FX Themes and Trades
Monthly Outlook
May 22, 2020

Economics
FICC Strategy

Beginning Down the Road to Recovery

Currency	What's Changed
USD	Expect the greenback to slowly give back strength over the course of this year
CAD	Look for the loonie to weaken in the near-term, as markets could be overly optimistic
EUR	An extension in monetary policy and ongoing fiscal spending should provide support for the euro
GBP	Expect sterling headwinds to persist in the near-term
JPY	Yen gains should be supported by a strong current account
Commodity FX	The AUD and NZD should both find ongoing stability following the recent macro risk rebound
LATAM FX	Regional central banks continue to ease interest rates, while Chile stands out as the most resilient economy in the face of crisis
FX Asia	Re-escalating tension between the US and China look set to last at least through year-end, while challenges surrounding demand and portfolio flows will delay recoveries in regional currencies

Currency Outlook

End of Period:	May. 21/20	Q2 20	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
USD/CAD	1.39	1.41	1.43	1.40	1.37	1.38	1.39	1.41
EUR/USD	1.10	1.11	1.12	1.14	1.15	1.15	1.16	1.16
USD/JPY	108	105	104	103	101	100	100	99
GBP/USD	1.22	1.20	1.24	1.27	1.30	1.31	1.33	1.34
USD/CHF	0.97	0.95	0.97	0.95	0.95	0.95	0.94	0.94
USD/SEK	9.58	9.55	9.33	8.99	8.83	8.70	8.53	8.49
AUD/USD	0.66	0.66	0.65	0.65	0.66	0.66	0.67	0.68
NZD/USD	0.61	0.61	0.61	0.62	0.62	0.63	0.64	0.65
USD/NOK	9.92	9.82	9.64	9.43	9.26	9.09	8.84	8.62
USD/ZAR	17.64	18.10	17.75	17.50	17.20	17.00	16.85	16.60
USD/BRL	5.59	5.50	5.30	5.10	5.00	5.20	5.00	4.80
USD/MXN	22.9	22.0	21.0	22.0	21.0	20.5	20.5	20.0
USD/COP	3769	3800	3800	3600	3700	3600	3500	3500
USD/CLP	803	830	830	830	820	820	840	820
USD/CNY	7.11	7.12	7.07	7.02	6.97	6.90	6.80	6.70
USD/KRW	1231	1230	1225	1210	1195	1185	1175	1165
USD/INR	75.6	76.5	76.0	75.5	74.5	73.5	72.5	71.0
USD/SGD	1.41	1.43	1.43	1.42	1.41	1.41	1.40	1.39
USD/TWD	29.9	30.20	30.10	30.00	29.90	29.75	29.50	29.30
USD/MYR	4.35	4.42	4.35	4.25	4.15	4.05	3.95	3.85
USD/IDR	14710	15100	15000	14900	14750	14600	14450	14300

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Other Crosses

End of Period:	May. 21/20	Q2 20	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
CADJPY	77.40	74.47	72.73	73.57	73.72	72.46	71.94	70.21
AUDCAD	0.92	0.93	0.93	0.91	0.90	0.91	0.93	0.96
GBPCAD	1.70	1.69	1.77	1.78	1.78	1.81	1.84	1.89
EURCAD	1.53	1.57	1.60	1.60	1.58	1.59	1.61	1.64
EURJPY	118	117	116	117	116	115	116	115
EURGBP	0.90	0.925	0.905	0.895	0.885	0.880	0.875	0.865
EURCHF	1.06	1.05	1.08	1.08	1.09	1.09	1.09	1.09
EURSEK	10.52	10.60	10.45	10.25	10.15	10.00	9.90	9.85
EURNOK	10.89	10.90	10.80	10.75	10.65	10.45	10.25	10.00

