

AMERICAS

The USD's short covering rally is running out of steam with a lot of good news in terms of growth and rate expectations priced in. Longer term structural challenges remain and the underlying secular trend remains negative. The CAD and MXN may be buffeted by trade tensions. We think the positive evolution in Canada's terms of trade will support the CAD but the MXN may remain volatile ahead of the presidential election. Regional LATAM FX has held up very well during the recent phase of USD strength.

EUROPE

The EUR sell-off is looking over extended and we expect a stabilization and recovery. Heightened, politically-inspired volatility in Italian and Spanish markets should remain contained. Rising inflation pressures will support ECB policy normalization expectations. The GBP's decline has also moderated but lingering Brexit risks suggests that further weakness remains possible.

ASIA-PACIFIC

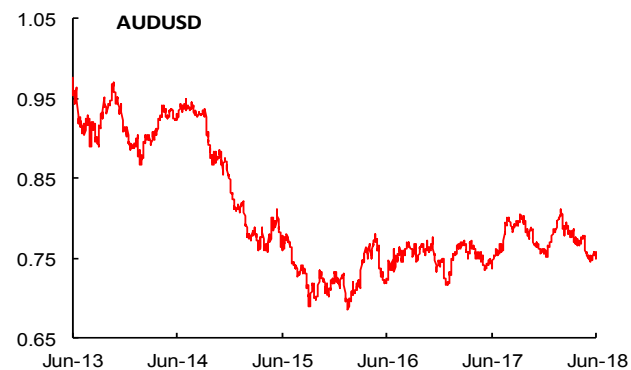
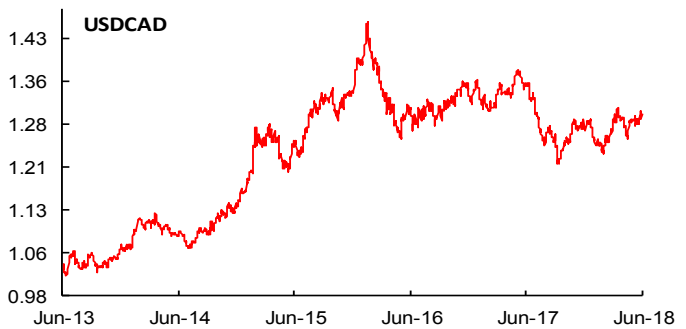
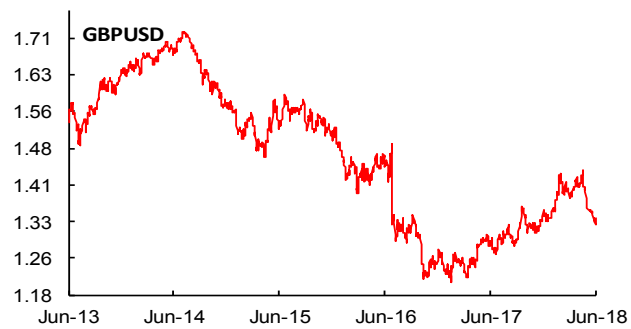
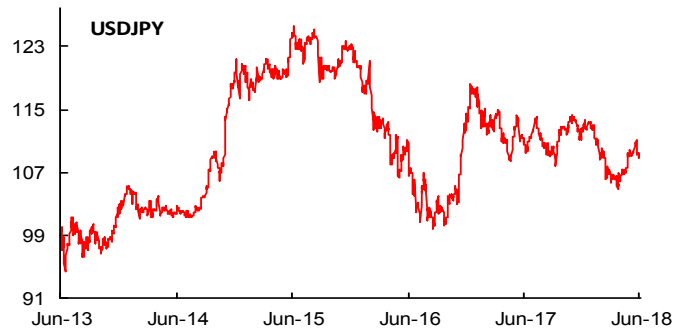
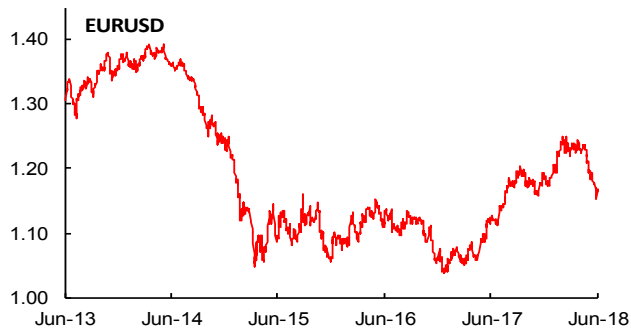
We expect the JPY to retain a softer bias as the BoJ pursues policy accommodation but that trend may be interrupted briefly by periods of safe-haven related demand. We expect the CNY to remain broadly stable in the near-term.

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Core Exchange Rates

Global Foreign Exchange Outlook									
June 1, 2018	2018f					2019f			
	Spot	Q1a	Q2	Q3	Q4	Q1	Q2	Q3	Q4
EURUSD	1.17	1.23	1.25	1.28	1.30	1.30	1.33	1.35	1.35
USDJPY	110	106	108	110	110	110	110	108	105
GBPUSD	1.34	1.40	1.40	1.42	1.47	1.48	1.48	1.50	1.50
USDCAD	1.30	1.29	1.27	1.26	1.25	1.25	1.22	1.22	1.25
AUDUSD	0.76	0.77	0.79	0.80	0.80	0.81	0.81	0.82	0.82
USDMXN	19.86	18.18	20.13	20.07	19.95	20.06	19.89	19.94	20.23



Market Tone & Fundamental Focus

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The US dollar (USD) retains a firm undertone and continues to out-perform relative to our (and most banks') expectations. The currency weakened steadily through late 2017 and into early 2018 amid fears over dysfunction in Washington and a growing appreciation among investors for the improving fundamental prospects outside of the US. The USD's recent rebound has been abrupt, however, driven by position-adjustment initially and fueled more recently by a jolt of political concerns in Europe.

The US economy retains a strong undertone overall and looks poised to grow strongly this year. But the Fed appears in no hurry to tighten rates, signaling via its latest meeting minutes that policy makers could allow inflation to run a little "hot" in the future. That dampened market expectations that the Fed tightening process could step up a gear in the coming months. We think a lot of good news is already priced in to the USD in the form of growth and rate expectations and view current strength as unsustainable. Longer-term risks remain for the USD in the form of structural negatives (wider US fiscal imbalances) and bearish, longer-term secular pressures.

While we remain positive on the longer term outlook for the CAD, the ongoing focus on Canada's trade relationship with the US has clouded some positive developments on the fundamental front. The global economic cycle, reflecting positive growth prospects and rising, if still very low, inflation pressures represents a "sweet spot" for commodity prices. Firm energy, lumber and metals prices recently have produced a significant, positive swing in Canada's terms of trade—fully reversing the terms of trade deterioration seen in 2015/16 amid the slump in crude oil prices. This is a powerful economic positive for the Canadian economy and would, ordinarily, constitute a significant source of strength for the CAD. The Bank of Canada left the door wide open for a moderate tightening in monetary policy in the next few months and appears to be looking through near-term trade uncertainties. We feel that fundamental CAD positives (such as terms of trade) are not fully reflected in the exchange rate currently.

