December 7, 2018

AMERICAS

The USD has performed strongly in H2, providing investors with one of the very few opportunities across a range of assets for positive, risk-adjusted returns this year. With US growth trends poised to moderate and the Fed tightening process maturing, however, we expect the USD to weaken broadly in the months ahead. The CAD has weakened back to the mid-year low amid lower oil prices and BoC caution but we look for modest gains into 2019. We expect the MXN to remain stable in the near to medium term. Pacific Alliance currencies have weathered recent volatility relatively well; positive domestic fundamentals point to modest gains for the COP, PEN and CLP.

EUROPE

The EUR is grinding higher as growth trends underpin steady gains in inflation and markets ready for the ECB to halt its asset purchase programme this month. The GBP has steadied as the UK parliament scrutinizes the government's Brexit plan. Significant uncertainties remain but the worst case scenario of a "no deal Brexit" may be averted.

ASIA-PACIFIC

We expect a de-escalation of US/China trade tensions to lift the CNY and regional exporters. The JPY may under-perform as the BoJ will lag the move towards policy normalization in the major economies.

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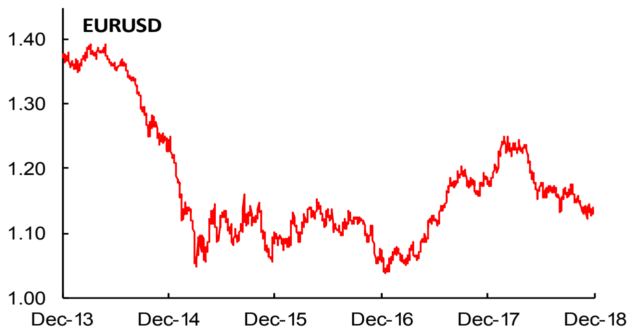
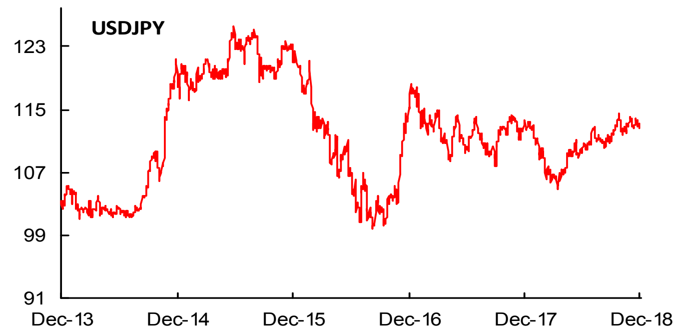
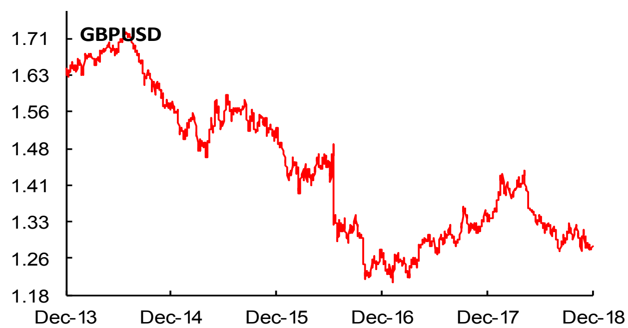
Core Exchange Rates

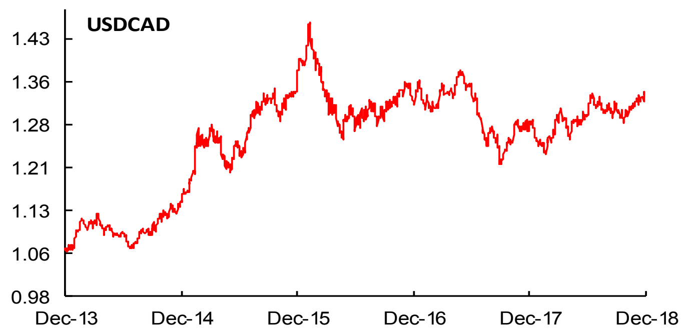
Global Foreign Exchange Outlook

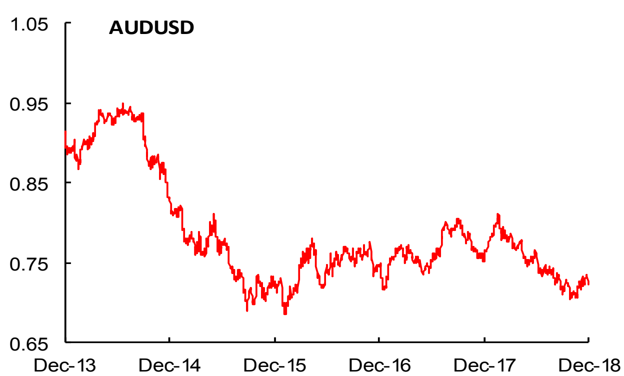
		2018f				2019f			
December 7, 2018	Spot	Q1a	Q2a	Q3a	Q4	Q1	Q2	Q3	Q4
EURUSD	1.14	1.23	1.17	1.16	1.15	1.17	1.22	1.26	1.30
USDJPY	113	106	111	114	112	110	110	108	108
GBPUSD	1.28	1.40	1.32	1.30	1.28	1.32	1.35	1.37	1.40
USDCAD	1.33	1.29	1.31	1.29	1.34	1.32	1.30	1.27	1.27
AUDUSD	0.72	0.77	0.74	0.72	0.73	0.75	0.77	0.77	0.78
USDMXN	20.27	18.18	19.91	18.72	20.07	20.32	20.15	20.21	20.40











Market Tone & Fundamental Focus

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The US dollar (USD) is heading into the end of the year having accumulated broad gains against most of its major currency peers. In recent months, USD strength has been supported by firm growth and rising interest rates—contrasting with less robust growth or rising uncertainties elsewhere. According to a recent Bloomberg report, risk-adjusted returns for the world's most significant assets reflected the "worst cross asset performance in more than a century". The USD is one of the few global investment vehicles that offered a positive, risk-adjusted return this year.

We do not expect this trend to extend, however, and rather see the USD resuming the decline that we think began with 2017's significant slide. While the USD has benefitted from rising interest rates and solid US growth dynamics, we think a lot of good news is factored into the exchange rate at current levels. Any negative surprises in terms of monetary policy or growth are liable to weigh on USD sentiment quite significantly. Indeed, in just the past week or so evident concerns among market participants that the Fed may be near the end of its tightening cycle prompted the USD to slip back. Our longer run concerns for the USD revolve around valuation (it is "rich" versus most major currencies in purchasing power terms) and the accumulation of combined current account and fiscal deficits. Slowing growth and narrowing interest rate differentials as other central banks "catch up" with the Fed's maturing tightening cycle will add to negative pressure on the USD.

Investors are facing some significant market risks in the next few weeks, however. The US and China have less than 90 days to agree on a trade deal that will avert more tariff action. The US and EU may clash on auto trade. A new Congress resumes business in January and promises more oversight on President Trump's policies and other issues. The UK parliament will vote on Dec 11th on Prime Minister May's Brexit plan, with her parliamentary majority clearly in doubt. Global stocks retain a soft undertone but US markets are just about managing to limit losses to around 10% from the peak, suggesting that the decline is a "correction", rather than anything more severe at this stage. More losses may prompt further moves into "safe havens". The binary nature of some of these risks suggests that markets may remain subdued in the short term but volatility may well increase in 2019.