Key Indicators- Latest Data Point

	Quarterly Real GDP (y/y %)	CPI (y/y %)	Current Acct (% of GDP)	Central Bank Rate (%)
US	0.3	0.3	-2.3	0.125
Canada	1.5	-0.2	-1.1	0.250
Eurozone	-3.2	0.3	2.7	0.000
Japan	-2.0	0.4	3.6	-0.100
UK	-1.6	1.5	-3.9	0.100
Switzerland	1.5	-1.1	12.3	-0.750
Sweden	0.8	-0.4	3.2	0.000
Australia	2.2	2.2	0.5	0.250
New Zealand	1.6	2.5	-3.3	0.250
Norway	1.1	0.8	3.4	0.000
South Africa	-0.5	4.1	-3.0	4.250
Brazil	1.7	2.4	-2.7	3.000
Mexico	-0.5	2.1	-0.2	5.500
Colombia	3.4	3.5	-4.3	3.250
Chile	-2.1	3.4	-3.9	0.500
China	-6.8	3.3	1.0	3.850
South Korea	1.3	0.1	4.2	0.750
India	4.5	6.7	-2.0	3.750
Singapore	-2.2	0.0	15.0	n/a
Taiwan	1.7	-1.0	11.4	1.125
Malaysia	0.7	-1.6	2.4	2.000
Indonesia	3.0	2.8	-2.7	4.250

CAD

Avery Shenfeld | Taylor Rochwerg

Oil Still Holding Back C$ Gains

Q3 20: 1.43 | Q1 21: 1.37 (USDCAD)

Oil's modest recovery over the past couple of weeks has seen the loonie pick up some strength relative to the weakness we saw back in mid-March, when the pandemic first ensued. But oil prices are still sitting at low levels, and the trend back to risk assets looks vulnerable, so we don't expect the C$ to hold onto that strength in the near-term. Markets could be pricing in slightly too much optimism as of right now. As the reality of depressed equity earnings, and the limitations on the recovery by the potential for a second wave set in, that would see a stall in oil's rebound, allowing USD/CAD to reach 1.41 by June and ending Q3 at 1.43.

Looking ahead to the first half of 2021, we expect the C$ to strengthen alongside a more pronounced economic recovery, whose timing is likely dependent on the evolution of the virus and progress towards a vaccine. Even so, Canada's weak trade record in the last cycle points to the need for a more competitive exchange rate in the longer-term, as the economy weans itself off of debt-financed consumption and housing as sources of growth. Look for USD/CAD to still be hovering around 1.41 by the end of next year, held back by the country's trade imbalance.

USD

Avery Shenfeld | Taylor Rochwerg

Greenback Giving Back Ground

Q3 20: 97.9 | Q1 21: 94.8 (DXY)

The dollar is still holding onto some of the flight to safety strength that it picked up during the early days of the pandemic. And while it may retain that in the near-term – especially considering the reignition of tensions with China - we expect the dollar to slowly give up ground over the course of this year and next. Having been the winner when pandemic fears were at their height, the dollar has room to give ground against other majors as those fears gradually abate.

We still see the US dollar as being relatively overvalued on trade and current account fundamentals, so looking longer-term, expect dollar strength to continue fading as other majors pick up some steam.

Jeremy Stretch | Bipan Rai

EUR Set to Recover Later This Year

Q3 2: 1.12 | Q1 21: 1.15 (EURUSD)

As of now, it's too early to tell if the Franco-German proposal for a €500bn rescue fund is an absolute game changer. However, it could eventually be seen as a template for fixing one inadequacy of the eurozone project - monetary union without fiscal transfers. The key point of the proposals, aimed at providing support for those countries and regions most disadvantaged by the Covid-induced economic fallout, is that the proposal is based upon grants, as opposed to loans. Providing funds without recourse to repayment is a material distinction from the euro debt crisis.

However, there still won't be any debt mutualization, absent treaty changes to the Functioning of the European Union (TFEU). We've seen the EU attempt to circumvent system, including via the recent German Constitutional Court ruling regarding the proportionality of the PSPP bond buying programme. But we do not expect the ruling to tie the hands of the ECB, as we look for the Pandemic Emergency purchase programme to expand further from its current €750bn, come the June 4th ECB decision. In addition, we could see asset purchases extend to those of non-investment grade.

An extension in monetary policy (PEPP) allied to ongoing fiscal spending, should see a positive spill-over from German fiscal loosening, which together should provide a more constructive backdrop for the euro into H2. For now, the EU rescue fund proposal currently comes with Covid-19 specificity. However, all the major players in Europe seemingly back the plan, and Germany has belatedly acknowledged that fiscal conservatism is no longer so appropriate. Fiscal support should lessen the reliance on negative rates in the medium-term, helping the euro grind back towards the mid-point of the long-term trading range, near 1.16.