European currencies have borne the brunt of the USD rebound over the past month but we think the EUR in particular is looking oversold. Italian and Spanish political developments may cloud the near-term outlook for the currency but we think growth should be steady and improve after a "soft patch" at the start of the year while inflationary pressures may be ticking higher through the spring amid rising energy prices. We continue to expect a gradual normalization process in the European Central Bank's asset purchase program in the coming months, ahead of a modest tightening in interest rates in 2019. The pound (GBP) looks somewhat more vulnerable in the near-term, however. UK rate hike expectations have receded sharply and the UK government is struggling to develop a workable Brexit policy. We rather think near-term risks for the GBP have tilted to the downside again but valuation considerations should limit broader losses in the weeks ahead to the USD1.30 area.

We expect the Mexican peso (MXN) to end this year near current levels but the MXN's recent performance has been somewhat defensive, with the USD testing the MXN20 zone amid a rise in broader market volatility. Market volatility may rise around trade talks and the July Presidential election but we expect Banxico to closely monitor developments and note our forecast continues to reflect an expectation for a further, modest tightening in monetary policy later this year. The major Latin American currencies have been remarkably resilient to the stronger USD, heightened regional FX volatility (centered on Brazil and Argentina) as well as a jump in broader market risk aversion. The Peruvian sol (PEN), Chilean peso (CLP) and Colombian peso (COP) have softened but positive economic data have helped keep the PEN's losses to a minimum (less than 0.5% down versus the USD over the past month). The first round of Colombia's presidential election provided no surprises for the COP. The PEN, COP and CLP all out-performed versus their G-10 peers over the past month.

We are bearish on the Japanese yen (JPY), primarily because we expect the Bank of Japan will retain significant policy accommodation over our forecast horizon amid stubbornly low inflation. The JPY has strengthened modestly over the past month amid temporary, safe-haven demand, however. Regional currency prospects continue to be clouded by geo-political and trade risks. Rising interest rates and generally tighter monetary conditions do represent a threat to the more highly leveraged economies in the region, however. We expect the Chinese yuan to remain in a broader range in the near-term but trends in the currency generally are liable to mirror developments in the major currencies' performance versus the USD.

Canada
Currency Outlook

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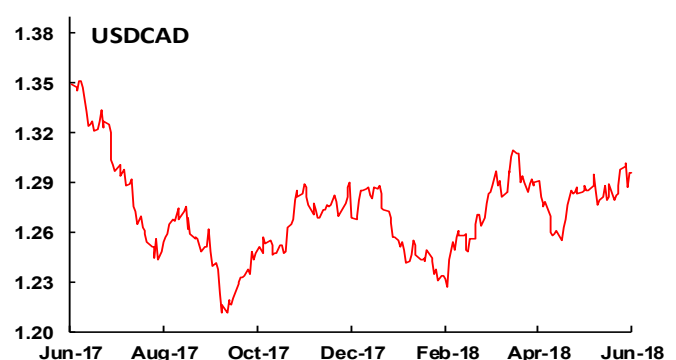
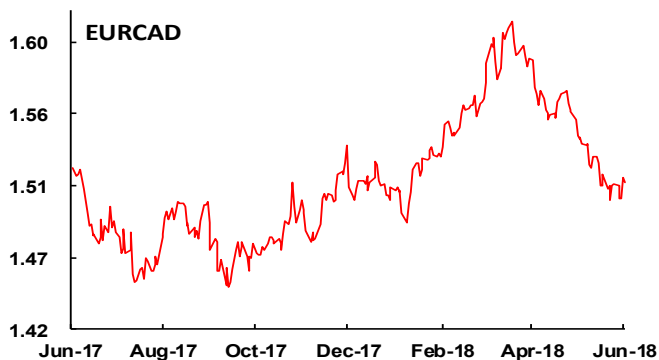
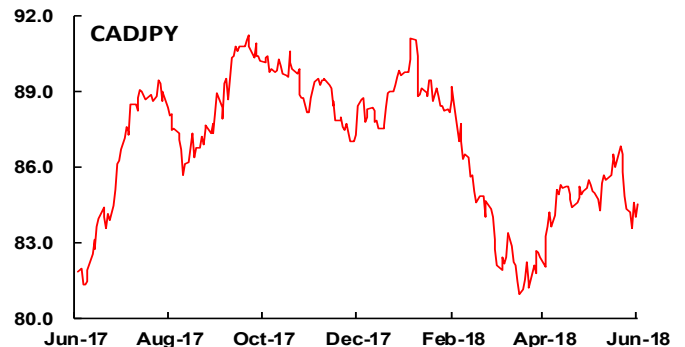
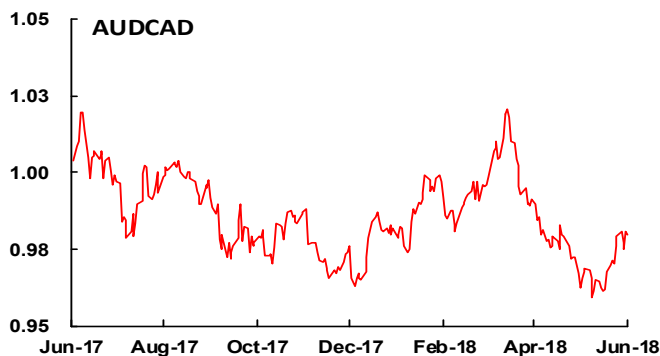
After a protracted period of softness through Q1, the past month has at least seen the CAD stabilize against the USD. This has driven a fairly significant CAD out-performance on the crosses but we do think the CAD is overdue for a rise against the USD.

Much of our focus in the past few weeks has been on the sharp improvement in Canada's terms of trade, reflecting strong gains for key commodity prices. Terms of trade have made back all the ground lost during the negative terms of trade swing in 2015, reflecting the slide in oil prices, and returned to levels prevailing when USDCAD was trading nearer the 1.10 level. Meanwhile, the Bank of Canada is sounding more confident about the outlook for moderately tighter monetary policy (we expect two 25bps rate hikes in the second half of the year) and economic data trends certainly support the notion of the economy growing at around 2%, or a little above potential at present.

While we do not think USDCAD will drop to the 1.10 area, we do think narrowing US-Canada yield differentials and firm commodity prices support USDCAD pushing back to the 1.25 area (about where we expect the USD to end the year) in the next few weeks, all else remaining equal.

Trade renegotiations have been a restraint on the CAD's ability to strengthen which rather suggests that markets have already factored in an adverse (for Canada) outcome to trade talks. Our base case remains for a NAFTA agreement (eventually) which suggests some scope for a relief rally in the CAD ahead and bolsters the case for a bounce in the currency towards 80 cents (US – or about CAD1.25).

