June 7, 2019

AMERICAS

We have adjusted some of our near-term forecasts to reflect the persistent strength in the USD so far this year. However, we continue to feel that longer term dynamics point to a weaker currency over our forecast horizon. We expect a little less CAD strength this year but continue to target a push under 1.30 for USDCAD into 2020. Tariff concerns have weighed on the MXN, adding to longer run fundamental headwinds. Global growth concerns stemming from trade tensions have weighed on commodity prices and spilled over into the CLP and the COP.

EUROPE

Serial growth and inflation disappointments have undercut the EUR in recent months (and we have downgraded our forecast accordingly) but we do not anticipate any further monetary easing from the ECB through 2020. Meanwhile, the persistence of Brexit uncertainties will count against the GBP in the near-to-medium term (and have also required a downgrade of our forecasts for the next few quarters).

ASIA-PACIFIC

The JPY may out-perform our expectation for modest gains versus the USD in the coming months as global risk appetite remains fragile. The CNY has weakened in response to the US/China trade confrontation but is likely to remain stable ahead of the Osaka G-20 meeting.

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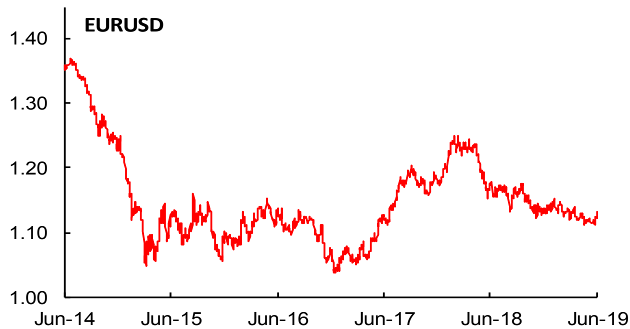
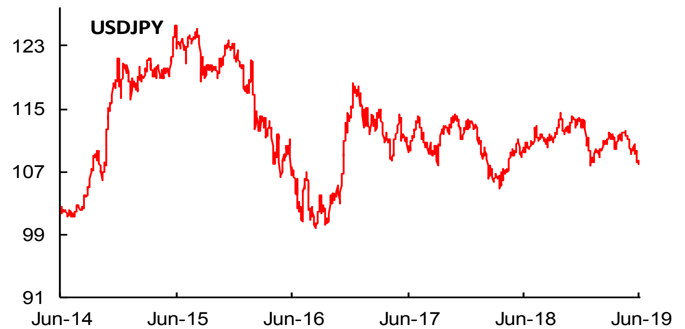
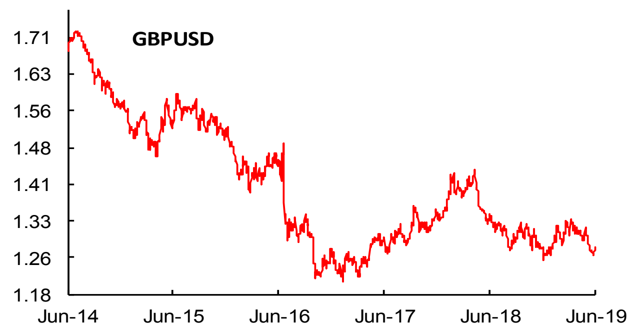
Core Exchange Rates

