

The pressure on the greenback is still downward, but most of its depreciation is in the past

Highlights

- The greenback kicked off the year to a poor start, but most of the depreciation is now behind us.
- Despite a very hawkish European Central Bank and rising recession risks in the United States, the euro is hesitating as it nears US\$1.50.
- Downward pressure on the pound caused by expected deterioration in UK real estate.
- The Japanese economy's fundamentals should limit the yen's appreciation.
- The loonie is facing headwinds: economic risks vs. high oil prices.
- The Australian dollar should continue benefiting from the local economy and Asia's demand for commodities.
- Because of the slowing U.S. economy, expect weakness in the Mexican peso in the near term.
- The yuan appreciation should remain rapid in 2008.

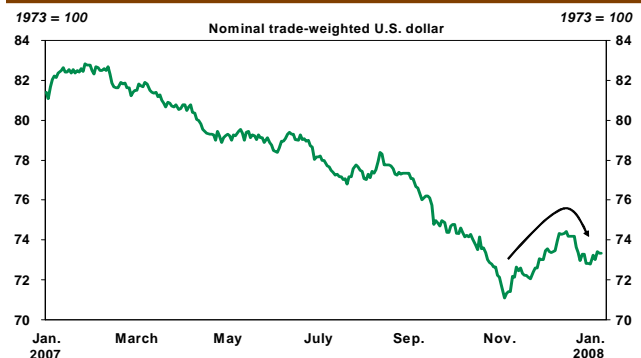
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Editorial

After having turned things around in November and December (Graph 1), the greenback got the year off to a poor start. Note that the latest statistics indicate that the economic situation deteriorated. In December, the ISM manufacturing index fell to 47.7, close to three points below the 50 mark, pointing to contracting manufacturing activity. Then home sales and housing starts came out weaker than forecast that month, showing that the end to the housing market correction is not yet in sight. All of this was crowned by anaemic job creation, a jobless rate jump of three tenths of a point, to 5.0%, and weak retail sales.

Graph 1 – The U.S. dollar got the year off to a bad start



Sources: Federal Reserve Board and Desjardins, Economic Studies

The bad news prodded the U.S. Federal Reserve (Fed) to show more flexibility. In a recent speech, Fed Chair Ben Bernanke stated that he was ready to take further action as needed to support growth and provide adequate assurance against downside risks. With the Fed lagging more and more behind market expectations, it is now likely that key rates will be cut substantially in the months to come in the United States. According to the Cleveland Fed, 53% of market participants are expecting a 50 basis point decrease, while 44% expect a 75 basis point cut (Graph 2).

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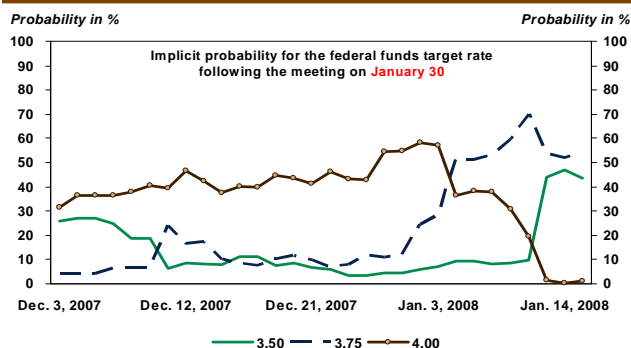
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NOTE TO READERS: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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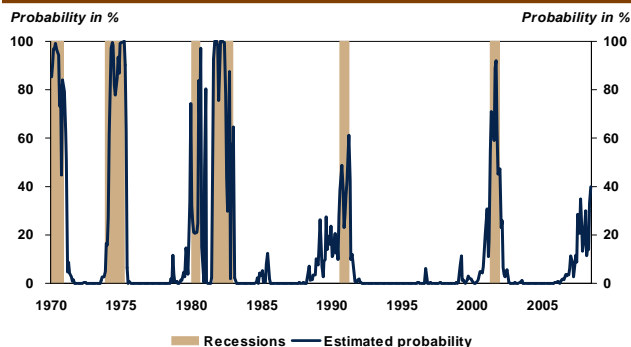
Graph 2 – The market expects aggressive cuts to federal funds



Sources: Réserve fédérale de Cleveland and Desjardins, Economic Studies

Under these circumstances, further short-term deterioration by the greenback seems to be inevitable, but things could prove to be better than they seem. First, we are not ready to throw in the towel on the U.S. economy. Growth does promise to be weak, but the United States should be able to avoid the worst. With the likelihood of a recession at about 40% (Graph 3), the risks are clearly tilted to the downside. However, we believe growth will be between 1% and 2% in the first half of 2008, a pace that is similar to the final quarter of 2007.

Graph 3 – Probability of a U.S. recession is high, but not dominant

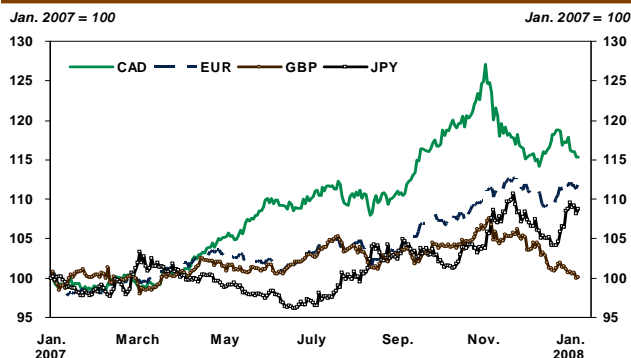


Source: Desjardins, Economic Studies

Then, with major bellwethers of economic slowing in the United Kingdom and the euro area, and a moderate growth outlook for Japan, it appears that the U.S. currency has reached a low point against the major currencies (Graph 4). The case of the euro, which is struggling to go past November's peak (US\$1.49) despite a very hawkish ECB and a Fed that is ready to go into action, illustrates the situation nicely.¹

¹ In the near term, if U.S. key interest rates come down sharply, the market is likely to test US\$1.50/euro (see page 5), but, all in all, the euro's potential for appreciation appears limited.

