended as the second best performing after the US dollar. The expectation of some market participants that the Bank of Japan would again expand its massive quantitative easing program during the year following a substantial increase in 2014, was never realized. Some adjustment of the terms of the program that took place in the last BoJ meeting of the year were not so serious so as to bring about renewed yen weakness and instead the yen gained on this announcement. While the Japanese economy's prospects are not looking particularly bright, it is possible that 2016 will also disappoint those looking for additional stimulus.

A key theme during 2015 was the slide in commodity prices. The CRB commodity index lost an additional 25% in 2015 after posting losses of around 22% in 2014 and traded at its lowest in almost 13 years. This hurt commodity-related currencies, while the significant drop in oil prices caused the selling of currencies of oil exporters. In addition, the latest leg of the downtrend in energy prices could create renewed worries about deflation for next year. This in turn could convince central banks around the world to keep monetary policies looser than they initially planned, in order to fight off negative inflation. As commodity prices eventually bottom out, they will stop being such a consideration for inflation, but as long as the downtrend is in place, they will keep influencing policymakers who want to avoid deflation.

A possible reason for the weakness in commodities has been the slowdown in emerging economies and particularly the growth slowdown in the world's second largest economy. During 2015, it seemed that Chinese authorities were successfully handling the economy's slower growth rates (to around 7%) as well as the transition to a more domestically-focused and services-oriented growth. Although the devaluation of the yuan in August and worries about the Chinese economy briefly spooked world markets, calm returned as the situation in China appeared to be under control. Still, China is expected to draw a lot of attention in 2016, as the economy faces major challenges such as excessive business debt, the aftermath of a red-hot real estate market and the shift away from an export- to a domestic demand-oriented model.

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In other economies, the UK pound was also under some pressure as the absence of inflation and wage pressures convinced the Bank of England that it was better to wait on raising rates. At the beginning of the year, some analysts bullish on sterling expected rates to go up by the end of 2015; presently it looks like rates won't go up until about mid-2016. The UK economy put in a relatively positive performance as growth was in excess of 2%, unemployment dropped but inflation was too low.

Finally the Australian dollar was under significant pressure during the year, as despite the relatively positive performance of the country's economy, its resource exports and the fact that China is its biggest export destination, led to intense selling of the aussie. The Reserve Bank of Australia also cut interest rates twice during the year but perhaps less than some analysts were expecting. The chances of additional rate cuts and perhaps further depreciation of the aussie are dependent on additional commodity price weakness and on developments in China. Therefore, 2016 will be a very interesting year as well for the Australian currency.

To sum up, in 2016 the US dollar is expected to stay strong and US interest rates to go up more. The euro will probably remain weak, but now that the divisions within the ECB Governing Council have been uncovered, additional policy loosening may not take place so fast. The pound is getting some benefit from the fact that the UK will probably be the first country to follow the US and hike rates at some point, but that point is proving difficult to determine. The yen from its part has proved resistant to the dollar's advances this year and its fate in 2016 also depends on whether the Bank of Japan will implement more stimulus. Finally the aussie is still facing the strong headwinds of weak commodity prices and the Chinese slowdown, which should eventually push it lower, but the domestic situation is supporting the economy and interest rates.

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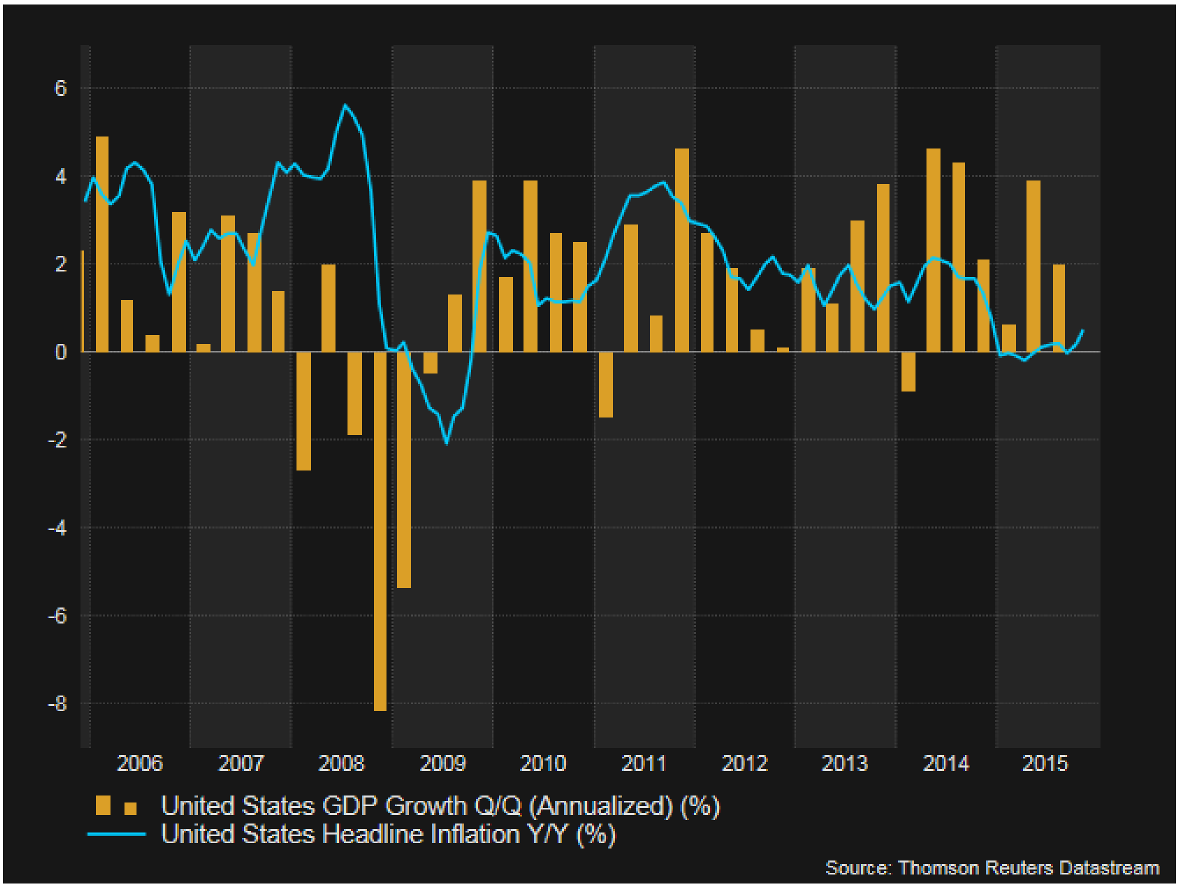
Country Focus: United States

Rate rise anticipation drives dollar to 12-year high as Fed delivers end of year lift-off

The United States economy continued to strengthen in 2015, prompting the Fed to signal its first rate rise since June 2006. But the path to monetary tightening proved longer and bumpier than many would have expected at the start of the year as the US economy faced unexpected headwinds.

The first such headwind was the first quarter slowdown, which was characterized by several GDP revisions. A downward revision showing negative growth of -0.7% on an annualized basis was eventually revised to positive growth of 0.6%. Bad weather, port strikes and a stronger dollar were cited as the main factors dragging down growth in the first quarter. The series of mixed data continued into late autumn, making it difficult for the Fed to make its case for a rate hike, especially after stressing that its decision will be data dependent.

The mixed data put a pause in the dollar rally as investors started to push their expectations of when the Fed will increase the Fed funds rate. The dollar index, which measures the value of the US dollar against a basket of currencies, has been moving in a wide range since March 2015.



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GDP growth strongly rebounded in the second quarter of the year and some economists had been expecting the Fed to raise rates in June, but stubbornly low inflation stood in the way. Lower energy and fuel prices as a result of falling commodity prices have been the main cause in driving down CPI to below zero for the first time since the financial crisis. The slump in commodity prices, particularly in the price of crude oil, has been deeper and more prolonged than what most analysts anticipated when prices first began to slide in the middle of 2014.

On the positive side, lower energy bills have helped lift disposable incomes and boost spending. It has also triggered looser monetary policy in many parts of the world such as much of Europe and Australasia, further fueling the dollar's strength against currencies such as the euro and the Australian dollar. Personal consumption has remained fairly robust in the US economy, though there are some signs that it may be easing in the final quarter of the year.

Less fortunate has been the manufacturing sector. The dollar's 25% appreciation between July 2014 and March 2015 has held back export growth and put further downside pressure on inflation. But as personal consumption's contribution to GDP is so dominant, the struggling manufacturing sector has been less prominent in the eyes of the Fed policymakers who are more concerned about the tightening labor market.

But even jobs growth appeared to be cooling off at the height of the turbulence in financial markets seen in August following China's shock decision to devalue the yuan. The uncertain nature of the volatility in global financial markets and the extent of the slowdown in China and other emerging market economies, forced the Fed to delay a rate rise in September when many economists had been expecting the Fed to proceed with a hike.

However, the increase in the monthly nonfarm payrolls has gathered pace since then and unemployment has fallen to 5%. The Fed hawks have been arguing that it is only a matter of time for wage growth to pick up as the slack in the labor market continues to shrink, even as inflation remains near zero. October's big jump in nonfarm payrolls was the trigger that ultimately shifted market expectations that the Fed is unlikely to hold off a rate rise for much longer. This helped drive the dollar to a fresh 12-year high in December with the dollar index peaking at 100.51.