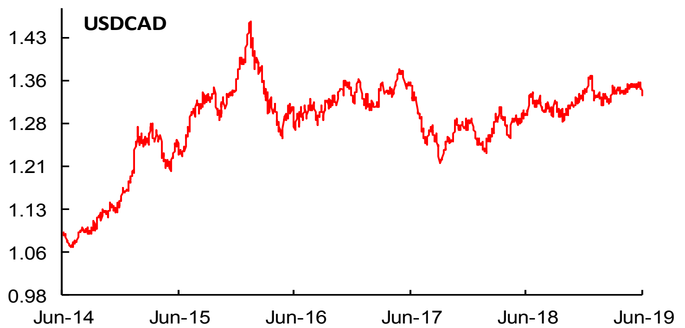
Global Foreign Exchange Outlook

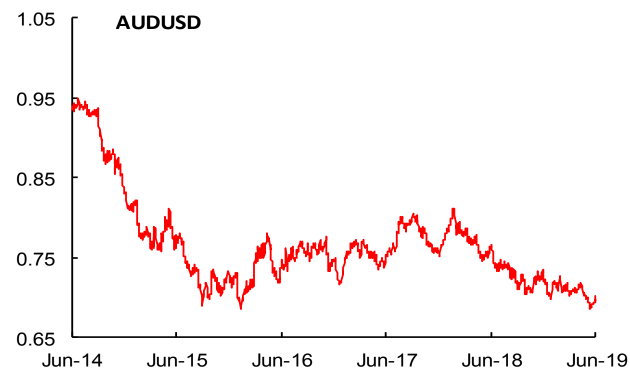
June 7, 2019	Spot	2019f Q1a	2019f Q2	2019f Q3	2019f Q4	2020f Q1	2020f Q2	2020f Q3	2020f Q4
EURUSD	1.13	1.12	1.12	1.13	1.15	1.19	1.22	1.24	1.24
USDJPY	108	111	110	108	108	107	107	105	105
GBPUSD	1.28	1.30	1.26	1.25	1.25	1.28	1.30	1.32	1.40
USDCAD	1.33	1.33	1.35	1.33	1.30	1.28	1.28	1.25	1.25
AUDUSD	0.70	0.71	0.70	0.70	0.71	0.72	0.72	0.73	0.73
USDMXN	19.64	19.43	19.90	20.48	21.26	21.40	21.26	21.36	21.71

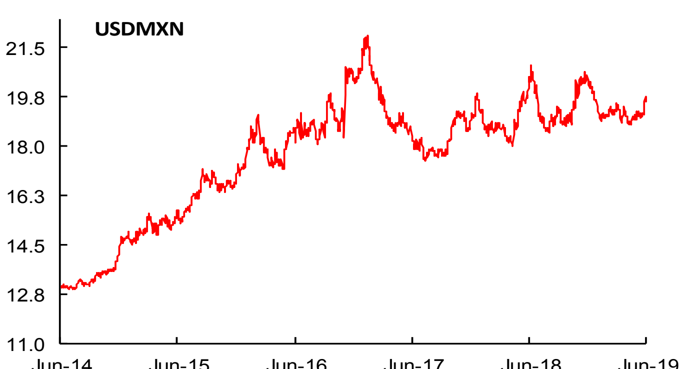












Market Tone & Fundamental Focus

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The US dollar (USD) is nearing the half year mark a little below its highest level in two years, frustrating our negative outlook for the currency that has been predicated on the assumption that the drivers of its out-performance, namely superior growth and supportive interest rate differentials, would weaken and focus investors' attention on burgeoning trade and fiscal deficits.

While US growth has been a little more robust than anticipated, we still expect the economy to gear down to a speed that is closer to trend (around 2%) through the end of this year. Interest rate differentials have narrowed—meaningfully in some cases—even if this development largely reflects US yields falling, rather than other central banks gaining sufficient confidence in the outlook to tighten their monetary policy settings. And there are signs, via waning foreign interest in US bonds, that deficits do matter for foreign investors; but they don't seem to matter enough for the foreign exchange market at the moment.

Trade tensions and weaker equity markets added to the USD's underpinnings in recent weeks as investors moved to safer and more liquid markets amid heightened market volatility. More recently, however, there are clear signs that investors are moving away from the USD amid concerns over the White House's tariff-happy trade policy and the slide in US interest rates. Fed fund futures imply the strong risk of an easing in monetary policy before year-end and there has been no real pushback from Fed officials to dispel the markets of this notion.

We continue to view the longer term risks for the USD as being tilted to the downside, given the US economy's structural (i.e. twin deficit) challenges and we are mindful of easing back too much on the USD bear call when circumstances may be—finally—moving more in favour of our directional call. But the USD's persistent strength through the first half of the year requires some fine tuning of some of our forecasts which we have included in this update.

We remain constructive on the longer run outlook for the Canadian dollar (CAD) but its performance through May is a testament to the resilience of the USD. The CAD has failed to generate any meaningful gains from range of ordinarily supportive factors and developments (interest rate spreads, crude oil prices, economic data, the lifting of US metal tariffs which pave the way for the formal ratification of the USMCA). In fact, despite all of these CAD-positive developments, the currency finished up the May month with a small (1%) net loss versus the USD. The Australian and New Zealand dollars have both under-performed in recent weeks and look poised to remain soft as their respective central banks have both moved to ease monetary policy. We have adjusted our forecasts lower here as a result.

