FOREIGN EXCHANGE OUTLOOK

June 2017

AMERICAS

The USD retains a soft undertone and we think the longer run secular bull run is close to – or may have reached – a peak. Both the CAD and MXN have stabilized; positive growth data have bolstered the CAD and higher interest rates have supported the MXN.

EUROPE

EURUSD has strengthened further in May, benefitting from capital outflows from the US amid heightened political risk. Sterling, on the other hand, has weakened and will likely retain a defensive feel ahead of the June 8th general election.

ASIA-PACIFIC

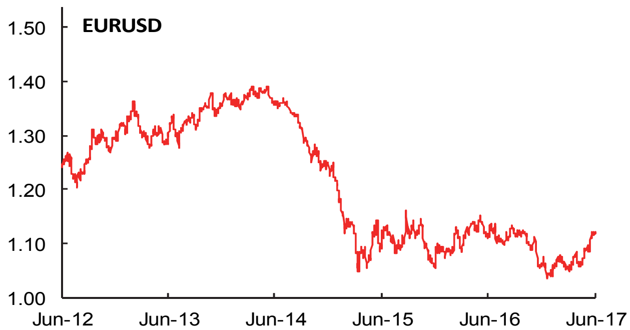
The JPY has been stable over the past month but typically strengthens through mid-year. The Chinese authorities are attempting to reduce volatility in the CNY further. The NZD has gained on improved terms of trade, while the AUD has weakened.

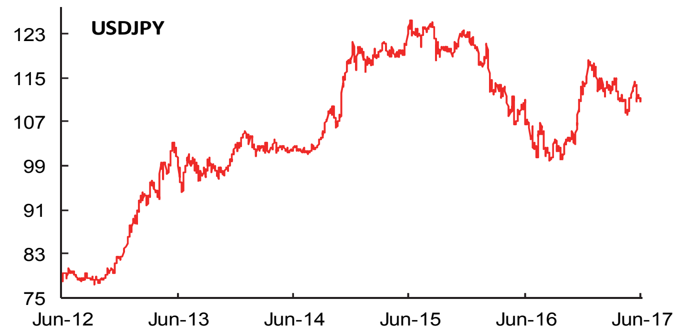
CONTENTS

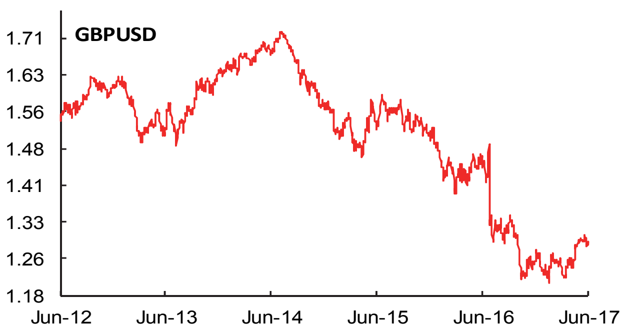
Core Exchange Rates

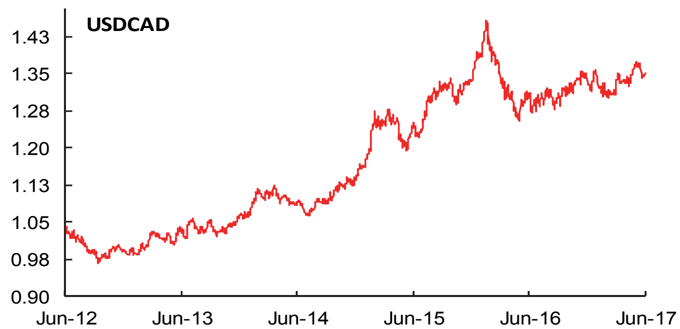
Global Foreign Exchange Outlook

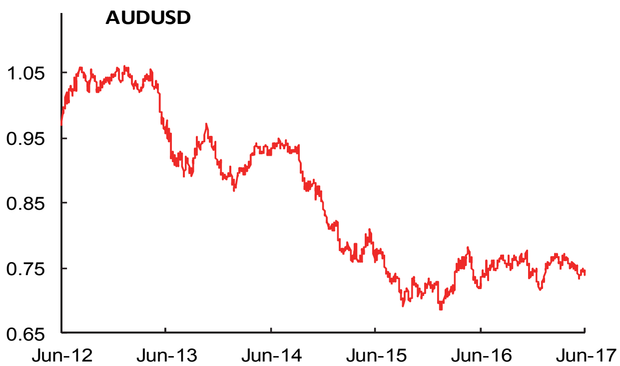
		2017f				2018f			
June 1, 2017	**Spot**	**Q1a**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
EURUSD	1.12	1.07	1.02	1.05	1.10	1.12	1.12	1.15	1.15
USDJPY	111.4	111	115	117	117	121	121	122	122
GBPUSD	1.29	1.26	1.20	1.25	1.25	1.30	1.30	1.35	1.35
USDCAD	1.35	1.33	1.40	1.38	1.36	1.36	1.34	1.32	1.30
AUDUSD	0.74	0.76	0.76	0.75	0.75	0.75	0.75	0.78	0.78
USDMXN	18.62	18.72	19.27	19.86	20.39	20.60	20.45	20.51	20.79











Market Tone & Fundamental Focus

Shaun Osborne, 1.416.945.4538
Foreign Exchange Strategy
shaun.osborne@scotiabank.com

The US dollar (USD) remains soft, with the dollar index (DXY) now back to levels prevailing around the time of the US Presidential election in November. US longer-term yields have retreated and the USD has fallen as the “Trump trade” has deflated. Investors are concerned that persistent focus on allegations surrounding Russian attempts to influence the outcome of the election will impinge on the administration’s ability to advance its pro-growth agenda. With uncertainties rising, the outlook for the USD looks less buoyant than just a few weeks ago.

The US economy will recover from its Q1 growth stumble and the Federal Reserve is widely expected to tighten policy by 25 bps at the upcoming policy meeting (June 14th) but the asymmetric growth and diverging monetary policy narrative has faded somewhat in recent weeks. Global growth momentum is picking up, narrowing the US’ expected growth advantage this year. Moreover, markets are less convinced that the Fed will follow up with a third rate increase after the June move (we continue to look for additional tightening) and are more concerned that other central banks are closer to moving away from extreme policy accommodation. We have long expected the secular bull trend in the USD to moderate from H2 2017 onwards but have to recognize the risk that subtle changes in the market’s perception of risks around the growth and policy outlook may mean that the USD is already at or near a longer run peak against its major currency peers.