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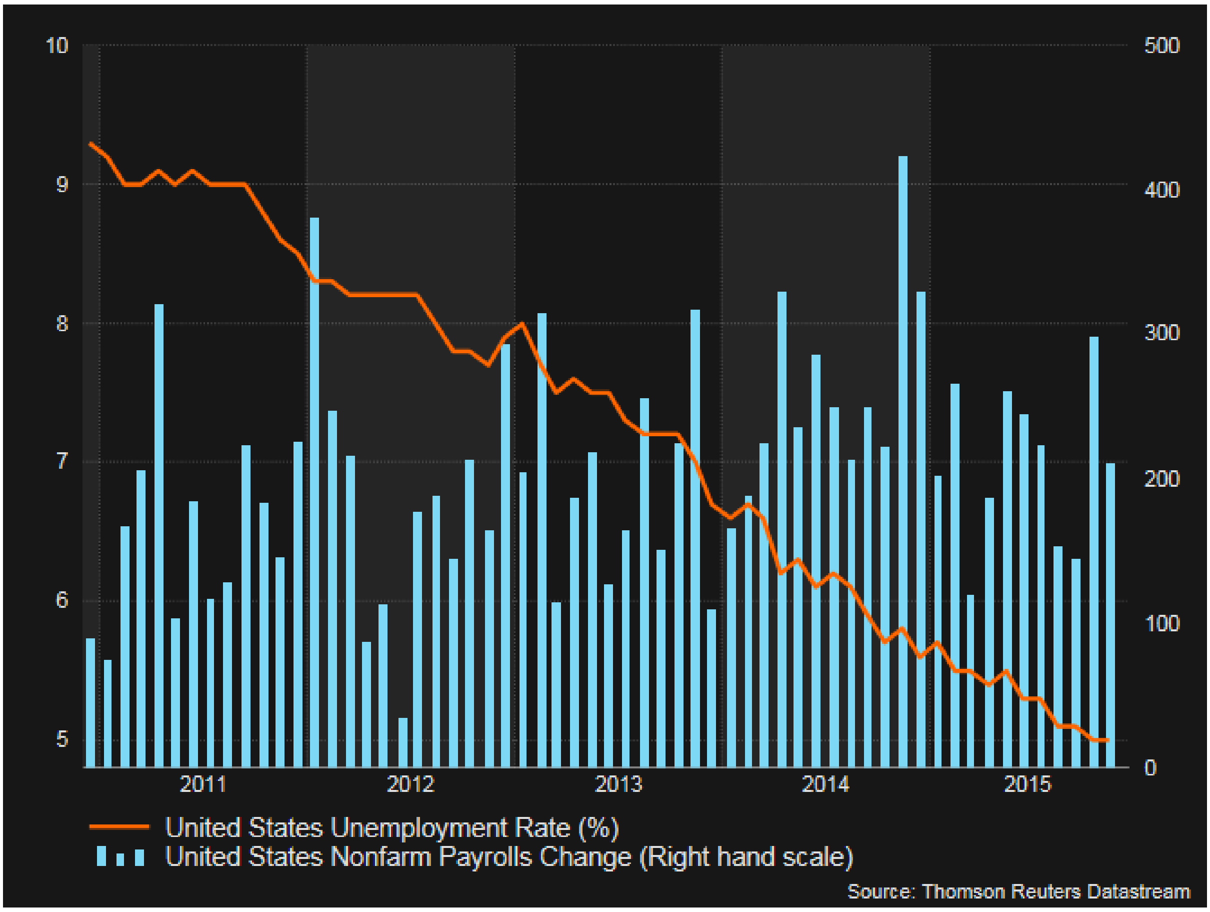

Apart from unexpected headwinds and a slower-than-expected recovery, another difficulty faced by the Fed has been to convince the markets that a rate rise is on the cards in 2015. After the September delay and dovish FOMC minutes, markets moved back their expectations for lift-off to March 2016. However, Fed policymakers gave contrasting views in the run-up to the October FOMC meeting where Chair Janet Yellen and others were signaling that rates could still go up in 2015, while dovish member were urging caution.

The Fed been careful to improve its communication since then and made a point in the October FOMC statement to specifically refer to the December meeting as a live possibility. Subsequent comments by Fed officials reiterated this expectation to prepare the markets for the first increase in the Fed funds rate in over nine years. The Fed finally delivered the much anticipated move to start the normalization process of interest rates on December 16, raising the Fed funds target range by 25 basis points.

Going into 2016, the pace at which the Fed will tighten monetary policy will likely be largely data dependent. The US economy is expected to expand next year at a similar pace to 2015 at 2.5% year-on-year and this should help the unemployment rate to dip to 4.9% in 2016. With the first rate hike seen as a pre-emptive move, subsequent increases will focus more on the actual and expected path of inflation. The consumer price index is forecast to average at just 0.1% annually during 2015 but is expected push up to 1.7% in 2016.

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According to a Reuters poll, economists are on average forecasting three increases of 25 bps each to the Fed funds rate during 2016. The Fed funds target range is expected to stand at between 1.00% and 1.25% by the end of the fourth quarter of 2016.

The diverging monetary policy between the US and its peers is projected to lead to further dollar appreciation. The euro is expected to fall to 1.04 against the dollar by the end of 2016, down from its current value of around 1.0950 dollars. Some analysts are forecasting an even weaker rate for the euro of parity against the dollar. The dollar should also make some further gains against the yen from its current level of around 121 yen, but is not forecast to rise much past above 125 yen over the next 12 months.

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Country Focus: Eurozone

Euro escapes Greek crisis but ECB's fight against deflation pushes it to 12-year low

The Eurozone had an eventful year starting with the launch of the ECB's quantitative easing program in January, to the Greek crisis in the summer and the ECB's under-delivery in December of a big enough stimulus.

The euro area's common currency, the euro, has been on a downtrend since March 2014 as the European Central Bank's interest rate cuts proved ineffective in lifting growth and inflation, and speculation built on the possibility of a quantitative easing program.

When the ECB finally launched its 1.1 trillion quantitative easing program in January 2015, markets reacted positively to the announcement and the euro depreciated further. The euro fell by around 13% between January and March against the dollar.

Weakness in the Eurozone's economy has also dragged on the currency as the region is struggling to recover from the debt crisis that has engulfed member states since 2009. The Greek crisis resurfaced once again, threatening to destabilize the euro area. However, the ECB's asset purchase program had managed to cushion the rest of the Eurozone from Greek contagion when the crisis escalated in the summer. This was highlighted by the more confined spread in bond yields between German bunds and periphery Eurozone government bonds at the height of the crisis compared to the previous crises. A third bailout for Greece was finally agreed in August, but only after Greek banks had been depleted of their liquidity reserves and were kept on a lifeline by the ECB's ELA fund.

Eurozone economic sentiment improved after the bailout agreement but economic growth remains weak. The slowdown in China and in other emerging markets has weighed on Eurozone exports just as the weak euro had helped generate an export-led recovery. But there has been a positive impact from the fall in oil price as lower fuel and energy costs have boosted consumer spending across the Eurozone.

Despite this, Eurozone GDP growth has been moderate at best. GDP expanded by 0.3% quarter-on-quarter in the third quarter and is projected to grow by just 1.5% annually for the whole of 2015. Going into 2016, growth is expected to pick up somewhat to 1.6% year-on-year.

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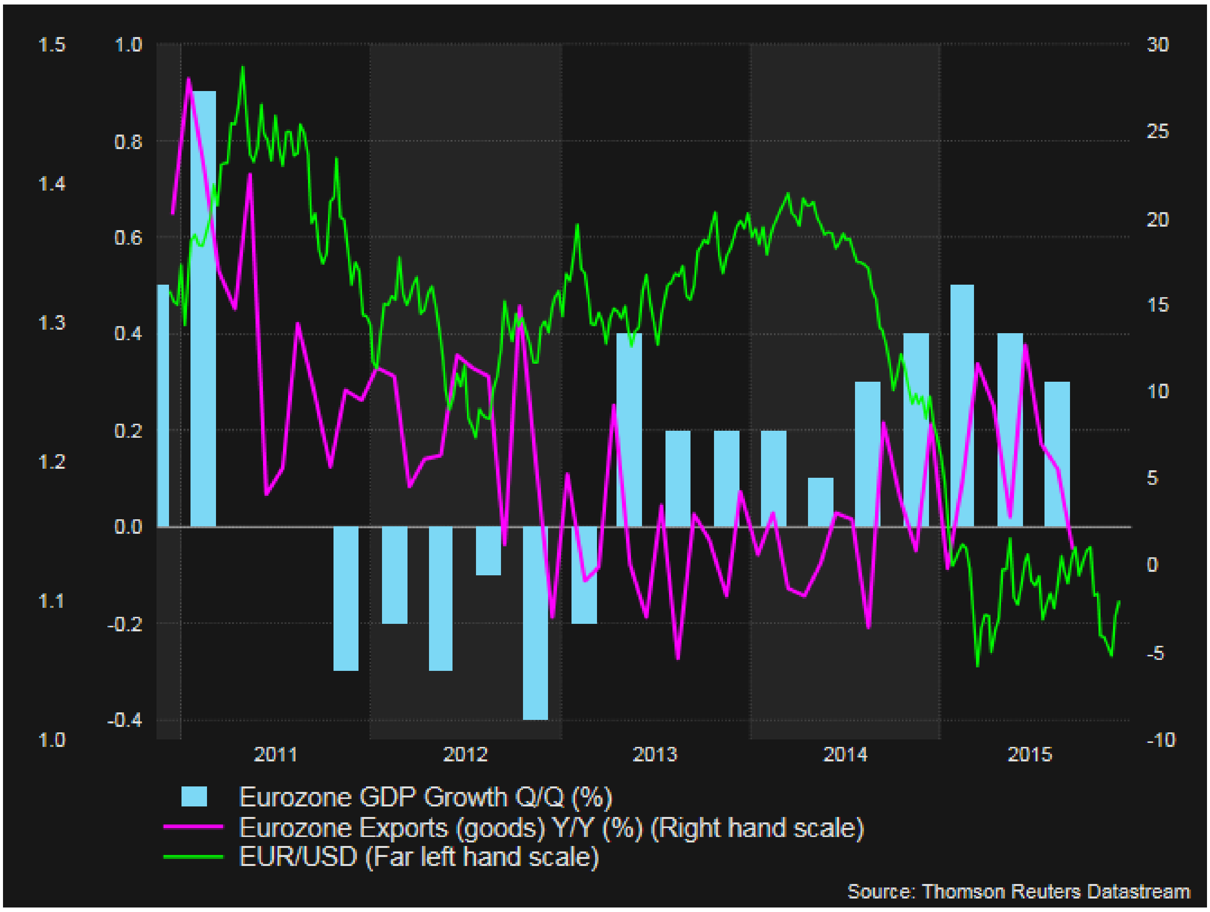