The EUR's performance has been dogged by serial disappointments on the growth and inflation fronts which have delayed the start of the European Central Bank's policy normalization process. We have adjusted our EUR forecast modestly lower over the next four quarters to reflect the EUR's persistent softness but we continue to see some fundamental value in the EUR at or near the recent range lows and still rather expect the single currency to improve as yield spreads slowly narrow against the USD. The Japanese yen (JPY) is conforming largely to expectations but risks overshooting our forecast of modest strength against the USD through the second half of this year if global equity market volatility increases. The JPY retains the strongest, negative correlation with US equity markets and remains a "go to" safe haven in times of stock market weakness especially.

In the United Kingdom, the Brexit process is proving to be more protracted than we expected. The departure date has been extended until the end of October but may be further complicated by Prime Minister May's decision to step aside; the election of a new leader of the Conservative Party, who will then succeed her as Prime Minister, may mean the formulation of a new approach to the process and might renew concerns of a "no-deal" Brexit, pressuring GBP sentiment in the next few months.

FX trends outside of the G-10 space are being dominated by trade and tariff issues—or concerns about their knock-on effects. The Mexican peso (MXN) had been trading comfortably in range around the 19.00 versus the USD but weakened abruptly on President Trump imposing escalating tariffs on all Mexican goods in response to the flow of illegal immigrants. We expect the MXN to retain a soft undertone from a fundamental point of view in the next few quarters but losses may be more severe if tariffs are not averted. Weaker commodity prices resulting from slower global growth fears have undercut the Chilean and Colombian pesos.

Meanwhile, the US-China trade tensions show no sign of abating following the US decision to raise tariffs on Chinese goods (and Chinese retaliatory action) as of June 1st. Bilateral meetings may take place at the G-20 Osaka Summit but there is no sign of an early resolution to the stark differences that seem to remain between the countries. We expect the yuan (CNY) to remain relatively stable around the 6.90 level versus the USD at least until the summit is over but see some risk that the exchange rate is allowed to take some of the strain of the higher tariff burden absent a resolution to the trade confrontation.

Canada

Currency Outlook

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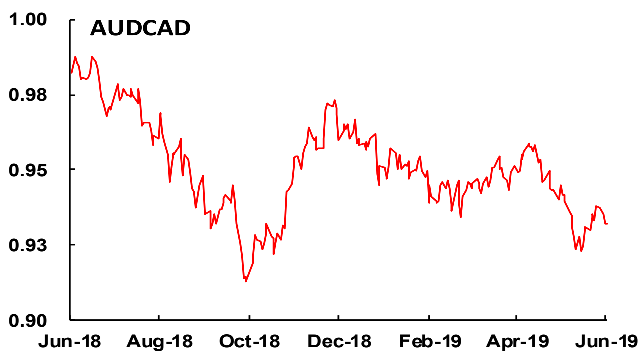
The CAD has been choppy over the past few weeks and has looked to be on the cusp of both a significant sell-off and a major recovery within the space of a few days around the end of May. We still rather think that the CAD's downside is limited (essentially by our weaker USD prognosis) in the months ahead. But we have downgraded the outlook for the CAD modestly over the forecast horizon as a result of the weak start for domestic GDP growth to 2019 and lingering trade headwinds. We now forecast and end 2019 rate of 1.30 (0.77 USc), from 1.28 and an end 2020 rate of 1.25 (0.80 USc), from 1.23 in our last forecast iteration.