These broader considerations are relevant for the Canadian dollar (CAD); the currency retained a defensive undertone through early May, falling to near 1.38 versus the USD before stabilizing. Persistent speculative pressure on the CAD through late April and early May has failed to weigh on the currency. Canadian economic data reflected stronger Q1 growth while crude oil prices recovered on the OPEC-led production curb extension. Stronger growth trends suggest that excess capacity in the Canadian economy is being slowly reduced but we think rate increases are a distant prospect. We had expected the USDCAD rally to stall around 1.40 through mid-year and again have to concede the risk that the broader trend appreciation in the USD is closer now to a peak. Our directional bias is changing and we favour fading USDCAD gains from here.

The major European currencies have experienced mixed fortunes through May; the Euro (EUR) has strengthened broadly, reflecting positive economic momentum. A relief bid following the win for Monsieur Macron in the French presidential election run-off has also supported the currency. We think the transfer of political risk from the Eurozone to the US has also prompted capital inflows into Eurozone stocks, supporting the EUR. Some European Central Bank (ECB) members are militating for an early end to the central bank’s accommodative policy stance but we expect the current asset purchases programme to be fully completed and rates to rise only in 2018. Here too, however, the risk/reward proposition for EUR shorts is looking much less compelling as growth trends improve and political worries have (for now, at least) receded. We had expected EURUSD to trough around 1.02 mid-year but the early 2017 low of 1.03 may well represent the low point for the cycle.

The GBP has struggled in the past month. Prime Minister May’s snap election call in late April surprised the markets but a strong lead in the opinion polls suggested that the ruling Conservatives were on their way to a significant (or even “landslide”) win over Labour. More recently, tighter polling, implying a closer race on the June 8th election day, has weighed on the GBP. The Conservatives remain likely to win but the size of the working majority may well shape the GBP’s reaction to the vote.

The Australian and New Zealand dollars (AUD and NZD, respectively) have experienced mixed fortunes through May, with the NZD out-performing while the AUD under-performed in the G-10 space. This evolution may persist as it reflects a shift in relative terms of trade (higher NZ dairy prices versus weaker iron ore prices for Australia).

The Japanese yen (JPY) is little changed in the past month. Weak inflation and sluggish growth suggest the Bank of Japan will maintain an easy policy bias for the foreseeable future. However, the JPY has picked up support via “safe-haven” demand in times of geo-political risk or equity market volatility. The JPY may remain better supported near term. Seasonal studies reflect a bias towards JPY appreciation in June and August over the past 25 years on average which coincides with the seasonally weak part of the calendar year for US equity markets.

The Mexican peso (MXN) has stabilized around 18.50 versus the USD with the help of tighter Banxico monetary policy. Firmer crude oil prices and easing concerns, for now, regarding NAFTA renegotiations have also helped lift the MXN. LATAM FX trends are mostly softer in May; local politics continues to weigh on the Brazilian real while soft metals prices have kept the Chilean peso on the defensive. The Colombian peso has out-performed on the back of stronger crude oil prices while the Peruvian sol is weaker in response easier to monetary policy following the slowdown in growth as a result of adverse weather conditions earlier in the year.

Canada
Currency Outlook

Shaun Osborne, 1.416.945.4538
Foreign Exchange Strategy
shaun.osborne@scotiabank.com

The CAD has improved through most of May, having spent the latter part of April and the early part of the past month under significant pressure, falling for ten consecutive days against the USD through that period. The CAD remains one of the weakest-performing major currencies of 2017 but that means it is virtually flat against the USD since the start of the year.

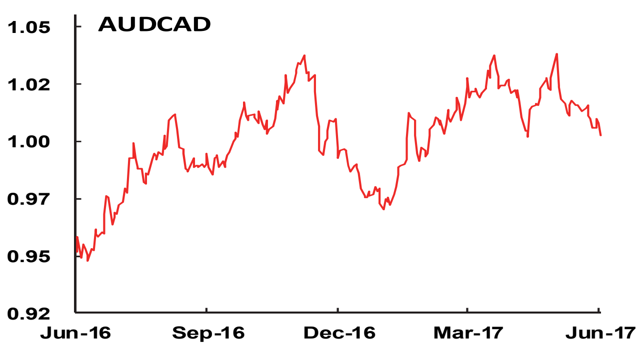
Lower oil prices and wider US-Canada short-term interest rate spreads account for much of the pressure on the CAD at the start of the month. Signs of softness in the local housing market piqued the interest of CAD short sellers in the past few weeks but the build-up of a massive (record) net short CAD position via the futures market has not translated into additional losses. Uncomfortably, for the CAD shorts, the currency has actually strengthened as net shorts increased in the past few weeks.

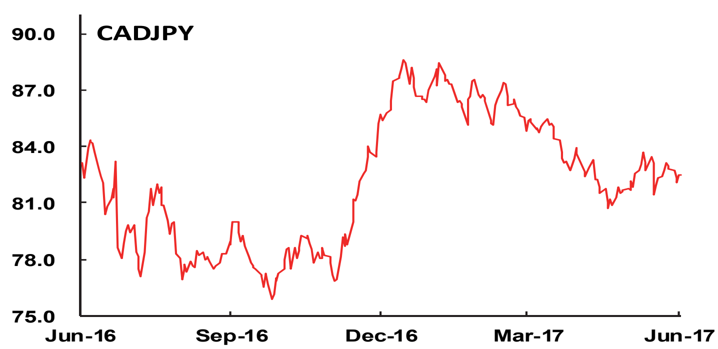
Short sellers are perhaps being a little myopic and focusing only on some signs of softness in Canadian housing (nothing significant at this point) and clear stress in the relatively small alternative home lender space. These issues are unlikely to lead to significant problems, we feel. At the same time, crude oil prices have recovered from the early May weakness and domestic growth trends remain relatively strong. Inflation remains low and we think the risk of a Bank of Canada rate increase remains very remote at this point but US-Canada spreads have steadied.

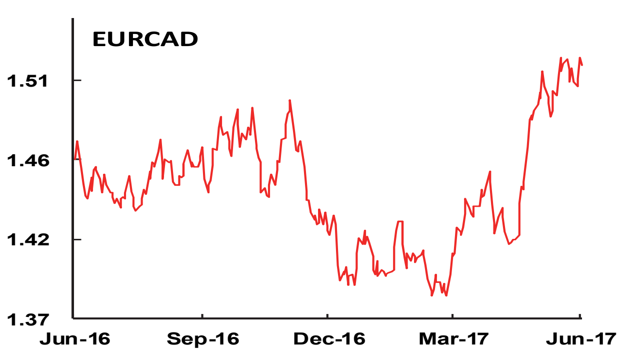
With the USD having neared our Q2 target of 1.40 at the start of May, we have to ponder how much more downside risk there is in the CAD at this point. Our answer is; probably not that much – we think we might have seen the top of the USD bull cycle in early May. The CAD may not improve that much in the near term but downside risks do seem to be diminishing a little.