The Canadian dollar (CAD) has under-performed relative to our expectations. While growth has slowed after a robust start to the year, the economy remains in respectable shape. Trade and competitive uncertainties that dogged the currency earlier this year have been mitigated to some extent by agreement on a new trade pact with the US and Mexico and by measures unveiled in the Federal government's Fall Fiscal update. But a sharp fall in oil prices—and the glut of domestic production especially—has weighed on the CAD and clouded the outlook for the economy more recently. We think the worst may be over for crude as output is cut back but the CAD may remain soft until energy prices pick up materially. We have downgraded the outlook for the CAD to account for its recent weakness and a cutback in the amount of monetary policy tightening the Bank of Canada is likely to introduce in 2019. In Mexico, a weaker growth outlook and the uncertainty being generated in the early days of the new administration has led to a depreciation of the Mexican peso (MXN), which we think will depreciate to USDMXN 21.9 as 2019 progresses.

We remain broadly positive on prospects for the euro (EUR), pound (GBP) and yen (JPY). The Eurozone economy slowed in the latter half of the year but is still likely to track above-potential rates of expansion in the coming quarters, keeping inflation on an upward track and the European Central Bank on course to shift—gradually—towards policy normalization later next year. We expect this process to help boost the EUR more materially in H2 2019 towards USD1.30. Downside risks to that view revolve around any escalation in EU/US trade tensions. The outlook for the GBP hinges on the outcome on the Brexit debate currently underway in the UK parliament. Recent developments have lessened the risk of a disruptive "no deal" Brexit in our opinion but a number of potential outcomes remain in play and price action is likely to remain volatile in the near term. We assume a relatively smooth Brexit will allow the GBP to improve into 2019 as "worst-case" fears subside. We expect the JPY to underperform against the EUR and GBP, however, as the Bank of Japan is liable to maintain policy accommodation for some time to come.

We expect a de-escalation of US/China trade tensions to allow a further reversal in the yuan (CNY) after USDCNY reached a 10-year high in late October and look for the USD to ease back to the 6.70 area by the end of next year. Asian currencies will remain sensitive to trade issues as well as the course of US interest rates but broader trade détente should be supportive of the likes of the Korean won and Taiwan dollar. Pacific Alliance currencies have weathered regional currency tensions and a difficult international environment relatively well. In year to date terms versus the USD, the Peruvian sol (PEN) has out-performed the EUR while losses for the Colombian peso (COP) are little or no worse than the major European currencies. We expect the COP, CLP and PEN all to strengthen in the year ahead (mainly on positive domestic fundamentals) but we recognize that external factors (trade tensions and the broader course of the USD) will shape trends as much as developments at home.

Canada

Currency Outlook

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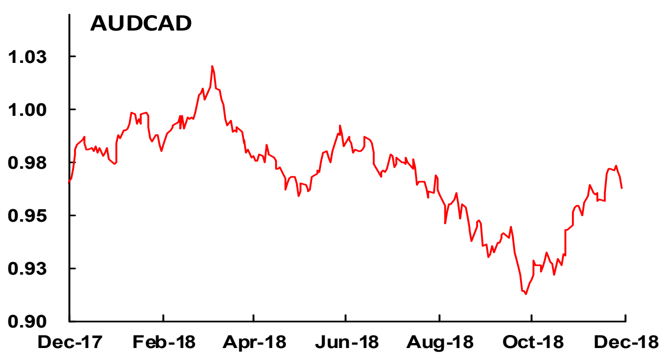
We remain constructive on the CAD in the longer run but market developments and the Bank of Canada's (BoC) seemingly inconsistent messaging are trying our patience. We have marked up our forecasts for USDCAD as our near-term call for CAD gains is clearly wrong. We expect oil prices to rebound on output cuts but reduced domestic production to lift heavily discounted bitumen prices has cast another uncertainty over the outlook for the Canadian economy, even with the massive investment in west coast LNG announced in October still fresh in the market's mind. Our long run call for CAD appreciation into 2020 remains unchanged.

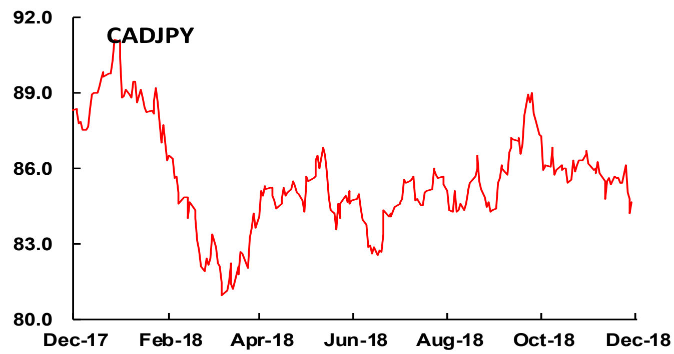
Crude oil may account for some of the seemingly "dovish" lilt to the BoC's December policy meeting but the Bank had sounded a little more confident as recently as October when it dropped the word "gradual" in describing the pace of future hikes, suggesting that rates might move up a little more quickly, especially with trade tensions fading. The general run of Canadian data releases suggests the economy is about where the BoC expects it to be and there have been some positive surprises from retail sales, inflation and housing data even as some US data prints have tended to disappoint. None of this has had any lasting bearing on the CAD's performance, however.

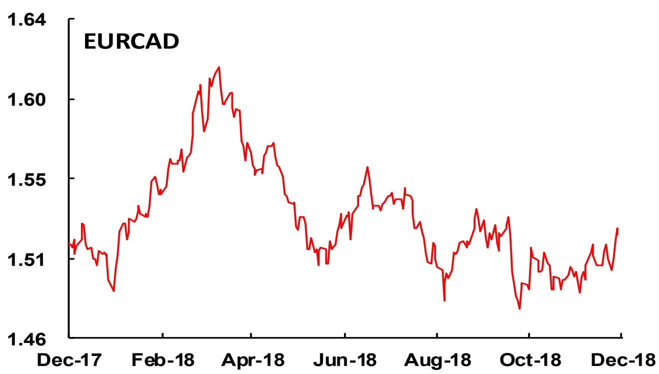
Investors seem equally bemused by the CAD. Market positioning among speculative accounts has failed to capture much of the recent volatility in the CAD and CFTC data through November reflects a mostly flat exposure to the CAD following a round of short -covering since mid-year. Technical signals are bullish for the USD, with early December gains extending above the 1.34 area (near USc74.50), the CAD low point from mid-year suggesting the USD may appreciate further (towards 1.37/1.38) before the market starts to see some value in the CAD again.