Jeremy Stretch | Bipan Rai

JPY Holding Up With Little Yield Disadvantage

Q3 20: 104 | Q1 21: 101 (USDJPY)

Just as the Abe administration began ending the state of emergency, data was released that indicated that the Japanese economy had entered a recession. Of course, that's because the economy contracted in Q4 2019, as the consumption tax was raised for the first time in years. Unfortunately, the outlook for domestic economy doesn't look any better going forward, as key export partners are struggling to re-open.

Despite the domestic gloom, we're still expecting the JPY to remain firm, based on macro themes. For one, Japan's

massive net external surplus position remains supportive for the currency. Moreover, Japanese investors no longer have as much of an incentive to chase yield outside of the country, given the compression of yields since COVID-19 began. These are reasons enough to maintain a downward profile to our USD/JPY forecasts in the coming years.

Jeremy Stretch | Bipan Rai

Sterling to Keep Battling Headwinds

Q3 20: 1.24 | Q1 21: 1.30 (GBPUSD)

It may be mere coincidence, but the month of May has proved historically tough for Sterling versus the USD, falling in each of the last 10 years with the average decline being just over 2.1%. This month, the currency has lost around 2.5%, and we expect near-term headwinds to persist.

We look for leveraged players to rebuild shorts, as no-deal Brexit risks move back into focus. Moreover, with the scale of the potential correction in Q2 GDP likely to be greater than other comparative markets, due to the slower exit from the lockdown, sterling could temporarily trade below our 1.20 June-end target.

While the Bank of England is mindful of reviewing its effective lower bound, we would not expect, under current circumstances, the bank to determine that negative rates would benefit the UK economy. However, we could see the bank adopt further easing measures, such as an additional £100bn of QE. Those additional bond purchases would help mop up the £180bn of Gilt issuance between the May-July period.

We expect the UK economy to experience an unprecedented contraction in Q2, but assuming no second wave, we anticipate some macro resilience into year-end, partly due to government response measures. While we expect sterling to register modest gains versus a cheaper USD in H2, we expect near-term downside risks into mid-year, as no-deal Brexit risks advance. However, we're currently ascribing a 40% probability to such an outcome. Should the UK continue trade discussions into H2, avoiding movement towards a no-deal outcome, that will help facilitate a GBP rebound.

Jeremy Stretch | Bipan Rai

SNB Looking to Contain CHF Action

Q3 20: 1.08 | Q1 21: 1.09 (EURCHF)

The SNB has continued acting to contain CHF impetus, demonstrated by the uptick in total sight deposits. The CB has managed to avoid EUR/CHF breaching 1.05, though it has traded at lows since the end of Q1. The rational for continued action is avoiding disinflation. Annual prices eased to -1.1% in April, marking the lowest level since 2013. In terms of the SNB, we expect the Bank to continue to look beyond the fact that the CPI outlook will remain compromised for the foreseeable future.

Should EUR/CHF become pressured towards the 1.05 threshold, expect this to amplify concerns of potential SNB action. The Bank could take rates down to -1.00%, irrespective of actions by the ECB. Note that the next rate decision comes on June 18th. The central bank remains mindful of not only inflation, but also competitiveness. The CHF is still relatively strong, being the most overvalued major versus the EUR, according to OECD estimates. While the CB acts to contain potential safe haven flows, it will surely hope that events in the eurozone, within the context of potential future fiscal transfers, could limit SNB buying. That should allow EUR/CHF to gradually grind back towards the 200-day MAV at 1.08.

Jeremy Stretch | Bipan Rai

Further SEK Strength Lies Ahead

Q3 20: 10.45 | Q1 21: 10.15 (EURSEK)

Issues surrounding extreme lockdowns are not so pertinent for Sweden, as the country followed a rather different covid-19 containment strategy. Given that the economy didn't face an enforced lockdown, the drop in household consumption in March (down 5.4% in the month) suggests that consumers indulged in precautionary isolation.

Hence, Sweden's economy will likely still see a significant correction, led by retreating exports. However, the correction should be relatively more moderate than its peers, including the EU. With exports closely tied to Germany and the other Nordic nations (consisting of roughly 35% of exports), signs of a resuming activity in those markets will prove integral to long-run SEK demand.