Canadian Dollar Cross-Currency Trends									
FX Rate	Spot 1-Jun	18Q1a	18Q2f	18Q3f	18Q4f	19Q1f	19Q2f	19Q3f	19Q4f
AUDCAD	0.98	0.99	1.00	1.01	1.00	1.01	0.99	1.00	1.03
CADJPY	84.5	82.4	85.0	87.3	88.0	88.0	90.2	88.5	84.0
EURCAD	1.51	1.59	1.59	1.61	1.63	1.63	1.62	1.65	1.69
USDCAD	1.30	1.29	1.27	1.26	1.25	1.25	1.22	1.22	1.25



United States and Canada

Fundamental Commentary

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UNITED STATES — The US economy is picking up after a slow start to the year. GDP growth in the second quarter is tracking around a 3% annualized rate, with firmer retail sales reinforcing ongoing strength in industrial activity and services. Household spending remains well supported by a robust job market, solid income growth, and stronger household balance sheets. Steady hiring gains have pushed the unemployment rate to just 3.9%, its second lowest reading in 48 years, while broader measures of labour market slack are at cycle lows. Consumer confidence is near a 17-year high, and major purchase plans remain elevated. Industrial production is advancing at a solid 4% y/y clip, paced by a booming oil and gas sector, and more modest expansion in manufacturing output. Tightening production constraints—industrial capacity utilization is at its highest level in over three years—and corporate tax reforms are driving increased business investment in machinery and equipment and structures. Export growth also has picked up on the back of firmer global demand and a 5% slide in the trade-weighted US dollar over the past year. Service sector activity is expanding broadly, led by transportation and warehousing, and professional and business services. Fiscal stimulus is expected to provide a sizeable boost to GDP growth, with an average contribution of about half a percentage point this year and next. Inflation pressures are trending higher alongside the tightening in labour and production capacity: the core PCE deflator increased 2% y/y in April, up from a low of 1.3% last August.

CANADA — Canadian economic growth is moderating from 2017's banner year. Real GDP rose an annualized 1.3% in the first quarter of 2018, in line with our estimate of potential. Several temporary factors, including transportation bottlenecks and maintenance shutdowns, have weighed on recent activity. Growth is expected to rebound back above a 2% annualized rate over the remainder of the year. Consumer spending remains quite resilient, supported by a robust labour market and rising wage gains. The unemployment rate has fallen to a 43-year low of 5.8%, while average hourly earnings growth has accelerated sharply to 3.6% y/y as of April. Even so, rising borrowing costs and slower employment gains are expected to temper household spending in the year ahead. Stricter mortgage underwriting guidelines and higher interest rates have begun to slow home sales, though residential construction volumes remain elevated. Auto sales appear to have plateaued. Service sector activity remains brisk, with 12 of the 15 major subsectors posting healthy expansion over the past year, led by arts and entertainment, wholesale trade, and transportation and warehousing. Manufacturing activity is accelerating, and order books remain firm. Business investment is picking up alongside tightening capacity rates, though ongoing trade-related uncertainties and competitiveness challenges are curtailing major expansion plans. Forward-looking surveys of investment intentions have become more cautious. The latest trade figures point to underlying support from both external and domestic demand. Federal and provincial fiscal stimulus remains highly pro-cyclical. Inflationary pressures, while rising, are relatively well contained. The average of the Bank of Canada's preferred measures of core inflation held steady at 2.0% y/y in April, compared with a low of 1.3% last May.

G10

Currency Outlook

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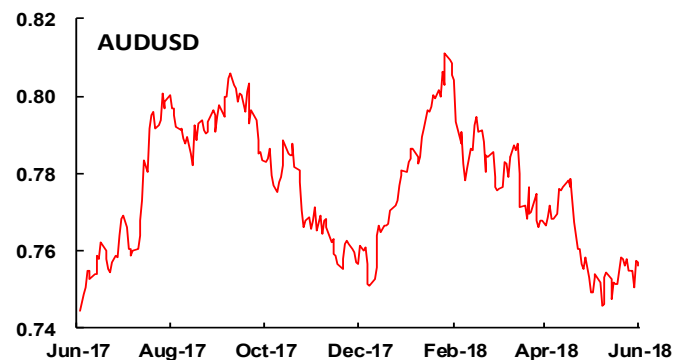
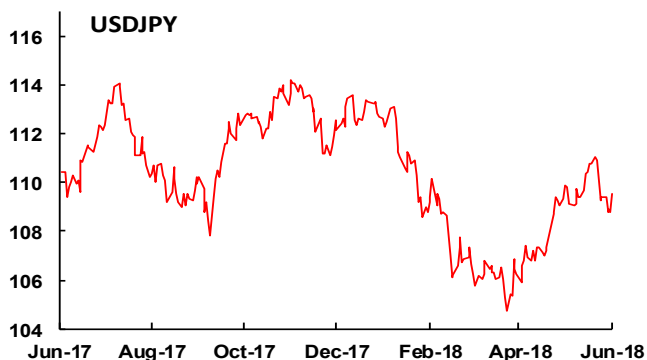
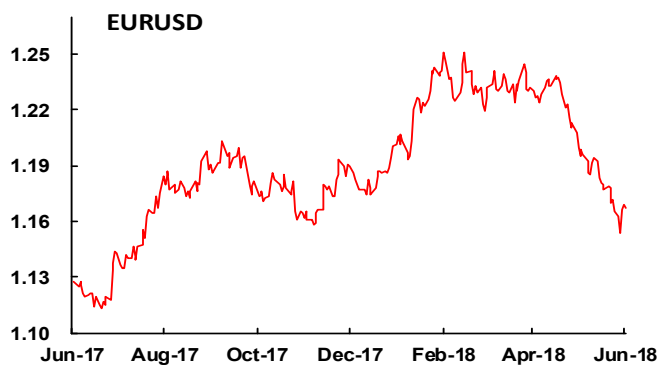
EUROZONE — EUR is entering June on the defensive just above its 10 month low around 1.15. The recent decline leaves EUR technically oversold and poised for a rebound. Interest rate differentials and risk reversals have shown signs of stabilization from extended levels, opening up the potential for a shift in the balance of risk. We remain long-term EUR bulls and hold a Q4 2018 forecast of 1.30 and a Q4 2019 target of 1.35.

UNITED KINGDOM — GBP is weak and entering June around 1.33, down over 7% from its mid-April high. Positioning adjustments and softening rate expectations have characterized much of the recent movement in GBP. Domestic developments appear set to remain dominant throughout the month of June as market participants look to upcoming parliamentary votes on Brexit legislation. We remain bullish GBP with a Q4 2018 forecast of 1.47 and a Q4 2019 target of 1.50.

JAPAN — JPY is showing early signs of stabilization following its recent safe haven rally. Fundamentals remain bearish in a rising rate environment, and we hold a Q4 2017 USDJPY forecast of 110. The outlook for relative central bank policy is expected to provide JPY support in 2019. We hold a Q4 2019 USDJPY target of 105.

AUSTRALIA — AUD has shown some signs of stabilization through the month of May, halting a three month run of weakness from the late January high. Measures of sentiment and positioning are bearish and appear relatively extended, leaving AUD vulnerable to adjustment. We remain bullish and hold a Q4 2018 forecast of 0.80 and a Q4 2019 target of 0.82.

Currency Trends									
FX Rate	Spot 1-Jun	18Q1a	18Q2f	18Q3f	18Q4f	19Q1f	19Q2f	19Q3f	19Q4f
EURUSD	1.17	1.23	1.25	1.28	1.30	1.30	1.33	1.35	1.35
GBPUSD	1.34	1.40	1.40	1.42	1.47	1.48	1.48	1.50	1.50
USDJPY	110	106	108	110	110	110	110	108	105
AUDUSD	0.70	0.77	0.79	0.80	0.80	0.81	0.81	0.82	0.82



G10**Fundamental Commentary**

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EUROZONE — Survey and activity data have come off the boil of late, but are still pretty hot. Surveys such as the German Ifo have lost ground of late, but remains above the pre-crisis peak. Surveys are still consistent with robust expansion in activity indicators, with GDP growth above trend. Nonetheless, recent political volatility has renewed concerns about the eurozone, particularly given the anti-establishment leadership in Italy and corruption claims in Spain. Ultimately we doubt these will derail the ongoing recovery in the eurozone. However, it once again illustrates the region's vulnerabilities. Underlying inflation has remained stubbornly low, with core inflation languishing below 1% once again. Headline inflation is only a little higher at 1¼% y/y, but we expect the pace to approach 2% during H2. Against that backdrop, the ECB could yet expand its QE programme once the latest instalment runs out in September. However, our base case is that with headline inflation close to target, GDP growth above trend and the US and UK in hiking mode, the ECB will stop its asset purchase programme in September.