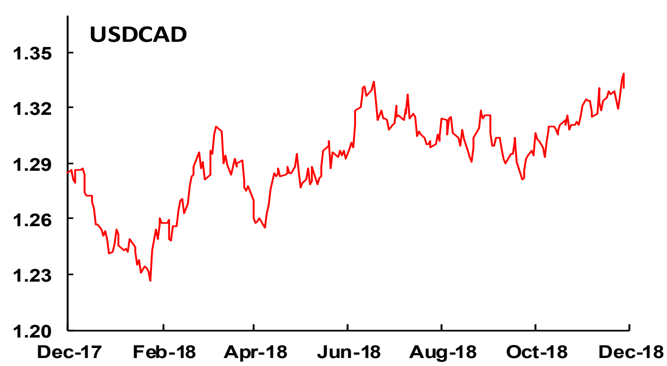
Canadian Dollar Cross-Currency Trends

FX Rate	Spot 7-Dec	18Q4f	19Q1f	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
AUDCAD	0.96	0.98	0.99	1.00	0.98	0.99	0.98	0.98	0.96	0.96
CADJPY	84.7	83.6	83.3	84.6	85.0	85.0	85.6	85.6	85.4	85.4
EURCAD	1.52	1.54	1.54	1.59	1.60	1.65	1.63	1.63	1.62	1.62
USDCAD	1.33	1.34	1.32	1.30	1.27	1.27	1.25	1.25	1.23	1.23









United States and Canada

Fundamental Commentary

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UNITED STATES — The economic rush from the White House's early-2019 fiscal stimulus continued to wane in the second half of 2018. Growth slowed from Q2's 4.2% in seasonally-adjusted annualized terms to 3.5% in Q3. Corporate tax reforms have not produced the boon in investment anticipated by the White House, and after an initial burst in in Q1 and Q2, capital formation made its smallest contribution to growth in Q3 of any quarter in two years. As a result, we continue to expect that US growth shall slow from 2.9% in 2018 to 2.4% in 2019. Consumption growth is expected to come in solidly at 2.7% in 2018, owing to still-tight labour markets as unemployment plumbs new 48-year lows at 3.7%, average income growth runs ahead of inflation, and total debt-service ratios hover just below 10% of personal disposable income, the lowest level in over 40 years. However, residential real estate investment data continue to register progressively softer as households take a cautious approach to reloading balance sheets with debt in the current late-cycle context of rising interest rates. The federal fiscal deficit shall continue yawning ever wider and trade wars will prove neither good nor easy to win: a string of record bilateral trade deficits and overall US trade deficits are expected to continue. Following signature of NAFTA 2.0 / USMCA on November 30, 2018, the Congressional ratification process is expected to take at least six months into mid-2019. Congress may demand additional protections on labour and environmental issues that would be dealt with through side letters or the US enabling legislation, not through reopening the signed agreement. Additional tariffs on imports from China are likely to be deferred indefinitely as they would hit consumer goods to a greater extent than other Trump duties and visibly penalize voter pocketbooks on the way into the 2020 election season. Nevertheless, although the inflationary impact of additional tariff hikes may be limited, headline and core inflation are projected to remain at or slightly above the 2% target.

CANADA — Canadian real GDP growth has continued to moderate in 2018, but remains on track for our previously forecast 2.1% expansion. Looking ahead, the outlook has dimmed slightly and we have sliced our growth projection for 2019 from 2.2% to 1.9% on the back of oil production cuts and softening global demand. Growth in 2020 is still expected to come at around the same pace at 1.9%. With growth consistently at or above potential, excess demand, capacity constraints, and tight labour markets, inflation is expected to remain above the 2% target over the next 24 months. Consumption gains remained stable in Q3, sustained by unemployment at 40-year lows, climbing vacancy rates, and wage settlements moving up at the strongest rates in several years. Although many major industrial and service sectors are operating at our above their long-run average capacity utilization levels, and net exports surged in Q3 in response to stronger US demand, investment growth stalled in Q3, marking an unexpected hiccup in the ongoing rotation of the sources of Canadian growth from residential real estate and consumption to capex and trade. Investment is expected to pick up again in the coming quarters following the Federal government's introduction in its Fall Economic Statement of accelerated tax expensing for depreciation on capital investment. Real estate markets remain broadly balanced across the country, with Toronto and Vancouver appearing to have found their inflection points after the introduction of tighter lending rules earlier this year. Following the announcement late on September 30 that the three NAFTA countries had reached understandings on the accord's successor, the signature of NAFTA 2.0 / CUSMA on November 30 moves the agreement into its ratification process. US steel and aluminum tariffs are expected to be lifted in early 2019 as they are inconsistent with the new NAFTA's rules of origin on autos, but this timing remains contingent on the stridency of US demands for binding quotas on both countries that would cut their shipments to the US.

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Monetary Policy Commentary

UNITED STATES — Our forecast for additional rate hikes by the Federal Reserve is unchanged. After hiking on December 19th 2018, we expect the Federal Reserve to raise borrowing costs three more times in 2019 and stop at a terminal rate of 3.25% by 2019Q3. There is the risk of a more erratic path than forecast as the Federal Reserve approaches the neutral range after creating considerable distance from zero rates and as the pace of balance sheet unwind has recently hit a peak. At this point, inserting potential skips is deemed to be a wholly arbitrary exercise versus the general path guidance that we are more comfortable with providing. Furthermore, it is unclear that unwinding the balance sheet has proven to be a rate substitute through raising the term premium given other offsetting influences that may prove to be transitory.

CANADA — Scotiabank Economics expects the Bank of Canada to hold rates through to the April 2019 meeting and to hike at a pace of once per quarter through to 2020Q1. This will raise the overnight rate to a cycle peak of 2.75%. This forecast is a compromise between incorporating higher uncertainty versus not over-reacting to recent events. A high bar has been set to raise rates during 2019Q1 given present uncertainty surrounding energy market developments, trade policy as it relates to US tensions with China and Europe as well as CUSMA implementation risks. There is also uncertainty regarding the impact of multi-year GDP revisions to estimates of slack. Our underlying assumptions include eventual OPEC production cuts, traction on Canadian heavy and light oil discounts and expected progress in US-China trade negotiations. Such a scenario could re-ignite rate pressures by Spring but we're well aware of the risks in the other direction.

G10

Currency Outlook

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EUROZONE — EUR is entering December around the midpoint of its one month range and just above the 16 month low reached in early November. The outlook for relative central bank policy appears to be offering fundamental support and longer-term spreads have narrowed considerably. Sentiment is bearish however, reflecting a sizeable liquidation of EUR longs and a meaningful build in shorts. We maintain a constructive medium-term view, with a Q219 target of 1.22 and a year-end 2019 forecast of 1.30.

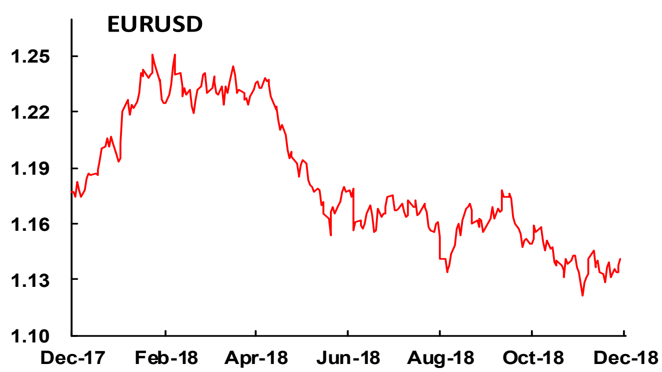
UNITED KINGDOM — GBP is incredibly vulnerable heading into the December 11 parliamentary vote on Brexit. A fresh 18 month low was reached in early December and technical signals remain moderately bearish. The latest Brexit developments appear to be GBP-supportive however, offering a broadened set of scenarios beyond the deal/no deal choices that had been offered by PM May. Our forecast is based on a constructive outcome and we anticipate GBP gains toward 1.40 by Q4 2019.

