

USD Bear Run Set To Extend Through End Of 2019

We maintain a bearish USD outlook on the basis of cyclical, structural, and secular trends. The outlook for relative central bank policy has reached its climax in terms of offering the USD support, and widening fiscal and current account deficits are expected to deliver medium-term weakness in the currency. Longer-lasting secular trends also appear to be bearishly aligned, given the USD's 2017 turn marking the end of its post-crisis rally.

The Fed has signaled a pause in further rate increases, reflecting concerns over tighter financial conditions and softer global growth. The 2016 episode has been referenced, a year in which the Fed capitulated to markets and shifted from its intended four-hike path to one 25bp hike in December of that year. Policymakers on the Board of Governors are now broadly neutral and regional presidents' equivocation on rates clearly reveals the dove (Bullard, Bostic) / hawk (Evans, Rosengren) divide.

The global growth outlook is indeed awful—at the moment—reflecting trade-war driven weakness in China and Germany. However, the tenor of trade negotiations appears to have improved and talks between the U.S. and China are ongoing. China's policymakers are stimulating their domestic economy in order to offset trade-related headwinds, opening up the risk of a pickup in growth in the coming months. The ECB is also taking a measured approach to rate normalization while signaling ongoing confidence in their forecast for steady, above-trend growth.

Ultimately, we look to a narrowing in growth differentials between the U.S. and its developed economy peers as the effects of U.S. fiscal stimulus fade and other economies recover from their 2018 soft patch. These developments should erode the USD's supportive growth and interest rate differentials.

An improvement in the outlook for global growth is typically USD-negative (reflecting the middle of the USD 'smile') as investment flows migrate to out of safer, USD-denominated assets into higher-risk securities. Indeed, we've observed relative outperformance in emerging market and European indices relative to North American benchmarks in the period since October 3rd. Shifting global portfolio investment flows will pose a challenge for the USD as fiscal deficits remain relatively wide on a cyclically-adjusted basis.

U.S. political developments remain a negative for the USD as the government shutdown extends into mid-January. Currency markets also remain attuned to headlines relating to the Mueller investigation.

Technically, the USD reached a high in mid-December, just ahead of the Fed's 25bp hike. The subsequent decline has been relatively swift, reflecting material weakness vs. all of the G10 currencies as well as MXN, BRL, and CNY.

Weekly speculative positioning data have not been released since the start of the U.S. government shutdown. The last report, released December 21, revealed bearish positions in nearly all of the reporting currencies (vs. USD) and sizeable shorts in the G3 (JPY, EUR, GBP). The recent turn in the USD has likely been exacerbated by extended bullish USD positioning.

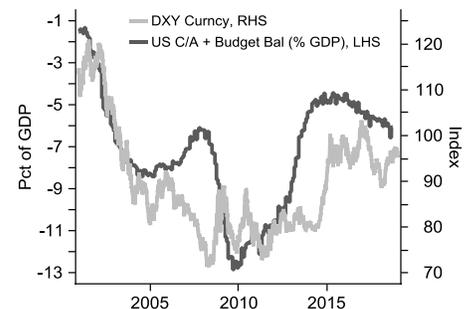
We continue to feel that 2017 marked a turning point for the USD, ending a multi-year bull run that began in the aftermath of the financial crisis. These alternating USD cycles typically last around 8 years in length and we suspect that the USD's 2018 gains reflected a counter-trend move in the context of a secular bear run. In terms of our FX forecast for Q4 2019, we have USDCAD softening to 1.27, EUR climbing to 1.30, GBP rallying to 1.40 and AUD recovering to 0.78.

 FOLLOW US ON TWITTER [@SCOTIABANKFX](https://twitter.com/SCOTIABANKFX)

Shaun Osborne
Chief FX Strategist
461.945.4538
shaun.osborne@scotiabank.com

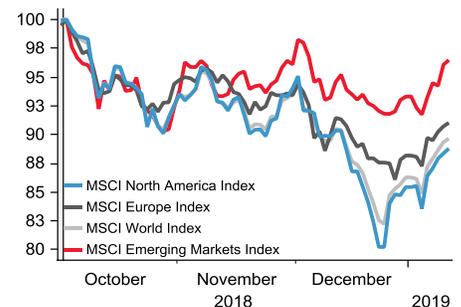
Eric Theoret, CFA, CMT
FX Strategist
416.863.7030
eric.theoret@scotiabank.com