UNITED KINGDOM — The BoE left rates on hold at the May MPC meeting—having been persuaded to wait to see if the recent soft patch in the activity data was transitory or more deep-rooted. The recent downwards surprise in the CPI inflation data also didn't help the committee to rush into another rate hike. We judge that the situation is a case of 'not now' rather than, 'not this year' as some have suggested. In particular, if the Q1 weakness proves transitory—i.e. Q2 GDP resumes at least trend-like expansion, then that is one pre-condition for a near term hike. We also expect CPI inflation to exceed the BoE's 2.5% y/y assumption for June—the last print ahead of the August Super Thursday—another box ticked for a hike. Last but not least, if unemployment continues to fall or employment rises at the recent pace, this will point to narrowing spare capacity. We believe that the combination of these three signals would cement the case for a BoE rate hike at the August meeting.

JAPAN — Recent soft GDP and inflation data suggest that the Bank of Japan (BoJ) will not be normalizing monetary policy any time soon. We expect the central bank to continue its "Quantitative and Qualitative Monetary Easing with Yield Curve Control" through 2019. The next monetary policy meeting is scheduled for June 15. Japan's real GDP contracted 0.2% q/q (non-annualized) in the first quarter of 2018, according to preliminary estimates. Domestic demand growth was virtually flat while net exports supported the economy. In year-over-year terms, the economy expanded by 0.9% compared with a 1.8% pace recorded in the final quarter of 2017. While the weak outcome is concerning, it is worth noting that Japan's GDP figures are often revised substantially; revised Q1 data will be published on June 8. We now expect Japanese output gains to average 1.0% y/y in 2018–2019. Japan's headline inflation rate dropped to 0.6% y/y in April from 1.1% a month earlier. The CPI excluding fresh food—the BoJ's preferred measure—is currently at 0.7% y/y while the measure that leaves out both food and fuel remains low at 0.4% y/y, highlighting the absence of demand-driven inflation. We estimate that headline inflation will barely reach 1% y/y by the end of this year. The planned hike in the consumption tax rate from 8% to 10% in October 2019 will temporarily take inflation above the BoJ's 2% inflation target in late 2019. The key factor impacting future demand-driven price pressures is wage inflation; encouragingly, real wages rose by 0.8% y/y in March, marking the first gain in 2018.

AUSTRALIA — Australia's Treasurer Scott Morrison delivered the Federal Budget for fiscal year 2018–19 (July–June) on May 8. The country's budget deficit (i.e. the underlying cash balance) is expected to narrow from an estimated AUD18.2bn (1.0% of GDP) in FY2017–18 to AUD14.5bn (0.8% of GDP) in FY2018–19. The government remains committed to returning public finances into a balanced position in FY2019–20 and to a surplus by FY2020–21. A key measure in the Budget is a seven-year scheme to lower personal income taxes for low and middle-income earners; furthermore, the planned corporate tax cut was maintained. Australia's improved budgetary outlook was welcomed by Standard & Poor's (S&P) and Moody's. S&P pointed out that there is now less pressure on Australia's "AAA" sovereign credit rating, yet it maintained a "negative" outlook on the rating due to uncertainties related to global trade tensions and emerging market vulnerabilities. Moody's maintains Australia's triple-A rating with a "stable" outlook. According to May 1 meeting minutes, the Reserve Bank of Australia's (RBA) monetary policymakers agree that it is "more likely that the next move in the cash rate would be up, rather than down". Nevertheless, they also highlight that "there was not a strong case for a near-term adjustment in monetary policy". We maintain our long-held forecast that the RBA will begin a cautious monetary normalization phase in the fourth quarter of 2018 on the back of expected gradual strengthening in wage pressures that will feed demand-driven inflation. Australia's headline inflation remained unchanged at 1.9% y/y in the first quarter of 2018. We expect it to hover below the mid-point of the RBA's 2–3% target range through 2018.

China, India, Brazil
Currency Outlook

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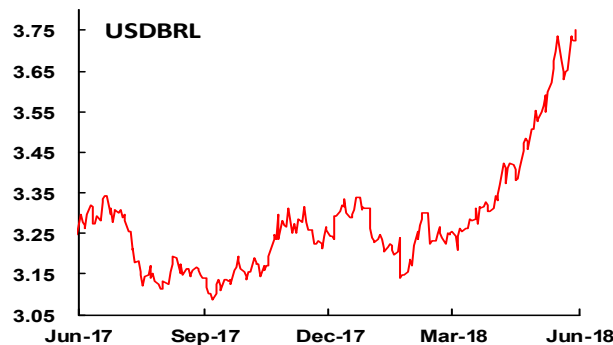
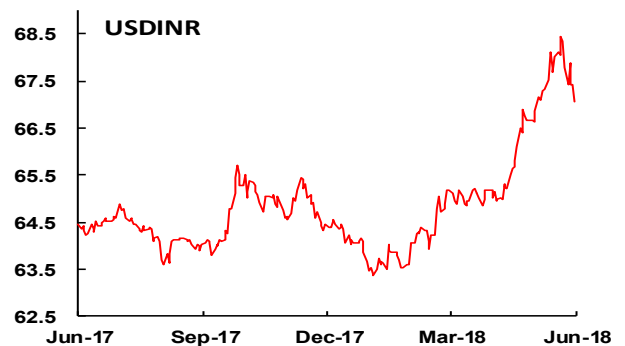
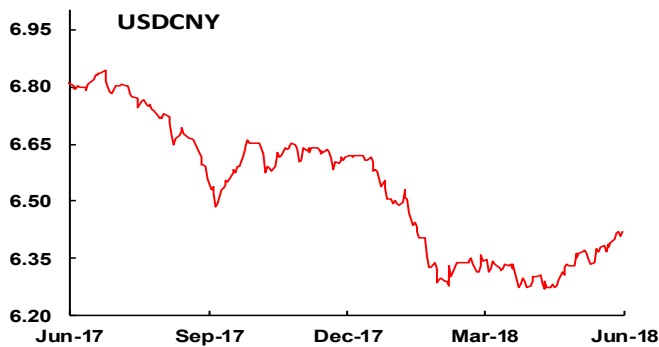
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CHINA — With China A-share MSCI inclusion, more foreign investors will raise their holdings in yuan-denominated financial assets in the months and years ahead. It will bolster the yuan in the medium- to long-term. The PBoC will likely set USDCNY fixing with an upside bias going forward for a pullback in the CFETS RMB index. The CNY is expected to continue running a tight correlation with the EUR and to fluctuate in a range of 6.35-6.45 in June.

