AMERICAS

USD weak but oversold in the short term. CAD rally may pause with good news largely factored in. MXN cheap, but still prone to weakness in response to market volatility.

EUROPE

EUR rallies on strengthening economic data, ECB expectations. GBP pulled higher on USD weakness but Brexit risks still loom over prospects.

ASIA-PACIFIC

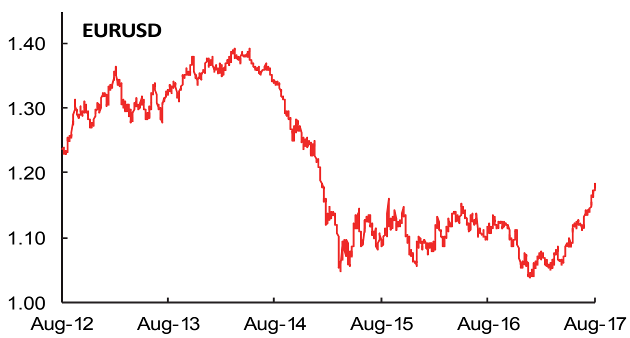
JPY lags as low inflation keeps BoJ policy risks corralled. CNY stable, but market attuned for official comments suggesting that volatility may be allowed to rise. INR supported by portfolio inflows.

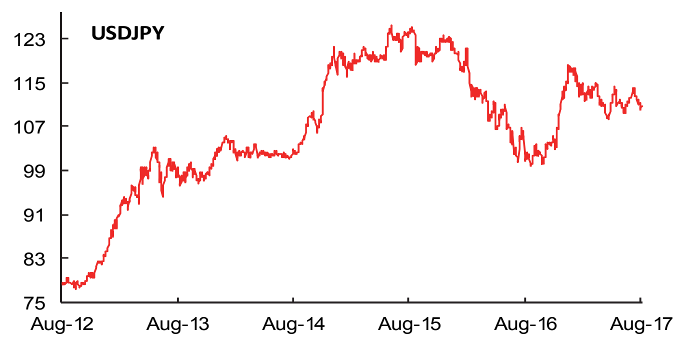
CONTENTS

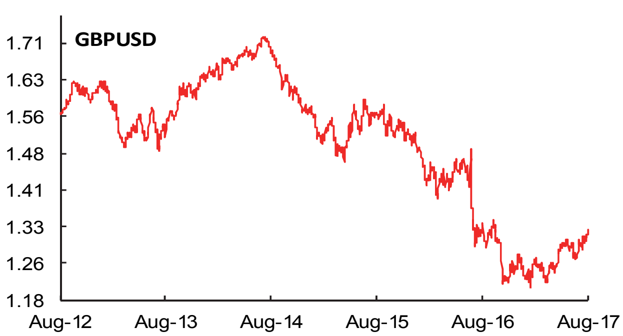
Core Exchange Rates

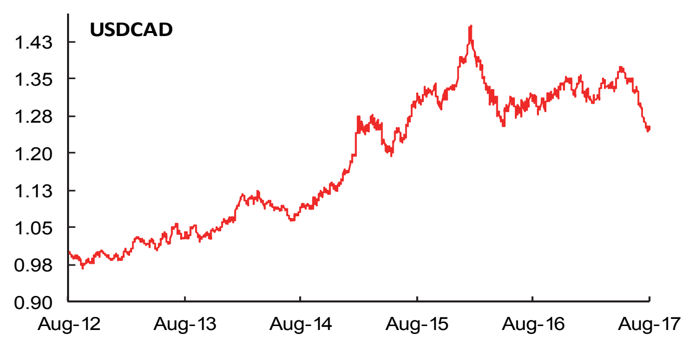
Global Foreign Exchange Outlook

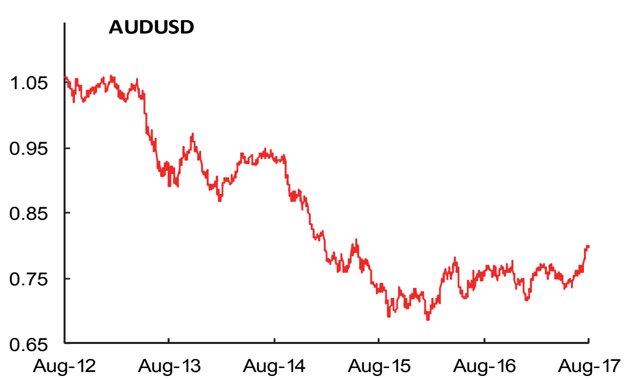
August 2, 2017	Spot	2017f Q1a	2017f Q2a	2017f Q3	2017f Q4	2018f Q1	2018f Q2	2018f Q3	2018f Q4
EURUSD	1.18	1.07	1.14	1.12	1.13	1.15	1.18	1.20	1.20
USDJPY	110.7	111	112	110	110	112	112	115	115
GBPUSD	1.32	1.26	1.30	1.28	1.28	1.28	1.28	1.31	1.31
USDCAD	1.25	1.33	1.30	1.30	1.28	1.28	1.27	1.25	1.25
AUDUSD	0.80	0.76	0.77	0.75	0.75	0.77	0.77	0.78	0.78
USDMXN	17.91	18.72	18.12	18.46	19.32	19.52	19.37	19.44	19.70

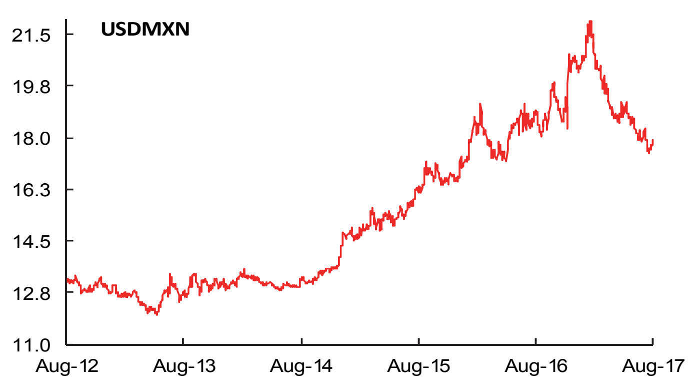












Market Tone & Fundamental Focus

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The US dollar (USD) has continued to lose ground over the past few weeks. The dollar index (DXY) has now lost more than 10.5% since the start of the year, with the slide showing signs of accelerating in July when the DXY lost nearly 4%. We think the USD slide is starting to look somewhat stretched from a short-term point of view but we think the broader turn lower over the past few months supports the notion that the longer-term secular trend in the USD is reversing and that the USD risks losing more ground in the medium-to-longer run.

The weaker USD performance comes against a backdrop of generally positive, domestic economic news; US growth trends improved in Q2 after a soft Q1 and equity markets are rising. It is evident that the most recent slide in the USD has neither reflected relatively weaker economic data (more positive US data surprises have run ahead of those from the Eurozone and Japan in the past few weeks) nor any major deterioration in short, medium or longer run interest rate differentials, even with US yields stuck in a narrow range as markets remain unconvinced that the Fed will be able to deliver on a third rate tightening this year. If anything, yield spreads are at very supportive nominal levels for the USD against most major currencies.

Absent any evident fundamental driver of USD weakness, we continue to feel that some of the dollar's decline can be ascribed to the unsettled domestic political backdrop in the US and President Trump's inability to advance his policy agenda. This is persuading investors to look elsewhere for less risk and higher returns.