Perhaps the biggest threat to the Eurozone economy in 2015 was negative inflation. The region sunk into deflation at the end of 2014 and had emerged out of negative prices by spring. However, Eurozone inflation fell back near 0% by August and is expected to average just 0.1% year-on-year for the whole of 2015. Many analysts see it as unlikely for the ECB to meet its 2% inflation target within two years' time. Inflation is forecast to pick-up only gradually to an annual rate of 1.0% in 2016 and 1.5% in 2017.

Continued falls in the price of commodities is likely to maintain the downward pressure on prices in the near term so further monetary easing by the ECB cannot be ruled out during 2016. The ECB disappointed the markets at its December policy meeting by not delivering a bigger stimulus package. Many analysts had expected that the ECB would expand the size of its asset purchase program from the current 60 billion euros per month in addition to cutting the deposit rate to -0.30%. It's also possible that the duration of the QE program could be extended beyond its new timeline of end of March 2016.

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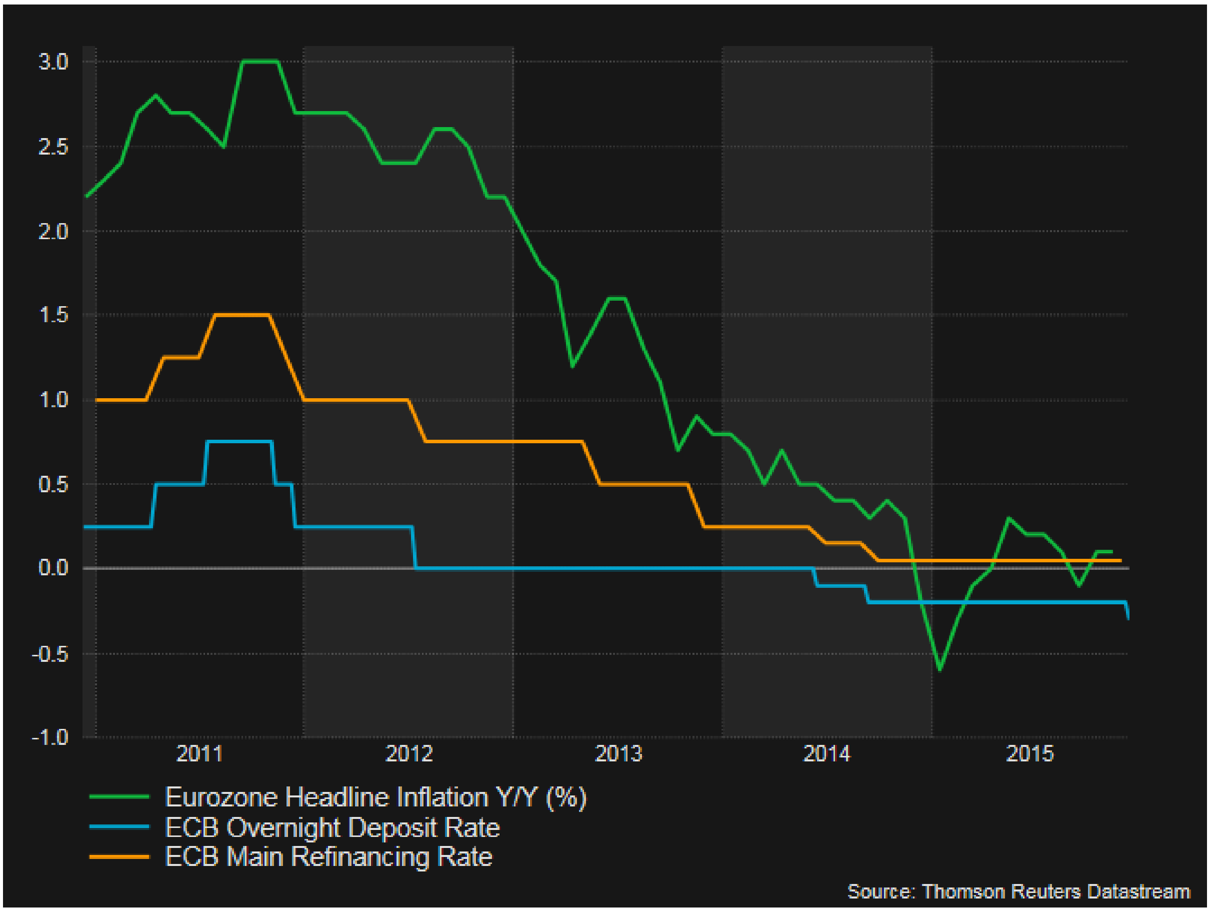

The euro's exchange rate is another factor that could determine ECB policy in the coming months. ECB officials appeared to talk down the currency during the course of the year every time EUR/USD spiked above 1.14 dollars. The euro attempted to appreciate against the dollar several times despite the policy divergence as the market turbulence over the summer increased the euro's appeal as a funding currency.

Many investors have been taking advantage of cheap lending rates in the Eurozone to borrow in euros and use the funds to purchase a currency yielding higher interest rates. They would then deposit the currency or buy other risky assets. These carry trades peaked during the period of high market volatility seen in the summer and supported the euro even as speculation mounted over whether the Fed would raise interest rates.

However, since the ECB's let down in December, verbal intervention may prove less effective given the ECB's miscommunication to the markets in the build up to the December policy announcement. A shallower-than-expect rate rise cycle in the US could also prevent any further falls in the euro. The single currency is projected to depreciate to around 1.04 dollars by the end of 2016. It remains to be seen if it will hit parity, though some analysts are forecasting the euro will fall to as low as 0.95 by the end of next year.

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Country Focus: Japan

Bank of Japan refuses to budge as growth stalls and inflation back near zero

Japan's economy is set to end another year with an uninspiring growth rate as the impact of last year's big QE boost and the yen's depreciation fade. The weak growth and falling inflation rates had raised expectations that the Bank of Japan might match October 2014's shock to the markets and again announce a big increase to its quantitative easing program in October this year.

But the Bank opted for a surprise on a much smaller scale when it decided to make some tweaks to its existing program in December. In an unexpected but disappointing move, the Bank decided to extend the maturity of the Japanese government bonds it purchases from 7-10 years to 7-12 years. It also decided to add more exchange-traded funds (ETF) to its list of purchases. By buying ETFs that target firms that are actively investing in physical and human capital, the Bank is hoping this will encourage business spending.

The central bank maintains its stance that inflation should pick-up once the effects of lower oil prices have fallen out of the calculations. It is also hoping that falling unemployment would boost wage growth, which in turn would push up prices as well as lift household consumption.

However, while private consumption has remained resilient, it has been weaker-than-expected. Household expenditure has seen positive year-on-year growth for only two months of the year to date. Wage growth has also been slow despite unemployment continuing to decline since emerging out of the financial crisis. Japan's jobless rate fell to a 20-year low of 3.1% in October but real wages were up just 0.4% year-on-year during the same month.

Inflation has also been running below the Bank of Japan's projections and CPI has dropped back to around zero per cent after 2014's sales tax increase briefly pushed it above 3% annually. In October, the headline rate of CPI edged up to 0.3% year-on-year, but excluding fresh food, core CPI remained in negative territory at -0.1%. When stripping the effects of energy prices from the core rate, CPI has shown signs of picking up and stood at 0.7% in October.

However, the Bank of Japan's 2% inflation target is still very distant whichever CPI measurement is looked at. The central bank has twice had to push back the timing of when it expects for inflation to rise to its target level. It now expects inflation to rise to 2% by the end of March 2017. In its October outlook report, the Bank lowered its CPI projections for 2015 to 0-0.4% year-on-year from 0.3-1.0% and for 2016 from 1.2-2.1% year-on-year to 0.8-1.5%.