INDIA — The INR dropped further amid portfolio outflows in May. The RBI's monetary policy committee will meet for three days in June rather than the typical two days, heralding a possible 25 bps rate hike on June 6. Oil prices could consolidate for a while as major oil producers will discuss a relaxation of the global oil production cap in Vienna on June 22, which could alleviate some downward pressure on the INR. USDINR is likely to trade between 67.5 and 69.0 in June.

BRAZIL — The BRL got crushed the past month, with a combination of domestic political turmoil (trucker strikes, lack of reforms, and fiscal uncertainty), rising US yields, and a lower carry in the *real* all contributing to make it the third worst performing emerging markets FX (-5.8% in May). Our sense from recent client chats, is that BRL has replaced MXN as an EM proxy hedge due to carry differentials, making it still vulnerable.

FX Rate	Spot 1-Jun	Currency Trends							
		18Q1a	18Q2f	18Q3f	18Q4f	19Q1f	19Q2f	19Q3f	19Q4f
USDCNY	6.42	6.28	6.30	6.30	6.30	6.20	6.20	6.10	6.10
USDINR	67.1	65.2	65.5	65.0	65.0	64.5	64.5	64.0	64.0
USDBRL	3.75	3.31	3.60	3.65	3.70	3.70	3.65	3.64	3.63



China, India, Brazil

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CHINA — The risk of a notable escalation in the US-China trade conflict has risen once again following the US administration's announcement at the end of May that it will move ahead with imposing a 25% tariff on US\$50 billion worth of imports from China that contain industrially significant technology, such as those related to the "Made in China 2025" industrial strategy. The final list of imports will be announced on June 15. The Chinese economy's gradual internationalization continues. As of June 1, 226 Chinese A-shares will be included in MSCI's Emerging Markets Index. A two-step inclusion process will be used due to the existing daily trading limits on Stock Connect; the second phase will take place in September 2018. While this is an important step in the Chinese economy's opening process, even after the September step only 5% of A-shares' market capitalization will be included in the index. With full inclusion, Chinese A-shares would have a weight of 25.8% in the index due to the massive size of the Chinese market. We expect the People's Bank of China (PBoC) to continue to raise the 7-day reverse repo rate (the PBoC's de-facto policy rate) cautiously over the coming months. The next hike—of 5 bps to 2.60%—will likely be announced after the expected interest rate increase by the US Federal Reserve on June 14. China's consumer price inflation eased to 1.8% y/y in April from 2.1% y/y a month earlier. We expect inflation to reaccelerate in the second half of 2018 and close the year at 2.1% y/y. The PBoC's Governor Yi is a firm proponent of the central bank's efforts to reduce financial risks; accordingly, monetary policy continuity and sustained deleveraging efforts can be expected. Nevertheless, following a series of corporate defaults, the PBoC has extended the implementation period for tighter rules on asset management businesses until end-2020 (from mid-2019) in order to better manage the potentially tumultuous transition.

INDIA — India's inflation outlook is worsening and it has impacting our forecast for the Reserve Bank of India's (RBI) benchmark interest rate. Headline inflation picked up to 4.6% y/y in April from 4.3% a month earlier; meanwhile, core inflation accelerated more notably, reaching 5.8% y/y in April from 5.2% in March. Increasing housing rental prices and miscellaneous costs (such as household goods, health, transport, education, and personal care) are the key drivers of core inflation. We estimate that headline inflation will pick up further over the coming months—peaking at 5¾% in June 2018—before easing to 4¾% y/y by year-end. The RBI's Monetary Policy Committee (MPC) has repeatedly highlighted various upside risks to inflation. Our analysis of the minutes of the April 4–5 policy meeting shows that the six-member MPC is about to become significantly more hawkish. While only one member voted for a hike in April—and the others for maintaining the policy rate at 6.0%—another member said he will vote for a hike in June. In addition, we assess that another two members are close to switching to a policy tightening mode. With core inflation having picked up substantially since then, we believe that those members will vote for a hike in June, taking the policy rate to 6.25%. The next bi-monthly monetary policy meeting will now be held over three days on June 4–6 instead of on June 5–6. The economy's growth signals are robust with business confidence in both the services and manufacturing sectors on the mend while investment activity is reviving. Moreover, India's fiscal policy stance remains growth-supportive with a focus on the rural economy and infrastructure. Real GDP expanded by 7.7% y/y in the first quarter of 2018, following a 7.0% gain in the final three months of 2017. Given favourable growth traction, several members of the RBI's MPC estimate that India's negative output gap is closing. We forecast India's real GDP to grow by 7½% y/y over the next two years following a 6.3% advance in 2017. Higher international oil prices are widening India's trade deficit; accordingly, the Indian rupee will likely continue to face depreciating pressure in the near term. The RBI has intervened in the foreign exchange market in order to support the INR, leading to a decline in the central bank's reserves. Nevertheless, we assess that India's reserve coverage remains adequate.

BRAZIL — On the macro front, the recent slide in the BRL has presented problems for the BCB's efforts to stimulate the economy further, at a time when recent data has put the resilience of the rebound somewhat into question. The March GDP proxy came in at a disappointing -0.7% y/y (consensus looked for +0.2% y/y), even if April data (industrial production and retail sales) are better. Overall, there are signs that the rebound remains in place, but could be losing steam, this is happening at a time when inflation risks are rising, and the *real* is falling—somewhat constraining the BCB's ability to further inject stimulus into the economy to support growth. It's relevant to highlight that manufacturing PPI, and FGV IGPM inflation are already rising materially. With Presidential elections taking place in Q4, and the electoral picture highly uncertain, we think local markets, including FX, will remain volatile, which suggests the BCB's most prudent path is to end its easing cycle in order to avoid inflationary risks materializing. There is currently no clear cut candidate who looks to be pulling ahead, and "anti-establishment" players have relevant voter intentions in current polls. A key question is whether the establishment vote will consolidate behind any of the contenders—and whether one anti-establishment can also become the challenger.

Pacific Alliance

Currency Outlook

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MEXICO — The Mexican peso is once again under pressure after the US Government decision to impose tariffs to Steel and Aluminum imports from Mexico and other countries. The Mexican Government retaliated immediately, imposing tariffs to some US products such as steel of certain kinds, lamps and certain pork cuts. The US government measure is an unfortunate development of rising protectionism that could have serious repercussions worldwide, and NAFTA renegotiation process could be affected.