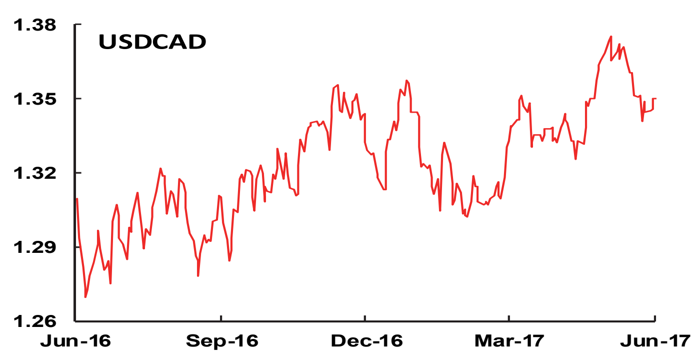
Canadian Dollar Cross-Currency Trends

FX Rate	Spot 1-Jun	17Q1a	17Q2f	17Q3f	17Q4f	18Q1f	18Q2f	18Q3f	18Q4f
AUDCAD	1.00	1.02	1.06	1.04	1.02	1.02	1.01	1.03	1.01
CADJPY	82.5	83.6	82.1	84.8	86.0	89.0	90.3	92.4	93.8
EURCAD	1.51	1.42	1.43	1.45	1.50	1.52	1.50	1.52	1.50
USDCAD	1.35	1.33	1.40	1.38	1.36	1.36	1.34	1.32	1.30









United States and Canada

Fundamental Commentary

Brett House, 1.416.863-7463
Scotiabank Economics
brett.house@scotiabank.com

Adrienne Warren, 1.416.866.4315
Scotiabank Economics
adrienne.warren@scotiabank.com

UNITED STATES — The US economy stumbled in early 2017, with real GDP growth advancing at an annual rate of just 1.2% in Q1. The slowdown was primarily attributable to a sharp pullback in consumer spending which has since shown signs of rebounding. Consumer fundamentals—a robust job market, rising incomes, and improved household balance sheets—remain favourable. Labour market conditions continue to tighten, with the unemployment rate at a decade-low 4.4%. Consumer sentiment and major purchase plans have wavered somewhat in recent months, but remain elevated. Home sales and starts are still trending higher and could get a temporary boost from lower mortgage rates. Meanwhile, non-residential construction is being bolstered by strengthening commercial projects. Services activity is expanding across a range of industries, led by financial and professional services. Recent data continue to point to a broad recovery in industrial production, though a weakening in core durable goods orders is signalling some renewed softness in businesses investment. Infrastructure spending and personal and corporate tax cuts are expected to provide a modest boost to growth later this year, though the timing and extent of government stimulus remains uncertain. Net trade should exert a drag on growth amid rising import demand and a strong US dollar. Price pressures remain muted, with an appreciated greenback continuing to suppress goods inflation. Core inflation slowed to an 18-month low of just 1.9% y/y in April.

CANADA — The Canadian economy led G7 nations in Q1 growth, with output increasing at close to a 4% annualized rate. Output gains continue to be led by the consumer and housing sectors: home and auto sales through April were still near record levels, and housing starts remain elevated. Household spending and confidence are being supported by low interest rates, increased government transfers, and robust job growth. Monthly job gains have averaged 31,000 since last August, pushing the unemployment rate to a cycle low of 6.5%. Even so, weak wage gains and elevated household debt are expected to moderate consumption growth this year, while affordability pressures and new regulations should cool housing activity. Service sector activity remains brisk, with notable gains in the financial, professional, and hospitality industries. Public infrastructure spending, though proceeding slower than planned, remains supportive of growth. Business earnings and capital goods investment spending are rebounding, led by the oil and gas sector, though ongoing US policy uncertainty may be delaying major expansion plans in export-intensive sectors: exports have continued to disappoint despite a weaker Canadian dollar and signs of improving global industrial activity. Non-energy export volumes in the first quarter of 2017 were 4% below year-ago levels. Core inflation remains on a downward trajectory, consistent with persistent economic slack. The average increase in the Bank of Canada's new preferred core inflation measures slowed to just 1.4% y/y in April.

Derek Holt, 1.416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com

Monetary Policy Commentary

UNITED STATES — We expect the Federal Reserve to hike at the June 14th FOMC meeting and once more this year in December. In between these hikes we expect the FOMC to evaluate growth and particularly inflation dynamics after both have waned over this year. Just as it took several months for inflation evidence to begin waning, it is likely to take at least as long to have comfort in assessing whether a soft path is transitory in nature. Guidance from the minutes to expect reduced reinvestment in a capping approach this year will be fighting the calendar such that a signal that such a move is drawing nearer would likely include statement codification of the policy shift in advance. We expect reduced reinvestment commencing in December.

CANADA — No rate change is expected this year with the overnight lending rate ending 2016 at 0.5%. A pair of rate hikes is expected next year starting in summer. After Q1 GDP growth of 3.7%, there is now little to no spare capacity by twin output gap measures. That growth rate was in line with the BoC's upwardly revised estimate in the April MPR and hence it probably did not materially alter Governor Poloz's "decidedly neutral" bias. It is as possible to poke holes in both dovish and hawkish arguments which may suggest there is no compelling urgency to alter the policy bias. It is possible that noninflationary long-run potential GDP growth is being underestimated at the same time as ongoing risks to US trade policy, a mature household cycle, falling core inflation and weak wage growth suggest caution. That exports remain soft is an added concern while nascent evidence of an investment recovery could raise disinflationary spare capacity.

G10

Currency Outlook

Eric Theoret, 1.416.863.7030
Foreign Exchange Strategy
eric.theoret@scotiabank.com

EUROZONE — EUR was the second strongest G10 currency in May, notching up a near-3% gain vs. the USD on the back of a continued migration of political risk to the U.S. from Europe. Equity flows propelled EUR well above levels implied by spreads, and net long CFTC positioning climbed to a multi-year high. However, the re-emergence of Greece- and Italy-related risk has generated a clear shift in sentiment with options markets once again pricing a premium for protection against EUR weakness. EUR is trading well above our Q3 2017 forecast of 1.05 and closer to our Q1 2018 forecast of 1.12.