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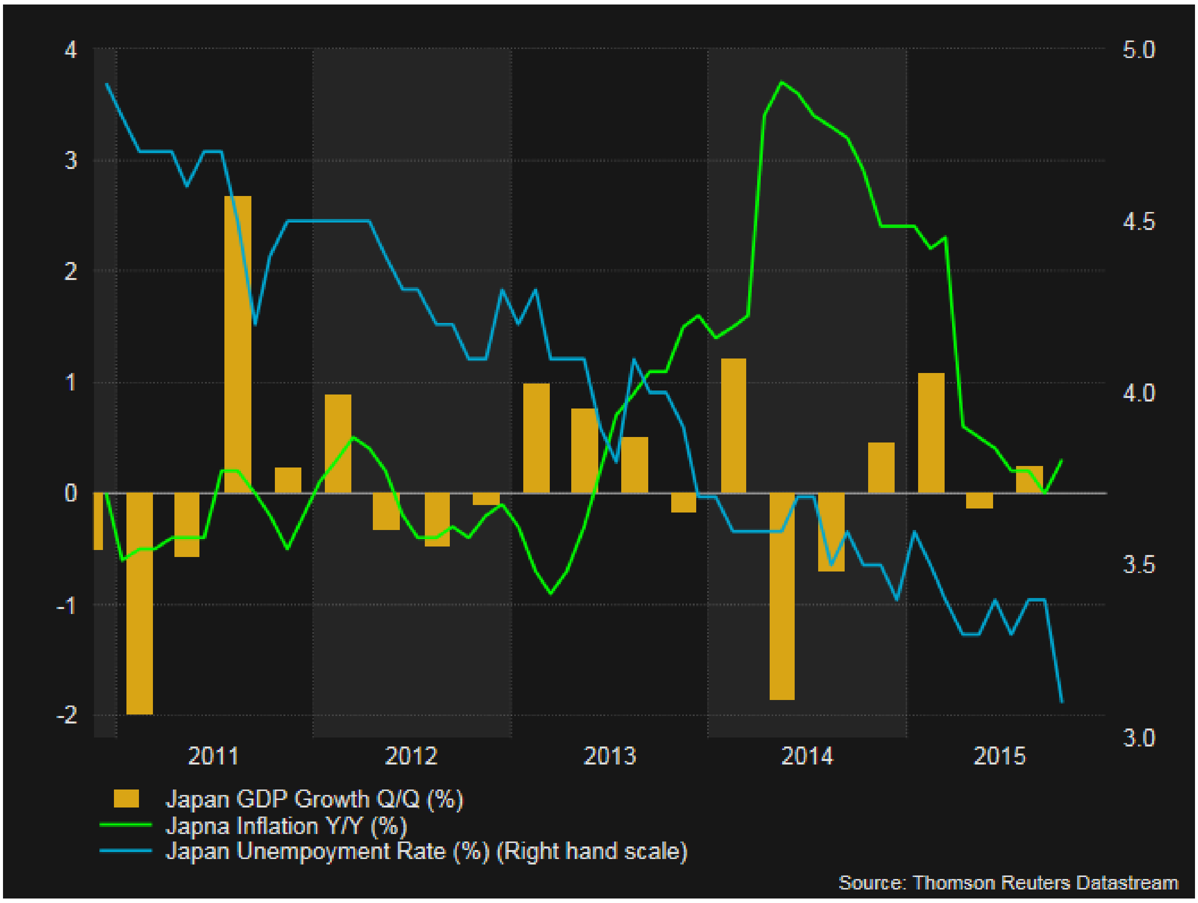


With continued weakness in commodity prices, it's unlikely that the downward impact on inflation has run its course. The Bank has been keen to point out it stands ready to adjust monetary policy if necessary even though it has so far appeared reluctant to do so. Should further falls in the price of oil force the BoJ to lower its forecasts once again, it will become increasingly difficult to justify its current policy as accommodative enough.

Economic growth forecasts have also been revised down and GDP is expected to grow by just 0.9% annually in 2015 and to quicken to 1.5% in 2016. If wage negotiations next spring lead to higher earnings growth and higher consumption as a result, the Bank of Japan may yet be proved right for its optimism. Growth is also likely to receive a boost from a fiscal stimulus being prepared by the government.

But countering this is export growth that is flattening on slowing overseas demand and the yen bottoming out against the dollar. The dollar is expected to peak around 125 yen by the end of 2016. The planned sales tax hike for April 2017 could also jeopardize growth like it did in 2014 when the economy plunged into a brief technical recession.

According to a recent Reuters poll, the majority of economists are now forecasting that the Bank of Japan will expand its stimulus program in the first half of 2016. The consensus is for the Bank to increase the size of its quantitative easing program sometime between January and April 2016.

Country Focus: China

China avoids hard landing but slowdown remains risk to global growth

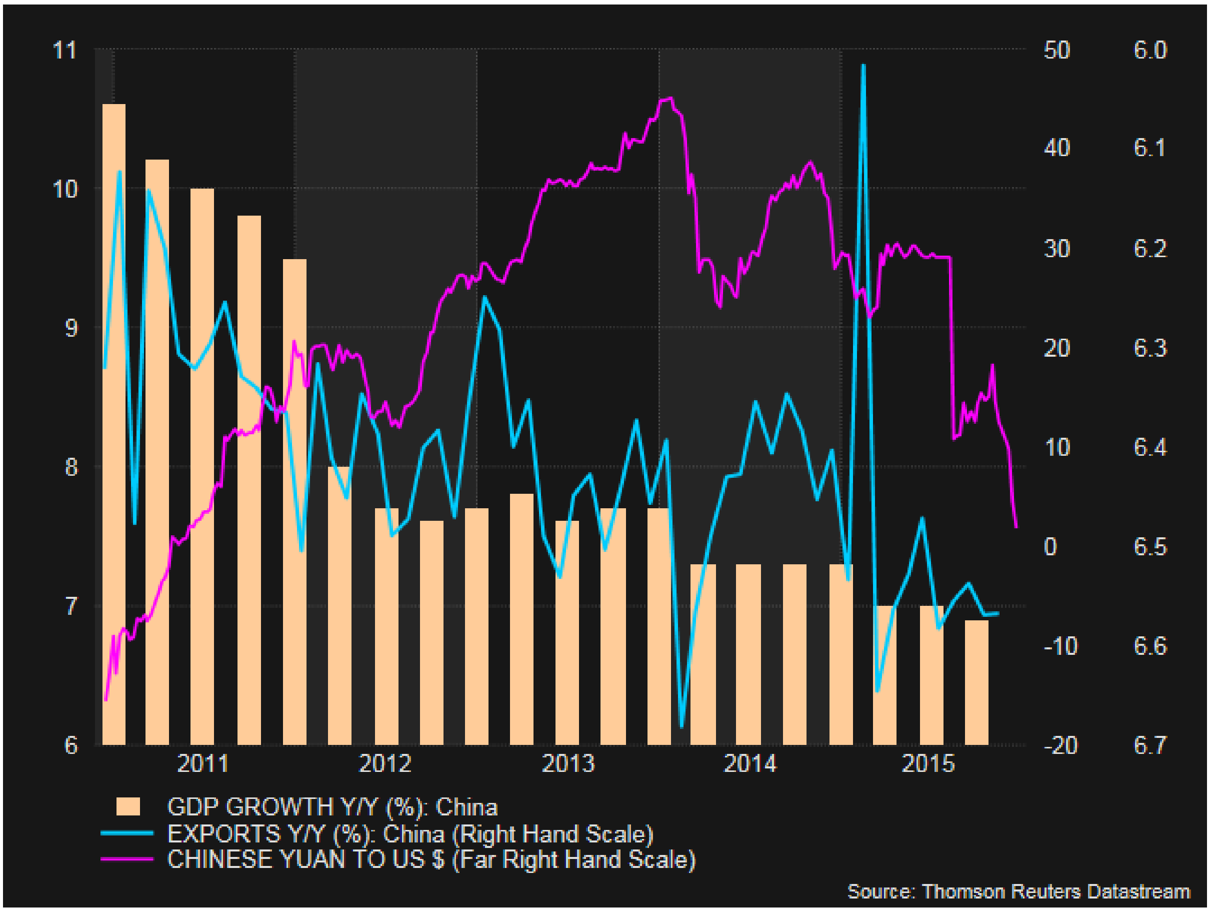
China's economy lost further steam in 2015 as GDP growth continued to decline from its post-crisis peak in 2010. GDP growth hit 6.9% year-on-year in the third quarter of the year – the lowest since the height of the financial crisis in 2009. The economy is expected to slow further in 2016 to an annual rate of 6.5%. While growth rates of 6-7% are still an enviable level for advanced economies, the impact of growth averaging below 8% has been very bruising on commodity prices and on demand for globally produced goods.

China's government has carried out a series of reforms during the year, including tightening regulation for the stock market and making the fixing of the yuan's daily midpoint more market orientated. The biggest test to the government came during the summer when share prices plunged by over 40% between June and August after soaring by 60% since the start of the year. Chinese authorities are thought to have pumped 1.5 trillion yuan into the stock market to support share prices. Stocks have since stabilized but remain around 30% below their 2015 peaks.

The stock market crash sent other Asian equity markets into a tailspin and there was further volatility when China's central bank, the People's Bank of China (PBOC), unexpectedly devalued the yuan on August 11. Market turbulence hit its peak on August 24 or 'Black Monday' when global stock markets suffered a sharp sell-off on heightened concerns on China's and other emerging market economies. The PBOC has since attempted to calm market nerves by moving to devalue the yuan more gradually. It has also implemented several reforms to qualify the yuan as a reserve currency in the IMF's special drawing rights basket, which it succeeded in doing in November.

However, further reforms as well as more monetary easing will be needed to steer China's economy out of the current slowdown. With inflation forecast at an annual rate of 1.6% for 2015 and 2.0% in 2016, the PBOC has still some room for maneuver to cut rates. The PBOC has already cut its prime lending rate six times from 6% in November 2014 to 4.35% in October this year. It has also cut the reserve requirement ratio for most big banks and is likely to lower this further in 2016.