The Canadian dollar (CAD) rally has extended further in the past few weeks, to the point that we now think the rally is overshooting fundamentals and may correct somewhat in the next few weeks. The CAD is one currency that is reflecting a significant, supportive shift in interest rate differentials versus the USD. May industry level GDP showed the Canadian economy expanding strongly (+4.6% Y/Y, the strongest since 2000). Economic data supports the outlook for further Bank of Canada (BoC) tightening once more before year-end but we are cautious on the outlook for additional rate increases coming through quickly in 2018. The USD's yield advantage has narrowed dramatically but may struggle to move much beyond parity unless the Canadian economy powers significantly ahead of the US. A generally soft USD has helped lift commodity prices—crude oil, metals—in recent weeks, allowing the likes of the NOK and AUD to out-perform.

The Euro (EUR) has led the major currencies' advance against the USD so far this year; Eurozone growth is strengthening (Q2 GDP at +2.1% Y/Y puts growth trends on par with the US) and European Central Bank (ECB) policy makers appear to be closer to deciding that the economy is strong enough to allow a reduction in QE policy later this year. Additionally, political risks associated with key elections in the Eurozone earlier this year have passed and the strong appreciation in the EUR is making investments in European blue chip stocks look extremely attractive. While the USD does run the risk of a short-term trading "bounce" in the short run, we think EURUSD's recent gains through the 1.17 area support the outlook for additional, medium-term gains for the single currency.

Sterling (GBP) has been pulled higher amid the broader slide in the USD but the UK economy remains sluggish, dampening market expectations that the BoE might consider tightening policy shortly, and Brexit risks and uncertainties remain high. The UK government is struggling to develop a unified front on Brexit talks and priorities. We think Sterling will continue to under-perform on the crosses even if it remains firm against the beleaguered USD. Like the GBP, the JPY has lagged behind broader currency appreciation versus the USD through July. Sluggish inflation suggest that the BoJ remains some distance still from reaching its inflation target and may well lag behind the policy normalization process that appears to be underway, or under consideration, at other major central banks. The biggest positive for the JPY right now is perhaps that speculators have aggressively sold the currency and are prone to a short squeeze.

Outside of the G-10 space, rising commodity prices are helping lift the MXN, COP (crude oil) and CLP (copper) while the PEN is virtually flat over the past month. We think the MXN still looks somewhat undervalued, even after the USD's 20% drop from its post-election peak, but the MXN rebound may slow somewhat from here as investors start to consider NAFTA, Banxico monetary policy etc. risks. Asian regional FX has been relatively stable through July. The KRW has appreciated modestly despite regional geo-political risks. We expect the CNY to remain broadly stable in the near-term but internal discussions around increasing the yuan's flexibility appear to be increasing.

Canada

Currency Outlook

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The CAD has been on a tear since the USD peaked around 1.38 in May. The run of CAD-positive news has propelled the currency sharply—and broadly—higher. Oil prices have firmed, Canadian economic data has been supportive, with economic reports generally running strongly ahead of expectations, and yields have risen to reflect the BoC's recently unveiled hawkishness.

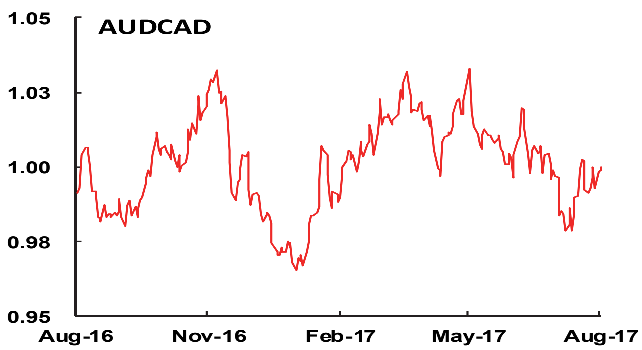
The CAD has rallied a little beyond its early 2016 peak to reach its highest level in some two years. We remain generally constructive on the outlook for the CAD but we feel that the CAD's rally may reverse modestly in the near-term with a lot of good news factored in to the exchange rate at this point.

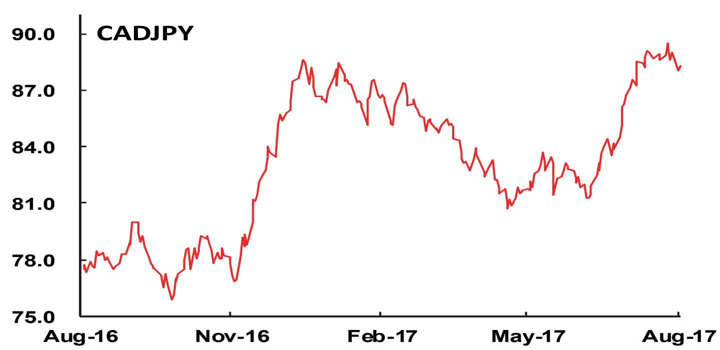
While investors have clearly under-estimated the strength of the Canadian economy, some clear problems remain. Growth is strong but unbalanced. Government officials have started to express discrete concern about the BoC's tightening path and its impact on the economy, especially considering that rate-sensitive sectors like housing and consumer spending are doing much of the economic heavy lifting at the moment. Moreover, a broad-based measure of the CAD's effective exchange rate performance shows the currency has appreciated around 16% since January 2016, which will tighten domestic monetary conditions somewhat above and beyond any additional rate increases from the BoC.

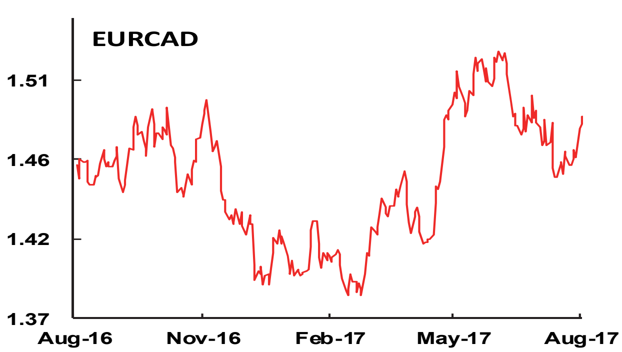
We think USDCAD is looking somewhat oversold at the moment. Technical signals suggest the risk of a minor rebound in the next few weeks towards the 1.27 area, possibly a little higher, before USD selling pressure resumes. Seasonal patterns suggest the USD will retain a defensive posture until later in Q4 at least.

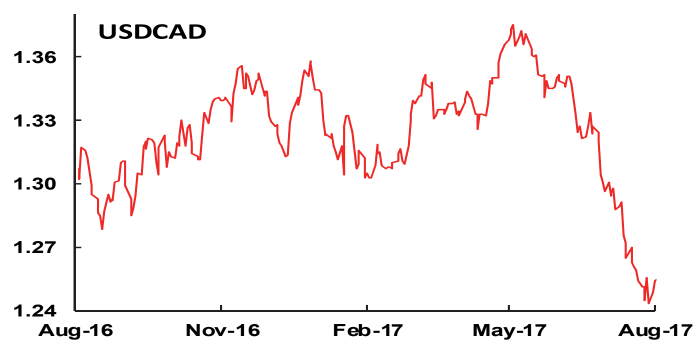
Canadian Dollar Cross-Currency Trends

FX Rate	Spot 2-Aug	17Q1a	17Q2a	17Q3f	17Q4f	18Q1f	18Q2f	18Q3f	18Q4f
AUDCAD	1.00	1.02	1.00	0.98	0.96	0.99	0.98	0.98	0.98
CADJPY	88.2	83.6	86.7	84.6	85.9	87.5	88.2	92.0	92.0
EURCAD	1.48	1.42	1.48	1.46	1.45	1.47	1.50	1.50	1.50
USDCAD	1.25	1.33	1.30	1.30	1.28	1.28	1.27	1.25	1.25