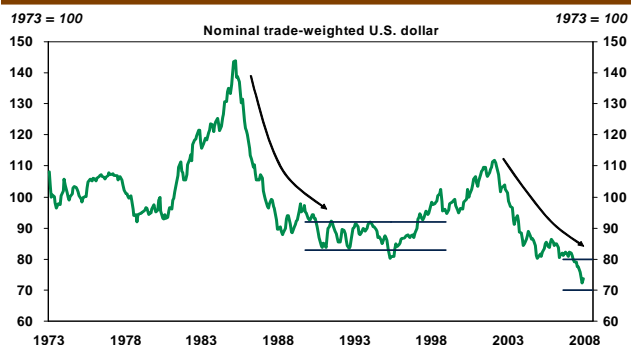
Graph 4 – The major currencies appear to have crested against the greenback



Sources: Datastream and Desjardins, Economic Studies

We thus expect the greenback to oscillate close to current levels over the next few quarters, or even years. Historically, this would be in line with what happened following the 1985 Plaza Accord, where, after a sharp drop, the effective dollar went into a stabilization period that lasted several years (Graph 5).

Graph 5 – The trade-weighted U.S. index should stabilize in 2008



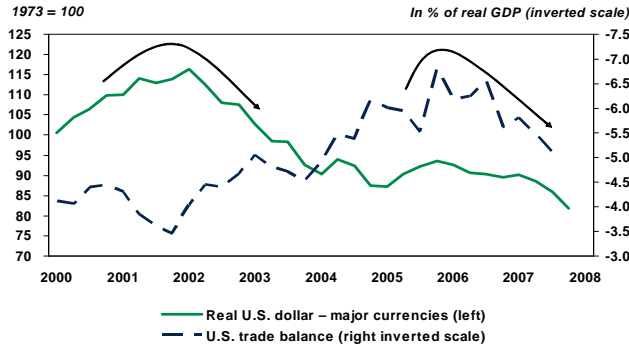
Sources: Federal Reserve Board and Desjardins, Economic Studies

What's more, the trade-weighted index has come down 35% since February 2002 (10% in 2007 alone), and this is beginning to bear fruit. The U.S. current account deficit has partially resolved in recent years, going from a peak of 6.8% of GDP in Q4 of 2005 to 5.1% in Q3 of 2007 (Graph 6).

With the major currencies out of momentum, subsequent improvement in the U.S. trade situation should come via appreciation by the currencies of countries with very positive current account balances, such as China and the oil exporting nations (Graph 7).

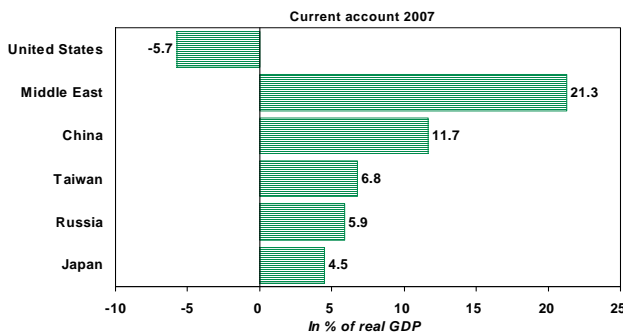
The case of China's yuan is especially promising. Because inflation has accelerated, the Chinese government has taken a tougher stance lately, shifting to a more aggressive monetary policy. However, measures such as the tightening

Graph 6 – The U.S. trade deficit has started to correct



Sources: Federal Reserve Board, Datastream and Desjardins, Economic Studies

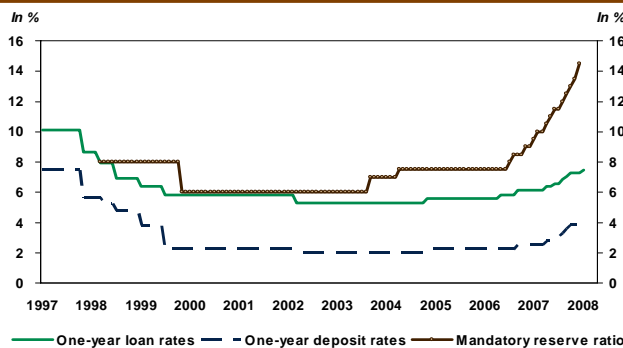
Graph 7 – In 2008, there will be strong pressure to adjust the currencies of countries with surpluses



Sources: International Monetary Fund and Desjardins, Economic Studies

of the reserve requirement ratio and increased interest rates proved to be rather ineffective in a controlled currency regime (Graph 8).

Graph 8 – Monetary policy was further tightened recently

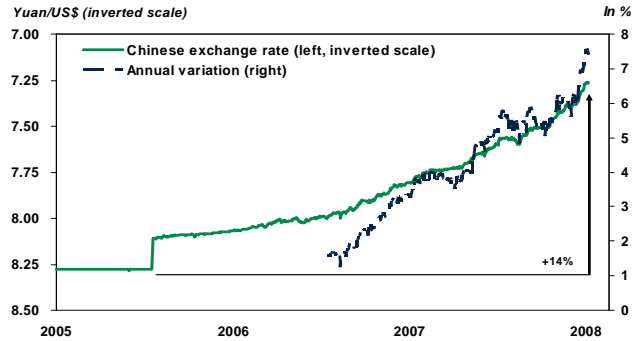


Sources: Datastream and Desjardins, Economic Studies

With much of its growth coming from foreign trade, the best way the government can control inflation pressure would be through making China's currency more flexible. Peking will certainly not want to bow to international demands, but we

can expect yuan adjustments to keep accelerating until the end of 2008 (Graph 9).