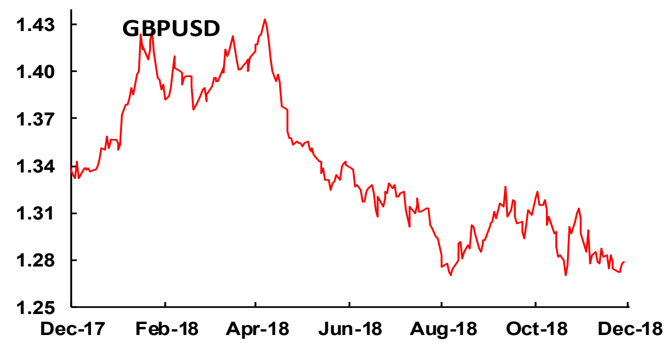
JAPAN — JPY has been range bound for most of the past three months, consolidating on the back of an ongoing reassessment in the outlook for relative central bank policy. Haven-related strength has been remarkably muted throughout this latest period of risk aversion, and the YTD technical trend has been bearish (bullish USDJPY). We look to a modest decline in USDJPY and hold a year-end 2019 target of 108.

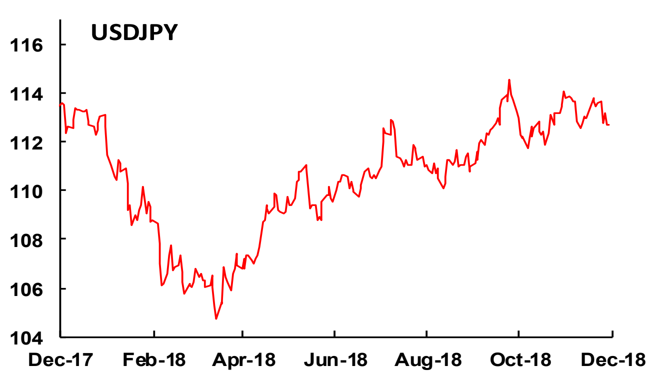
AUSTRALIA — AUD outperformed all of the G10 currencies in November, rallying in tandem with its growth sensitive commodity currency peer NZD. The outlook for relative central bank policy has offered considerable support and improving trade tensions should allow for continued, medium-term strength. We are bullish targeting 0.77 for Q2 2019 and 0.78 by year-end.

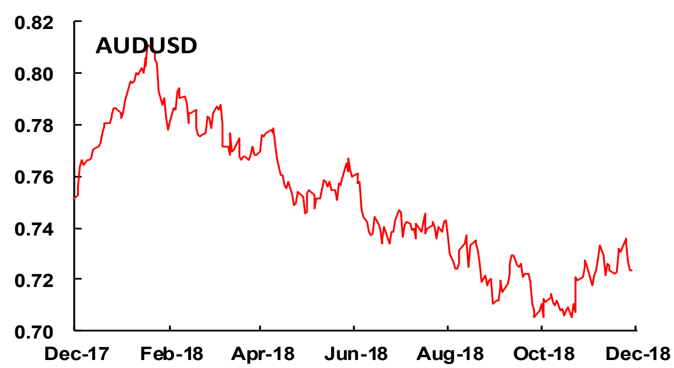
Currency Trends

FX Rate	Spot 7-Dec	18Q4f	19Q1f	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
EURUSD	1.14	1.15	1.17	1.22	1.26	1.30	1.30	1.30	1.32	1.32
GBPUSD	1.28	1.28	1.32	1.35	1.37	1.40	1.42	1.42	1.45	1.45
USDJPY	113	112	110	110	108	108	107	107	105	105
AUDUSD	0.69	0.73	0.75	0.77	0.77	0.78	0.78	0.78	0.78	0.78









G10

Fundamental Commentary

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EUROZONE — The Eurozone economy slowed in the second half of the year, although this was not unexpected. Weaker auto production has extended into Q3 following the imposition of new emissions rules which is curtailing activity in the auto sector. We expect Eurozone growth to pick up again, however, and above-potential output in the coming quarters will slowly reduce excess capacity and keep the European Central Bank on track to end asset purchases at this month's policy meeting and edge—slowly—towards policy normalization. Eurozone inflation reached 2.2% in October, the highest since late 2012, before easing modestly in November, while the latest employment data for the Eurozone reflected rising wages and a 1.0% Q/Q advance in labour costs which suggests tight labour market conditions are adding to the domestic inflation impetus.

UNITED KINGDOM — The UK economy has struggled to recover meaningfully from a soft start to the year amid weak exports and soft business investment. Broader economic trends have taken a back seat to the Brexit negotiations, however, and—at writing—the House of Commons is debating the Withdrawal Agreement—the Brexit deal hammered out by Prime Minister May to provide a framework for the UK's post-Brexit relationship with the EU. These deliberations are not going well for the government and the risk of a heavy defeat is looming large over Number 10. On a positive note, we do think that developments—MPs will now have a stronger say in what happens in the event of a (likely) government defeat—has significantly reduced the risk of a "no deal Brexit". Yet if the worst case scenario has been averted, what happens next remains highly uncertain; potential outcomes range from an attempt to renegotiate the current deal, a whole new deal, a new prime minister and/or a whole new government and a new referendum.

JAPAN — Japan's inflationary pressures are set to stay below the Bank of Japan's (BoJ) 2% y/y target through 2020. Headline inflation picked up to 1.4% y/y in October from 1.2% a month before, yet the acceleration will likely prove short-lived as inflation is expected to return to 1% y/y by December. The CPI excl. fresh food—the BoJ's preferred measure—remained unchanged at 1.0% y/y in October. Highly-accommodative monetary policy will likely be maintained over the coming quarters. Following the October 31 monetary policy meeting, the BoJ maintained the short-term policy rate at -0.1% and left the asset purchase program unchanged. The BoJ will continue to adjust the amount of bond purchases depending on market developments, aiming to keep the 10-year bond yield close to 0%. Given that the forthcoming consumption tax rate hike, scheduled for October 2019, may cause a drop in real GDP or a notable growth slowdown, the BoJ will not be able to join other global central banks in their policy normalization efforts. Against this backdrop, we do not foresee any adjustments to the policy rate in the foreseeable future, yet the BoJ may allow long-term yields to rise marginally in 2020 assuming that the economy sails through the tax rate hike reasonably unharmed. According to preliminary estimates, Japan's real GDP contracted by 0.3% q/q (non-annualized) in the third quarter, compared with a 0.8% q/q gain in the prior quarter. In year-over-year terms, growth slowed to 0.3% from 1.4% in the second quarter. The weak outcome reflected natural disasters, such as flooding and typhoons in Western Japan and an earthquake in Hokkaido, which caused airport closures and disruptions to industrial activity and supply chains. We expect Japan's real GDP to rebound in the final quarter of 2018 with growth stabilizing near the economy's potential of 1.0% y/y over the coming quarters.