United States and Canada

Fundamental Commentary

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UNITED STATES — The US economy has rebounded from a weak start to the year. Led by a resurgent consumer, real GDP advanced at a 2.6% annualized rate in Q2. Strong consumer fundamentals—a robust job market, growing incomes, and wealth gains from rising home and equity prices—are expected to maintain solid household spending momentum into next year. Labour market conditions continue to tighten, with both narrowly- and broadly-defined indicators of joblessness at decade lows. Consumer confidence is near its highest level in over a decade and a half. Housing activity remains healthy, though inventory shortages and worsening affordability continue to restrain overall sales. 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 and business investment spending. Core capital goods orders have increased in five of the past six months. Non-residential construction is being bolstered by strength in commercial projects. Net trade is expected to exert a drag on growth amid rising import demand and a strong US dollar. Prospects for fiscal stimulus have diminished, and we anticipate virtually no meaningful tax reform or expanded infrastructure spending to be implemented by the US federal government over the next 18 months. Price pressures remain muted, but are showing tentative signs of bottoming. Core inflation held steady at a two-year low of 1.7% y/y in June.

CANADA — The Canadian economy has ramped up sharply in 2017, with output growth tracking above a 3% annual rate through the first half of the year. Output gains continue to be led by the consumer and housing sectors: auto sales in June set another monthly record, and housing starts are trending at their highest level in almost five years. 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 so far this year, pushing the unemployment rate to a cycle low of 6.5%, equivalent to 5.4% under the same methodology used in the US. Even so, weak wage gains and elevated household debt are expected to moderate consumption growth going forward, while affordability pressures and new regulations appear to be cooling resale housing activity. Service sector activity remains brisk, with notable gains in wholesale and retail trade, transportation and warehousing, and financial and professional services. Business earnings and capital goods investment spending are rebounding, led by the oil and gas sector. Exports have begun to revive alongside strengthening global industrial activity. Public infrastructure spending, though proceeding slower than planned, remains supportive of growth. Inflation remains subdued, but is expected to trend gradually higher in the latter half of the year and next. The average increase in the Bank of Canada's preferred measures of core inflation inched up to 1.4% y/y in June from 1.3% the prior month.

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Monetary Policy Commentary

UNITED STATES — We expect the Fed to hold back on another rate increase until its final meeting of the year in December. As the FOMC watches and waits for a bounce-back in growth and inflation, amid what most officials consider transitory, one-off "idiosyncratic factors" that have kept prices in check, eyes have turned to signals from the Committee regarding the date by which it will begin scaling back its balance-sheet reinvestments. Details on policy normalisation were outlined at the June meeting and the FOMC remarked in its July statement that the anticipated change in reinvestments will kick off "relatively soon", which may imply a September start. Q2 growth figures showed a modest improvement in the US economy and are supportive of the country's labour market: with the unemployment rate at a 16-year low of 4.3%, we expect to see an uptick in wage growth in the months ahead.

CANADA — With nearly no spare capacity in the Canadian economy and growth at a quick 3.7% q/q annualized in Q1 and the expansion in Q2 forecast at 3.2% q/q annualized, we expect the Bank of Canada to hike again in October in anticipation of a return to the BoC's 2% inflation target within the next two years, and possibly much sooner. The Bank should by Q3 have a solid sense of whether core inflation has bottomed out, as forecast in its latest Monetary Policy Report, with the dampening effect of weak gasoline prices on headline inflation likely continuing for some months. While the recent strength in labour markets has yet to be significantly reflected in wage gains, we anticipate a higher pace of earnings growth in 2018 as the commodity shock continues to fade and minimum wage increases take hold in Ontario and Alberta, all of which should boost household incomes. So long as GDP growth continues to exceed estimates of its long-run potential, emergency rates will no longer be warranted and the BoC may find itself raising its policy rate quicker than expected so as to avoid an overheating of economic conditions.

G10

Currency Outlook

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EUROZONE — EUR is entering August at fresh multi-year highs with limited technical resistance ahead of 1.20. Solid fundamentals and supportive interest rate differentials are driving EUR strength and U.S. political uncertainty is compounding the move. Bullish EUR CFTC positioning is extended at multi-year highs (net position) and details show a record level of gross longs. The options market is also once again attributing a premium for protection against short-medium term EUR strength. EUR is trading well above our Q4 2017 target at 1.13 and pushing toward the Q4 2018 forecast at 1.20.

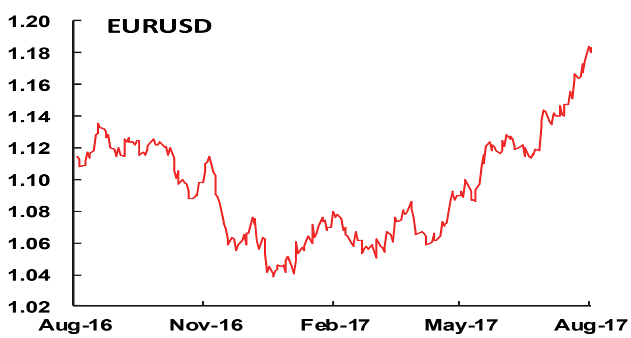
UNITED KINGDOM — GBP staged an impressive recovery from its post-election tumble and ended July at fresh post-flash crash highs above 1.32. There is no major resistance ahead of the post-Brexit high at 1.35. GBP appears to be running ahead of levels implied by short-term interest rate differentials, and political uncertainty remains elevated. We maintain a relatively neutral GBP outlook and highlight our Q4 2017 forecast for 1.28.

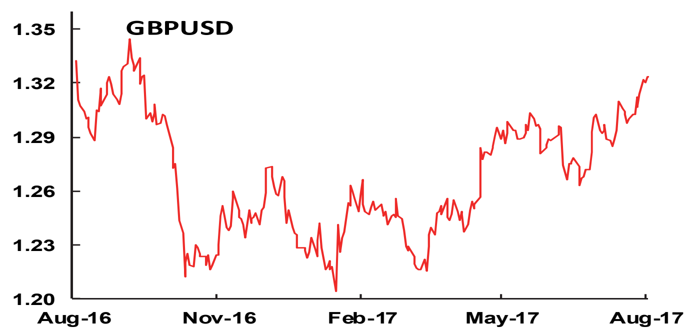
JAPAN — JPY has entered August at the upper end of its 2017 range following a modest 2.0% gain in July. Its relative performance (vs. G10, G4 peers) has been disappointing despite a 6.0% YTD rally vs. the USD. The shifting outlook for relative central bank policy remains a dominant theme as we note the ongoing JPY-supportive compression in longer-term interest rate differentials. Positioning risk is elevated with extended bearish net CFTC positioning and gross shorts are at levels last seen in 2007. USDJPY is in line with our Q4 2017 target at 110.

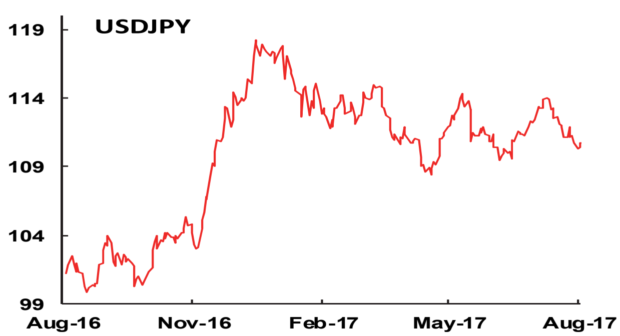
AUSTRALIA — AUD appears to be struggling around its multi-year highs near 0.80 following an impressive 10% rally from its May low. Technicals are suggestive of exhaustion and narrowing spreads are eroding AUD support. Bullish AUD CFTC positioning is extended at the upper end of its multi-year range and we highlight the risk of an adjustment. AUD is trading well above both our Q4 2017 target at 0.75 and our Q4 2018 target at 0.78.