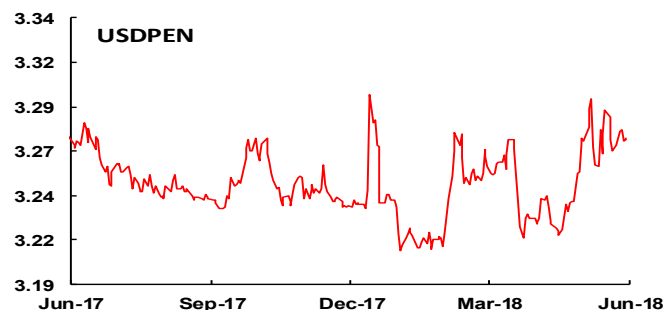
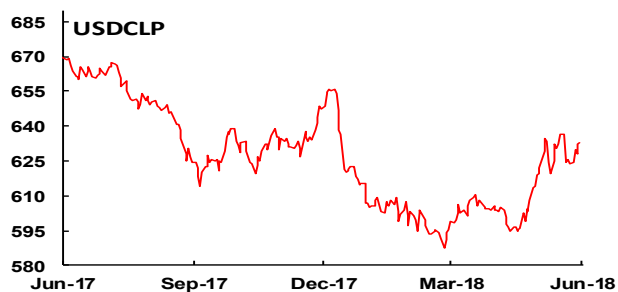
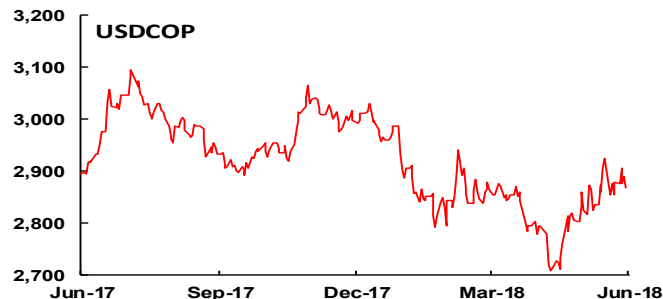
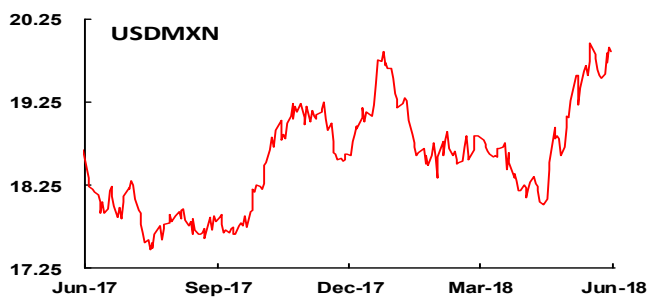
COLOMBIA — Despite still robust oil prices (WTI trading at US\$67/bl), COP has been hit in the recent sell-off (-3.1%). We'd argue that to some degree, the hit on the peso has been relatively mild, due to a combination of supportive oil prices, seemingly more certain politics in the country (not fully exempt of risk), and what at the moment seems like less hostile rhetoric by the US on trade relative to other regional economies.

CHILE — Pressure on the Chilean peso (CLP) continued in May, but now increased by risk in the biggest two economies in South America. Fundamentals for the CLP have not changed, beyond transitory increases in risk aversion and normal copper price volatility, but it does not seem big enough to change our forecast for year-end (595 USDCLP) and beyond. Even more, risk of a significant correction the exchange rate in H2 remains the same and high volatility as well.

PERU — Peru's PEN, like most currencies, has been under upward (weakening) pressure, vis-à-vis a strengthening USD, although the 1.8% that it has depreciated since mid-April is less than regional peers, thanks to the Central Bank (US\$520 million in swaps in May). The PEN neared S / 3.29 in mid-May, and has since corrected to a S / 3.26 and S / 3.27 range. More weakening is possible if the USD continues to strengthen and pressure down metal prices, which are currently testing technical support levels. If so, we may need to revise our forecast of S / 3.18 for year-end 2018. Whether or not the Central Bank intervenes at S / 3.30 will be key.

Currency Trends

FX Rate	Spot 1-Jun	18Q1a	18Q2f	18Q3f	18Q4f	19Q1f	19Q2f	19Q3f	19Q4f
USDMXN	19.86	18.18	20.13	20.07	19.95	20.06	19.89	19.94	20.23
USDCOP	2866	2794	2900	2900	2950	2950	3000	3000	3050
USDCLP	633	604	608	602	595	592	589	587	584
USDPEN	3.27	3.23	3.19	3.20	3.18	3.18	3.14	3.15	3.12



Pacific Alliance
Fundamental Commentary

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MEXICO — The world is getting more complicated for open economies such as Mexico, with rising protectionism in the US, political instability in some European countries (Italy, Spain) that could produce pressure on financial markets, especially with some relevant central banks in the process of normalizing their monetary policies; geopolitical tensions in the middle east and the Korean peninsula, and rising international oil prices. On the domestic front, Mexico is preparing to have the largest election in history, on which the economic development model could be significantly changed, thus generating some internal anxiety. Up until now, the economic outlook has been built considering mainly the relevant economic trends, but it seems that there will be significant events in the near future that will change this expected path.

COLOMBIA — Recent data has been positive on the inflation front (CPI back to within target, to 3.8% y/y, down from 4.05% the previous month), while growth data has been much more disappointing, with Q1 GDP printing at +0.7% y/y. In this environment, we would expect BanRep's board to ease rates further, but volatility on the currency front seems to be keeping them in check—which we'd argue is the prudent path. This seems consistent with the comments made by Governor Echavarria, who said at this time, he does not see much more room to cut rates—i.e. not shutting the door, but suggesting only modest moves. We would not expect any changes in policy to take place until global markets stabilize. The main event this month in Colombia will likely be the second round vote, scheduled for June 17th. The run-off features right leaning Ivan Duque vs left leaning Gustavo Petro. In terms of policy, our take is Duque represents status-quo on the macro front, but likely a more aggressive stance on both the peace process with the FARC, and potentially stronger use of force with the guerrillas. For Petro, the main implications of a victory appear to be plans to boost the government's presence in the financial sector, as well as a potential change of course in the natural resources industry.

CHILE — Good annual changes in many critical variables have continued, as comparison bases have been weak. As said, that effect should start to decrease significantly since May. Instead of it, force from deeper cyclical recovery will become more relevant, but the process will be progressive and uneven. Both business and consumer confidence indices are expected to recede a tad in the current quarter, due to some transitory factors, like jittery currency markets, higher inflation expectation for the current year (though still below the 3% reference level), etc. However, as terms of trade trend (basically, copper price) is not severely hit by these turbulences (it is not our base case), it should be considered a transitory effect, while domestic activity gains traction. The domestic currency depreciation has finally been included in inflation and the market currently esteems it at 2.8%, that is, our long sustained forecast. Consensus is now expecting an earlier start of the monetary policy normalization with one 25bp hike in December. We think there are good reasons to expect it even earlier. Though the exchange rate upsurge is technically a supply-shock, and a plunge of it in Q3 remains a significant risk, a cheaper currency leaves the Central Bank more prone to preemptive actions (and to the market more ready to tolerate them). As for annual growth, we keep our forecast of 3.6%: international turbulences and the ongoing installment process may crimp its upward bias, results have been marginally stronger than expected (statistical factors aside). On the political front, the Government continued working to get wide parliamentary support for some reforms which should be positive for the economic growth in the following years. Though agreements for approval seem likely, it has not been easy. The President's popularity remains comparatively high, which is not surprising since the Chilean people usually support a new Administration by half a year, more or less. So far, attempts of the deeply divided and confused opposition to impose some issues have been well contained by the political team. However, since last quarter, more concrete and remarkable economic achievements will be required.