AUSTRALIA — Australia's economic momentum in the third quarter of 2018 was slower than anticipated with real GDP growing by 0.3% q/q (2.8% y/y), following a 0.9% q/q (3.1% y/y) advance in the prior three-month period. Activity was driven by public outlays and net exports, while household spending growth slowed notably. We now expect the Australian economy to expand by 3.0% in 2018 as a whole (vs. a prior forecast of 3.1%). Australian labour market conditions continue to strengthen. In October, the economy added 33,000 jobs; over the past year, monthly job creation has averaged 26,000 positions, with most of the jobs (77%) in the full-time category. Australia's unemployment rate has declined to 5%; joblessness is now in line with the RBA estimate for the economy's NAIRU (non-accelerating inflation rate of unemployment). This implies that labour market slack has virtually disappeared, which should be reflected in wages over the coming quarters. Australia's wages rose 2.3% y/y in the third quarter, faster than consumer prices that increased by 1.9% y/y. Nevertheless, softer household spending prospects will likely keep demand-driven inflationary pressures in check. We have revised our forecast for Australia's end-2019 inflation to 2.3% y/y from 2.5%. These forecast changes will push out our expectation for the Reserve Bank of Australia's (RBA) first interest rate hike to the third quarter of 2019. The RBA left the benchmark interest rate unchanged at 1.50% following the December 4 monetary policy meeting. The RBA's policymakers have highlighted that the next move in the cash rate would more likely be an increase than a decrease. Meanwhile, they have also pointed out that there is no strong case for a near-term adjustment in monetary policy.

China, India

Currency Outlook

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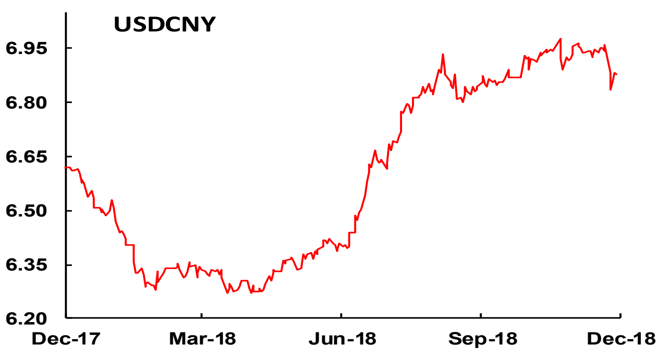
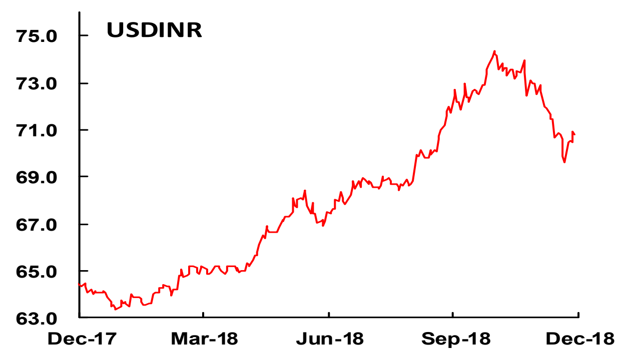
CHINA — The US and China has declared a 90-day ceasefire on new tariffs. According to Xinhua News Agency, the two nations will step up negotiations towards the elimination of all additional tariffs. Beijing's top trade negotiator, Vice-Premier Liu He, could lead a delegation of 30 Chinese officials to Washington on a mission tentatively scheduled for December 12-15. We stay with our long CNHJPY cross position targeting 16.8 and see USDCNY trading towards 6.80-6.85 in December.

INDIA — The RBI's OMO scheme is in fact a mini-QE programme that could prop up local financial assets and the INR with infusing rupee liquidity to the system. We maintain our short USDINR position with a new target of 68.5 and a 70.5 stop amid weak oil prices, while staying nimble on the RBI-GoI relations and awaiting the results of five state assembly elections due on December 11th. The next RBI board meeting is set for December 14th.

Currency Trends

FX Rate	Spot 7-Dec	18Q4f	19Q1f	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
USDCNY	6.88	6.85	6.80	6.60	6.70	6.70	6.60	6.60	6.50	6.50
USDINR	70.8	70.0	69.0	67.0	68.0	68.0	67.0	67.0	66.0	66.0





China, India, Brazil

Fundamental Commentary

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CHINA — US President Trump and China's President Xi met on December 1st following the conclusion of the G20 Leaders' Summit in Buenos Aires. The two leaders agreed to continue their dialogue over the next 90 days in order to ease trade tensions. As a result, the US will refrain from raising tariff rates in January from 10% to 25% on USD 200 bn of imports from China, while China agreed to start purchasing more agricultural, energy and industrial products from the US in order to reduce the US's bilateral trade deficit with China. Over the 90-day negotiation period, talks will focus on China's structural changes with respect to forced technology transfer, intellectual property protection, non-tariff barriers, cyber security, services, and agriculture. While the truce in the trade dispute is a welcome development for the global economy, we highlight that deep divisions between the two countries remain in place that will likely make the negotiations challenging. The Chinese economy continues to be under downward pressure on the back of trade-related uncertainties and the government's efforts to deal with the country's sizable debt burden. Indeed, we expect real GDP growth to slow further from the third quarter pace of 6.5% y/y toward 6.0% by the fourth quarter of 2019. While China's recent credit growth data show that the government continues to limit shadow banking activities, we expect the administration to lessen its focus on deleveraging and increasingly prioritize economic growth stability. China's monetary policy will remain accommodative to support the economy, allowed by reasonably contained inflationary pressures. We expect headline inflation to average 2½% y/y over the next two years, remaining in line with the October reading of 2.5% y/y. The People's Bank of China will use various tools—such as open market operations, reserve requirements, as well as standing and medium-term lending facilities—to provide the financial system with ample liquidity ensuring that sectors with favourable growth prospects will continue to have access to funding. Simultaneously, expansionary fiscal policy is expected to play a key role in keeping China's economic growth at 6% y/y or above in the foreseeable future.

INDIA — The Reserve Bank of India (RBI) continues its wait-and-see policy approach for the time being. Following the scheduled monetary policy meeting that concluded on December 5th, the benchmark repo and reverse repo rates were left unchanged at 6.50% and 6.25%, while the stance of "calibrated tightening" was kept in place. The RBI raised the policy rates at its June and August meetings; in October, it left the policy rate unchanged but adopted a monetary tightening bias. Given the policy stance and various upside risks to inflation, we assess that the RBI will raise the policy rates by 25 basis points in early 2019. The central bank likely extended the break from monetary tightening in order to support the economy; it noted trade tensions, tighter global financial conditions, and weaker global demand as downside risks to the domestic economy. Indeed, India's real GDP growth weakened to 7.1% y/y in the July-September period from the 8.2% pace in the prior quarter. We expect the country's output to grow by 7.5% in 2018 as a whole. India's headline inflation eased to 3.3% y/y in October, giving the RBI some breathing room to focus on supporting the economy. Nevertheless, we note that the lower inflation reading reflects base effects as well as muted food and energy price developments. Meanwhile, India's core inflation has continued to accelerate, reaching 6.1% y/y in October, warranting close monitoring by the RBI. We estimate that India's headline inflation will rebound in early 2019, returning to the midpoint of the RBI's 4% ±2% target. However, on the back of our expectation for further gradual monetary tightening by the RBI, India's inflation will likely remain within the central bank's target range in the foreseeable future.