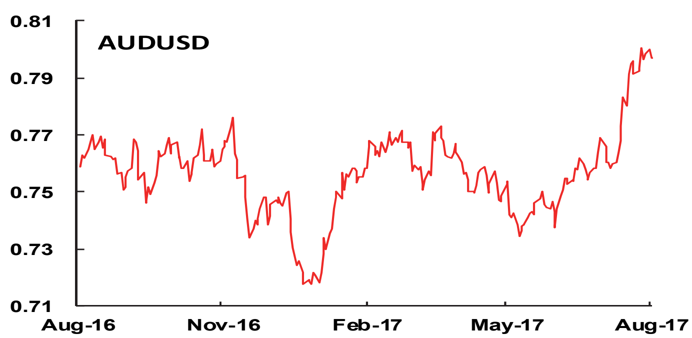
Currency Trends

FX Rate	Spot 2-Aug	17Q1a	17Q2a	17Q3f	17Q4f	18Q1f	18Q2f	18Q3f	18Q4f
EURUSD	1.18	1.07	1.14	1.12	1.13	1.15	1.18	1.20	1.20
GBPUSD	1.32	1.26	1.30	1.28	1.28	1.28	1.28	1.31	1.31
USDJPY	111	111	112	110	110	112	112	115	115
AUDUSD	0.74	0.76	0.77	0.75	0.75	0.77	0.77	0.78	0.78









G10
Fundamental Commentary

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EUROZONE — Eurozone survey indicators are extremely elevated and suggest that GDP growth should continue accelerating throughout 2017. We are relatively optimistic versus the consensus and forecast an annual average growth rate of 2¼% y/y. Survey indicators suggest that growth could even exceed our expectations. Headline inflation briefly touched the 2% ECB target before subsequently falling back to 1¼% y/y. Given unfavourable base effects (not least lower oil prices) inflation is likely to slow further and could even slip below 1% y/y. Meanwhile core inflation is gradually edging higher, though we expect the pace to reside between 1¼ and 1½% y/y by late-2018—a good margin below target. In that context, the ECB is unlikely to be rushing to withdraw monetary policy accommodation. The ECB has committed to continue purchasing EUR60bn of government bonds per month until the end of 2017. We believe that two boxes need to be ticked for the ECB to consider removing accommodation. Firstly, above-trend GDP growth needs to persist well into 2018. Secondly, core inflation will need to rise consistently above 1% y/y by end-2017 and appear likely to remain on an upwards trajectory thereafter. If both of these conditions are met, then a rate hike from late-2018 is plausible. The key risk to this view is that sub-1% y/y inflation around the turn of the year provokes a final instalment of asset purchases during H1 2018.

UNITED KINGDOM — UK growth has slowed and we expect a further deceleration over the remainder of the year, particularly centred on the consumer. Sharply higher inflation and sluggish wage inflation have pushed household real disposable income growth into negative territory, crushing household consumption growth. While there is a glimmer of hope that investment and net trade could provide an offset, we remain glass half-empty on growth during 2017. We expect growth of just 1.6% y/y. The good news is that the headwinds to growth this year are likely to reverse next year. In particular, lower inflation and firmer wage inflation should help to push consumption growth higher next year. While 2018 should boast a better profile for quarterly GDP growth rates, the annual average is likely to be a lowly 1.1% y/y. Inflation surged to 2.9% y/y earlier in the year, but has since eased back to 2.6% y/y. We view this as a temporary pause for breath before resuming upwards traction into the autumn. We expect a peak of around 3% y/y. Thereafter we expect inflation to revert back towards the 2% target relatively swiftly. Although BoE language has turned more hawkish in recent weeks, with three dissenters for rate hikes, we expect muted wage inflation and pedestrian GDP growth to dissuade the Bank from raising Bank Rate this year. We expect the first hike to arrive in H2 2018.

JAPAN — The Japanese economy is gaining strength, at least temporarily. The external sector is a key growth motor, responding to firming global demand. In addition, activity has recently become more broadly based with consumer spending and fixed investment providing additional support to the economy's momentum. Accordingly, the Bank of Japan (BoJ) has become more optimistic about the country's economic outlook. Monetary authorities expect Japan's output to rise 1.8% in the current fiscal year (April–March) and 1.4% in FY2018. While we agree with the BoJ that the Japanese economy will continue to outpace its potential growth through 2018, we consider the central bank's forecasts optimistic. We estimate that the country's real GDP growth will average 1.0% y/y in 2017–2018. The BoJ kept its monetary policy stance unchanged following the July policy meeting. Nevertheless, it revised the expected timeline for achieving the 2% annual inflation target. It was pushed back to a more credible timing of FY2019; the prior projection was a year earlier. We do not expect the BoJ to unwind its ultra-accommodative monetary policy stance in the foreseeable future given still-muted inflationary pressures. The headline inflation rate remained at 0.4% y/y in June. Japan and the European Union agreed on a free-trade deal on the sidelines of the G20 meeting in Hamburg in early July. The trade agreement will cover about 30% of the world GDP.

AUSTRALIA — Australian inflationary pressures remain contained. Consumer price inflation eased to 1.9% y/y in the second quarter from the 2.1% y/y reading in the first three months of 2017, dropping below the Reserve Bank of Australia's (RBA) 2–3% target range. We expect the headline inflation rate to hover close to the lower end of the target range through 2018. Weak wage growth and a recent appreciation bias of the Australian dollar (the AUD has strengthened by around 9% vis-à-vis the USD since May) will limit any underlying inflationary pressures. Accordingly, the Australian central bank is in no rush to join other major central banks in their monetary normalization efforts. We expect the RBA to leave the benchmark cash rate at 1.50% over the coming months in order to support domestic demand. The most recent policy decision was made on August 1. We expect a cautious monetary tightening phase to commence in the second half of 2018. The RBA will continue to monitor labour and housing market developments closely, yet monetary authorities' persistent concerns regarding the former should be alleviated by recent employment data. The economy created 101,000 new jobs in the second quarter of 2017 with all gains coming from full-time employment. Australia's real GDP is expected to grow in line with the country's potential growth rate of 2½% y/y in 2017–18.

China, India, Brazil
Currency Outlook

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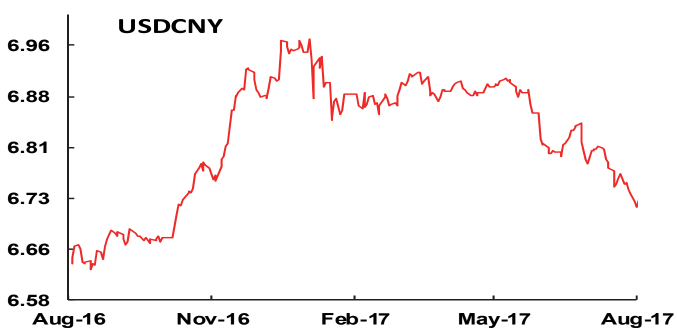
CHINA — Monetary policy convergence between the US and the Eurozone is likely to weigh on the USD, together with ongoing US political uncertainty and debt-ceiling concerns. The CNY and CNH should outperform a basket of currencies if global liquidity conditions tighten, with the CFETS RMB index trading at around the 93 mark. In our view, indications are likely to be provided by the authorities prior to any band widening.