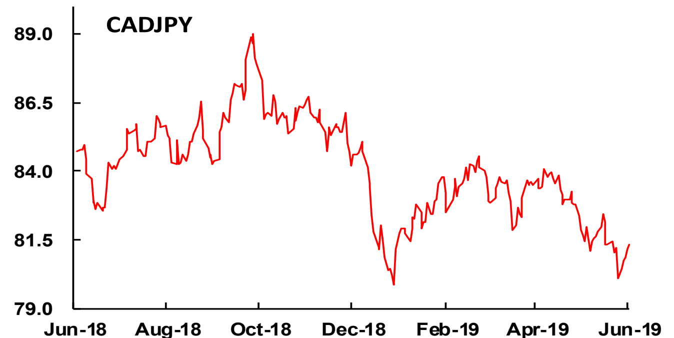
Overall, we think the recent backdrop for the CAD has been somewhat more encouraging than price action would suggest. US-Canada interest rate differentials narrowed dramatically along the curve as US yields retreated in recent weeks. The 2-year cash bond spread fell from a yield premium for US instruments of 85 basis points in March to 48bps at writing, a major reduction in the USD's yield advantage that we would have expected to translate into a stronger CAD. Meanwhile, the CAD made no real headway in response to a record one-month gain in Canadian employment in Apr (+106.5k).

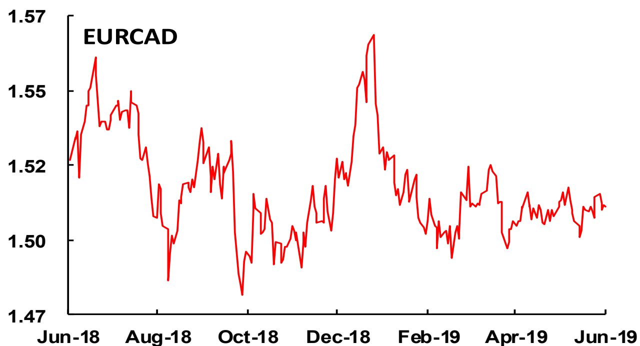
Indeed, our Fair Value regression model, which tracks yield spreads and commodity prices relative to the CAD to determine an "equilibrium" estimate of the exchange rate has flagged a large and persistent overvaluation in the USD since early May. It suggests "fair value" for spot is a little above 1.31 (against a market rate around 1.34) at writing. We look for the USD to soften a little more (towards 1.31) near-term if the market pushes clearly under technical support around 1.3275/00.

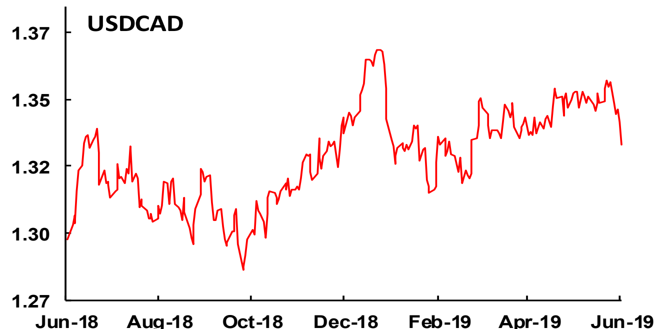
Canadian Dollar Cross-Currency Trends

FX Rate	Spot 7-Jun	19Q1a	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
AUDCAD	0.93	0.95	0.95	0.93	0.92	0.92	0.92	0.91	0.91
CADJPY	81.3	83.0	81.5	81.2	83.1	83.6	83.6	84.0	84.0
EURCAD	1.51	1.50	1.51	1.50	1.50	1.52	1.56	1.55	1.55
USDCAD	1.33	1.33	1.35	1.33	1.30	1.28	1.28	1.25	1.25









United States and Canada

Fundamental Commentary

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UNITED STATES — Data revisions brought US Q1-2019 real GDP growth down a touch from 3.2% to 3.1% q/q SAAR and growth is projected to slow below potential to 1.4% in Q2 as the effects of the 2018 Trump stimulus continue to wane, prospects for a Federal infrastructure package fade again, and chronic trade-policy uncertainty from the White House weighs increasingly heavily on business activity. Even if the current threat to impose across-the-board tariffs on Mexico is not realized, it has injected delays into the USMCA ratification process and chilled prospects for the conclusion of trade negotiations with China, Japan, and Europe. Accordingly, we have cut our growth outlook further, down to 2.4% in 2019 and just 1.5% in 2020, driven by softer consumption growth and weaker investment plans. Inflation looks set to stay at or around the 2% target with core measures registering softer-than-previously-expected numbers. As a result, our forecasts no longer anticipate any changes in the Fed funds target rate during the remainder of 2019 or in 2020.