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Pacific Alliance

Currency Outlook

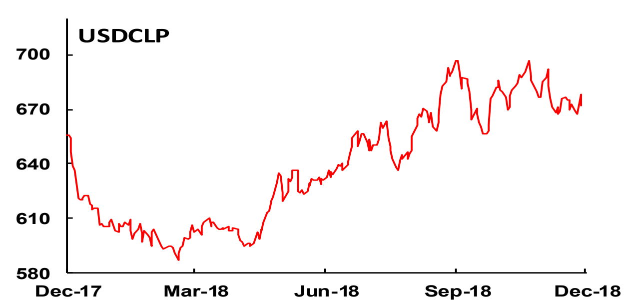
MEXICO — We are revising our MXN forecast to incorporate a higher uncertainty from both, external and internal sources. On the external front, global financial markets are getting tighter and more volatile, with a growing negative sentiment against emerging markets. On the domestic side, some of the actions and intentions from the new government are producing heightened uncertainty for investors, thus pressuring the exchange rate. Cancelling the Mexico City's Airport project in Texcoco has proven to be an unfortunate decision in the eye of financial markets, which are getting anxious about the possibility of more difficult-to-understand actions.

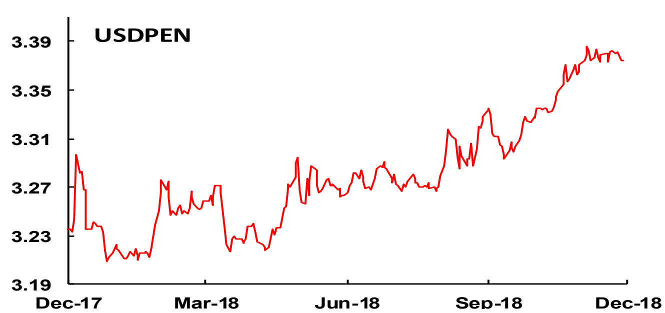
CHILE — In the last three and a half months the exchange rate (USDCLP) has been fluctuating within the trading range between 657 and 696, influenced by foreign factors, especially the behavior of the US dollar in the international market and risk aversion, that is, dominated by a relatively high volatility (6% in two or three weeks). Our equilibrium approach shows a little deviation, but factors of which the model is made up are rather downward biased. Accordingly, we expect some additional correction in the current month, to reach around the 650 to 660 range at the end of the year. Next year we expect a very moderate appreciation of the local currency.

PERU — The PEN has depreciated 4.5% YTD, much more than we expected. This has more to do with a strong USD than with fundamentals, as Peru's external accounts remain robust. Furthermore, the Central Bank has not intervened as strongly as in the past to stem the PEN depreciation. The PEN seems about due for a correction from the current 3.37-3.38 levels, but will not reach our year-end forecast of 3.26, which we are revising to 3.34. We are also revising our forecast for 2019 to 3.30, from 3.22, although this will continue to depend on the direction and strength of the USD globally.

Currency Trends

FX Rate	Spot 7-Dec	18Q4f	19Q1f	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
USDMXN	20.27	20.07	20.32	20.15	20.21	20.40	20.50	20.33	20.39	20.69
USDCLP	672	650	650	650	650	650	650	640	640	640
USDPEN	3.37	3.34	3.35	3.31	3.32	3.30	3.31	3.27	3.28	3.26





Pacific Alliance

Fundamental Commentary

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MEXICO — Uncertainty went through the roof after the President's decision to cancel the Mexico City airport project in Texcoco, severely impacting risk premiums and interest rates and generating a lot of anxiety among investors. It is likely that this environment will have a material impact on investment, which will limit GDP growth for the next year. We are now revising, as many other analyst are, our forecasts for the next couple of years, by reducing economic activity projections and by increasing the FX rate and interest rate expected paths. Federal budget for 2019 will be announced by December 15th, and it will be a key piece of information to shape our macroeconomic framework for coming years.

CHILE — Rhythm of the economic expansion slowed in Q3, to 2.8% y/y, following the 4.5% and 5.4% in the first two quarters. Higher comparison base can be partially blamed for it, but this is a more normal base and velocity. We expect an annual GDP growth of 3.9% for the current year, which should decelerate to the 3.2%–3.5% range in 2019. Again, the slowdown can not be attributed to a slower velocity, but mainly to the more demanding comparison year. Also in Q3, domestic demand grew 4.6% y/y, with private consumption at 3.8% and capital spending keeping this velocity at around 7% (machinery 11.8% and construction 4.4%). About the latter, the cadaster of investment projects for the next 5 years improved significantly in this last quarterly edition, particularly for 2019 and 2020. On the opposite, some foreign conditions and some deterioration of the Government support in surveys (due to many non-dramatic reasons) seem to have dented the business confidence index, that came back to the pessimistic zone for the first time in the current year. The inflationary panorama eased considerably. The stabilization and retrenchment of the exchange rate besides the significant fall of oil price reduced inflation expectation for the current year and the next. The forecasts for the year were changed to 2.7% for 2018 and to 3% for 2019, but the average of the market is expecting 2.6% and 2.8%, respectively. The Monetary Policy Rate was kept at 2.75% in December, and we expect three 25bp hikes in 2019, starting on January 30th followed by one towards midyear and one more in H2. In line with our preview at the beginning of the year, and despite the most important reforms, like the tax law, the labour market framework and that of the pension system being delayed for next year, previous ability shown by the Government to reach enough support and the adequate environment in the centrist opposition, allow us to remain optimistic.

PERU — GDP rose 2.3%, y/y, in 3Q18. This was much lower than the 5.4% of 2Q18. However, many of the factors, such as a poor fishing campaign, low government investment, and low agricultural output, will improve in 4Q2018. Formal employment and, consequently, consumption, are performing particularly well, thanks to strong investments and expansion in mining and agroindustry. There have been encouraging announcements of progress in stalled infrastructure projects, including the Lima airport. We maintain our forecasts of 4.1% growth in 4Q, and 3.7% growth in full-year 2018, as well as 4.0% in 2019. The 2019 budget, which has been just approved by Congress, calls for a 6.9% in public sector expenditure. The economy is doing well despite uncertainty surrounding widespread corruption investigations that involve all major political parties and a series of prominent political figures. Peru's 12-month fiscal deficit is 2.3% to October, which is well below the 3.0%-3.5% range that many expected early in the year. The deficit will rise in 4Q, but close the year at 2.5%, and likely fall even more in 2019. Inflation is well contained at 2.2% to November, and will likely end the year near our forecast of 2.0%. We expect the CB to maintain its reference rate at 2.75% at least until 2Q2019.