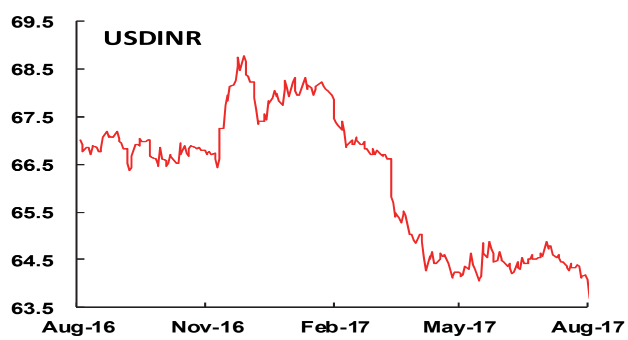
INDIA — India's foreign reserves rose to a record high of USD 391.33bn as of 21 July on the back of continued foreign portfolio inflows. Above-normal monsoon rainfall will keep the nation's retail inflation benign, paving the way for the RBI to boost bank lending. USDINR is expected to reach 64.5 by the end of September amid potential concern over the withdrawal of global liquidity. We maintain our short TWDINR cross position.

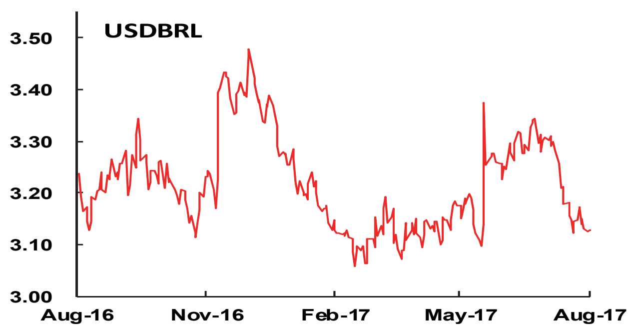
BRAZIL — Politics rare likely to be a major influence on the BRL in the coming weeks and they remain very fluid in Brazil, where we have to be mindful not only of the outcomes of investigations and proceedings involving both the current government and members of past administrations, but also the ongoing pace of reform. President Lula's trial could affect the PMDB-PSDB coalition and limit its ability to proceed with critical policy changes. Next to the fate of pension reforms, Lula's second trial is likely to be the key driver of Brazilian financial markets. In terms of valuations, we think the BRL is getting into stretched territory as most of the nominal depreciation the currency has seen since 2013 has now been eaten up by inflation.

Currency Trends

FX Rate	Spot 2-Aug	17Q1a	17Q2a	17Q3f	17Q4f	18Q1f	18Q2f	18Q3f	18Q4f
USDCNY	6.73	6.89	6.78	6.75	6.80	6.75	6.75	6.70	6.70
USDINR	63.7	64.9	64.6	64.5	65.0	64.5	64.5	64.0	64.0
USDBRL	3.13	3.12	3.31	3.35	3.45	3.55	3.60	3.60	3.40







China, India, Brazil

Fundamental Commentary

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CHINA — The Chinese economy is showing surprising resilience as real GDP expanded by 6.9% y/y in the second quarter, unchanged from the first quarter. With such strong performance in the first half of the year, it is clear that China will meet the official real GDP growth target of around 6.5% this year. We have revised our Chinese growth forecasts slightly upwards and now expect output to expand by 6.7% in 2017 and 6.3% in 2018 (previously 6.6% and 6.1%, respectively). This sound momentum alleviates the pressure on the government to stimulate the economy ahead of the 19th National Congress of the Communist Party of China, which will be held at the end of this year. Therefore, we expect to see more efforts on the regulatory side to make the banking system more resilient, which is one of the government's key reform priorities ahead of further liberalization of the economy. Indeed, the country's banking regulator has announced the implementation of around 50 legislative initiatives for the financial sector that aim to improve risk management, promote gradual deleveraging, and manage troubled loans. China's consumer price inflation remained contained in June with the CPI rising by 1.5% y/y, in line with the reading in May. We expect price gains to accelerate only gradually over the course of the year to close 2017 at around 2.0% y/y. The People's Bank of China's (PBoC) will continue to implement "prudent and neutral" monetary policy over the coming months. The 7-day reverse repo rate, which can be interpreted as the PBoC's *de-facto* policy rate, is now 2.45%; it was raised by 10 bps in February and March. Meanwhile, the official benchmark one-year loan and deposit rates have been kept at 4.35% and 1.50%, respectively, since October 2015. We do not expect any changes to the current monetary policy stance in the near term.

INDIA — The Reserve Bank of India (RBI) lowered its benchmark repo rate by 25 bps to 6.0% following its bi-monthly policy meeting during August 1–2. A lower headline inflation rate—which dropped to 1.5% y/y in June from 2.2% a month earlier—allowed for the cut despite the fact that prices in the core have been stickier; our estimates imply that core inflation continued to hover around 4% y/y in June. In addition, further monetary stimulus was justified by the economy's weakness following the government's recent demonetization efforts. Previously, the RBI's policymakers had looked through the temporary dip in headline inflation (which mostly reflects falling food prices) and emphasized that monetary policy must be forward-looking. Pressure from the government to ease monetary policy may have influenced the RBI's decision; this might raise questions about central bank independence, potentially undermining policy credibility and investor confidence in India. We do not expect the RBI to implement further interest rate cuts over the coming quarters. As of early-August, India's cumulative rainfall during this year's southwest monsoon (June–September) was 1% above a long period average. The monsoon season plays a key role in India's rural economy as only about 40% of the country's agricultural land is irrigated. A second consecutive year of normal rainfall (after two consecutive years of drought) would support rural incomes and overall economic growth given that current momentum is driven by household spending. We expect India's output growth to recover over the coming quarters, with real GDP gains averaging 7.5% y/y during 2017–18.

BRAZIL — Brazil spent the last few years in the deepest recession in the country's history, during which the economy contracted at a 4%–8% pace. Now, some positive growth signs are starting to emerge: recent data imply that the economy is starting to move back toward expansion (Q1 GDP growth was -0.4% y/y, and +1.0% q/q). Industrial activity has stabilized and domestic demand is firming, with retail sales turning positive. In addition, after seeing inflation peak at 10.8% in 2015, price increases are back under 4%, which has given the Brazilian Central Bank (BCB) room to cut rates in order to give the economy some support: the SELIC rate has been sliced from 14.25% to 10.25% over the past year. On the external front, the country's current account deficit has narrowed from 4.2% of GDP in 2014 to 1.3%; we expect the deficit to remain around this level, where it is fully funded by foreign direct investment. On the fiscal side, the public deficit has fallen from 10.2% of GDP in 2015 to an expected 9.1% in 2017—good, but not enough. Gross public debt hasn't been stabilized: it rose from 62% of GDP in 2008 to an expected 81% in 2017, which makes the government's reform efforts, especially on pensions, critically important. The current pension reform proposal is expected to save about USD 190 bn over the next 10 years, but if the reform agenda is stymied by political turmoil there is a risk that investors' newly-found confidence in Brazil would dissipate, which could prompt a sell-off in the BRL, higher inflation, more pressure on household finances, a worsening in the fiscal situation, and slower growth.

Pacific Alliance

Currency Outlook

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MEXICO — The peso continued to gain ground against the greenback for much of the recent few weeks, trading below 18 per USD for most of the month, and at times threatening to break 17.50. Our fundamental estimates suggests the peso is still cheap, and arguably among the weakest EMFX based on either REER or PPP. However, its still a very high beta FX, and should take a strong hit—as a proxy hedge if for no other reason—and it may be a good time to at least partially hedge.