CANADA — Canada's end-2018 soft patch continued through February 2019, but a rebound began to take hold in March. Canada's major macroeconomic indicators firmed up with housing starts, home resales, manufacturing shipments, hours worked, and employment data all notching strong gains. Canada added more new jobs in the first four months of 2019 than in any entire calendar year between 2013 and 2018, with the exception of 2017's standout performance. The quality of these jobs has been strong, with an emphasis on full-time, private-sector positions across the country. Consumption growth is likely to remain moderate, however, as household debt burdens remain large and wage growth lags expectations. Large unfilled order books and high capacity-utilization rates would normally imply that business investment should drive Canada's rebound through 2019 and into 2020, but the ongoing uncertainty created by protectionist threats from the US has dampened the outlook for capital spending and eliminated the prospect of any further rate increases from the Bank of Canada in 2019 and 2020 as inflation looks set to remain around the 2% target. We still expect USMCA to be ratified, but with delays that could extend beyond its intended January 1, 2020 start date.

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Monetary Policy Commentary

UNITED STATES — Scotiabank Economics has taken a tentative step toward revising our rates forecasts. The Fed funds rate is assumed to be on hold at 2.5% over 2019-20. The risk of administered rate cuts is expressed through Treasury yields particularly in the 2s through 5s maturities. The Treasury curve is forecast to remain inverted for some time. Even if the Fed does not ease in the nearer term, the rates complex is likely to retain a more modest rate cut premium in the face of high uncertainty. Our base case macro projections remain positive and we still don't believe that an aging expansion must by definition come to some automatic end which is what the cut camp was assuming all along. New information has nevertheless arisen, yet we don't have enough information to judge risks to US-centric global trade policy, Brexit, Middle East tensions and Italian fiscal tensions to name a few. Further, policy easing could be oriented toward achieving faster than potential economic growth, raising inflation expectations, perhaps seeking to run 'hot' with inflation over the 2% target, and avoiding market disappointment.

CANADA — The same dilemma that overhangs our Fed views plagues the outlook for the Bank of Canada, but with important additional twists. We have the BoC on hold throughout 2019-20 and retain curve inversion for similar reasons to the US call. A case against easing in favour of neutral or tightened policy includes referencing a growth rebound (while US growth slows), a much weaker currency than the Fed faces, strong activity readings from jobs to a housing rebound, and inflation very near the BoC's 2% target. However, commodity prices are pushing back to levels seen early this year and late last year on average with some, like lumber, much lower. This is dampening prior gains in the terms of trade which may put downward pressure on domestic profits, household incomes and fiscal balances. If this continues then recall it was a main motivator for the 2015 rate cuts. This is an election year and that may put added emphasis upon monetary policy to respond to shocks as broader public policy stagnates. All of this is in the context of bloated inventories at manufacturers and wholesalers and high household debt levels.

G10
Currency Outlook

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EUROZONE — The EUR remains challenged despite the recent shift in the outlook for relative central bank policy. Bearish interest rate differentials have narrowed significantly but remain firmly in the USD's favour. The options market appears to have turned however, and medium-term risk reversals (out to six months) are now pricing a slight premium for protection against EUR strength. Extended speculative shorts appear vulnerable to adjustment. We maintain a mildly constructive medium-term outlook for the EUR, targeting 1.15 by Q4 2019.

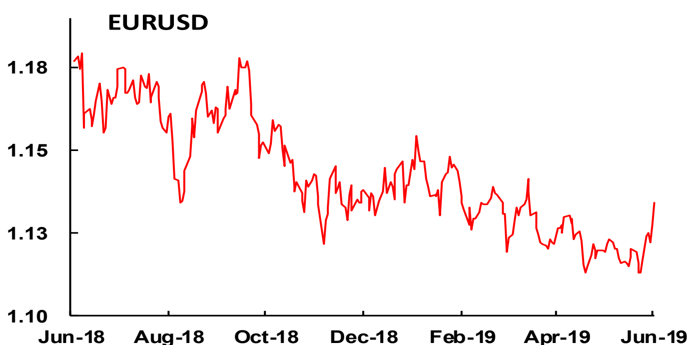
UNITED KINGDOM — GBP has seen a modest counter-trend bounce in the first few trading sessions of June however the medium-term trend remains decidedly bearish, given ongoing political uncertainty. Brexit developments are likely to remain a headwind into the scheduled October 31 departure date and hard Brexit risks are rising. We expect GBP to end the year around current levels and have a Q4 2019 forecast of 1.25.