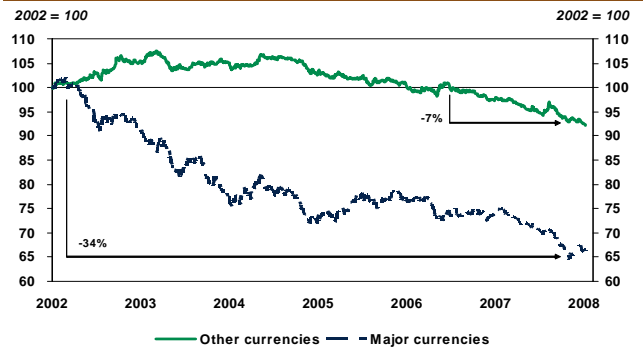
Graph 9 – Appreciation by China's yuan is accelerating



Sources: Datastream and Desjardins, Economic Studies

In our opinion, gradual yuan appreciation should help to ease the pressure on the other Asian currencies. The "Asia ex-Japan" group, which accounts for 64% of the U.S. dollar index weighted against other important trading partners (OITP²) could push the OITP index down by about 10% in 2008 (Graph 10). This would help to correct some of the global imbalances and give a break to the major currencies.

Graph 10 – Faster depreciation by the currencies of emerging Asian nations will give the major currencies a break



Sources: Federal Reserve Board, Datastream and Desjardins, Economic Studies

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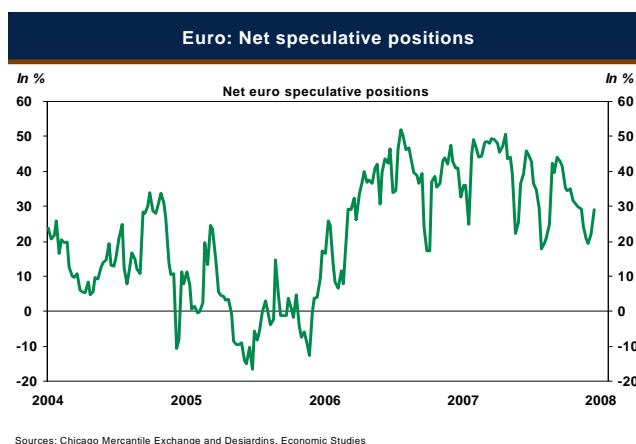
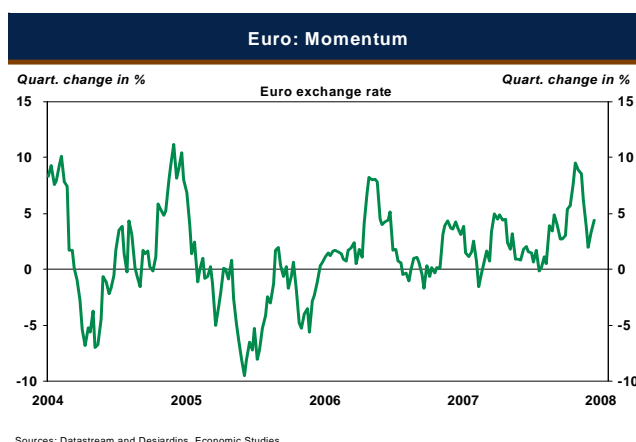
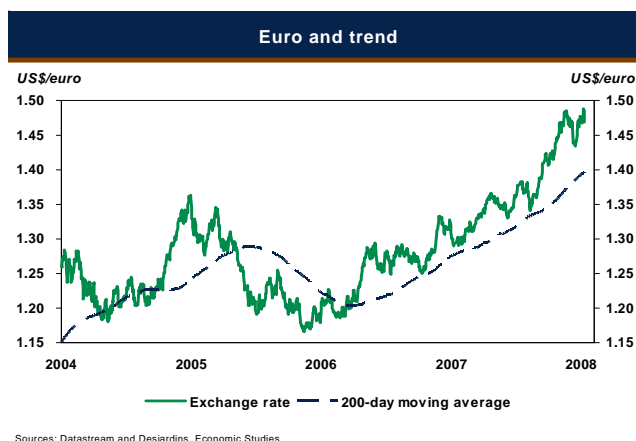
² Other Important Trading Partners.

EURO (EUR)

The euro stumbles as it nears US\$1.50

- The euro's up trend paused in December as the U.S. dollar's renewed strength pulled the EURUSD down to close to US\$1.43. This slight correction by Euroland's currency did not last, however. The intransigence shown by the European Central Bank (ECB), the growing risk of a U.S. recession and clear signals from the U.S. Federal Reserve (Fed) to the effect that it would not hesitate to bring its key rates down substantially gave the euro some support, taking the currency back over US\$1.49, very close to the peak it reached last November.
- In the near term, interest rate spreads should continue to support Euroland's currency, as ECB President Jean-Claude Trichet once again confirmed on January 10 that the monetary authorities were very concerned about intensified inflation pressure and had absolutely no plans to soften their monetary policy.
- Technically, if the euro succeeds in crossing November's peak, the US\$1.50 mark should be reached shortly, and the currency could even test higher levels on upcoming U.S. key rate cuts. The euro's slight dip at the end of 2007 slowed the currency's momentum and was accompanied by a reduction in speculative positions. Despite a surge in the last few days, market indicators remain below the elevated levels we have seen previously.
- The longer-term outlook for the euro is less favourable. A slowdown by Europe's economies seems inevitable, with decelerating U.S. demand and the strong euro weighing heavily on foreign trade. The latest statistics released in the euro zone also weigh in on the side of deceleration as retail sales fell in November, and German investor confidence has deteriorated. The more stubborn the ECB is, the bigger the economic slowdown could be, and the more it will have to lower its key rates in the second half of 2008 and perhaps even 2009.