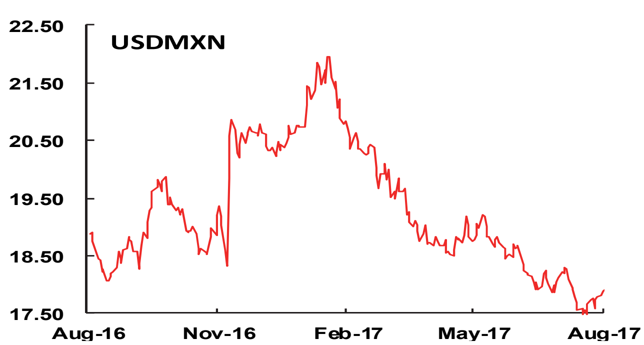
COLOMBIA — The peso has been somewhat volatile since the start of June. Following a sharp sell off a month ago, which was partly driven by fiscal concerns, we've since seen it stabilize a weaker level, around COP 3,000–3,100 per USD. The country is holding Presidential elections on May 2018, but for the moment the stronger preliminary contenders seem to be candidates that are seen as prudent by market participants, so we don't see politics as a major driver of volatility—at least for now.

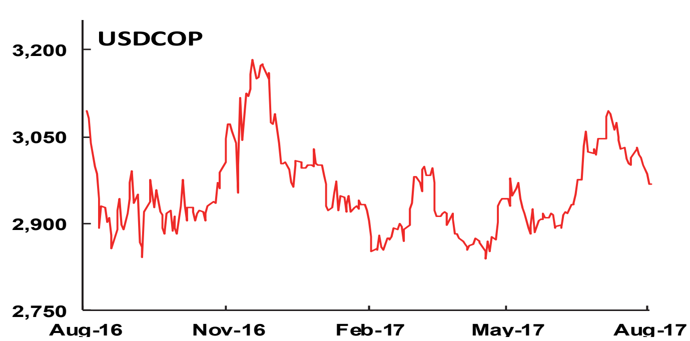
CHILE — Last month's volatility was partly explained by the country's credit rating cut, while going forward it will likely be due to the developments on the November Presidential election front. At the moment, it seems the likely candidates are all market friendly, and unlikely to drive violent volatility. On the data front, growth remains subdued, which is not helping fiscal dynamics, and is one of the main reasons for the credit ratings cut. It's relevant to highlight that the moderate pressure that resulted from the ratings cut has now been more than reversed, and the CLP is now stronger than at the time the cut was announced.

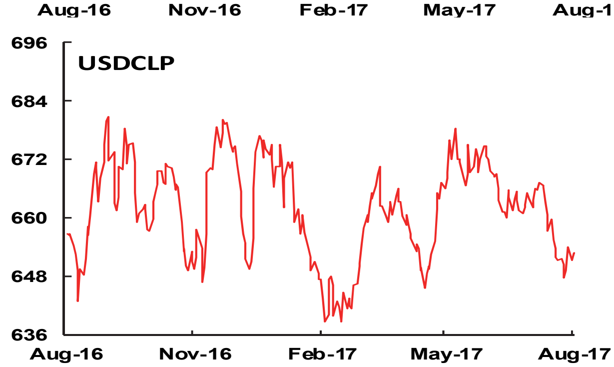
PERU — Despite a very complex political environment, where the PPK government is struggling to push through reforms, and even keep a consistent cabinet due to its weak presence in the legislative (about 10%), appetite has remained strong for Peruvian assets, likely because the country's macro fundamentals remain strong (growth, low debt, etc.) and even Peru's complex politics look somewhat stable. Hence, USDPEN continues to face downwards pressure, at times forcing the central bank to step in to intervene and keep appreciation at bay.

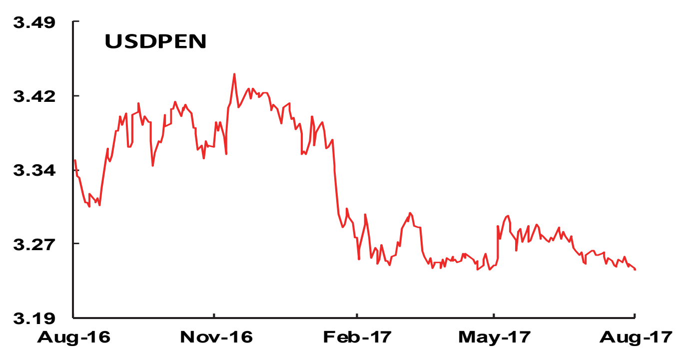
Currency Trends

FX Rate	Spot 2-Aug	17Q1a	17Q2a	17Q3f	17Q4f	18Q1f	18Q2f	18Q3f	18Q4f
USDMXN	17.91	18.72	18.12	18.46	19.32	19.52	19.37	19.44	19.70
USDCOP	2969	2874	3046	3015	3005	3100	3100	3050	3000
USDCLP	653	660	664	649	655	654	652	650	648
USDPEN	3.24	3.25	3.25	3.27	3.25	3.23	3.22	3.20	3.20









Pacific Alliance
Fundamental Commentary

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MEXICO — Recent events have been supportive of a stronger MXN, which reached levels close to 17.50 per USD. Worth noting is Standard and Poor’s change in the “Outlook” for the Mexican sovereign debt, to Stable from Negative, pointing out the economic authorities response to the negative shocks experienced by the Mexican economy and resting on the assumption that the NAFTA renegotiation will end with a positive result. There are, however, several factors that will have some impact on the MXN the coming months, most of them injecting uncertainty. The first of these is the negotiation process of NAFTA, which after the first weeks will throw some signs about the tone and obstacles faced by the parties. Since this negotiation appears to be complicated, it is hard to think there will be positive news from the beginning, and then it could provide some drive for a higher exchange rate. Second, the Federal Reserve monetary policy normalization will also have an impact on the MXN, and since the Fed is wording the beginning of the reduction of its balance sheet relatively soon, that could also provide a drive for a higher MXN. Finally, the internal political environment represents another uncertainty driving factor for the MXN, since there will be a new governor in Banco de Mexico, the presidential candidates could be defined and there is also the expectation of changes in the cabinet.

COLOMBIA — The Colombia peso has been somewhat volatile since the start of June. Following a sharp sell off a month ago, which was partly driven by fiscal concerns as the positive expectations regarding the impact of the tax reform where undershot, we've since seen it stabilize at a weaker level, around COP 3,000–3,100 per USD. Valuation metrics for both FX and local rates still look somewhat cheap relative to metrics like PPP or REER, but on a relative value perspective, there are other EMs that look more compelling, and we are starting to see some rotation out of Colombia, and into other emerging markets. In terms of what could trigger a sharp Colombian peso sell-off, our main concern is the important increase we have seen in the foreign holdings of local currency Colombian government debt (TES). From levels around 20% about 1.5 years ago, we have seen foreign holdings increase to a couple of percentage points under 30%. The risk here is that if we were to get a turn in global risk appetite, we could either get outflows from the bond market, or at least pressure on COP as hedges are put on. On the political front, the country is holding Presidential elections in May 2018, but for the moment the stronger preliminary contenders seem to be candidates that are seen as prudent by market participants, so we don't see politics as a major driver of volatility—at least for now.