In terms of monetary policy, we see little reason for the CB to consider lowering rates, aside from the CPIF subsiding to -0.4% y/y in April, given that the Riksbank remains painfully aware of the limitations of negative rates. For now, we expect the central bank to remain on hold. Should moderate optimism concerning a global recovery persist into 2021, expect the cyclically-correlated SEK to continue to perform well, following gains of 7.5% over the last two months against the USD.

Commodity FX

Jeremy Stretch | Bipan Rai

Expect NOK Gains to Continue

Q3 20: 10.80 | Q1 21: 10.65 (EURNOK)

In Norway, the oil sector accounts for nearly 10% of jobs and more than a third of exports. Therefore, in view of the

H1 capitulation in the sector, it's unsurprising that the NOK has been the lead underperformer amongst the majors year-to-date, losing 12% versus the USD and almost 10% versus the EUR.

The combination of a collapse in oil and the ravages of covid-19 prompted the Norges Bank to cut rates to zero. That was before Q1 mainland GDP came in below median expectations, at -2.1% q/q. But despite rates being taken to zero, the fact the central bank appears to be uninterested in taking rates into negative territory or indulging in QE suggests that further impetus rests in the hands of government fiscal policy, which is supportive for the NOK.

Norway was well-positioned to lean heavily on fiscal policy. The country went into the Covid-19 crisis with a positive budget balance, averaging 7% of GDP over the last seven years. The fiscal stimulus thus far, with another package likely to come within the next month, has been equivalent to roughly 5% of GDP. With the central bank passing the buck to the government, we've seen the country tap into the sovereign wealth fund. The government is set to utilise at least NOK420bn from the fund this year, prompting significant repatriation flows. The ability to avoid launching into negative rates or QE provides scope for the NOK to extend its recent gains into H2.

Jeremy Stretch | Bipan Rai

AUD: Stability On the Horizon

Q3 20: 0.65 | Q1 21: 0.66 (AUDUSD)

The Aussie is up over 4% since mid-April, thanks in large part to the recovery in macro risk and reversion from excessive losses to start the year. Additionally, the currency has benefitted from optimism, as the antipodean nations have been the first to re-open economies, after shutting down due to the COVID-19 crisis. On the policy front, the RBA is expected to keep rates at emergency levels well past this year, while continuing to target the 3-year yield at 0.25%.

Despite the 'feel good' tone for the AUD, there are headwinds looming. For one, the current spat with China (Australia's most important trading partner) over barley, meat and suspicion with respect to messaging over COVID-19, could threaten inward investment from China at the margin. Additionally, prior yield advantages are no longer there, and the AUD is expected to benefit far less from speculative flows relative to the past. Finally, trends toward de-globalization will naturally harm commodity proxies in the currency markets – including the AUD.

An earlier than anticipated dose of optimism has forced us to revise our AUD and NZD forecasts higher this month. As that confidence is tested, we see a stable environment for the AUD this year.

Jeremy Stretch | Bipan Rai

NZD: On the Rebound, But Still Defensive

Q3 20: 0.61 | Q1 21: 0.62 (NZDUSD)

Much like the AUD, the NZD has benefitted tremendously from the macro risk rebound, and its ability to re-open relatively quicker than most developed economies in the midst of the COVID-19 shock. Additional tailwinds come from the fiscal end, as the government has been proactive in spending. Indeed, looser fiscal policy is here to stay, with government debt levels set to rise above 50% in the coming years.

Much has been made about monetary policy – especially as markets were quick to price in higher odds of negative rates later this year. But the real story is the chance that the RBNZ will expand its asset purchases to potentially buy foreign assets later this year. This type of intervention probably won't raise too many eyebrows at this point, but we don't expect it to be sterilized and this will naturally keep the NZD on the defensive relative to the AUD.