Forecasts: In the near term, the euro could cross the US\$1.50 mark and appreciate a bit more in the coming months. After that, the euro should move on a down trend against the greenback, and end 2008 below US\$1.40.

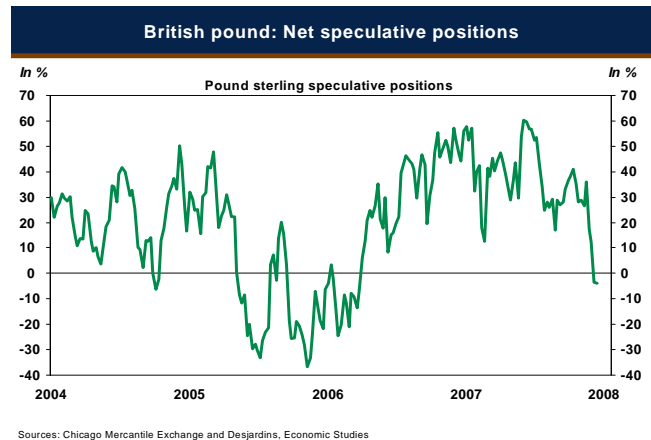
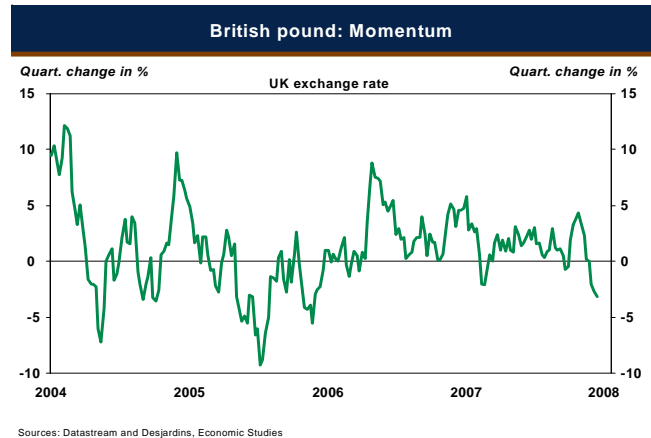
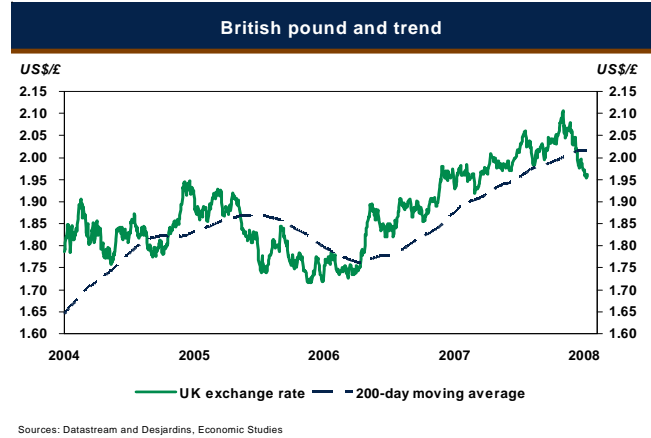


BRITISH POUND (GBP)

Downward pressure on the pound

- In the last few weeks, the pound sterling has depreciated substantially against the U.S. dollar and euro, as intensified strain on the financial market and deteriorating economic outlook convinced the Bank of England (BoE) to initiate a monetary easing cycle in December. After brushing US\$2.11 last November, the pound has recently come down to close to US\$1.95. For its part, the EURGDP jumped to close to 0.76, shattering the old record. 0.725.
- Market indicators show that sentiment about the pound is poor, as net speculative positions in the currency and its momentum have fallen into negative territory. The quick reversal of speculative positions has certainly played its part in the pound's recent retreat.
- The pound will remain under pressure in the short term, and could continue to depreciate somewhat against the euro and greenback. Contrary to the ECB, the BoE seems primarily concerned about the darkening economic outlook, as the housing market's drop in pace is promising slower consumption by British households. The BoE should thus once again cut its key rates in the next few months.
- In the longer term, the pound sterling's evolution is hedged about by much uncertainty. In theory, the BoE's pre-emptive action should help to limit the British economy's slowdown. In this context, the pound could stabilize against the U.S. dollar and come back up somewhat against the euro starting in mid-2008. However, if the British housing market's slowdown turns into a sharp correction similar to the one being seen in the United States, the BoE will have to slash its rates, which will bring the pound down further.

Forecasts: The pound will remain under pressure in the near future and could go below US\$1.95. After that, the most likely scenario, if the economy does not slow too much, is for the currency to stabilize at close to US\$1.90 and appreciate somewhat against the euro.