CHILE — The CLP received support in July due to several effects (most of them highly correlated with each other): rising copper price (positive), the broad based decline of the greenback and very strong global risk appetite. Those factors are important and could persist, but seemed to have reached extreme values in the past month. The main two risks for our forecast are the Chinese growth expectation for 2018 and what the Fed is construing as the neutral interest rate for the US economy. In both cases the volatility may be higher as we get closer to the end of the year and first months of next. Domestic risk related with Presidential and parliamentary elections on November 19th might cause some turbulence, but it would be short lived. Political risk has demonstrated to have a limited effect on the exchange rate in Chile in the past and that is likely to remain so in the future. As room for a more supportive monetary policy looks very limited (the most enthusiastic expect just a couple of 25bp cuts in coming months), and that is the only domestic variable able to influence the exchange rate, but require dramatic changes in level, possibilities for domestic fundamental factors to derail the exchange rate trend are scarce compared with foreign ones.

PERU — Politics continue to dominate over economics in Peru. Congress appointed Luis Galarreta, one of the government’s most vocal opponents to preside the 2017–2018 legislature. This may not be a bad thing, as Galarreta has signaled that he will now adopt a more conciliatory stance, opening up the door to establishing a working relationship with the government. GDP growth has been a paltry 1.9% in the year-to-May. We expect a natural post-Niño rebound henceforth, however the strength of the rebound will depend largely on government spending. The second semester will tell us how strong the rebound is, and how aggressive the government will be in its public investment plans. With the resignation of Alfredo Thorne as Minister of Finance, and his replacement by the head of the cabinet, Fernando Zavala (who will have a dual responsibility), fiscal policy is becoming clearly more expansionary. The government has announced a number of spending initiatives, as well as modest progress in infrastructure tenders. However, the government goal of a 19% increase in public sector investment in the second semester is a tall order. But, it does have the intention and the resources, so whatever delay in spending occurs this year will only mean more spending in 2018. The Central Bank has signaled that monetary policy will continue to be supportive of growth, which means that further decreases in its reference rate, currently at 3.75% are possible. Inflation, at 2.7%, annual, has declined sharply post-El Niño. Price stability includes the FX market. With external accounts strengthening more than expected, we ratify our year-end FX forecast of S/ 3.25.

Developing Economies

Currency Outlook

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SOUTH KOREA — The KRW will remain susceptible to external uncertainty. Growing concern over global liquidity conditions or geopolitical tensions could weigh on the KRW, and vice versa. The nation's foreign reserves have climbed persistently in the past four months. We would like to add to our long CNHKRW cross position on dips, while expecting USDKRW to trade in a range of 1,110 to 1,180 in August and September.

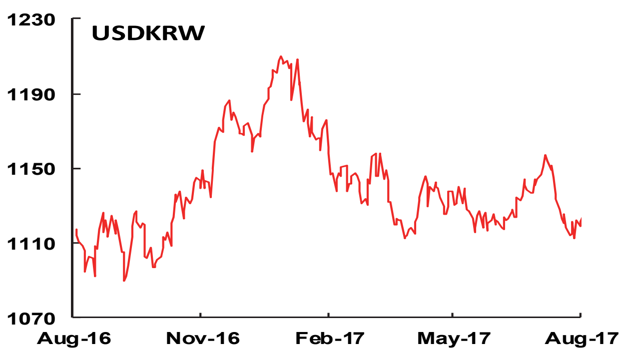
THAILAND — The THB has outperformed other regional currencies since end-May, although the central bank has stepped up efforts to discourage foreign investors from chasing higher real yields of local bonds. The THB will trade along with other EM Asian currencies but remain more resilient given the nation's solid external balance. Meanwhile, we note an excessively strong THB is not in local regulators' interest. USDTHB is expected to trade in a range of 33.0–33.8 in August to September.

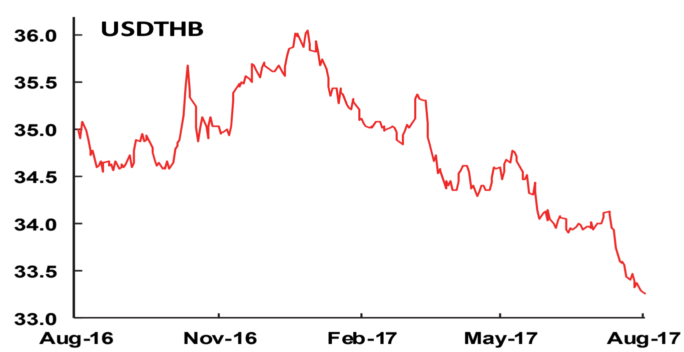
TAIWAN — The CBC is scheduled to release the minutes of June board meeting on 3 August to increase the transparency of policy making. The TWD has remained relatively steady amidst outward remittance of dividend payments. We think the new iPhone model due in September could prop up the TWD to some extent. USDTWD is anticipated to trade between 30.0 and 30.6 in the month of August and September. We maintain our long SGDTWD cross position with a target of 22.5.

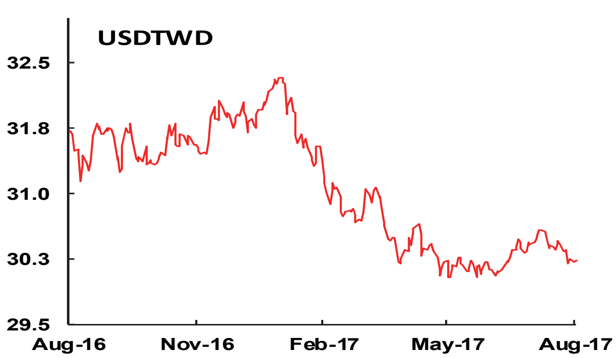
MALAYSIA — Foreign investors added to their holdings in local shares in July, sending the MYR slightly stronger. The BNM said on 13 July that the MYR has remained stable following the implementation of the two financial market development measures. We expect the MYR to follow a broader market tone with a lower volatility in the weeks ahead. The 4.30 level will continue to serve as a resistance for USDMYR in the third quarter.

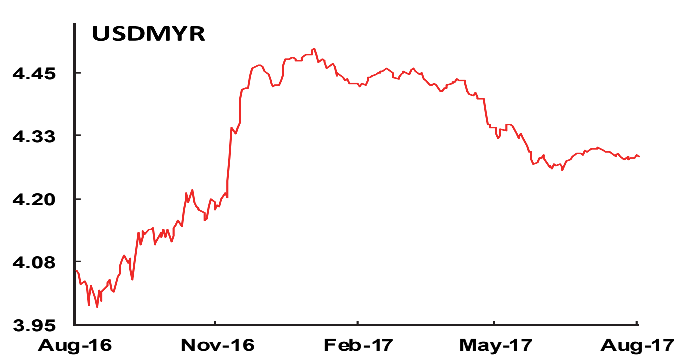
Currency Trends

FX Rate	Spot 2-Aug	17Q1a	17Q2a	17Q3f	17Q4f	18Q1f	18Q2f	18Q3f	18Q4f
USDKRW	1124	1118	1144	1140	1160	1140	1140	1120	1120
USDTHB	33.3	34.4	33.9	33.4	33.6	33.4	33.4	33.2	33.2
USDTWD	30.2	30.3	30.4	30.4	30.6	30.4	30.4	30.2	30.2
USDMYR	4.29	4.43	4.29	4.30	4.32	4.30	4.30	4.28	4.28









Developing Economies

Fundamental Commentary

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SOUTH KOREA — South Korea's economy is driven by domestic demand. Real GDP grew by 2.7% y/y in the second quarter compared with a 2.9% gain in the first quarter. Exports have responded to stronger global demand, but net exports are not contributing to GDP growth as imports are growing even faster than exports. We expect the nation's output to rise 2.8% in 2017, in line with the growth recorded in 2016. In July, the National Assembly passed a KRW11tn (USD9.6bn, equivalent to 0.6% of GDP) supplementary budget for the second half of this year. The spending is aimed at boosting the nation's job market, with a particular focus on addressing high youth unemployment (of 10.5%). The Bank of Korea (BoK) will likely leave the benchmark interest rate at the current level of 1.25% until the second quarter of 2018 when a cautious monetary tightening phase will commence. Inflation remains contained despite the fact that the headline inflation rate rose to 2.2% y/y in July from 1.9% a month before. We assess that a pick-up in inflation in the third quarter is temporary as it largely reflects base effects; the rate will likely return to the BoK's 2% inflation target by the end of the year. In July, the US requested a special session to be held with South Korea to discuss possible modifications to the Korea-US Free Trade agreement, which has been in force since March 2012. South Korea has accepted the invitation.