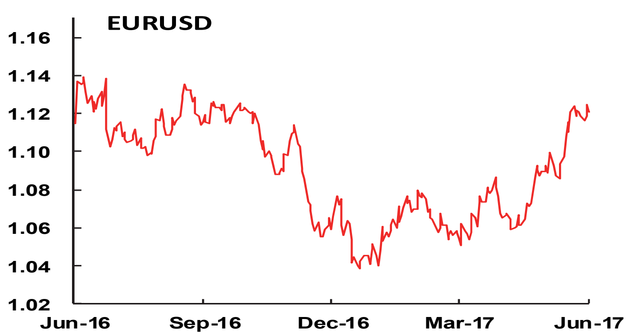
UNITED KINGDOM — GBP underperformed all of the G10 currencies in May as market participants assessed the implications of the Conservatives' shifting prospects into the June 8 election. Political risk is set to remain elevated, with the tone of Brexit negotiations expected to dominate thereafter. Options markets are suggestive of a renewed focus on downside risk with risk reversals showing a rising premium for protection against GBP weakness. We remain constructive on GBP from a longer-term perspective, with a Q4 2018 forecast of 1.35. We hold a Q3 2017 target of 1.25.

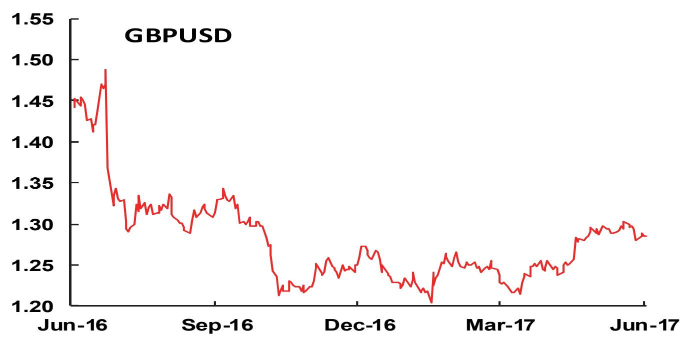
JAPAN — JPY is entering June at the upper end of its year-to-date range, threatening a push to the April highs on the back of a narrowing in interest rate differentials and an increasingly tentative market tone. U.S. political developments are the core focus, and geopolitical concerns are ongoing. JPY's risk profile leaves it vulnerable and CFTC positioning is net short. Risk reversals are pricing a sizeable premium for protection against JPY strength, with some measures threatening a push to levels last seen in early November. We hold a fundamentally-driven weak JPY forecast with a Q3 USDJPY target of 117.

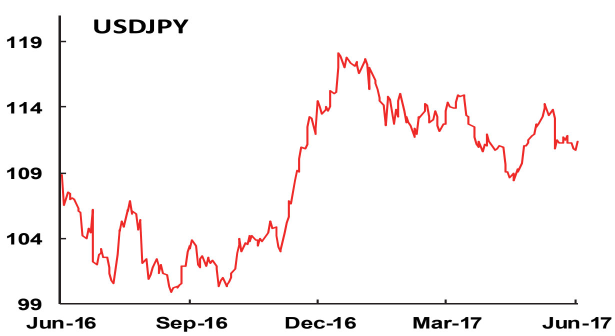
AUSTRALIA — AUD has staged a modest recovery from its multi-month low in early May and is entering June at the mid-point of its year-to-date range. China remains the dominant driver as policymakers seek to manage growth in the context of elevated financial stability risks. Iron ore is weak trading close to its year-to-date low and the 2Y Australia-U.S. yield spread has narrowed to levels last seen in 2001. We are neutral AUD and hold a Q3 target of 0.75.

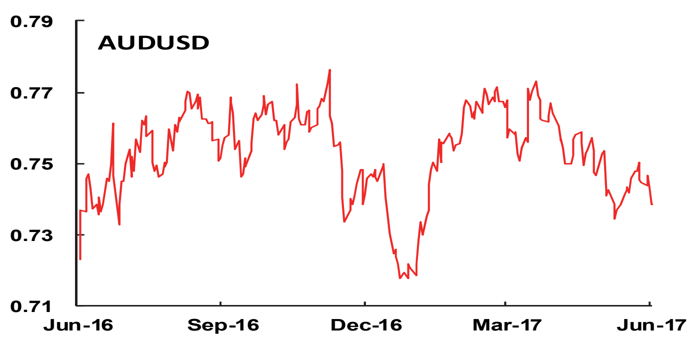
Currency Trends

FX Rate	Spot 1-Jun	17Q1a	17Q2f	17Q3f	17Q4f	18Q1f	18Q2f	18Q3f	18Q4f
EURUSD	1.12	1.07	1.02	1.05	1.10	1.12	1.12	1.15	1.15
GBPUSD	1.29	1.26	1.20	1.25	1.25	1.30	1.30	1.35	1.35
USDJPY	111	111	115	117	117	121	121	122	122
AUDUSD	0.71	0.76	0.76	0.75	0.75	0.75	0.75	0.78	0.78









G10
Fundamental Commentary

Alan Clarke, 44.207.826.5986
Fixed Income Strategy
alan.clarke@scotiabank.com

Tuuli McCully, 65.6305.8313
Scotiabank Economics
tuuli.mccully@scotiabank.com

Frédéric Prêtet, 33.1.703.77705
Fixed Income Strategy
frederic.pretet@scotiabank.com

EUROZONE — Eurozone GDP rose +0.5% q/q in Q1, the 16th consecutive quarter of expansion; further acceleration likely lies ahead. Indeed, (1) financial conditions are still very loose with real yields at records lows, equity markets rallying, credit spreads tightening, and the euro nominal effective exchange rate below its long-term average; (2) the degree of fragmentation inside the Eurozone has fallen: compared to 2010–11, increasing confidence is broadly-based across member countries, making the recovery more likely to be sustained; (3) budget policy is no longer an obstacle to growth: the European Commission expects the eurozone-wide structural primary surplus to drop from 1.2% of GDP in 2016 to 0.6% in 2018; (4) global demand is strengthening: in line with Scotiabank Economics' projections, the IMF revised world growth to 3.5% and 3.6% this year and next respectively, up from 3.1% in 2016; and (5) political risks are receding following the Dutch and the French elections. All in all, there is room for a significant acceleration of Eurozone GDP growth over the remainder of 2017. This should strengthen the case for the ECB to begin considering more explicitly its strategy for a staged exit from exceptional monetary accommodation, with communication on this likely to follow over the summer months. Nonetheless, the pace of exit is likely to be linked to the outlook for inflation. On this point, recent data have been more mixed and the lack of pickup in core inflation in particular should push the ECB to remain cautious and move on a gradual basis.