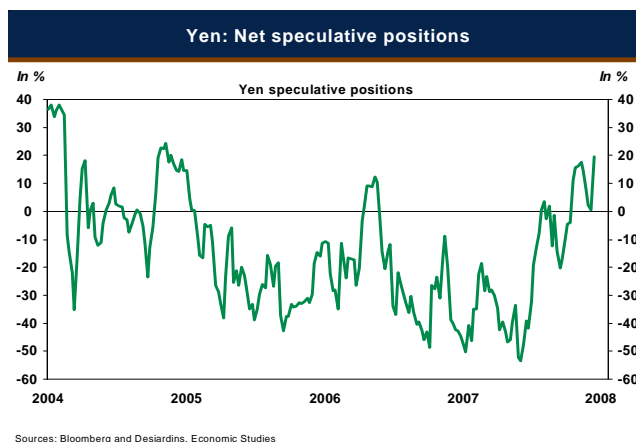
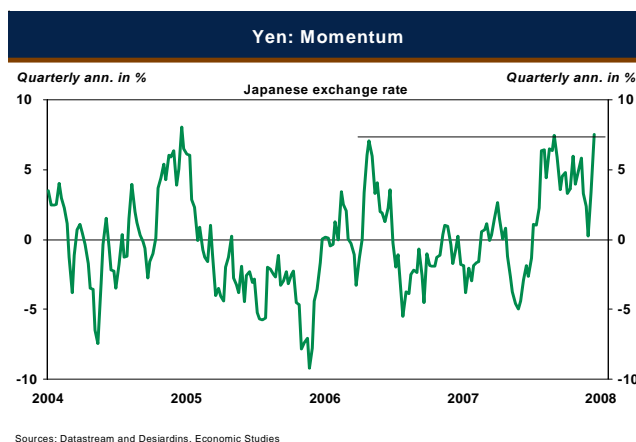
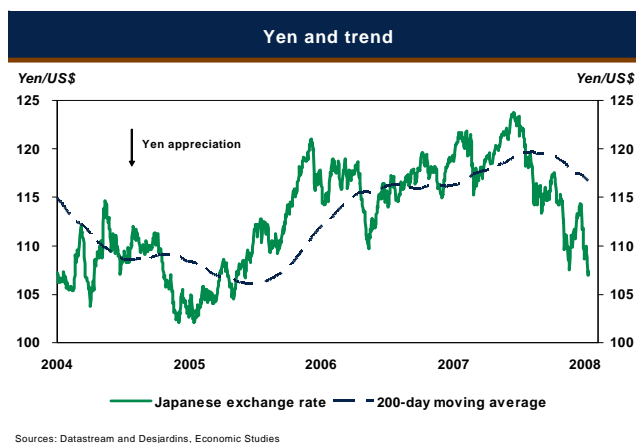


YEN (JPY)

The Japanese economy's fundamentals should limit the yen's appreciation

- The yen has been highly volatile in recent weeks. After appreciating to 107.5 yens/US\$ at the end of November, Japan's currency quickly fell to 114.5 at the end of December. The beginning of the year, with the yen appreciating, attests to the U.S. economy's struggles and risk appraisal.
- In the near term, financial market unrest and the major U.S. interest rate cuts expected should help to foster unwinding of carry trades, giving Japan's currency good support.
- Technically, the currency crossed the 107.5 yens/US\$ level, and has the potential of appreciating further. However, we are noting that net speculative positions in the yen have become very elevated recently, and the Japanese currency's momentum indicates that a change in course is likely in the near term.
- In terms of fundamental analysis, the yen's structural weakness persists. Japan's economic growth is still dependent on its foreign trade component. After showing negative economic growth in the second quarter, Japan's GDP jumped 2.6% in the third quarter, but the GDP is still below its first quarter level. The economy is expected to lose speed in the fourth quarter, and growth should only show some signs of vitality starting in the second quarter of 2008. The situation for inflation is still mixed. With inflation of 0.1% expected for 2007 and 0.4% for 2008, the risk of deflation is not completely ruled out. Therefore, interest rate increases could occur in the second half of 2008, once signs of sustained economic growth and higher inflation have emerged.
- That said, the faster appreciation by the Chinese yuan forecast for 2008 will continue to improve Japanese exporters' competitiveness, giving the yen more room to appreciate.

Forecasts: In the near future, the yen could continue to appreciate, but the Japanese economy's structural weakness will limit the yen's gains, and could even trigger a correction toward 110 yens/US\$.

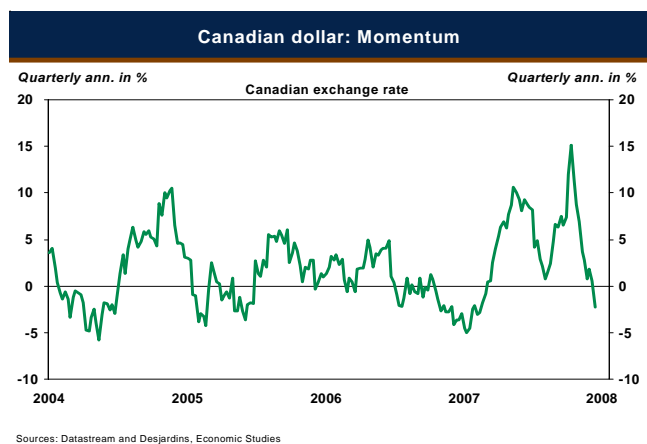
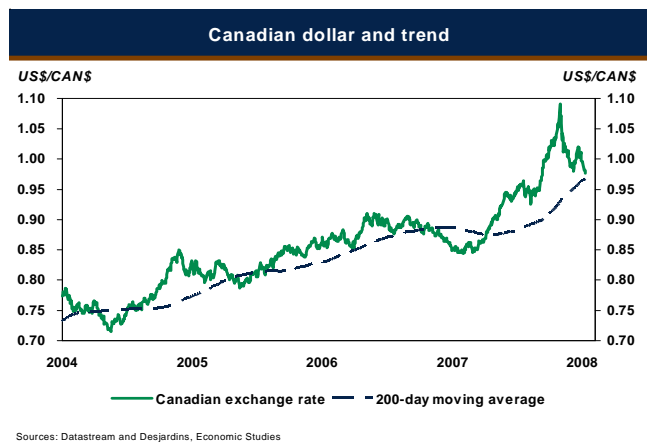


CANADIAN DOLLAR (CAD)