PERU — Peru GDP is in a sweet spot. GDP growth has accelerated from 2.5% y/y, in 4Q2017 to 3.2% in 1Q2018, to 3.9% in April, and we are expecting +5% in May. Although this is off a low base due to last year's El Niño, the trend is still stronger than expected, and has led us to increase our forecasts for 2018 GDP growth from 3.3% to 3.5%, with some upside still possible. Adding to our optimism is the fact that private investment (5.3% growth in 1Q) and domestic demand (4.0%) have become the main drivers of growth. Not everything is positive, though. Jobs and government spending continue to lag. Although public sector investment will not be the strong driver of growth the government wishes it to be, this matters less as the private sector is picking up the slack. Inflation is rebounding mildly, as expected, and should return to the 2% middle of the Central Bank target range fairly soon. Inflation may rise more if world oil prices resume their uptrend, although this is not likely to trigger a response from the Central Bank (CB), which ended its expansionary monetary policy in May after bringing the reference rate down from 4.25% in April, 2017, to 2.75%. We expect the CB reference rate to remain stable for the remainder of the year. The fiscal deficit over the past 12 months to April declined sharply, to 2.6% of GDP (from 3.2% at year-end 2017). Although much of the improvement is temporary, linked to the seasonal income tax season which ended in early May, fiscal accounts are still stronger than expected, and we forecast a 3.2% deficit for the year, compared to the government's 3.5% target. The government has announced that it will restructure its post-El Niño reconstruction effort to contemplate the use of global project managers and to increase the participation of local and regional governments. The cabinet has also increased and restructured the excise taxes on alcohol, tobacco, soft drinks containing sugar, and gasoline, in seeking to deter the consumption of unhealthy products, while raising tax revenue at the same time. The higher tax on gasoline and diesel have led to protests and it will be telling to see if the government follows through with the measures, or backs down in light of the protests.

Developing Economies

Currency Outlook

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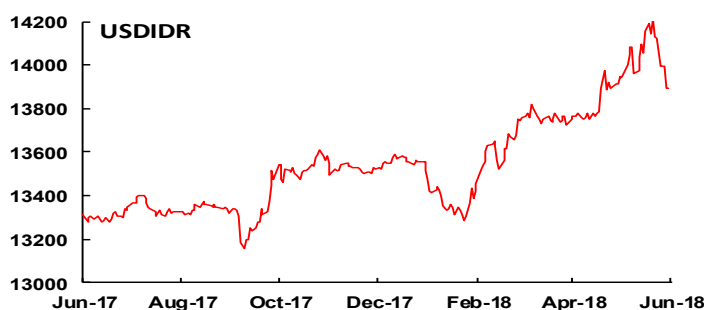
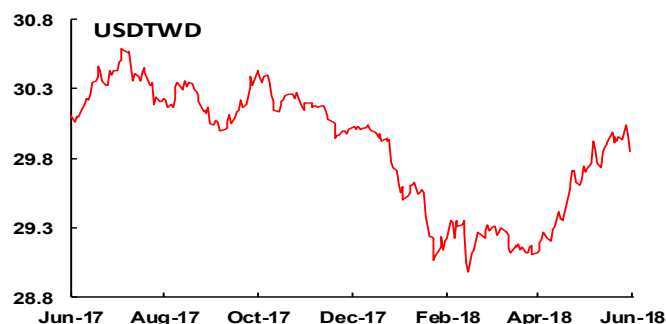
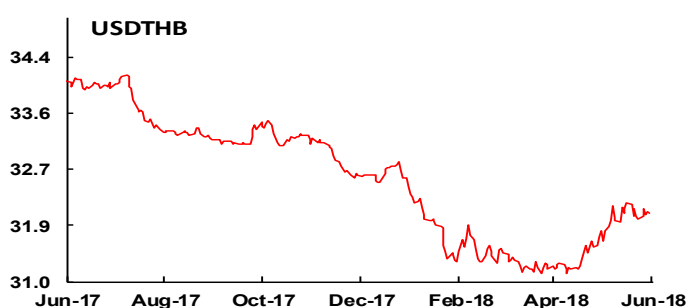
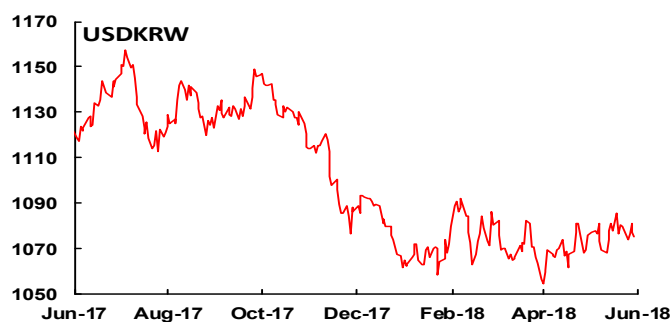
SOUTH KOREA — Due to the BoK's slightly negative real policy rate, a June Fed rate hike will see the South Korean central bank raising its policy rate by 25 bps in the third quarter. We keep a close eye on geopolitical situation on the Korean Peninsula and expect it to stay manageable for the time being. USDKRW is anticipated to trade in a broader range of 1,070-1,100 in the month of June.

THAILAND — PM Prayut Chan-o-cha reiterated on May 22 that the general election is due at the start of 2019. The government said that it may raise its GDP growth forecast this year to 4.5% from the previous prediction of 4.2%. The THB will likely face a continued reversal of portfolio inflows, following a broader market tone in the weeks ahead. In the medium, however, Thailand's sound fundamentals are supportive. USDTHB is likely to trade between 31.5 and 32.5 in June.

TAIWAN — The TWD has been declining persistently amid continued equity outflows since the beginning of April. We identified a rising correlation between the TWD and the DXY index, which suggests the market forces are now playing a bigger role in determining the TWD exchange rate. The CBC will leave its policy rate unchanged at 1.375% on June 21, in our opinion. USDTWD is expected to fluctuate between 29.8 and 30.2 in the month of June.

INDONESIA — The IDR's underperformance is attributed to the nation's twin deficits and a high foreign ownership of local bonds. Newly inaugurated BI Governor Perry Warjiyo pledged to stem a selloff in the nation's currency and bonds, after his swearing in ceremony at the Supreme Court in Jakarta on May 24. In the months ahead, the BI is expected to raise its policy rate again to defend the vulnerable IDR. We see upside potential for USDIDR towards 14,500 in June.

FX Rate	Currency Trends								
	Spot 1-Jun	18Q1a	18Q2f	18Q3f	18Q4f	19Q1f	19Q2f	19Q3f	19Q4f
USDKRW	1075	1064	1060	1040	1040	1030	1030	1020	1020
USDTHB	32.0	31.2	31.0	31.0	31.0	30.5	30.5	30.0	30.0
USDTWD	29.8	29.1	29.2	29.2	29.2	29.1	29.1	29.0	29.0
USDIDR	13896	13728	13700	13600	13600	13500	13500	13400	13400



Developing Economies

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SOUTH KOREA — Geopolitical tensions on the Korean Peninsula will remain elevated over the next few weeks ahead of the planned summit between the US President Donald Trump and Supreme Leader of North Korea Kim Jong-un on June 12 in Singapore. Uncertainty regarding the summit and its outcome remains very high. The South Korean parliament passed a US\$3.5bn supplementary budget (equivalent to 0.2% of GDP) on May 21. President Moon Jae-in's government will direct the additional spending on measures that will reduce youth unemployment; joblessness among young South Koreans remains elevated at close to 11%. South Korea government finances are solid. According to the IMF, South Korea's fiscal surplus—general government net lending—will average 2% of GDP in 2018–19. Meanwhile, gross public debt is expected to hover at a low level of 38% of GDP. South Korean domestic demand continues to show signs of strength and the economy's output gap has turned positive. Real GDP grew by 2.8% y/y in the first quarter of 2018, in line with the pace recorded in the final quarter of 2017. We expect the nation's output to rise by around 2¾% y/y in 2018–19 following a 3.1% expansion in 2017. Headline inflation is expected to accelerate gradually from the May level of 1.5% y/y. We expect the inflation rate to reach the Bank of Korea's (BoK) 2% inflation target in the second half of 2018. The BoK held a monetary policy meeting on May 24 and opted to leave the benchmark interest rate unchanged at 1.50%. When conducting monetary policy, the BoK will pay close attention to geopolitical and trade-related uncertainties. Assuming that global trade tensions do not escalate materially in the very near term, we assess that South Korea's economic environment points to further cautious monetary tightening by the BoK in the third quarter of the year. The most recent policy rate hike took place in November 2017, the first hike in over six years.