UNITED KINGDOM — The UK economy slowed sharply during Q1-2017, but there is a glimmer of hope that there will be a bounce -back during Q2. In particular, the PMI surveys have rebounded as have retail sales. However, we believe that any recovery in GDP during Q2 is likely to be temporary and the quarterly pace of growth will resume a downwards glide-path during H2. We now expect GDP growth of around 1.7% y/y during 2017, before decelerating further to 1.2% y/y in 2018. CPI inflation is now a fair margin above the Bank of England's 2% inflation target at 2.7% y/y, with further upside likely in the coming months. We expect a peak in headline inflation of 3¼% in the autumn. Thereafter, we expect inflation to return towards the Bank of England's 2% target over the subsequent 18 month period. Domestically generated inflation has remained muted. This is one of a number of reasons why we expect the BoE to remain on hold this year. The rationale is that the Bank cannot really control imported inflation, but it can have an influence over domestically generated (services) inflation. Hence as long as services inflation remains subdued, the BoE will be able to look through the target overshoot in overall inflation.

JAPAN — The Japanese economy had a very strong start to the year. According to preliminary estimates, real GDP grew by 0.5% q/q (non-annualized) and 1.6% y/y in the first quarter, exceeding the country's low potential growth of less than ½% y/y. Activity was reasonably broadly-based, yet the external sector was an important source of growth as Japanese exports have rebounded on the back of strengthening global demand. Stimulative fiscal and monetary policies will continue to support the economy through 2018. We expect Japan's output growth to average 1.2% y/y in 2017 and 0.7% in 2018. The period of deflation appears to be over in Japan, yet price gains remain minimal: the headline and core (excl. fresh food) inflation rates stood at 0.4% y/y and 0.3% y/y, respectively, in April. We do not anticipate the Bank of Japan's (BoJ) 2% y/y inflation target to be met in the foreseeable future given subdued wage growth (real cash earnings dropped by 0.3% y/y in March). We expect the headline inflation rate to reach 0.8% y/y by the end of 2017 and 1.1% by end-2018. The BoJ's next monetary policy meeting is scheduled for June 16. The short term policy rate and the 10-year yield target will likely be kept at -0.1% and 0%, respectively, over the coming months. In our view, market speculation regarding reduced monetary stimulus by the BoJ is premature.

AUSTRALIA — Australia's Treasurer Scott Morrison delivered the Federal Budget for fiscal year 2016–17 (July–June) on May 9. The country's budget deficit is expected to narrow from an estimated AUD37.6 bn (2.1% of GDP) in 2016–17 to AUD29.4 bn (1.6% of GDP) in FY2017–18. The budget forecasts a return to a fiscal surplus by FY2020–21. Standard & Poor's reaffirmed Australia's "AAA" sovereign credit rating in mid-May, and maintained a "negative" outlook on the rating. The rating agency remains pessimistic about the Australian government's ability to close the existing budget deficit by mid-2021. S&P noted that risks to government revenues remain negative; moreover, it assesses that the government may find passing further savings or revenue policies challenging. Meanwhile, Fitch and Moody's maintain Australia's triple-A rating with a "stable" outlook. The Reserve Bank of Australia (RBA) will likely leave the benchmark cash rate at 1.5% over the coming quarters in order to support domestic demand. A cautious monetary tightening phase will likely commence in the second half of 2018. The RBA will carefully monitor developments in the labour and property markets; employment metrics continue to show mixed signals while the real estate market remains heated in certain Australian cities, particularly in Sydney and Melbourne. Australian real GDP will likely increase in line with the country's potential growth rate of 2½% y/y in 2017–18.

China, India, Brazil

Currency Outlook

Qi Gao, 65.6305.8396
Foreign Exchange Strategy
qi.gao@scotiabank.com

Eduardo Suárez, 52.55.9179.5174
Scotiabank Economics
eduardo.suarez@scotiabank.com

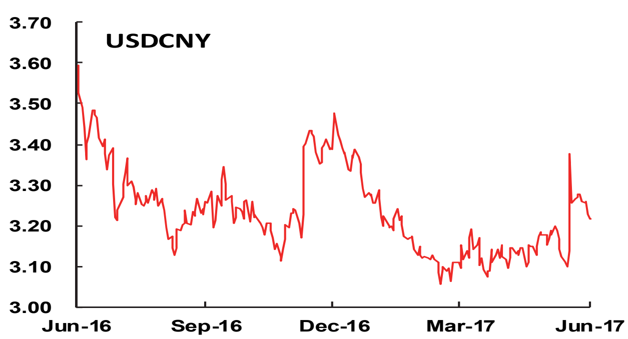
CHINA — We think China has introduced a counter-cyclical factor (CCF) to the pricing mechanism of USD/CNY fixing. The CCF is able to curb speculation about one-way yuan movements and reduce the role of USD/CNY closing price. A more stable fixing is expected going forward. Onshore yuan liquidity conditions could tighten intermittently in June on account of CNY 431.3bn of maturing MLF loans, the central bank's Q2 MPA assessment and the prospect of a Fed rate hike.

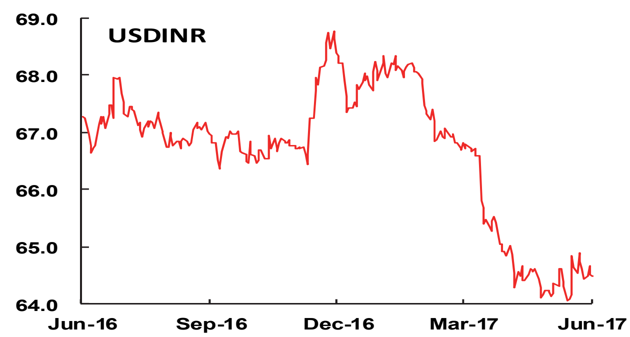
INDIA — India's foreign reserves rose to a record high of USD 379.31bn as of 19 May amid continued portfolio inflows. The government scrapped FIPB on 24 May in a move to reduce red tape in government and facilitate ease of doing business. Normal or above-normal monsoon rainfall would keep the nation's retail inflation benign and support the INR. Meanwhile, we stay cautious on NPAs of public and private banks. USD/INR is expected to reach 65.5 at the end of June.

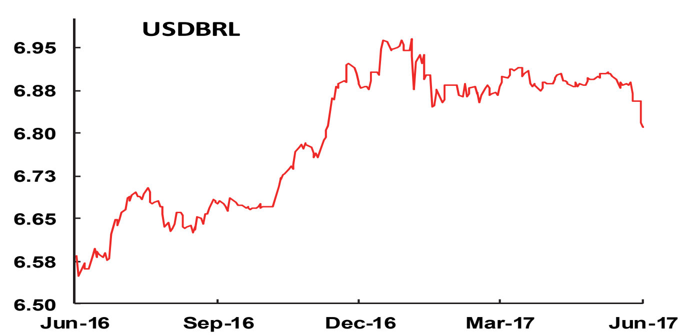
BRAZIL — After a very strong run for the Brazilian real over the past couple of years, which was supported by improvements on the public finance front, as well as optimism over structural reforms, a new chapter in the Lava Jato scandal has caused a renewed bout of concern and volatility. It's too early to tell how serious this threat is, but as we get a better handle of the situation, look for heightened volatility.