The loonie is facing headwinds

- In recent weeks, the Canadian dollar stabilized within a tight range, and has been oscillating around parity since the end of November 2007. As economic difficulties south of the border mount, the beginning of the year seems to be a bit tougher for the loonie. The currency, currently hovering close to US\$0.98, is still limiting the damage thanks to record oil prices.
- On a market basis, do not expect the Canadian dollar to fluctuate extensively. November's sharp correction took the loonie close to its long-term trend; net positions on non-commercial CAD contracts (a measure of market speculation) remain positive but low, and the movement in the currency is neutral, suggesting there will be a period of stabilization.
- The current situation indicates a change in market players' perception. In the United States, with the ISM manufacturing index' December tumble, soft employment and ongoing housing market correction, it seems increasingly clear that the economy is heading for a major slowdown, and the impact on U.S. demand for Canadian export products is promising to be bigger than initially forecast. In exchange, high oil prices are continuing to give the currency solid support but, in an uncertain context and with a strong probability of a recession south of the border, the absolute effect is mitigated.
- With aggressive interest rate cuts expected in the United States, interest rates will continue to favour the Canadian dollar. The Bank of Canada remains concerned about the downside risks associated with the U.S. slowdown, the strong loonie, and tightening credit conditions, and monetary easing will continue here. However, the economic situation is still relatively enviable, with some persisting inflation pressure due to the domestic economy's solid performance, low jobless rate and wage increases. As a result, rates will not come down as much as in the United States.

Forecasts: In the short term, the loonie should oscillate in a tight range, just below parity. A drop in oil prices to around US\$80 a barrel should, however, trigger a period of currency softness for the first half of 2008.



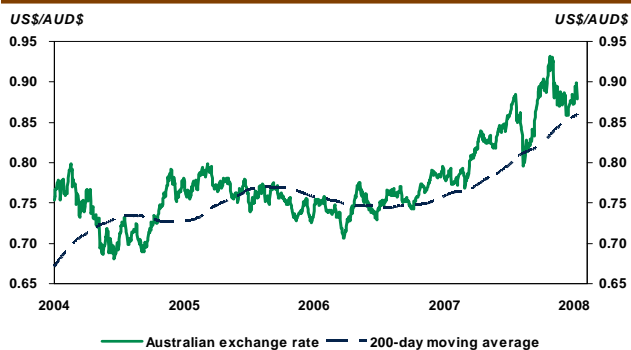
AUSTRALIAN DOLLAR (AUD)

The Australian dollar will continue to be strong

- Last November, the reappraisal of risk on the financial markets associated with the liquidity crunch caused another unwinding of carry trades and triggered a downward movement in the value of the Australian dollar. The down trend ended in mid-December. Since then, a decline in the risks and data attesting to the Australian economy's strength have helped the Australian dollar come back up. It has gone from a low of US\$0.8585 on December 19 to close to US\$0.90 today.
- In November, the Australian dollar's intense momentum promised a depreciation. The indicator's current level now suggests that the currency's appreciation can continue. It's the same story for net positions on non-commercial AUD positions: levels are not consistent with currency being overvalued.
- Moreover, the fundamentals are consistent with a strong currency. Economic growth rebounded in the third quarter, and expectations for the fourth quarter, as well as for 2008, are high. Growth is primarily due to the proximity to China and India and those countries' strong demand for Australian raw materials. This strong demand is driving up commodities prices and stimulating investment. Among other things, Australia is a major gold producer, and its economy and currency are both benefiting from the precious metal's high prices.
- Given the Australian economy's solid performance, inflation remains a concern and, after having taken a break in December, the central bank should continue with monetary firming. One or two rate hikes are expected in the first half of 2008, which will support the Australian dollar.

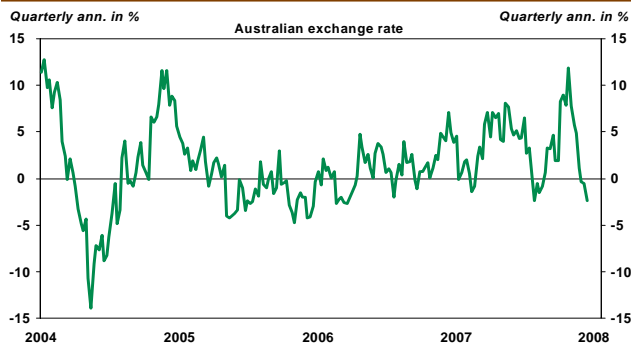
Forecasts: The AUD should continue to appreciate in the next few months on a return of carry trades and the forecast interest rate increases. Demand and high raw materials prices will continue to give the currency fundamental support. Lastly, the rate cuts expected in the United States will favour the Australian dollar against the greenback. The exchange rate should go back over AU\$90/US\$ in January, and fluctuate around AU\$92/US\$ until the end of the second quarter.

Australian dollar and trend



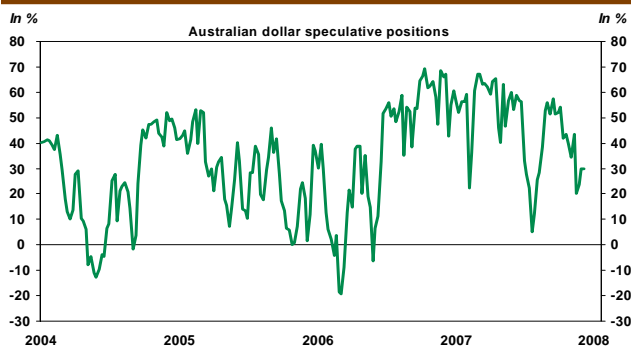
Sources: Datastream and Desjardins, Economic Studies