Developing Economies

Currency Outlook

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SOUTH KOREA — The BoK will stay on hold after delivering a 25 bp rate hike on November 30th. As a currency of the export-driven economy, the KRW remains susceptible to external uncertainties including the Fed's rate tightening path and the US-China trade spat and geopolitical situation on the Korean Peninsula. With the US and China suspending any new tariffs for 90 days, we maintain our short USDKRW position with a target of 1,100 and a stop of 1,140.

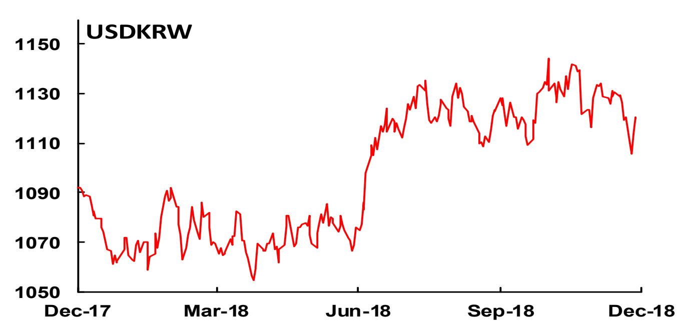
THAILAND — Thailand is planning a partial VAT refund to boost consumption. The government has reiterated February 24th, 2019 as an election date. A steady progress towards the general election would bolster the THB should external uncertainties ease. The THB will likely advance moderately after the US and China agreed to a 90-day ceasefire in their bitter trade war. USDTHB is expected to slide towards 32.5 in the weeks ahead.

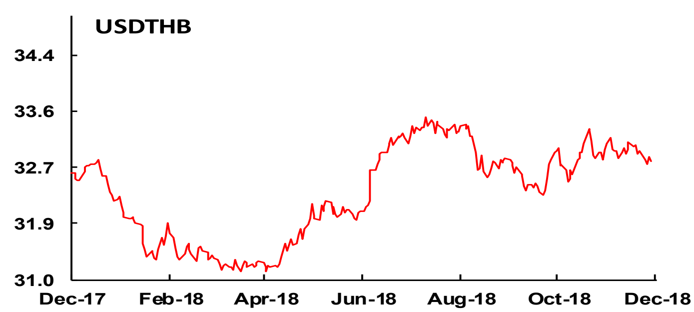
TAIWAN — The TWSE share index will rally moderately as the US and China have agreed not to impose additional tariffs after January 1st. Meanwhile, cross-strait relations are likely to improve somewhat after the island-wide local elections held on November 24th. USDTWD NDF has been trading at a discount to USDTWD DF since the beginning of November, suggesting rising expectations of the TWD appreciation. We keep our short USDTWD position with a target of 30.

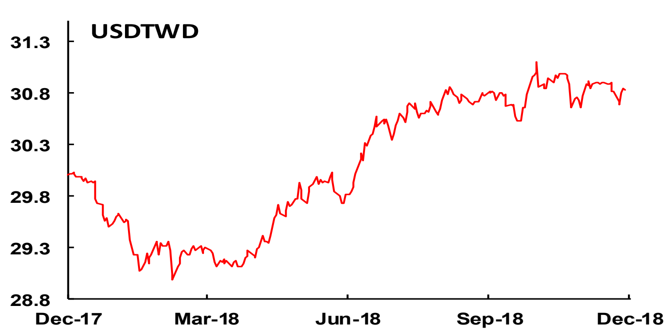
INDONESIA — The BI has pledged to "provide room" for the IDR to continue strengthening in line with market mechanism. With a lower 10Y UST yield, the IDR is expected to benefit from the yield advantage of IDR-denominated assets. Meanwhile, the central bank will take this opportunity to replenish the nation's foreign reserves. It would boost the IDR should incumbent President Joko "Jokowi" Widodo win the general election due on April 17th, 2019.

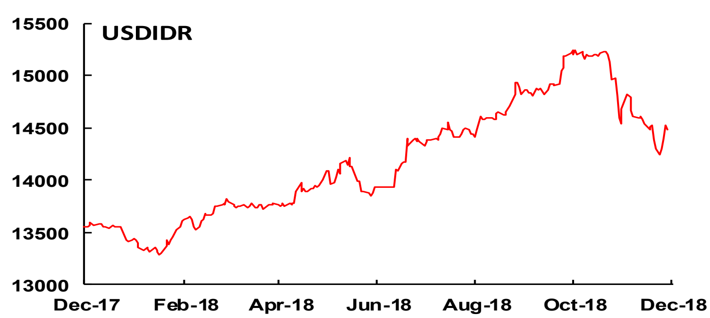
Currency Trends

FX Rate	Spot 7-Dec	18Q4f	19Q1f	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
USDKRW	1120	1100	1090	1080	1085	1085	1080	1080	1070	1070
USDTHB	32.8	32.2	32.0	31.6	31.8	31.8	31.6	31.6	31.4	31.4
USDTWD	30.8	30.5	30.4	30.0	30.2	30.2	30.0	30.0	29.8	29.8
USDIDR	14480	14000	13800	13600	13700	13700	13600	13600	13400	13400









Developing Economies

Fundamental Commentary

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SOUTH KOREA — The Bank of Korea (BoK) raised the Base Rate by 25 basis points (bps) to 1.75% following the November 30th monetary policy meeting, marking the first hike since November 2017. With South Korea's inflation in line with the BoK's 2% y/y target, the policy rate in real terms has dipped into negative territory. Against this backdrop, the central bank redirected its policy focus on maintaining financial stability in the face of high credit growth by South Korean households, elevated risk aversion globally, the risk of capital outflows, and tightening monetary conditions in the US and in several other economies. BoK Governor Lee Ju-yeol pointed out that the central bank's monetary policy stance remains accommodative with the policy rate below its neutral level. This, combined with our expectation for gradually rising inflation, points to another 25 bps hike in the fourth quarter of 2019, which is expected to be the final rate increase in the BoK's current tightening cycle. Given uncertainties surrounding South Korea's economic growth outlook, Governor Lee pointed out the South Korean government needs to conduct expansionary fiscal policy while the BoK focuses on financial stability. The nation's real GDP increased by 0.6% q/q in the third quarter of 2018, in line with the pace recorded in the second quarter. Momentum was driven by net exports as well as consumer and public spending; meanwhile, fixed investment contracted for a second consecutive quarter, warranting close monitoring over the coming months. The country's output growth is expected to be in line with the economy's potential of around 2¾% y/y over the next two years.

THAILAND — The Bank of Thailand (BoT) may raise its benchmark interest rate by 25 bps to 1.75% following the December 19th monetary policy meeting. The policy rate has been at the current level since April 2015, yet recent communications from the BoT point to an approaching shift in policy stance. At the November 14 meeting, three out of seven monetary policy committee members voted for a hike. While Thailand's inflation remains contained for the time being, with headline inflation at 0.9% y/y in November, we expect price pressures to intensify in early 2019. We estimate that inflation will pick up from the 1.0% y/y level at end-2018 to 2.0% by the end of the first quarter 2019. Thailand's real GDP grew by 3.3% y/y in the third quarter following a 4.6% advance in the second quarter. We expect the economy to expand by 4.1% y/y in 2018 and 3¾% y/y in 2019–20.