Currency Trends

FX Rate	Spot 1-Jun	17Q1a	17Q2f	17Q3f	17Q4f	18Q1f	18Q2f	18Q3f	18Q4f
USDCNY	6.81	6.89	6.90	6.95	7.00	6.95	6.95	6.90	6.90
USDINR	64.5	64.9	65.5	66.0	67.0	66.0	66.0	65.5	65.5
USDBRL	3.22	3.12	3.25	3.30	3.35	3.45	3.45	3.50	3.45







China, India, Brazil

Fundamental Commentary

Tuuli McCully, 65.6305.8313
Scotiabank Economics
tuuli.mccully@scotiabank.com

Eduardo Suárez, 52.55.9179.5174
Scotiabank Economics
eduardo.suarez@scotiabank.com

CHINA — China's economic growth will likely decelerate through the remainder of the year after a strong start to the year. High frequency indicators—such as purchasing managers' indices for the manufacturing and services sectors, industrial production, and fixed asset investment—lost some steam in April. Nevertheless, China is well positioned to meet the official real GDP growth target of "around 6.5%" in 2017. Investor concerns regarding China's economic growth deceleration and increasing leverage have re-emerged. Accordingly, Moody's downgraded China's sovereign credit rating by one notch to "A1" on May 24, and assigned a "stable" outlook to the new rating. The country may be subject to another rating revision over the coming quarters: Standard and Poor's rate China in the "AA-" category with a "negative" outlook. Consumer price inflation remained low in April; the CPI rose by 1.2% y/y following a 0.9% increase in March. Price gains will likely accelerate gradually over the course of the year, with inflation closing 2017 at 2.2% y/y. The People's Bank of China's (PBoC) quarterly monetary policy report—published in May— highlighted the central bank's commitment to maintaining a prudent monetary policy stance, keeping liquidity stable, and focusing on the elimination of financial risks. We expect the PBoC to tighten monetary conditions slightly over the course of 2017 by raising interest rates on its open-market operations. The 7-day reverse repo rate, which can be interpreted as the PBoC's de-facto policy rate, is now 2.45%.

INDIA — The Reserve Bank of India's (RBI) monetary policy stance is set to remain accommodative over the coming quarters. The next monetary policy meeting will be held on June 6-7; we do not expect any changes to the benchmark interest rates. Following the most recent meeting in early April, the central bank left the repo rate unchanged at 6.25% but raised the reverse repo rate by 25 basis points to 6.0%. Narrowing the policy rate corridor will help the RBI to control excess liquidity in the banking system. India's inflationary pressures are set to remain contained. In April, the headline inflation rate dropped to 3.0% y/y from 3.8% in March. We expect price gains to remain within the RBI's inflation target of 4% ± 2% y/y through 2018. The India Meteorological Department forecasts that the southwest monsoon's (June-September) rainfall will be within the "normal" category, which will support India's agricultural sector and limit food price inflation. High-frequency indicators point to solid momentum in the economy. We expect India's real GDP growth to average 7¾% y/y in 2017–18 following a 7.6% advance in 2016. The Indian government is on track to roll out a nationwide Goods and Services Tax (GST) on July 1, 2017. The GST will cut businesses' transaction costs as it synchronizes state and central levies into a nation-wide sales tax. Nevertheless, the multi-tiered structure of 0%, 5%, 12%, 18%, and 28% may mitigate some of the benefits.

BRAZIL — The macro story in Brazil seems to have touched bottom, with inflation expected to print around 4% in 2017 following a period of double digit inflation, while growth is expected to come back into positive territory, after a larger than 7% contraction over the past couple of years. However, the improving story is still highly vulnerable, as much of the growth pickup is supported by increased FDI, and inflation's improvement is also backed by the sharp rally in BRL (USDBRL back at 3.30, after reaching 4.20 back in 2015). The biggest near term risk seems to come back to the Lava-Jato investigations which took another unpredictable turn the past couple of weeks, with the newest allegations potentially implicating President Temer, threatening his reform seeking coalition. As the BCB has itself pointed out, if reforms stall – particularly in pensions – the interest easing cycle could be curtailed, thus hurting the growth rebound. In addition, stalled reforms risk derailing investor confidence, thus hurting investment, and risking a BRL sell-off, which could push inflation higher. Accordingly, we see Brazil currently facing a very binary outcome at the moment, with uncertainty not only present over whether Temer will be able to finish his mandate, but also on whether critical reforms will stall.

Pacific Alliance
Currency Outlook

Eduardo Suárez, 52.55.9179.5174
Scotiabank Economics
eduardo.suarez@scotiabank.com

MEXICO — Despite important looming elections in the State of Mexico, MXN is trading strongly these past few days, with its USD-cross currently just-south of 18.50. We would argue that based on macro fundamentals, MXN looks like the cheapest currency in the region (REER showing about 3 standard deviations cheap, and fading NAFTA risks, etc), but political risk is likely to keep the peso volatile. However, despite relatively high risks, the peso continues to test the bottom of its 18.47 – 19.30 recent range.

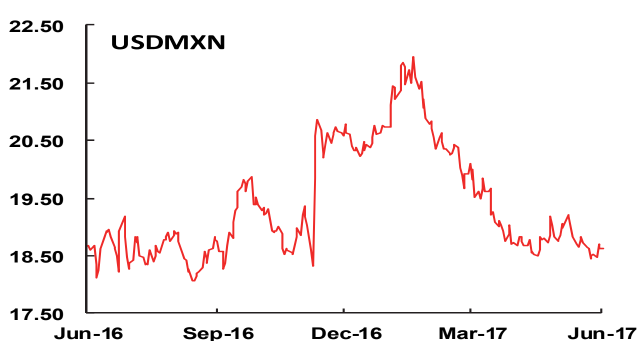
COLOMBIA — The Colombian peso has re-asserted its relationship with oil prices (currently 52%), with recent swings being primarily driven by crude market sentiment. With oil failing to make a clean break of recent levels, the peso has also found itself trapped in a relatively narrow 2830 – 2990 range. Its hard to pin down any Colombia centric event for the next month, meaning barring a more aggressive move in oil, or an unexpected shock, we expect the range to hold.