Australian dollar: Momentum



Sources: Datastream and Desjardins, Economic Studies

Australian dollar: Net speculative positions

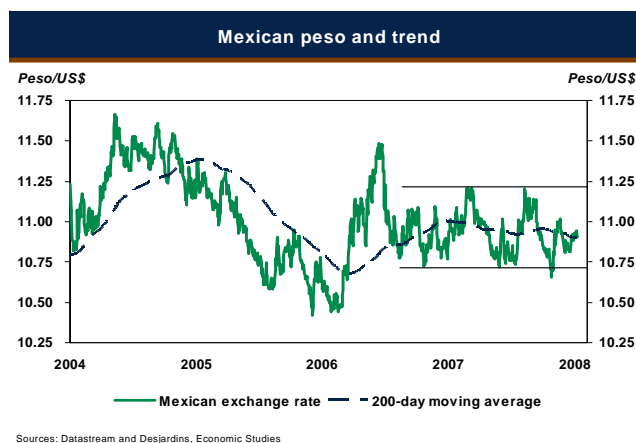


Sources: Datastream and Desjardins, Economic Studies

MEXICAN PESO (MXN)

Expect peso softness in the short term

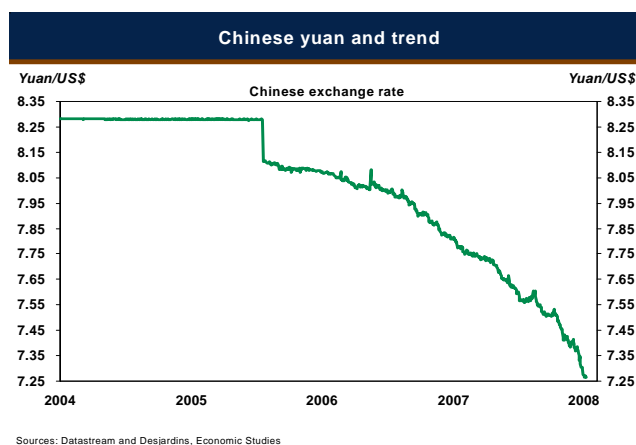
- The greenback's generalized rebound in November drove the Mexican peso from a low of 10.66 pesos to a peak of 11.07 pesos during the month. The softness was temporary, however, and Mexico's currency returned to its long-term moving average, close to 10.90 pesos/US\$.
- Fundamental analysis indicates that the currency should move on a slightly down trend in the next few months. Real GDP rebounded in the third quarter, but growth does not seem sustainable. Capital goods imports slowed from an average pace of about 13% in the first half of 2007 to 6% in September. Moreover, the problems north of the border are weighing heavy on the growth outlook for Mexico's foreign trade sector.



CHINESE YUAN (RMB)

The yuan should continue to appreciate quickly in 2008

- In December, the yuan appreciated 1.27% against the greenback, vs. 0.98% in November. For 2007 as a whole, in the end, the yuan rose 6.5% against the dollar. At a pace of one percent a month, the yuan could appreciate as much in 2008 as it has since it was revalued in July of 2005. Nonetheless, the yuan is fairly stable against the other currencies.
- The yuan is still under pressure. Driven by a major current account surplus, China's reserves of foreign assets are now in excess of US\$1,500B. Because it does not have a floating exchange rate, China amasses reserves to limit growth by the money supply and inflation pressure. It is, however, having more and more difficulty reining in monetary expansion. In 2007, faced with climbing inflation, along with raising interest rates and limiting bank credit, China raised the reserve requirement ratio ten times, taking it to 14.5%.
- Given these pressures, the yuan should continue to appreciate apace in 2008. By the end of January, the exchange rate could drop below 7.25 yuans/US\$.