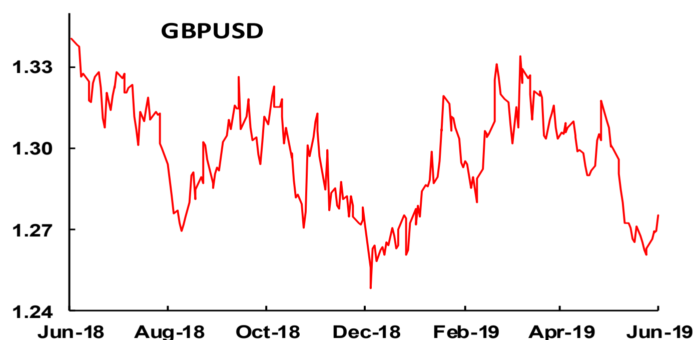
JAPAN — The JPY remains well supported in this environment of renewed global trade policy uncertainty, testing fresh highs at its best levels since early January. Interest rate differentials have narrowed significantly and haven-driven flows have powered additional gains. Measures of sentiment are mixed however, as risk reversals and speculative positioning offer conflicting signals. We are neutral JPY around current levels and hold a Q4 2019 USDJPY target of 108.

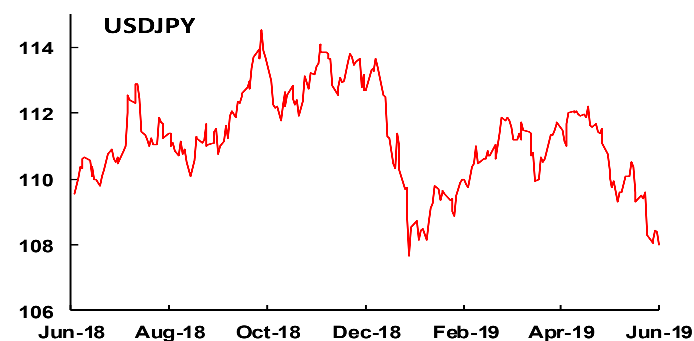
AUSTRALIA — The AUD has seen a modest recovery from its mid-May low however the longer-term trend remains bearish. The outlook for relative central bank policy is somewhat clouded at the moment, given the aggressive build in easing expectations for both the Fed and RBA. Global trade policy uncertainty will likely leave the AUD trading defensively through the end of the year, and we expected to end Q4 around current levels. We hold a Q4 2019 forecast of 0.71.

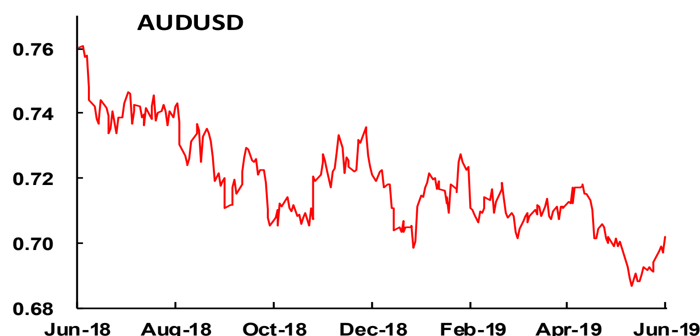
Currency Trends

FX Rate	Spot 7-Jun	19Q1a	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
EURUSD	1.13	1.12	1.12	1.13	1.15	1.19	1.22	1.24	1.24
GBPUSD	1.28	1.30	1.26	1.25	1.25	1.28	1.30	1.32	1.40
USDJPY	108	111	110	108	108	107	107	105	105
AUDUSD	0.67	0.71	0.70	0.70	0.71	0.72	0.72	0.73	0.73









G10

Fundamental Commentary

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EUROZONE — Economic risks in the Eurozone remain tilted to the downside owing to the still-unresolved EU-UK separation and continuing global trade uncertainty on the back of US protectionism. At home, the Italian economy will be on fragile footing for the remainder of 2019 as the country's unstable coalition government wrangles from within and with the EU Commission over public spending plans. The European manufacturing sector's woes, which began in the second half of 2018 with strong pullbacks in auto production due to the introduction of more stringent emission standards, have been compounded by a deceleration in external demand as global economic growth—namely in China—has led to a sharp slackening of global trade volumes amid depressed investment intentions and consumer confidence. On June 6th, the ECB reinforced its position to maintain monetary policy on a relatively accommodative stance as it prepares to launch a third round of long term loans to banks beginning in September. We expect that the ECB will leave its policy rates unchanged for the duration of our forecast horizon although erratic trade policy coming out of the White House poses significant risks for the global economy and may necessitate additional monetary stimulus.