TAIWAN — The beginning of a monetary normalization phase in Taiwan is approaching. Following the Taiwanese central bank's most recent quarterly monetary policy meeting in September, the benchmark interest rate was left unchanged at 1.375% for the ninth consecutive quarter. Monetary authorities assessed that the economy's output gap is still negative, indicating a stable inflation outlook. Indeed, inflation remains manageable in Taiwan; prices at the headline level rose by 1.2% y/y in November, while core inflation stood at 0.7% y/y. Despite a contained inflation outlook, Taiwanese monetary authorities may start normalizing monetary policy in the near future in order to bolster financial stability; the first rate hike—from 1.375% to 1.50%—could be announced as soon as at the central bank's December 20 policy meeting. Indeed, the minutes of the September meeting revealed that policymakers discussed the dynamics of a possible policy rate adjustment in great detail. The Taiwanese economy is on track to grow by 2.8% in 2018; the nation's real GDP expanded by 2.3% y/y in the third quarter following a 3.3% advance in the April-June period. The slowdown is attributable to a base effect as well as weaker business confidence, which reflects trade-related uncertainties. Given that the trade conflict between the US and China is the biggest downside risk to Taiwan's economic outlook, the truce agreed in early December is an encouraging development for Taiwanese exporters as they ship a notable amount of intermediate goods to China. We expect Taiwan's output growth to average 2⅓% y/y in 2019–20.

INDONESIA — The Indonesian economy grew by 5.2% y/y in the third quarter of 2018, following a 5.3% advance in the prior quarter. Momentum continues to be driven by domestic demand, which remains solid despite the central bank's aggressive monetary tightening in recent months. Meanwhile, the external sector continued to be a drag on growth due to strong demand for imports. We expect that the Indonesian economy will maintain the current 5¼% y/y growth trajectory through 2020. Bank Indonesia (BI) continues to tighten monetary conditions. Following the November 15 monetary policy meeting, BI raised the benchmark 7-day reverse repo rate by 25 bps to 6.0%. The policy rate has been increased by 175 bps since May 2018 as the central bank focuses on promoting financial stability and supporting the Indonesian rupiah. We expect BI to deliver another interest rate increase at its December meeting, which will be held a day after the US Federal Reserve's anticipated rate hike on December 19. Despite monetary tightening, we expect Indonesia to remain among the most volatile emerging market countries in the foreseeable future on the back of its weaker economic fundamentals, such as fiscal and current deficits. Net FDI inflows are not enough to finance the current account shortfall, making Indonesia dependent on volatile portfolio inflows. Indeed, the share of foreign holdings of local currency government debt is sizable. Political uncertainty will be elevated ahead of the presidential election in April 2019.

Global Currency Forecast (end of period)

		2018f	2019f	2020f	2018f				2019f				2020f			
Major Currencies					Q1a	Q2a	Q3a	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Japan	USDJPY	112	108	105	106	111	114	112	110	110	108	108	107	107	105	105
Euro zone	EURUSD	1.15	1.30	1.32	1.23	1.17	1.16	1.15	1.17	1.22	1.26	1.30	1.30	1.30	1.32	1.32
	EURJPY	129	140	139	131	129	132	129	129	134	136	140	139	139	139	139
UK	GBPUSD	1.28	1.40	1.45	1.40	1.32	1.30	1.28	1.32	1.35	1.37	1.40	1.42	1.42	1.45	1.45
	EURGBP	0.90	0.93	0.91	0.88	0.88	0.89	0.90	0.89	0.90	0.92	0.93	0.92	0.92	0.91	0.91
Switzerland	USDCHF	0.98	0.88	0.91	0.95	0.99	0.98	0.98	0.98	0.94	0.91	0.88	0.92	0.92	0.91	0.91
	EURCHF	1.13	1.15	1.20	1.18	1.16	1.14	1.13	1.15	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Americas																
Canada	USDCAD	1.34	1.27	1.23	1.29	1.31	1.29	1.34	1.32	1.30	1.27	1.27	1.25	1.25	1.23	1.23
	CADUSD	0.75	0.79	0.81	0.78	0.76	0.77	0.75	0.76	0.77	0.79	0.79	0.80	0.80	0.81	0.81
Mexico	USDMXN	20.07	20.40	20.69	18.18	19.91	18.72	20.07	20.32	20.15	20.21	20.40	20.50	20.33	20.39	20.69
	CADMXN	14.98	16.06	16.82	14.11	15.16	14.50	14.98	15.39	15.50	15.91	16.06	16.40	16.26	16.57	16.82
Chile	USDCLP	650	650	640	604	654	657	650	650	650	650	650	650	640	640	640
Peru	USDPEN	3.34	3.30	3.26	3.23	3.29	3.30	3.34	3.35	3.31	3.32	3.30	3.31	3.27	3.28	3.26
Asia-Pacific																
Australia	AUDUSD	0.73	0.78	0.78	0.77	0.74	0.72	0.73	0.75	0.77	0.77	0.78	0.78	0.78	0.78	0.78
China	USDCNY	6.85	6.70	6.50	6.28	6.62	6.87	6.85	6.80	6.60	6.70	6.70	6.60	6.60	6.50	6.50
Hong Kong	USDHKD	7.82	7.80	7.80	7.85	7.85	7.83	7.82	7.82	7.81	7.80	7.80	7.80	7.80	7.80	7.80
India	USDINR	70.0	68.0	66.0	65.2	68.5	72.5	70.0	69.0	67.0	68.0	68.0	67.0	67.0	66.0	66.0
Indonesia	USDIDR	14000	13700	13400	13728	14330	14903	14000	13800	13600	13700	13700	13600	13600	13400	13400
Malaysia	USDMYR	4.15	4.05	3.95	3.86	4.04	4.14	4.15	4.10	4.00	4.05	4.05	4.00	4.00	3.95	3.95
New Zealand	NZDUSD	0.69	0.73	0.73	0.72	0.68	0.66	0.69	0.71	0.71	0.73	0.73	0.73	0.73	0.73	0.73
Philippines	USDPHP	52.5	51.5	50.0	52.2	53.4	54.0	52.5	52.0	51.0	51.5	51.5	51.0	51.0	50.0	50.0
Singapore	USDSGD	1.37	1.35	1.33	1.31	1.36	1.37	1.37	1.36	1.34	1.35	1.35	1.34	1.34	1.33	1.33
South Korea	USDKRW	1100	1085	1070	1064	1115	1109	1100	1090	1080	1085	1085	1080	1080	1070	1070
Taiwan	USDTWD	30.5	30.2	29.8	29.1	30.5	30.5	30.5	30.4	30.0	30.2	30.2	30.0	30.0	29.8	29.8
Thailand	USDTHB	32.2	31.8	31.4	31.2	33.0	32.3	32.2	32.0	31.6	31.8	31.8	31.6	31.6	31.4	31.4

f: forecast a: actual

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FOREIGN EXCHANGE STRATEGY

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