Industrial production has so far maintained year-on-year growth but the closely watched survey, the Caixin Manufacturing PMI, has been in contraction territory since March. Exports have also been hit, registering year-on-year declines for much of the year as Chinese manufacturers grapple with overcapacity and weak overseas demand.



China's government has been trying to rebalance the economy away from an export-led growth to a consumer-led one. It's had some success in doing this and retail sales have continued to expand strongly throughout the slowdown.

In its latest assessment of the economy, the PBOC expects the economy to grow by 6.8% in 2016 - led by a rebound in exports of 3.1%. Exports are likely to be lifted from a further expected depreciation of the yuan, which is forecast to fall to around 6.55 yuan per dollar by the end of 2016. Fiscal and monetary measures implemented this year should also start to take effect in the first half of 2016. Additionally, the economy should benefit from higher infrastructure investment and a pickup in the property market.

The rest of the world will be watching closely how China's economy progresses in 2016 as any significant divergence from the forecasted numbers are likely to influence economic policies in other parts of the world. In particular focus will be what happens to the yuan as a sharper-than-expected depreciation could once again spark concerns of a currency war.

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Country Focus: United Kingdom

Pound ends year on bearish note as BoE rate hike moves into the distant

The UK pound made an impressive rally in the first half of 2015 with the pound index, which measures the UK currency against a basket of other currencies, gaining around 7.5% between January and August. Sterling's rally first came to a halt in August when the financial market volatility caused by concerns over China's economy drove investors to safe-haven currencies such as the euro and the yen. The pound rebounded in October but the Bank of England took markets by surprise when it published a gloomy outlook on inflation in its latest quarterly inflation report in November.

The general consensus up until November's inflation report was that the Bank of England would follow suit the US Federal Reserve in raising interest rates, with high expectations for a rate rise in the first quarter of 2016. However, the Bank of England's monetary policy committee (MPC) see greater downside risks to the UK economy from the slowdown in China and in other emerging market economies than the Federal Reserve does for the US economy.

Another unexpected development in recent months, apart from the ongoing slide in commodity prices, has been the weakness in UK wage growth. Average weekly earnings appeared to be strengthening starting in the second half of 2014 after struggling to grow by more than the rate of inflation since 2010. However, a renewed slowdown in wage growth, which slowed from an annual pace of 3% in the three months to September to 2.4% in October, has shifted expectations of how soon UK rates will need to go up. The BoE does not see earnings growth posing a threat to UK inflation as long as it's running below 3%.

The slowdown in pay growth is all the more surprising considering the strength of the UK labor market. Unemployment has continued to decline during 2015 and currently stands at 5.2% (October). It is expected to average 5.5% for the whole of the year and to drop to 5.3% in 2016.

With low fuel and energy prices and tough competition among British retailers, wage inflation was the main threat to pushing up the UK consumer price index. Inflation in the UK fell to the lowest since 1960 in April based on comparative figures. Headline CPI has hovered around 0% since and is expected to average just 0.1% year-on-year for the whole of 2015. It is forecast to rise by 1.3% year-on-year in 2016 but this may get downgraded given the new lows in crude oil prices in December.

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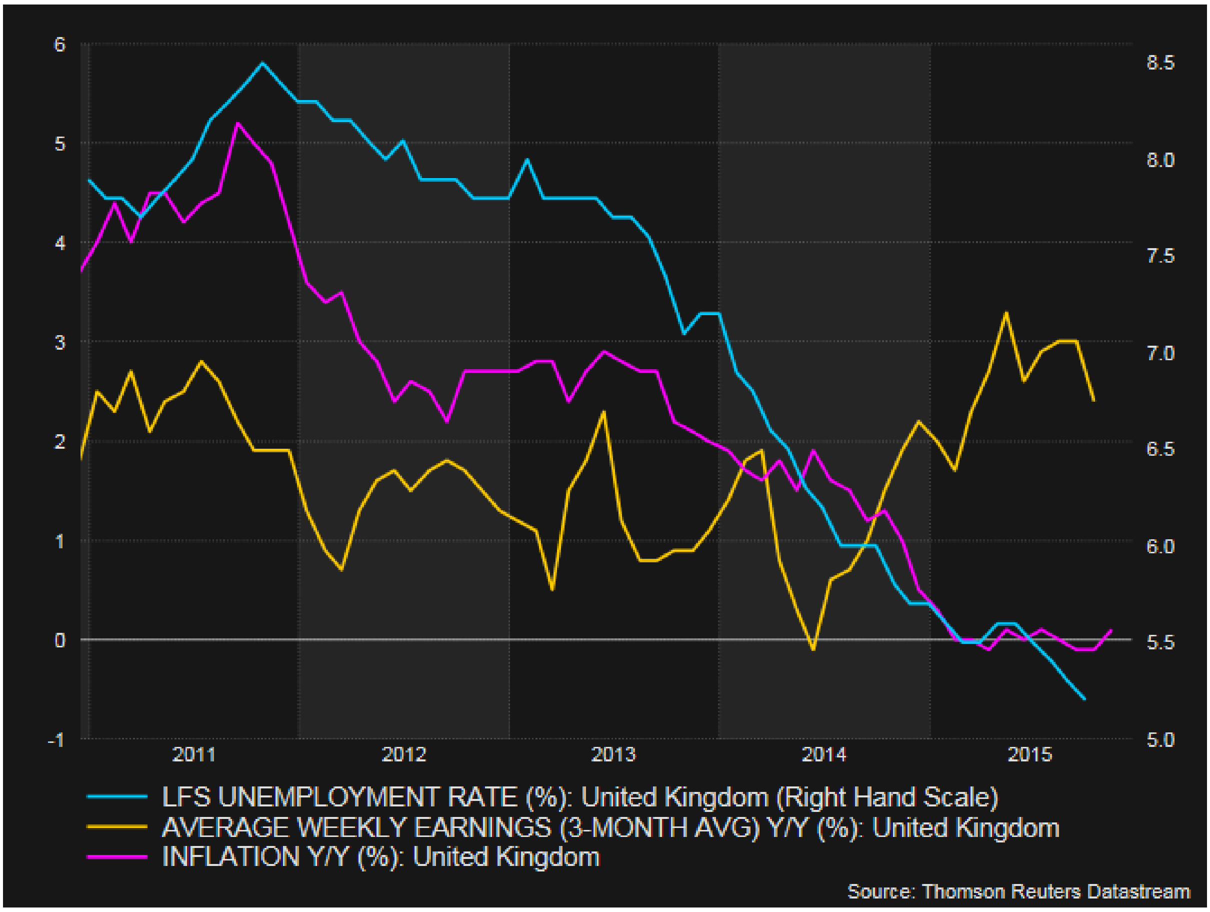

UK consumers have been the main beneficiary of the low inflation rate as disposable incomes have gone up after years of negative real wage growth post the financial crisis. The robust domestic demand has helped the UK economy regain momentum after growth got off to a bumpy start as it came out of the 2008-09 recession. UK GDP is forecast to grow by 2.4% annually in 2015 and 2.3% in 2016 - the highest in the G7 after China and the Unites States.

One weak point of the recovery has been the sluggish performance of the UK manufacturing sector. A slow recovery in the Eurozone, the stronger pound and fresh weakness in emerging markets has held back export growth. The Bank of England had previously cited the UK's large current account deficit as a possible risk for the pound.

Another factor that could be weighing on sterling in 2016 is the upcoming referendum on the UK's membership in the European Union. British Prime Minister David Cameron signaled at the EU summit in December that a referendum is likely to be held before the end of next year. The uncertainty of Britain's place in the EU could put downside pressure on sterling as it would threaten the UK's attractiveness for foreign direct investment if it doesn't have access to or influence in the single market.

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The pound has fallen from its peak of 1.5929 dollars in June to around 1.49 dollars currently. It is forecast for only a modest rise to 1.52 dollars by the end of 2016. However, it has appreciated by around 6% against the euro as ECB policy has widened the monetary divergence between the two currencies. The euro is expected to weaken further in 2016 to 0.69 pounds from the current levels of 0.72-0.73 pounds.

Of course, any changes to the rate outlook are likely to alter the path of sterling heading into 2016. The BoE's policy will largely depend on oil prices, wage pressures and growth rates in the UK's main trading partners. Based on the market implied curve, UK rates are not expected to rise until the first quarter of 2017. However, according to a Reuters poll, economists are expecting a 0.25% rate hike in the second quarter of 2016 and another quarter point rise in the final quarter of 2016.

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Country Focus: Australia

Australian dollar set to end year at 6-year low as commodities sink

The Australian dollar is set to close its third straight year of losses against the US dollar as the Chinese downturn and slump in commodity prices drag the currency to a 6-year low. The aussie has been declining for much of the year as iron ore prices, Australia's main export, continue to tumble and worsen the country's terms of trade.

The country's central bank, the Reserve Bank of Australia (RBA), has been steering the economy during the commodities rout by cutting interest rates. The RBA has cut its cash rate twice in 2015 by 0.25% each but the cuts have taken a pause since May when they were cut to 2%. The RBA's Governor, Glenn Stevens, has also been encouraging the depreciation of the Australian dollar by talking down the currency.

However, since its August monetary policy meeting, the RBA has refrained from calling for the further depreciation of the aussie. The shift to a less dovish stance comes as the currency was heading for fresh lows during the summer. It hit the trough of the year on September 4, reaching a 6½-year low of 0.6907 against the US dollar.