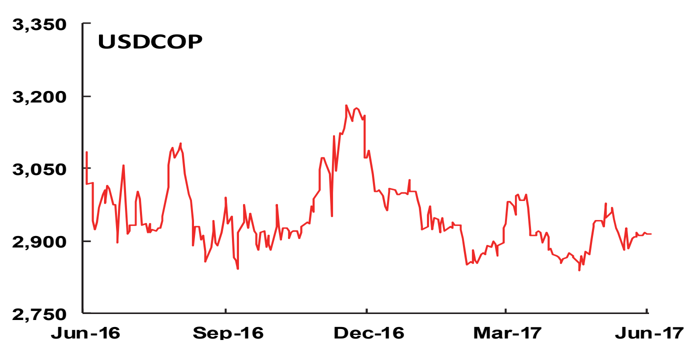
CHILE — The Chilean peso has traded range bound over the past few weeks (640 – 680). The main determinants of recent swings have been broad USD moves, shifts in copper prices, as well as compressing domestic rates, which are eroding the CLP's carry. These variables have triggered volatile trading, but no variable has managed to assert itself to break the peso out of its range – a pattern which we expect to be mostly present till year-end, although Presidential elections in November are a risk.

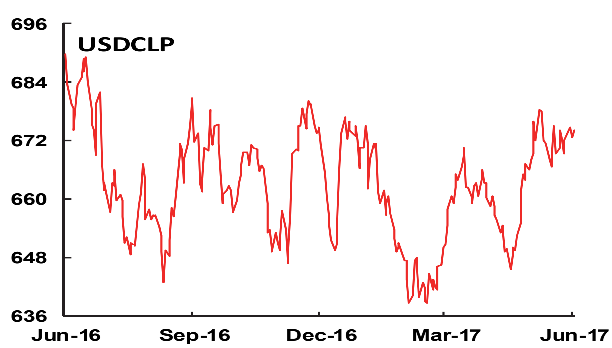
PERU — The central bank has been fairly active in capping the sol's upside, selling PEN through swaps on a fairly recurrent basis to keep the USDPEN cross from moving south of 3.23. These moves have been reinforced by a renewed interest rate easing cycle, which is eating away at Peru's already relatively low carry. With the BCRP putting the breaks on the sol's upside, and technicals holding at 3.30, trading is limited to a very narrow band.

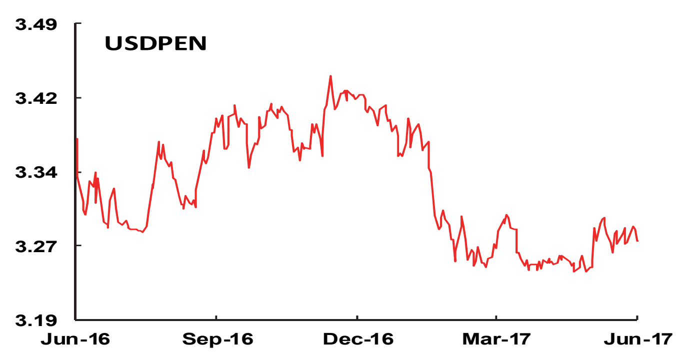
Currency Trends

FX Rate	Spot 1-Jun	17Q1a	17Q2f	17Q3f	17Q4f	18Q1f	18Q2f	18Q3f	18Q4f
USDMXN	18.62	18.72	19.27	19.86	20.39	20.60	20.45	20.51	20.79
USDCOP	2916	2874	3100	3125	3100	3125	3150	3100	3125
USDCLP	674	660	649	653	658	655	652	649	647
USDPEN	3.27	3.25	3.27	3.26	3.25	3.26	3.22	3.23	3.20









Pacific Alliance

Fundamental Commentary

Eduardo Suárez, 52.55.9179.5174
Scotiabank Economics
eduardo.suarez@scotiabank.com

MEXICO — For the past year, a large share of the uncertainty surrounding Mexico has come from its trade relationship with the US and Canada, driven by questions surrounding President Trump's plans to renegotiate NAFTA. At the moment, it seems that the tail risks on the trade front have been trimmed, and a constructive negotiation to update the agreement seems to increasingly look like the base case. Even as NAFTA risk seems to fade, we are now seeing investor focus zero-in on the outlook for inflation and politics. On the inflation front, Banxico and markets are both worried about the sharp upswing in prices that blasted through the top of the central bank's 3% +/- 1 percentage point target range (inflation just printed at 6.2%). Accordingly, the relatively aggressive interest rate hike cycle undertaken by Banxico (375 bps of hikes since December 2015) is expected to still have a little room to run, although with the rebound in MXN and given that much of the tightening is still flowing through the system, there is now a debate on how much longer Banxico will continue to follow the Fed (USDMXN now back at 18.50, after peaking at 22.0 earlier this year). It's possible that given Governor Carstens is set to depart in November, the central bank is erring on the side of caution, seeking to leave inflation well anchored in order to ease the transition to the central bank's new leadership. On the political front, this month's elections in the State of Mexico are likely to kick-off what is likely to be a tough electoral cycle for the 2018 Presidential vote. So far, the only candidate that looks like a lock is Andres Manuel Lopez Obrador (AMLO) for the Morena party. Although AMLO already governed Mexico City, and his administration of the City is fairly widely seen as solid, there are some points in his platform for the 2018 elections that make many investors nervous. These include his promises to cancel the Mexico City airport project, as well as potentially overturning the energy reform - which we think would be extremely challenging to accomplish.

COLOMBIA — The Colombian economy is slowly adjusting to the new reality of lower oil prices, which hit both public finances (every US$10/bl drop means about a 40 bps of GDP hit on revenues for the public sector), as well as the balance of payments, where the current account is expected to post a still wide deficit of around 3.6% of GDP in 2017. In addition, lower oil prices also hit investment, as well as indirectly household income, leading to a fairly significant drop in growth. In order to help offset this slowdown, the government is focusing on an ambitious infrastructure program (referred to as the 4G), which seeks about US$10bn in road infrastructure investments. However, even this program seems to have become at least partly ensnared by Brazil's Lava-Jato scandals, with one of the projects in which Odebrecht was involved now been temporarily suspended, putting about US$1.7bn of the program on hold. The good news is that the fiscal (approved in 2016) and labor (approved 4 years ago) reforms the government approved seem to be on the right track, with some estimates suggesting that the labor reform has already resulted in a drop of about 6.5% in labor informality in large cities, which should result in a positive feed-back loop as formalization drives financial sector inclusion, and improved tax collection. This improving dynamics in the labor market should be further boosted by the tax reform, which reduced payroll taxes, and compensated them with income taxes, thus reducing the burden on employers' hiring of formal workers.