Jeremy Stretch | Bipan Rai

ZAR: A Function of Risk Appetite

Q3 20: 17.75 | Q1 21: 17.20 (USDZAR)

After significant net bond selling by foreign purchasers in late April, South Africa was removed from the FTSE WGBI Global Bond Index. Since then, we've seen bond portfolios being rebalanced and external interest return to domestic bond markets. After 10-year rates peaked above 12.3% in late March, yields have now come down by almost 350 bps. As well, UST-SA bond spreads have compressed by over 3% in that period. Yields sitting above 5% underlines the attraction for investors who are prepared to accept that such a yield advantage is set against sizeable risks, as the ZAR remains a material underperformer in extreme risk-off scenarios. In terms of positioning, investors have added to speculative ZAR positions for six weeks now, thereby leaving the long positioning skew at a two-month high.

Yield-based investor appetite, as indicated by speculative investor flows, has helped the ZAR gain almost 5% versus the USD over the past month, and ongoing buying impetus will remain a function of broader risk appetite. The CB is set to continue providing monetary stimulus, the government announced a ZAR500bn budget package - taking the budget deficit towards 15% of GDP. The government is arguably no longer cowed by concerns over a ratings downgrade. The combination of aggressive fiscal measures alongside yield advantages suggests that, absent another bout of risk negativity, we continue to expect a positive ZAR backdrop.

LATAM FX

Luis Hurtado

Slight Relief for the MXN

Q3 20: 21.0| Q1 21: 21.0 (USDMXN)

In its latest rate decision, Banxico cut the overnight rate by 50 bps to 5.5%, in line with market consensus and our forecast. This wasn't relatively surprising, as the market was already pricing in a much lower year-end overnight rate before the announcement. However, the initial market reaction suggests that the decision was not more dovish than investors were expecting. However, the announcement did not preclude further rate cuts nor signal a lower magnitude of rate cuts going forward. Hence, we expect the overnight rate to end 2020 at 4.0%, given the lack of a significant fiscal response and the quick and steep deterioration of growth prospects.

We expect MXN volatility to remain elevated, given the deterioration of growth prospects and the peso's correlation to external news and US equities. That being said, we continue to see value in short USD/MXN positions on spikes toward the 25-25.55 range. No news is good news for the MXN, as the market has already priced in most of the country's fiscal uncertainties and political risks. Moreover, Mexico's considerable exposure to the US makes the country a primary beneficiary of a potential stabilization of the COVID-19 outbreak into late Q2 to Q3, while the MXN high carry relative to regional currencies should revive the market's interest in the currency alongside any signs of improvement in the global economy.

Luis Hurtado

Political headwinds Facing the BRL

Q3 20: 5.30 | Q1 21: 5.00 (USDBRL)

USD/BRL continued its upward trend since our last publication, approaching the 6.0 mark, following a Supreme Court investigation on President Bolsonaro and his family. The scandal already caused the resignation of the former head of the federal police and the Minister of Justice Sergio Moro, via alleged political pressures by the president. This situation will likely dominate Brazil's political environment for a few months, while investigation leaks will continue to be harmful for those with long BRL positions.

On the monetary policy front, the BCB cut the overnight rate by 75 bps to 3.00%, against market consensus and our 50bps forecast. Moreover, it also signalled another rate cut - but not larger than 75bps - at its next meeting. As a result, we've revised our Selic rate forecast to 2.0%-2.25% by the end of 2020. The clear dovish stance by the BCB, despite larger fiscal risks, should also put pressure on the BRL in the short-term. Furthermore, we note the ongoing large portfolio outflows, as political turmoil crowds local headlines. Hence, we revised our USD/BRL forecast for Q2 to 5.50.

Luis Hurtado

Limited Enthusiasm for the COP

Q3 20: 3800 | Q1 21: 3700 (USDCOP)

The last few weeks have prompted economists to revise their GDP growth forecasts lower. Average GDP estimates now sit at roughly -4% - a significant deterioration from the -2% predicted last month, and the initial +3% expected for this year. On the fiscal front, the Fiscal Rule Committee (CCFR) allowed the central government to increase its deficit by 6.1% this year, from 4.9% (and 2.2% at the start of 2020). This reflects lost revenue and increased expenditures due to COVID-19.

On the monetary front, we expect the CB to continue easing and cut the overnight rate by 50bps before the end of Q2. Although the timing of the opening and recovery of the economy makes it extremely difficult to assess the end-point of the easing cycle, we do not discount that the overnight rate could end up between 2.25%-2.75% by year-end.