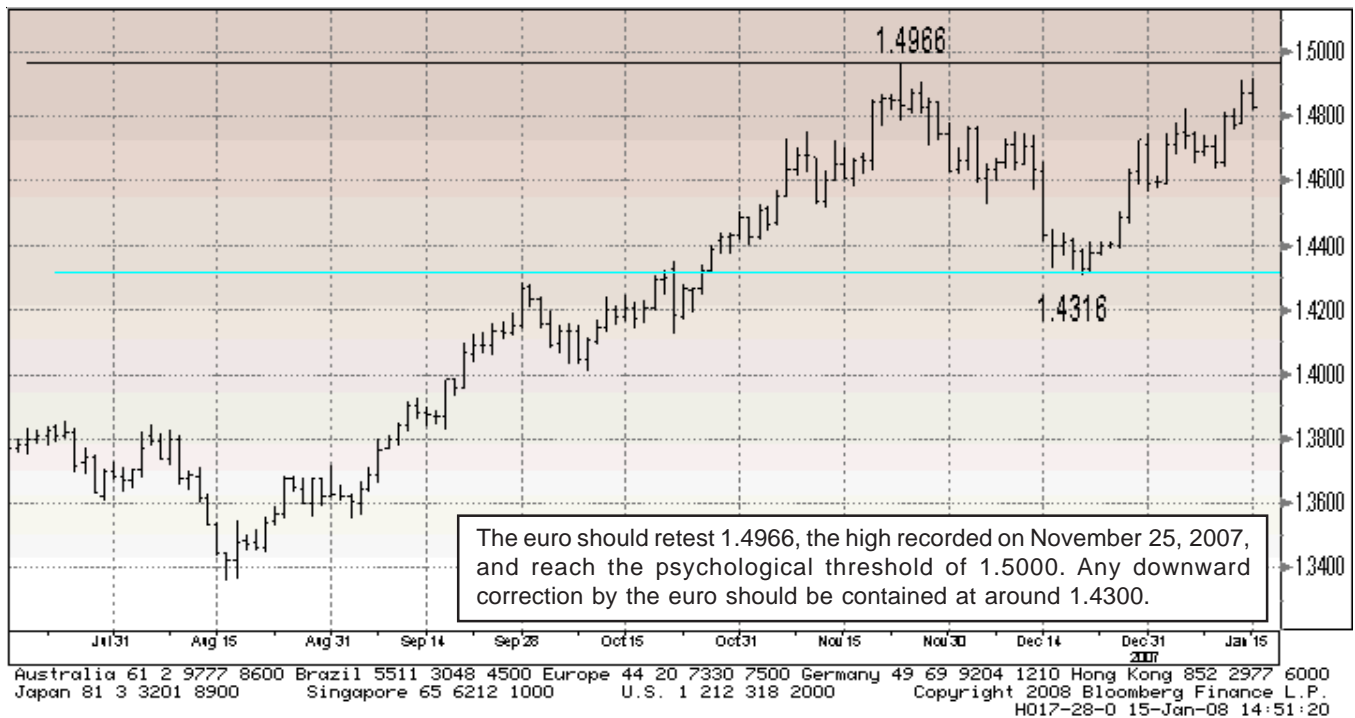


TECHNICAL ANALYSIS

USDCAD



EURUSD



TECHNICAL ANALYSIS

GBPUSD



JPYUSD



Currency market

Country – Currency*	Spot price		Previous data			Last 52 weeks		
	Jan. 16	-1 month	-3 months	-6 months	-1 year	Higher	Average	Lower
North America								
Canada – dollar	1.0249	1.0179	0.9795	1.0433	1.1728	1.1860	1.0665	0.9161
Canada – (CADUSD)	0.9758	0.9825	1.0210	0.9585	0.8527	0.8432	0.9376	1.0916
Mexico – peso	10.9514	10.8214	10.8452	10.7617	10.9855	11.2456	10.9271	10.6680
South America								
Argentina – peso	3.1418	3.1434	3.1638	3.0988	3.0805	3.1838	3.1182	3.0705
Brazil – real	1.7745	1.7861	1.8251	1.8628	2.1455	2.1455	1.9308	1.7311
Asia								
China – yuan renminbi	7.2334	7.3720	7.5190	7.5685	7.7919	7.7919	7.5839	7.2334
Hong Kong – dollar	940.05	930.10	917.45	918.20	935.55	951.40	929.37	900.70
India – rupee	7.7970	7.7974	7.7568	7.8214	7.8023	7.8299	7.8025	7.7507
Japan – yen	39.2105	39.3155	39.2405	40.2455	44.2315	44.3855	40.9834	39.0755
South Korea – won	107.45	113.33	116.89	121.91	120.66	123.82	117.29	106.93
Europe								
Denmark – krona	5.0807	5.1711	5.2586	5.4024	5.7692	5.7692	5.4140	5.0088
Euro zone – US\$/€	5.4198	5.5346	5.4097	5.7308	6.4428	6.4694	5.8153	5.2714
Norway – kroner	1.9648	2.0196	2.0319	2.0363	1.9610	2.1082	2.0023	1.9256
Russia – ruble	24.4538	24.6853	24.9468	25.4783	26.5567	26.5690	25.4829	24.2781
Sweden – krona	6.4352	6.5245	6.4570	6.6476	7.0101	7.1091	6.7309	6.2390
Switzerland – swiss franc	1.0974	1.1530	1.1835	1.2034	1.2482	1.2546	1.1944	1.0900
United Kingdom – US\$/£	1.4683	1.4435	1.4156	1.3774	1.2931	1.4881	1.3782	1.2904
South Pacific								
Australia – (USDAUD)	1.1373	1.1626	1.1241	1.1470	1.2793	1.3013	1.1885	1.0733
New Zealand – (USDNZD)	1.2995	1.3084	1.3365	1.2614	1.4497	1.4863	1.3540	1.2415

* In comparison with the U.S. dollar, unless otherwise indicated.
 Note: Currency table base on previous day closure.

Currency market: History and forecasts

End of period	2007		2008				2009			
	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
American dollar										
Canadian dollar (USDCAD)	0.9944	0.9979	1.0309	1.0417	1.0000	0.9756	1.0000	1.0204	0.9804	0.9524
Euro (EURUSD)	1.4222	1.4620	1.4700	1.4500	1.4000	1.3600	1.3300	1.3200	1.3000	1.3200
British pound (GBPUSD)	2.0471	1.9865	1.9500	1.9400	1.9300	1.9300	1.9100	1.9000	1.9000	1.9200
Yen (USDJPY)	114.80	111.69	110.00	110.00	108.00	106.00	104.00	102.00	100.00	98.00
Australian dollar (AUDUSD)	0.8885	0.8755	0.9000	0.9200	0.9200	0.9000	0.8800	0.8700	0.8500	0.8500
Mexican peso (USDMXN)	10.94	10.92	10.90	11.00	11.25	11.35	11.25	11.15	11.10	11.00
Chinese yuan (USDRMB)	7.51	7.31	7.02	6.85	6.55	6.25	5.90	5.60	5.30	5.00
Effective dollar* (73 = 100)	74.38	73.27	73.57	74.00	74.35	74.50	75.46	75.88	75.23	73.80
Canadian dollar										
American dollar (CADUSD)	1.0056	1.0021	0.9700	0.9600	1.0000	1.0250	1.0000	0.9800	1.0200	1.0500
Euro (EURCAD)	1.4143	1.4589	1.5155	1.5104	1.4000	1.3268	1.3300	1.3469	1.2745	1.2571
British pound (GBPCAD)	2.0357	1.9823	2.0103	2.0208	1.9300	1.8829	1.9100	1.9388	1.8627	1.8286
Yen (CADJPY)	115.44	111.92	106.70	105.60	108.00	108.65	104.00	99.96	102.00	102.90
Australian dollar (AUDCAD)	0.8836	0.8737	0.9278	0.9583	0.9200	0.8780	0.8800	0.8878	0.8333	0.8095
Mexican peso (CADMXN)	11.00	10.94	10.57	10.56	11.25	11.63	11.25	10.93	11.32	11.55
Chinese yuan (CADRMB)	7.5521	7.3254	6.8094	6.5760	6.5500	6.4063	5.9000	5.4880	5.4060	5.2500

f: forecasts

* Trade-weighted against major U.S. partners.

Sources: Datastream, Federal Reserve Board and Desjardins, Economic Studies