THAILAND — The Bank of Thailand's (BoT) monetary policy stance is set to remain accommodative for an extended period of time. The BoT's benchmark interest rate has been at 1.50% since April 2015; we expect the policy rate to remain at the current level until the second quarter of 2018 when a gradual monetary tightening cycle will likely begin. Following the most recent monetary policy meeting on July 5, the BoT's policymakers assessed that Thailand's economic growth momentum has improved, driven by a sounder external sector performance. Growth in merchandise exports—across various product categories—as well as tourism services has strengthened. On the domestic demand front, public sector investment spending will continue to be an important driver of activity. The BoT tweaked Thailand's 2017 real GDP growth forecast slightly upwards to 3.5% (from 3.4%). We remain somewhat more cautious until we see firmer data on private consumption and investment; we expect the country's output to advance by 3.2% this year. Thailand's inflationary pressures remain muted with prices at the headline level rising by 0.2% y/y in July, below the BoT's medium-term inflation target of 2.5% y/y ±1.5%. Nevertheless, we expect inflation to accelerate gradually over the coming months, reaching 1½% y/y in the second quarter of 2018.

TAIWAN — The Taiwanese economy has had a solid first half of the year. According to preliminary estimates, real GDP grew by 2.1% y/y in the second quarter following a 2.6% gain in the first three months of 2017. The external sector is the driving force of the economy. Growth in machinery and electrical equipment exports has been solid in recent months. As implied by strong export orders, the country's manufacturers and exporters will be further bolstered by the launch of the new Apple iPhone. We expect Taiwan's real GDP growth to average 2.2% in 2017, up from the 1.5% expansion recorded in 2016. The Taiwanese central bank held a quarterly monetary policy meeting on June 22. As expected, the benchmark interest rate was left unchanged at 1.375% on the back of a muted inflation outlook. We foresee a cautious tightening cycle to commence in the second quarter of 2018, with the key rate closing 2018 at 1.75%. The CPI increased by 1.0% y/y in June compared with a 0.6% y/y reading in May. The headline inflation rate will continue to rise over the next few months due to a hike in the country's cigarette tax. Nevertheless, underlying inflationary pressures remain contained on the back of low oil prices, weak inflation expectations, and soft domestic demand.

MALAYSIA — The Malaysian economy is performing strongly. Growth is driven by sound domestic demand, particularly private spending that is underpinned by continued wage and employment gains. Export growth is solid as well, yet strong domestic demand is supporting imports and limiting the external sector's contribution to real GDP growth. We expect the country's economy to expand by 4.9% this year, up from the 4.2% gain recorded in 2016. Malaysia's monetary conditions remain accommodative, buttressing economic activity. Following the July 13 monetary policy meeting, the central bank kept the Overnight Policy Rate at 3.0%; the key rate has remained at that level since July 2016. We do not foresee any changes to the benchmark interest rate over the coming months. Nevertheless, with domestic demand growing strongly, a monetary tightening phase is gradually approaching. We expect the central bank to start raising the benchmark interest rate cautiously around mid-2018. Malaysia's headline inflation rate eased to 3.6% y/y in June from 5.1% in March, reflecting slightly weaker price pressures in the transportation component of the CPI index, which includes the price of petrol. Monetary authorities expect further moderation over the second half of the year. We forecast that headline inflation will close 2017 at 3.1% y/y. The next general election is scheduled to be held by May 2018, yet the poll may be called early.

Global Currency Forecast (end of period)

		2017f	2018f	2017f				2018f			
Major Currencies				Q1a	Q2a	Q3	Q4	Q1	Q2	Q3	Q4
Japan	USDJPY	110	115	111	112	110	110	112	112	115	115
Euro zone	EURUSD	1.13	1.20	1.07	1.14	1.12	1.13	1.15	1.18	1.20	1.20
	EURJPY	124	138	119	128	123	124	129	132	138	138
UK	GBPUSD	1.28	1.31	1.26	1.30	1.28	1.28	1.28	1.28	1.31	1.31
	EURGBP	0.88	0.92	0.85	0.88	0.88	0.88	0.90	0.92	0.92	0.92
Switzerland	USDCHF	0.97	0.93	1.00	0.96	0.98	0.97	0.97	0.95	0.93	0.93
	EURCHF	1.10	1.12	1.07	1.10	1.10	1.10	1.12	1.12	1.12	1.12
Americas											
Canada	USDCAD	1.28	1.25	1.33	1.30	1.30	1.28	1.28	1.27	1.25	1.25
	CADUSD	0.78	0.80	0.75	0.77	0.77	0.78	0.78	0.79	0.80	0.80
Mexico	USDMXN	19.32	19.70	18.72	18.12	18.46	19.32	19.52	19.37	19.44	19.70
	CADMXN	15.09	15.76	14.06	13.99	14.20	15.09	15.25	15.25	15.55	15.76
Brazil	USDBRL	3.45	3.40	3.12	3.31	3.35	3.45	3.55	3.60	3.60	3.40
Chile	USDCLP	655	648	660	664	649	655	654	652	650	648
Colombia	USDCOP	3005	3000	2874	3046	3015	3005	3100	3100	3050	3000
Peru	USDPEN	3.25	3.20	3.25	3.25	3.27	3.25	3.23	3.22	3.20	3.20
Uruguay	USDUYU	31.0	33.5	28.6	28.4	30.0	31.0	31.5	32.0	33.0	33.5
Asia-Pacific											
Australia	AUDUSD	0.75	0.78	0.76	0.77	0.75	0.75	0.77	0.77	0.78	0.78
China	USDCNY	6.80	6.70	6.89	6.78	6.75	6.80	6.75	6.75	6.70	6.70
Hong Kong	USDHKD	7.80	7.78	7.77	7.81	7.80	7.80	7.79	7.79	7.78	7.78
India	USDINR	65.0	64.0	64.9	64.6	64.5	65.0	64.5	64.5	64.0	64.0
Indonesia	USDIDR	13400	13300	13322	13348	13350	13400	13350	13350	13300	13300
Malaysia	USDMYR	4.32	4.28	4.43	4.29	4.30	4.32	4.30	4.30	4.28	4.28
New Zealand	NZDUSD	0.72	0.74	0.70	0.73	0.72	0.72	0.73	0.73	0.74	0.74
Philippines	USDPHP	51.0	50.0	50.2	50.5	50.5	51.0	50.5	50.5	50.0	50.0
Singapore	USDSGD	1.38	1.34	1.40	1.38	1.36	1.38	1.36	1.36	1.34	1.34
South Korea	USDKRW	1160	1120	1118	1144	1140	1160	1140	1140	1120	1120
Taiwan	USDTWD	30.6	30.2	30.3	30.4	30.4	30.6	30.4	30.4	30.2	30.2
Thailand	USDTHB	33.6	33.2	34.4	33.9	33.4	33.6	33.4	33.4	33.2	33.2

f: forecast a: actual

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