CHILE — Investor focus for the next few months is likely to turn to the November Presidential elections. We still don't have defined candidates, but these should be clarified in the coming weeks. At the moment, former President Piñera remains at the top of the surveys, but his popularity dipped somewhat from the May 19th to May 26th polls. Piñera already occupied the presidency, and is widely seen as "market friendly". A big question for any new presidency will be if any measures are taken to boost investment after a loss of competitiveness in the mining sector (driven by surging costs), and changes to corporate taxes (increases in taxes, and reduced tax breaks for corporate investment) combined to drive a dip over the past few years (gross fixed investment has been negative in the 2014-2016 period), thus contributing to the overall slowdown in the Chilean economy. Going forward, focus will likely be on the macro platforms of the eventual candidates, as well as developments in coper prices and the Chinese economy.

PERU — The start of the year was relatively rough for Peru. First, the Lava-Jato scandal paralyzed a number of important infrastructure projects in the country, which Finance Minister Thorne said could shave as much as a full percentage point off the country's growth in 2017. Then, the el Niño storms caused important damage to the country's infrastructure, for which the rebuilding efforts risk being delayed by the challenges in the construction industry that Lava-Jato unleashed. Part of the growth hit from these shocks are expected to be offset by fiscal expansion, as the government uses its ample fiscal space in order to stimulate the economy. Furthermore, Peru already has the highest investment rate among the major LATAM economies, and the government has been pushing a number of reforms to boost growth even further, including cuts to corporate taxes, and regulatory changes to streamline investment. These changes should help growth rebound over coming months, although there is some uncertainty about whether investigations affecting the construction industry will, at least in the short term, affect the country's execution capacity. Our take on this is that the slowdown in execution capacity will be overcome, given the potential for new entrants if current players remain paralyzed. At the end of the day, engineers and machinery can just be deployed by other players if current ones remain stuck. For 2017, we are relatively bearish on Peruvian growth (about 2.5%), but look for a rebound next year as infrastructure projects, as well as rebuilding damaged infrastructure gain traction (we expect +3.7% growth for 2018).

Global Currency Forecast (end of period)

		2017f	2018f	2017f				2018f			
Major Currencies				Q1a	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Japan	USDJPY	117	122	111	115	117	117	121	121	122	122
Euro zone	EURUSD	1.10	1.15	1.07	1.02	1.05	1.10	1.12	1.12	1.15	1.15
	EURJPY	129	140	119	117	123	129	136	136	140	140
UK	GBPUSD	1.25	1.35	1.26	1.20	1.25	1.25	1.30	1.30	1.35	1.35
	EURGBP	0.88	0.85	0.85	0.85	0.84	0.88	0.86	0.86	0.85	0.85
Switzerland	USDCHF	1.02	0.98	1.00	1.09	1.07	1.02	1.00	1.00	0.97	0.98
	EURCHF	1.12	1.13	1.07	1.11	1.12	1.12	1.12	1.12	1.12	1.13
Americas											
Canada	USDCAD	1.36	1.30	1.33	1.40	1.38	1.36	1.36	1.34	1.32	1.30
	CADUSD	0.74	0.77	0.75	0.71	0.72	0.74	0.74	0.75	0.76	0.77
Mexico	USDMXN	20.39	20.79	18.72	19.27	19.86	20.39	20.60	20.45	20.51	20.79
	CADMXN	14.99	15.99	14.06	13.76	14.39	14.99	15.15	15.26	15.54	15.99
Brazil	USDBRL	3.35	3.45	3.12	3.25	3.30	3.35	3.45	3.45	3.50	3.45
Chile	USDCLP	658	647	660	649	653	658	655	652	649	647
Colombia	USDCOP	3100	3125	2874	3100	3125	3100	3125	3150	3100	3125
Peru	USDPEN	3.25	3.20	3.25	3.27	3.26	3.25	3.26	3.22	3.23	3.20
Uruguay	USDUYU	31.0	33.5	28.6	29.0	30.0	31.0	31.5	32.0	33.0	33.5
Asia-Pacific											
Australia	AUDUSD	0.75	0.78	0.76	0.76	0.75	0.75	0.75	0.75	0.78	0.78
China	USDCNY	7.00	6.90	6.89	6.90	6.95	7.00	6.95	6.95	6.90	6.90
Hong Kong	USDHKD	7.80	7.78	7.77	7.79	7.80	7.80	7.79	7.79	7.78	7.78
India	USDINR	67.0	65.5	64.9	65.5	66.0	67.0	66.0	66.0	65.5	65.5
Indonesia	USDIDR	13500	13400	13322	13400	13450	13500	13450	13450	13400	13400
Malaysia	USDMYR	4.40	4.30	4.43	4.35	4.38	4.40	4.35	4.35	4.30	4.30
New Zealand	NZDUSD	0.70	0.73	0.70	0.71	0.70	0.70	0.70	0.70	0.73	0.73
Philippines	USDPHP	51.0	50.0	50.2	50.0	50.5	51.0	50.5	50.5	50.0	50.0
Singapore	USDSGD	1.42	1.40	1.40	1.40	1.41	1.42	1.41	1.41	1.40	1.40
South Korea	USDKRW	1160	1140	1118	1140	1150	1160	1150	1150	1140	1140
Taiwan	USDTWD	31.0	30.5	30.3	30.5	30.8	31.0	30.8	30.8	30.5	30.5
Thailand	USDTHB	35.2	34.5	34.4	34.5	34.8	35.2	34.8	34.8	34.5	34.5
Europe / Africa											
Czech Rep.	EURCZK	26.8	27.6	27.0	26.0	26.3	26.8	27.2	27.2	27.9	27.6
Hungary	EURHUF	325	316	309	310	316	325	325	319	322	316
Norway	USDNOK	8.00	7.20	8.60	8.20	8.00	8.00	7.80	7.60	7.40	7.20
Poland	EURPLN	4.45	4.47	4.23	4.32	4.40	4.45	4.50	4.49	4.48	4.47
Russia	USDRUB	58.3	59.3	56.2	57.5	58.0	58.3	58.7	59.0	59.2	59.3
South Africa	USDZAR	13.90	14.40	13.41	13.51	13.71	13.90	14.03	14.15	14.28	14.40
Sweden	EURSEK	9.40	9.30	9.56	9.50	9.45	9.40	9.38	9.35	9.33	9.30
Turkey	USDTRY	3.80	3.90	3.64	3.70	3.73	3.80	3.82	3.85	3.87	3.90

f: forecast a: actual

SCOTIABANK ECONOMICS

Brett House
brett.house@scotiabank.com

Derek Holt
derek.holt@scotiabank.com

Eduardo Suárez
eduardo.suarez@scotiabank.com

Tuuli McCully
tuuli.mccully@scotiabank.com

Adrienne Warren
adrienne.warren@scotiabank.com

FOREIGN EXCHANGE STRATEGY

Shaun Osborne
shaun.osborne@scotiabank.com

Qi Gao
qi.gao@scotiabank.com

Eric Theoret
eric.theoret@scotiabank.com