Apart from the rapid depreciation of the aussie, strong domestic demand has been another reason why the RBA has been cautious not to cut rates further. At 2%, the cash rate is at a historically low level. The low lending rate has helped lift domestic consumption and fuel a property boom.

The resilience of the domestic economy is evident in the country's GDP performance. Quarterly GDP growth has only been negative twice since 2008, despite the financial crisis and a sharp drop in mining exports. GDP expanded by 0.9% in the third quarter of the year compared to the second quarter – one of the highest in advanced economies. It follows a brief slowdown in the second quarter of 0.2% quarter-on-quarter. For the whole of 2015, GDP is forecast to grow by a respectable 2.3% year-on-year and accelerate to 2.6% in 2016.

Strong performances in the country's services industry such as in financial services, tourism and health, and in the construction sector (attributed to the housing sector) have held up the growth rate during the mining downturn. The resources sector has been facing tougher times though and investment in the mining industry has plunged on fading demand from China.

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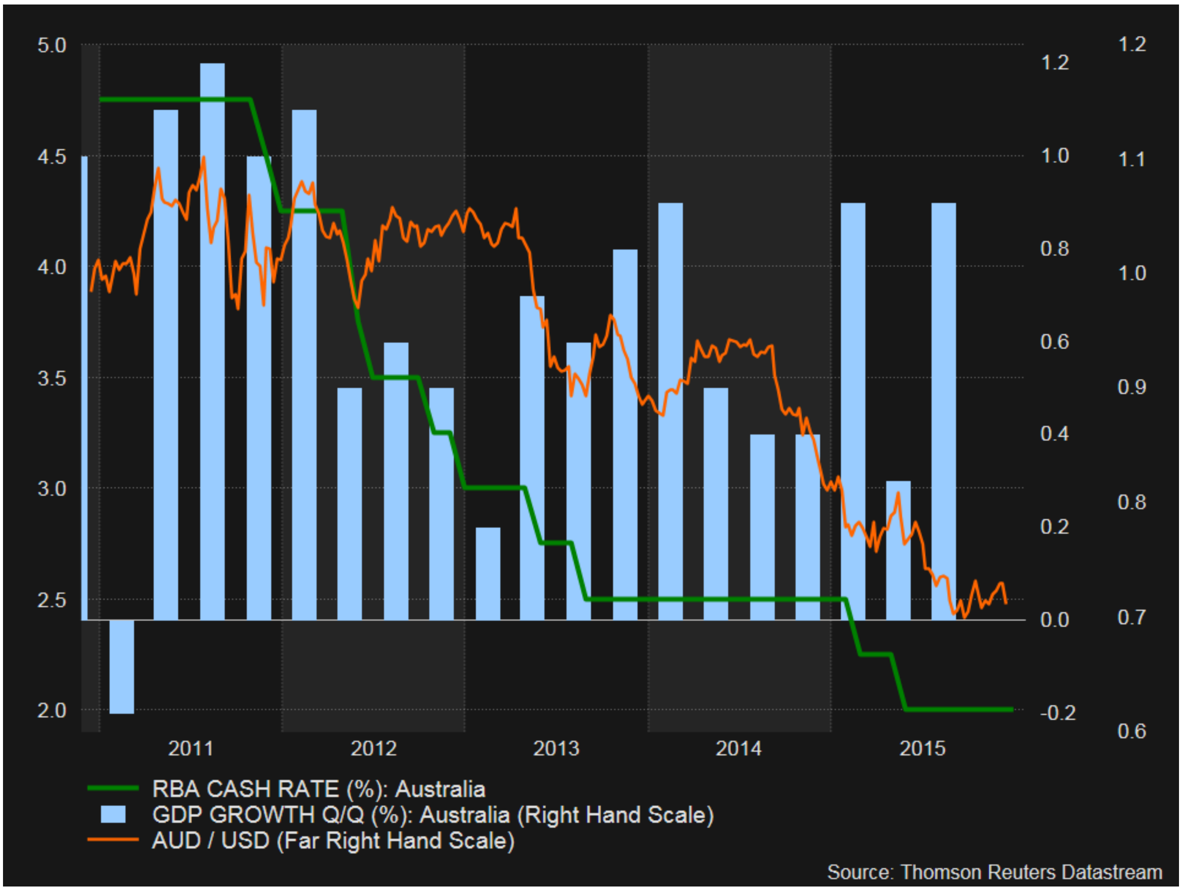


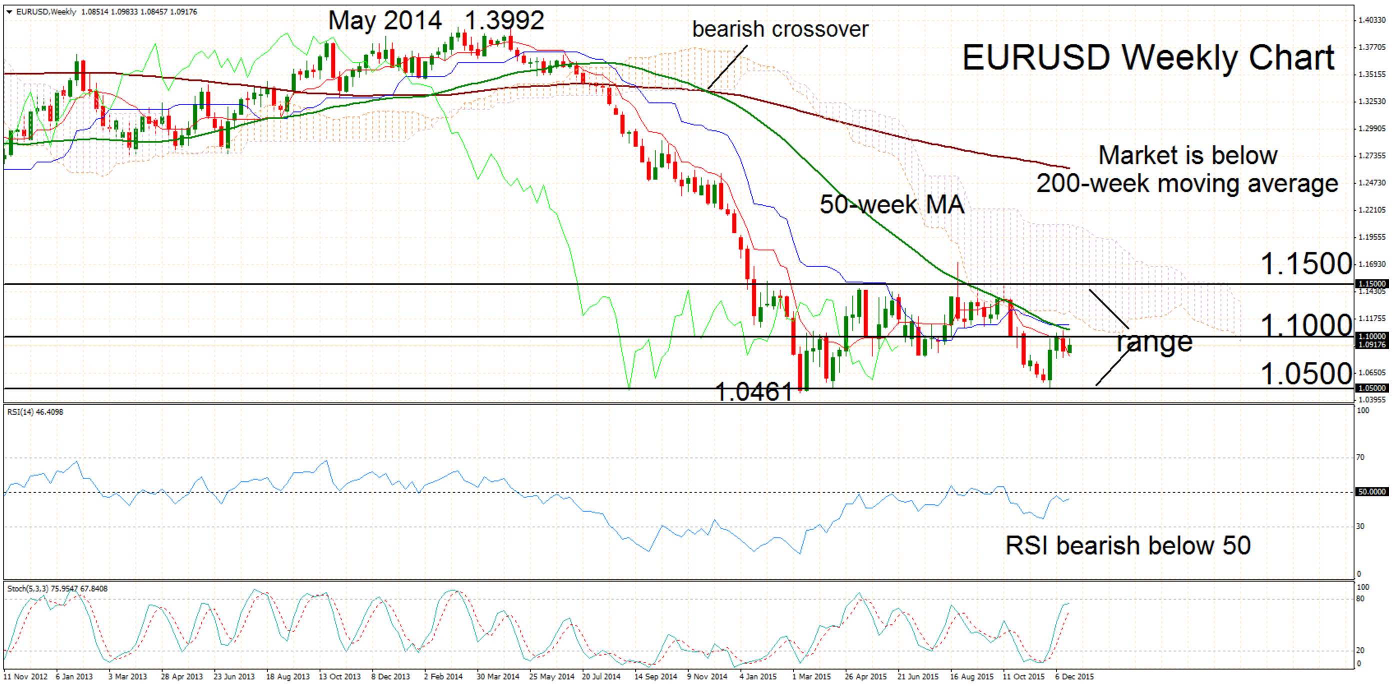
For years, Australia benefited from double digit growth rates in China, which absorbed Australia's iron ore exports for steelmaking during its construction boom. But despite the weaker demand and a slump in prices, exports have held up reasonably well during 2015. Exports had fallen sharply in April but have rebounded since the summer.

Looking ahead into 2016, the RBA is keeping its options open given that inflation may head lower if oil prices continue to slide. Annual inflation is expected to average 1.7% but is forecast to pick up to 2.4% in 2016.

The possibility of renewed downside risks from China and other Asian economies may also hurt Australia's growth prospects over the next 12 months. Recently introduced restrictions to housing lending, particularly against property investors, may make it easier for the RBA to cut rates below 2% without stoking a dangerous property bubble.

The RBA's actions will also depend on what direction the aussie follows in 2016. Signs of a solid turnaround in China would likely lead the aussie higher in foreign exchange markets as the currency often behaves as a liquid proxy for China's economy due to Australia's export dependency to China. A significant appreciation of the aussie is unlikely to be welcomed by the RBA. But the more probable scenario is that the aussie will continue to face some downside pressure as the slowdown in China is likely to continue for some time. The Australian dollar is forecast to end next year slightly weaker at 0.69 against the greenback.

Technical Analysis: EUR / USD



Will EUR/USD resume downtrend?

The bias in EUR/USD has been neutral on the weekly chart, since falling to a multi-year low of 1.0461 in March this year. The pair has been trapped in sideways action in a range between 1.0500 and 1.1500.

In recent weeks prices have been capped by resistance at 1.1000. The target to the downside is the 1.0500 level and the multi-year low of 1.0461, which if breached, would bring a resumption of the downtrend that started in May 2014 when prices fell from 1.3992.

The bearish crossover of the 200 and 50-week moving averages and the thickening Ichimoku cloud are keeping the bearish bias strong. With the RSI below 50 and the stochastic approaching overbought levels, upside momentum is likely weak.