Following the sharp drop in oil prices over the last two months, we expect short-term USD/COP volatility to remain high, as fiscal and external account concerns persist. Nevertheless, we maintain our strategic view of a USD/COP at 3800 by the end of Q2, and at 3600 by year-end. A ceiling for USD/COP appears to have formed in the 4100-4200 range, even following the stream of negative news hitting the Colombian economy over the past month.

Luis Hurtado

CLP: Resilient in the Face of Crisis

Q3 20: 830 | Q1 21: 820 (USDCLP)

In line with expectations, the Central Bank of Chile maintained the overnight rate at 0.5% in its latest rate announcement. The statement read very dovish on the economic growth outlook, it dismissed inflationary pressures resulting from the depreciation of the peso, and it restated that it will keep rates at 0.5% for a prolonged period of time. As the government's fiscal responses takes the lead, we see this as neutral for the CLP.

Despite potential further risk-off moves, given the recent polarization of the US-China relationship, the recent rebound of copper prices and Covid-19 vaccine hopes pushed USD/CLP below the 820 mark. Moreover, the Chilean government's rapid response to the virus outbreak has put the country in a much better position than its regional peers. The delay of the new constitution process until Q4 2020 has placed political risks on hold, as investors

focus on the reopening of the local economy, thereby providing a supportive environment for the recovery of the peso. We expect the CLP to outperform most of the regional currencies on the back a better fiscal position and much stronger public institutions. Nevertheless, as we approach early March lows, we expect to see strong USD/CLP support at 807 - a level difficult to envisage breaking, given the still-elevated risks for the global and local economies.

Asia FX

Patrick Bennett

USD/Asia

Q3 20: 7.07 | Q1 21: 6.97 (USDCNY)

As the world deals with challenges stemming from the coronavirus, heightened US-China trade tension and accusations surrounding concealing the source of the virus are to our view, part and parcel of a widespread hawkishness towards China. That is unlikely to pass anytime soon.

To date, though the market has moved to sell both CNY and CNH on a number of occasions, the market has held reasonably firm, anchored in part by stable USD/CNY fixings. Even so, the CNY, CNH, and KRW - via trade association and the high beta nature of the currency - have been underperformers amongst the Asian currencies, with all softer by roughly 0.5% against the USD over the last month.

There has been talk of China responding to the tensions with a weaker yuan. However, our view remains that any deliberate devaluation of the Chinese currency, by way of sharply higher fixings or otherwise, is highly unlikely, as doing so would walk back long-articulated commitments on opening up the financial system and economy to international norms, as well as risking domestic economic stability via the path of potential capital outflow.

Any extent that USD/CNY and USD/CNH trade higher on a broadly firmer USD are excluded from the idea of a deliberate devaluation. Year-to-date, both CNY and CNH are softer against a stronger USD, but with losses of just 2.1% and 2.3%, respectively. The moves are on the better side of the major currencies' performances, as well as amongst the other Asian currencies.

Pressure on China from President Trump and his administration that has been recently ramped up won't likely fade given the looming November election and the ongoing virus situation. Despite that recent suggestions that Trump was unhappy with the Phase One Deal and its implementation were somewhat calmed by reports of a bilateral phone call between high level negotiators on both sides, President Trump publicly maintained his general hawkishness towards China.

We're previously noted that an escalation of US-China tensions will likely play to the further deterioration of globalization and the emergence of regionalization. Over the last months, we've seen the expansion of intra-regional trade, and we will continue to monitor that. We continue to believe that Asia fits well within such a new regime, and that China will be relatively strong within its region. Asian economies' traditional roles as 'feeders' to China for re-export is not quite as strong as it used to be, but China remains a leader within the region.

Asian currencies, for the most part, have remained on the defensive year-to-date, although the IDR and INR both saw strong rebound gains over the last month. Stability in the Chinese currency can continue to act as an anchor, as well as a lower USD and improving global sentiment. But with a number of major economies remaining in lockdown, economies that are leveraged to external trade and to global demand more generally remain more vulnerable than others. For example, South Korea, given its extensive trade linkages to China and to global consumer demand, has come under pressure recently. Furthermore, the economies that were relatively exposed via deficits in their trade, current, or fiscal accounts – notably India – are now also underperforming.

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