US Twin Deficits A Concern For The USD



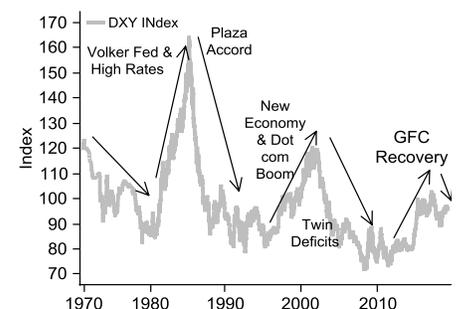
Source: Macrobond, Scotiabank FICC Strategy

Global Equity Indices Rebased To October 3



Source: Macrobond, Scotiabank FICC Strategy

DXY Bull/Bear Phases Last ~8 Years



Source: Macrobond, Scotiabank FICC Strategy

This report is intended for Sarah.Dawson@scotiabank.com. Unauthorized distribution of this report is prohibited.

IMPORTANT NOTICE and DISCLAIMER:

This report is prepared by Scotiabank as a resource for clients of Scotiabank for information and discussion purposes only. This report should be considered a marketing communication and has not been prepared by a member of the research department of Scotiabank, it is solely for the use of sophisticated institutional investors, and this report does not constitute investment advice or any personal recommendation to invest in a financial instrument or "investment research" as defined by the UK Prudential Regulation Authority or UK Financial Conduct Authority. This document has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and the information contained in this publication is not subject to any prohibition in the EU on dealing ahead of the dissemination of investment research. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from publically available sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness and neither the information nor the forecast shall be taken as a representation for which Scotiabank or any of its employees incur any responsibility. Neither Scotiabank nor its representatives accept any liability whatsoever for any loss arising from any use of this report or its contents. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instruments and has no regard to the specific investment objectives, financial situation or particular needs of any recipient. It is not intended to provide legal, tax, accounting or other advice. Scotiabank and/or its respective officers, directors or employees may from time to time take positions in the products mentioned herein as principal or agent. Directors, officers or employees of Scotiabank may serve as directors of corporations referred to herein. Scotiabank may have acted as financial advisor and/or underwriter for certain of the corporations mentioned herein and may have received and may receive remuneration for same. This report may include forward-looking statements about the objectives and strategies of Scotiabank. Such forward-looking statements are inherently subject to uncertainties beyond the control of Scotiabank including but not limited to economic and financial conditions globally, regulatory development in Canada and elsewhere, technological developments and competition. The reader is cautioned that the member's actual performance could differ materially from such forward-looking statements. Past performance or simulated past performance is not a reliable indicator of future results. Forecasts are not a reliable indicator of future performance. You should note that the manner in which you implement any of strategies set out in this report may expose you to significant risk and you should carefully consider your ability to bear such risks through consultation with your legal, accounting and other advisors. Information in this report regarding services and products of Scotiabank is applicable only in jurisdictions where such services and products may lawfully be offered for sale and is void where prohibited by law. If you access this report from outside of Canada, you are responsible for compliance with local, national and international laws. Not all products and services are available across Canada or in all countries. All Scotiabank products and services are subject to the terms of applicable agreements. This report and all information, opinions and conclusions contained in it are protected by copyright. This report may not be reproduced in whole or in part, or referred to in any manner whatsoever nor may the information, opinions and conclusions contained in it be referred to without in each case the prior express consent of Scotiabank. Scotiabank is a Canadian chartered bank.

If you are affected by MIFID II, you must advise us in writing at trade.supervision@scotiabank.com.

™Trademark of The Bank of Nova Scotia. Used under license, where applicable. Scotiabank, together with "Global Banking and Markets", is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including, Scotia Capital Inc. and Scotia Capital (USA) Inc., Scotiabank Europe plc, Scotiabank (Ireland) Limited - all members of the Scotia-bank Group and authorized users of the mark. The Bank of Nova Scotia is incorporated in Canada with limited liability. Scotia Capital Inc. is a member of the Canadian Investor Protection Fund. Scotia Capital (USA) Inc. is a broker-dealer registered with the SEC and is a member of FINRA, NYSE, NFA and SIPC. The Bank of Nova Scotia is authorized and regulated by the Office of the Superintendent of Financial Institutions in Canada. The Bank of Nova Scotia is authorized by the Prudential Regulation Authority and subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia's regulation by the Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorized by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

To unsubscribe from receiving further Commercial Electronic Messages click this link: www.unsubscribe.gbm.scotiabank.com.