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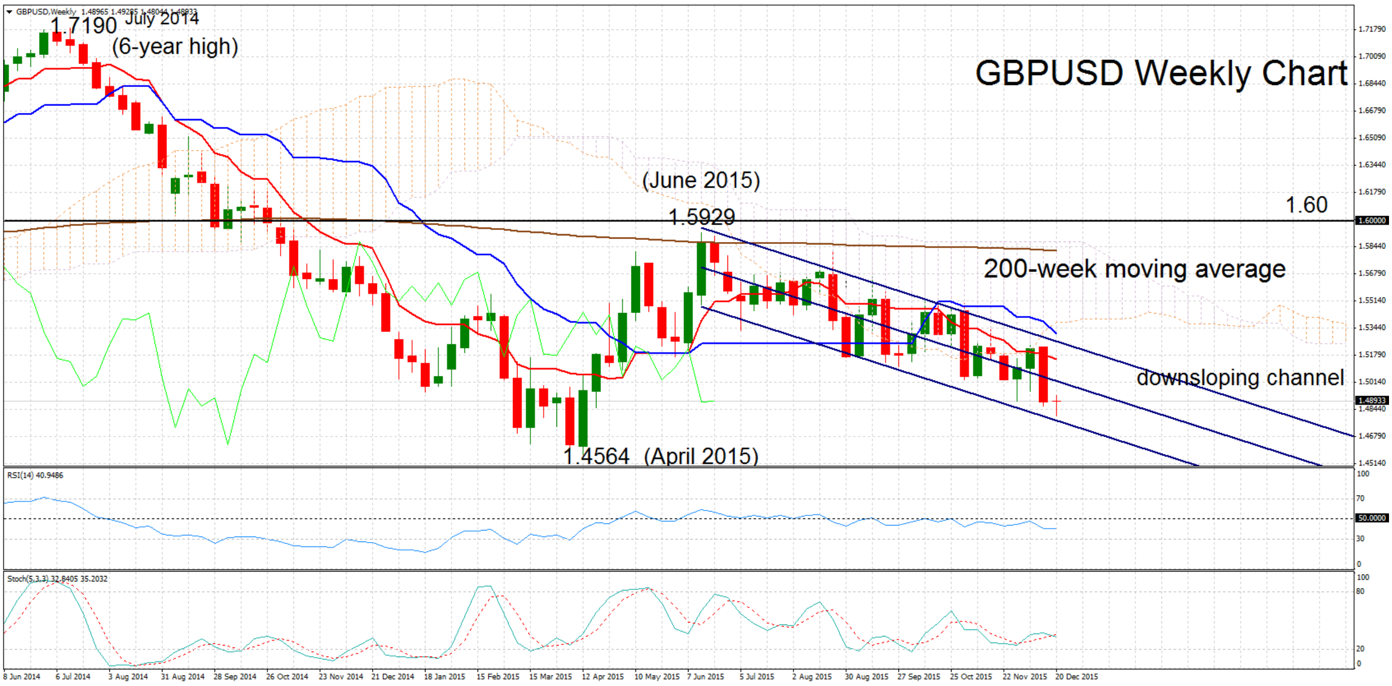
Technical Analysis: GBP / USD



Cable ends year in bearish mode

GBP/USD is falling in a downward sloping channel. The pair has been making lower lows and lower highs since declining in June this year, falling from a peak of 1.5929. Prices fell below the key $1.50 level and marked a new eight-month low in December this year. The market is below the weekly Ichimoku cloud and below the 200-week moving average, which highlights the bearish market structure. Also, the negatively aligned Tenkan-sen and Kijun-sen lines are adding to the downside bias.

If prices fall out of the channel, then the April 2015 low of 1.4564 is the next target to the downside. RSI is in bearish territory below 50 and stochastics are approaching oversold levels. Any bounces to the upside would find resistance levels at the top of the channel and at the Ichimoku cloud bottom around 1.5240. The overall bearish outlook is strong as long as the market remains below the key 1.6000 psychological level.

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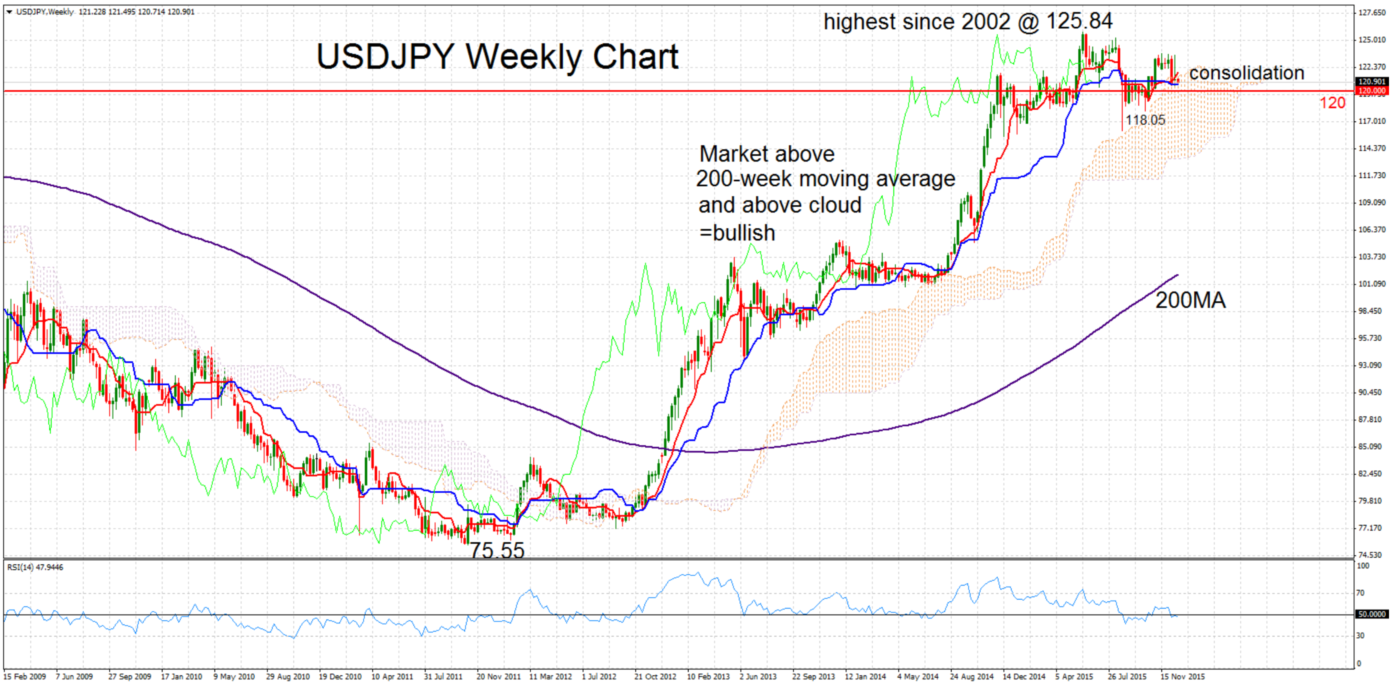
Technical Analysis: USD / JPY



USD /JPY rally stalls after hitting 13-year high

USD/JPY has been consolidating around the key psychological level of 120.00 during the year 2015. The pair was in a steady uptrend since rising from 75.55 back in the year 2011. The market has traded above the Ichimoku cloud since the end of 2012 and has also risen above the 200-week moving average. These factors support the bullish bias.

A thirteen-year high was reached in May 2015, when prices peaked at 125.84, the highest since 2002. Prices have failed to breach this high but dips lower have found support from the top of the Ichimoku cloud.

The bias has been neutral in recent weeks, as indicated by the sideways direction of the Tenkan-sen and Kijun-sen lines and also the RSI has been oscillating around the 50-point level. A break below the key 120.00 level could bring about a shift in the overall bullish outlook.

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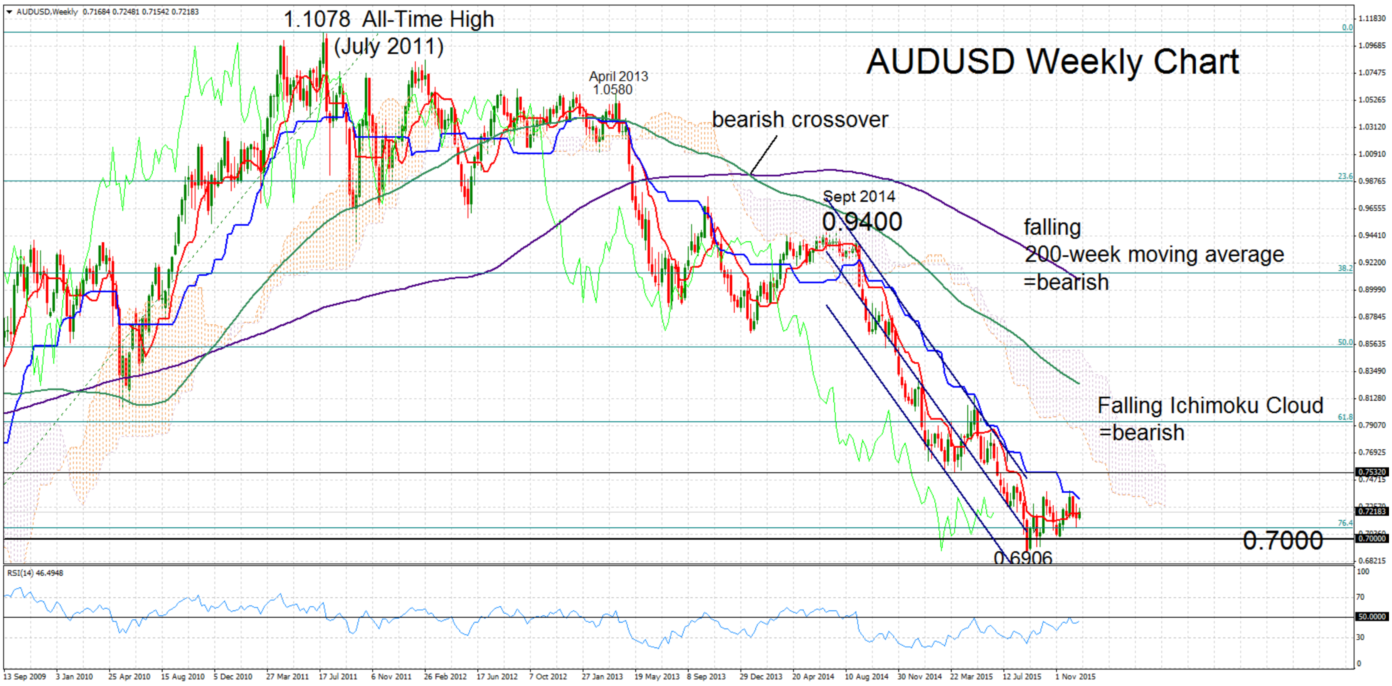
Technical Analysis: AUD / USD



AUD/USD consolidation a correction or beginning of a trend reversal?