THAILAND — The Bank of Thailand's (BoT) monetary policy stance is set to remain accommodative over the coming months in order to stimulate domestic demand. On May 16, the BoT's Monetary Policy Committee voted unanimously to leave the key interest rate unchanged at 1.50%. We anticipate that a cautious monetary normalization phase will commence in the final months of 2018. Inflationary pressures have intensified slightly in recent months with prices at the headline level rising 1.1% y/y in April, compared with a 0.4% y/y reading two months earlier. We expect the headline inflation rate to close the year near the lower boundary of the BoT's medium-term inflation target of 2.5% y/y ±1.5%, followed by a pick-up to 2% in 2019. The Thai economy is performing well. Real GDP grew by 4.8% y/y in the first quarter of 2018—a five year high—following a 4% gain in the final three months of 2017. Strong merchandise exports and tourism are driving economic activity while domestic demand, particularly fixed investment, is showing signs of a recovery. We expect Thailand's output gains to average 3¾% y/y in 2018–2019.

TAIWAN — Taiwan's real GDP grew by 3.0% y/y in the first three months of 2018 following a 3.3% gain in the final quarter of 2017. Exports of goods and services are underpinning the economy; in addition, household and government spending are supporting growth momentum. Taiwan's manufacturing sector sentiment remains strong and the nation's exports continue to grow much faster than imports; moreover, the labour market continues to tighten gradually, pointing to solid growth prospects. We expect the Taiwanese economy to expand by 2.7% y/y in 2018, virtually in line with the central bank's forecast of 2.6%. Taiwanese inflation accelerated to 2.0% y/y in April from 1.6% the month before on the back of higher food prices. While being volatile over the coming months, we expect the inflation rate to close 2018 near the current level as demand-driven inflationary pressures strengthen and higher oil prices and a slightly weaker currency filter through to consumer prices. Additionally, minimum wage hikes, higher public sector wages, and potential private sector wage increases are expected to contribute to higher price pressures. Accordingly, the central bank will likely maintain the status quo until the third quarter of 2018 when we expect it to raise the policy rate by 12.5 bps to 1.50%. The next quarterly monetary policy meeting will be held on June 21.

INDONESIA — Indonesian policymakers are acting swiftly to defend the value of the Indonesian rupiah (IDR) and stem capital outflows that reflect global investors' repricing of emerging market risk in the context of rising interest rates in the US and elevated global trade and geopolitical uncertainties. Bank Indonesia (BI) raised the benchmark 7-day reverse repo rate by 25 bps on May 17 and again on May 30 to 4.75%. According to the statement issued following the May 30 hike, BI sees the policy action as “pre-emptive, front-loading, and ahead-of-the curve to strengthen stability”. Indonesian headline inflation was 3.4% y/y in April; we expect price pressures to pick up over the coming months with the inflation rate closing 2018 at 4.9% y/y. Given that this is above the BI's inflation target of 3.5% ±1%, the central bank will likely end up tightening monetary policy further. We expect the next 25 bps hike to be implemented in the third quarter of 2018. We assess that the main fundamental weaknesses of the Indonesian economy are 1) its current account deficit of around 2% of GDP; 2) relatively fast real credit growth in the private sector over recent years, which raises concerns about debt sustainability; 3) high foreign holdings of local currency government debt (around 40%); and 4) relatively weak quality of governance.

Global Currency Forecast (end of period)

		2018f	2019f	2018f				2019f			
Major Currencies				Q1a	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Japan	USDJPY	110	105	106	108	110	110	110	110	108	105
Euro zone	EURUSD	1.30	1.35	1.23	1.25	1.28	1.30	1.30	1.33	1.35	1.35
	EURJPY	143	142	131	135	141	143	143	146	146	142
UK	GBPUSD	1.47	1.50	1.40	1.40	1.42	1.47	1.48	1.48	1.50	1.50
	EURGBP	0.88	0.90	0.88	0.89	0.90	0.88	0.88	0.90	0.90	0.90
Switzerland	USDCHF	0.91	0.89	0.95	0.93	0.92	0.91	0.92	0.90	0.89	0.89
	EURCHF	1.18	1.20	1.18	1.16	1.18	1.18	1.20	1.20	1.20	1.20
Americas											
Canada	USDCAD	1.25	1.25	1.29	1.27	1.26	1.25	1.25	1.22	1.22	1.25
	CADUSD	0.80	0.80	0.78	0.79	0.79	0.80	0.80	0.82	0.82	0.80
Mexico	USDMXN	19.95	20.23	18.18	20.13	20.07	19.95	20.06	19.89	19.94	20.23
	CADMXN	15.96	16.18	14.11	15.85	15.93	15.96	16.05	16.30	16.35	16.18
Brazil	USDBRL	3.70	3.63	3.31	3.60	3.65	3.70	3.70	3.65	3.64	3.63
Chile	USDCLP	595	584	604	608	602	595	592	589	587	584
Colombia	USDCOP	2950	3050	2794	2900	2900	2950	2950	3000	3000	3050
Peru	USDPEN	3.18	3.12	3.23	3.19	3.20	3.18	3.18	3.14	3.15	3.12
Asia-Pacific											
Australia	AUDUSD	0.80	0.82	0.77	0.79	0.80	0.80	0.81	0.81	0.82	0.82
China	USDCNY	6.30	6.10	6.28	6.30	6.30	6.30	6.20	6.20	6.10	6.10
Hong Kong	USDHKD	7.85	7.82	7.85	7.85	7.85	7.85	7.84	7.84	7.82	7.82
India	USDINR	65.0	64.0	65.2	65.5	65.0	65.0	64.5	64.5	64.0	64.0
Indonesia	USDIDR	13600	13400	13728	13700	13600	13600	13500	13500	13400	13400
Malaysia	USDMYR	3.80	3.60	3.86	3.85	3.80	3.80	3.70	3.70	3.60	3.60
New Zealand	NZDUSD	0.74	0.76	0.72	0.73	0.74	0.74	0.75	0.75	0.76	0.76
Philippines	USDPHP	51.0	49.5	52.2	52.0	51.0	51.0	50.0	50.0	49.5	49.5
Singapore	USDSGD	1.30	1.28	1.31	1.30	1.30	1.30	1.29	1.29	1.28	1.28
South Korea	USDKRW	1040	1020	1064	1060	1040	1040	1030	1030	1020	1020
Taiwan	USDTWD	29.2	29.0	29.1	29.2	29.2	29.2	29.1	29.1	29.0	29.0
Thailand	USDTHB	31.0	30.0	31.2	31.0	31.0	31.0	30.5	30.5	30.0	30.0

f: forecast a: actual

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Foreign Exchange Strategy

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