AUD/USD has retraced more than half of the rise from 0.6008 (October 2008) to the all-time high of 1.1078 reached in July 2011. The pair is now consolidating around the 76.4% Fibonacci level of this rise and support has been provided by the key psychological level of 0.7000.

Since September 2014, prices have been falling sharply in a downward sloping channel, falling from a peak of 0.9400 to 0.6906 (reached in early September 2015). Since reaching this low, the market has been consolidating at the critical 0.7000 level.

Technical indicators are suggesting the downside bias remains strong – there was a bearish crossover of the 50 and 200-week moving averages in early 2014 and prices remain below both moving averages. The falling Ichimoku cloud is also a bearish signal. The Tenkan-sen line is below the Kijun-sen line, also a bearish signal.

A break below the key 0.7000 psychological level would inflict serious technical damage, opening the way for a decline to target the October 2008 low of 0.6008.

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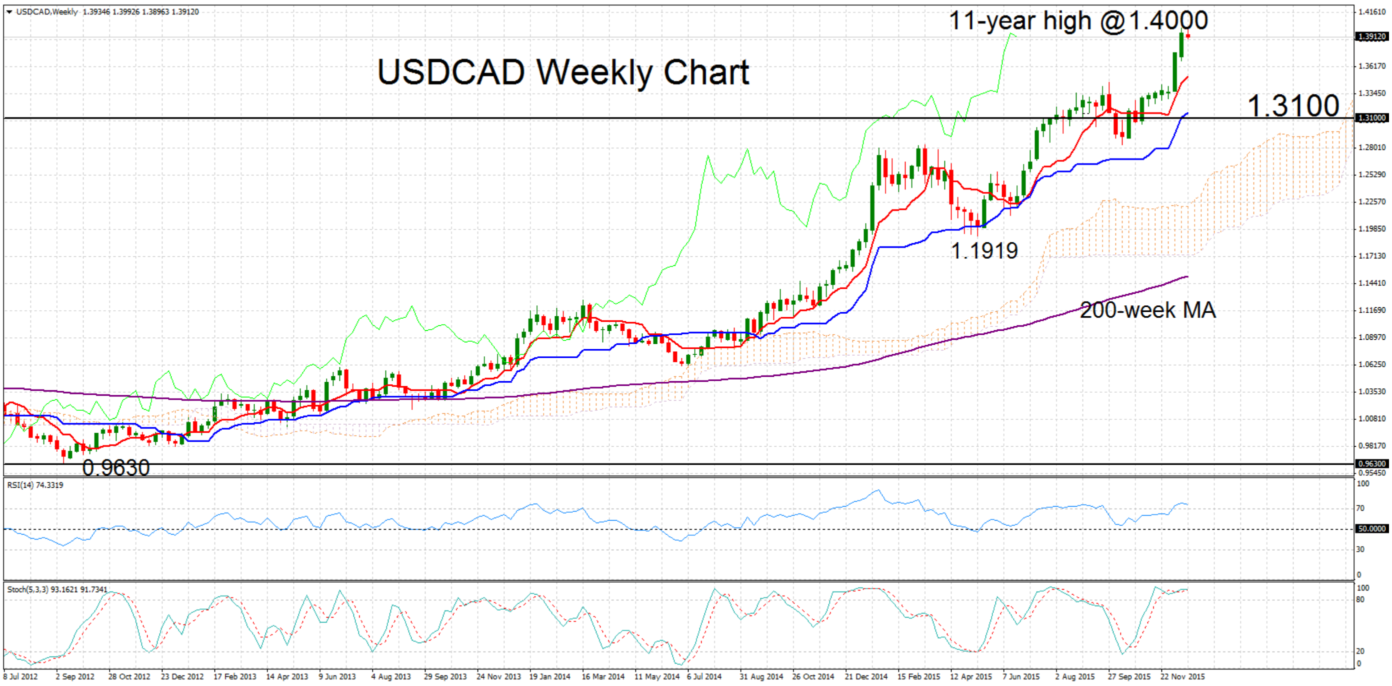
Technical Analysis: USD / CAD

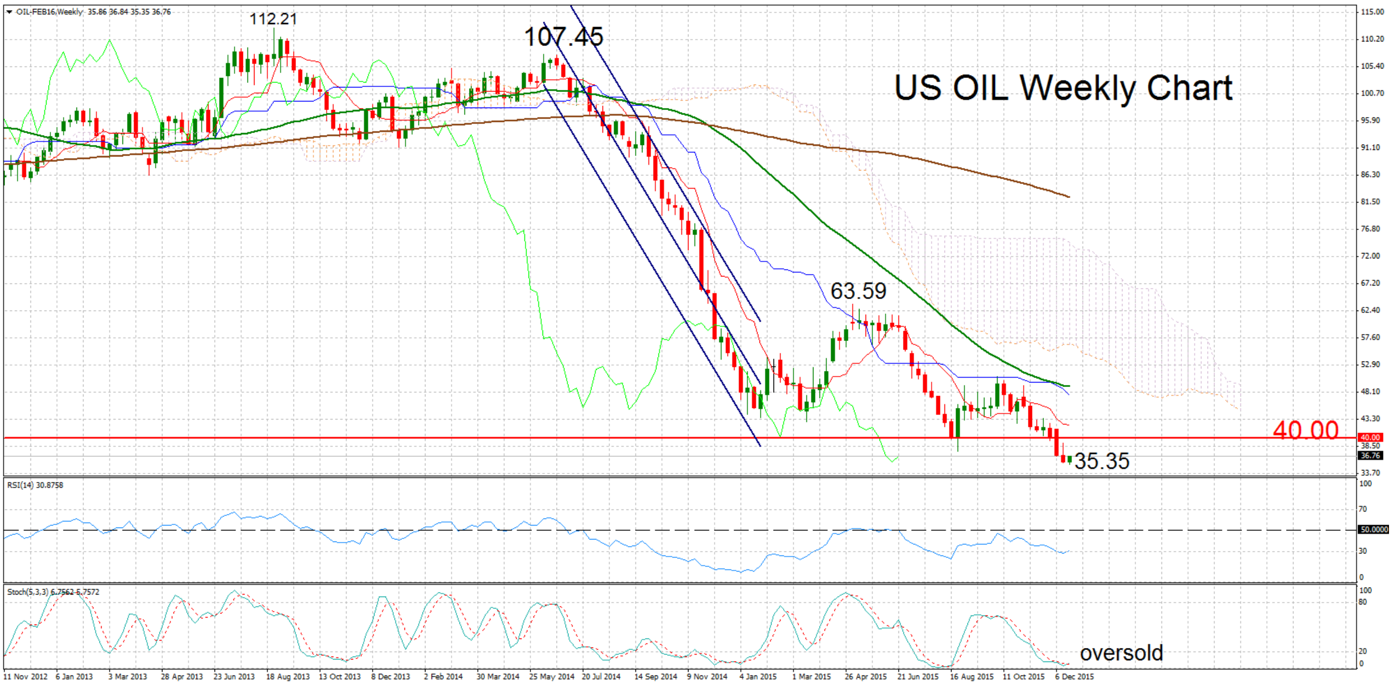


USD/CAD looking bullish at 11-year high

USD/CAD climbed to the highest level in eleven-years on December 18 this year, peaking at 1.4000. The market has been extremely bullish since September 2012, when prices rose steadily off a low of 0.9630. Prices broke above the Ichimoku cloud and 200-week moving average in mid-2013, giving a bullish signal.

The stochastic and RSI have reached overbought levels, indicating some consolidation at current levels. The key level of 1.3100 is an important support level. As long as the market remains above this level, the bullish bias will remain intact.

Technical Analysis: US Oil Futures



Are oil prices below $40 here to stay?

US oil prices have fallen to the lowest level in six years, breaking below the key $40 a barrel price level in December 2015, to reach $35.35.

Prices fell sharply in a downward sloping channel from a high of 107.45 in mid-2014 to early 2015 before attempting to make a recovery to 63.59 back in May this year. But a bearish crossover of the Tenkan-sen and Kijun-sen lines in August strengthened the downside bias.

Prices have now reached oversold levels, as indicated by the stochastic and RSI, so there is a possibility for the market to stabilize at current levels. Further downside brings the 2009 low of 33.21 into view. A thick falling Ichimoku cloud is keeping the bearish outlook strong.

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