UNITED KINGDOM — Economic growth in the UK will remain sluggish for the rest of the year due to Brexit uncertainty and fragile economic prospects abroad. Little progress has been made regarding the UK's separation from the EU since April 11th, when Britain was granted an extension to Brexit until October 31st. The odds of a positive arrangement have also fallen of late after the Conservative Party was dealt a harsh defeat in European Parliament elections in mid-May, which was followed by Theresa May's announcement that she will renounce the prime-ministership on June 7th. Among the frontrunners to replace her, Boris Johnson has indicated that he would be ready to exit the bloc in late-October with, or without, a deal, while Michael Gove appears more amenable to bridging differences within Parliament to guarantee an exit agreement with the EU. We expect that core inflation in the UK—which has remained relatively stable since mid-2018—will pick up in the latter third of 2019 and, alongside a boost to growth from fading Brexit uncertainty—our base case still remains that the EU and the UK will reach an agreement—, will prompt the Bank of England to raise its policy rate during Q2-2020 to 1.00% from 0.75% currently, with no further increases projected in the near-term.

JAPAN — According to preliminary estimates, the Japanese economy expanded by 0.5% q/q (non-annualized) in Q1 2019 following a 0.4% q/q gain in Q4 2018. In year-over-year terms, real GDP grew by 0.8%. Activity was driven by net exports as imports contracted more than exports; meanwhile, domestic demand was subdued. We expect Japan's output to grow by 0.8% in 2019 as a whole. The Bank of Japan (BoJ) will likely maintain its ultra-accommodative monetary policy stance through our forecast horizon until the end of 2020, under the framework of "Quantitative and Qualitative Monetary Easing with Yield Curve Control". Against the background of elevated global uncertainties and late-cycle dynamics, we note that the BoJ's monetary policy room is fairly limited. Should the economy need further stimulus in the foreseeable future, the main responsibility may fall onto fiscal policy despite already weak government finances. A decision on whether to go ahead with the consumption tax rate increase from 8% to 10%, currently scheduled for October 2019, will likely be made in the near future. Inflation remains low and the BoJ's 2% annual inflation target seems unattainable. Prices at the headline level rose by 0.9% y/y in April. The CPI excl. fresh food—the BoJ's preferred inflation measure—also increased by 0.9% y/y in April. We forecast headline inflation to stay below 1% y/y in the near term until the consumption tax rate hike will prompt a temporary pickup in the final months of 2019. After the tax hike impact wanes in late-2020, inflation is set to return below the 1% mark.

AUSTRALIA — A monetary easing phase has begun in Australia. Following the June 4th monetary policy meeting, the Reserve Bank of Australia (RBA) cut the benchmark interest rate by 25 bps to 1.25% on the back of muted inflationary pressures and rising concerns about the economy. We assess that the RBA's decision was justified. Australia's economy is showing signs of moderation with an opening of the output gap; employment gains are expected to slow in the coming quarters (albeit from above average levels); and inflation is persistently low. Headline inflation hovers below the RBA's 2–3% target with prices rising by only 1.3% y/y in the first quarter of 2019 on the back of lower fuel prices, muted housing-related price gains, and soft wage gains. We estimate that base effects will take headline inflation back toward the 2% mark in early 2020. The central bank has indicated that it stands ready to ease monetary policy further if needed. RBA Governor Philip Lowe pointed out that labour market developments would play a key role in directing future decisions. While we find the RBA's communications regarding future policy direction rather cautious, assuming labour markets do not strengthen materially in the coming months, we expect that another 25 bps cut is likely to follow sooner rather than later, most likely in the second half of 2019. The RBA will only communicate its intentions shortly before a critical policy meeting. Australia's real GDP expanded by 0.4% q/q (+1.8% y/y) in the first quarter following a 0.2% q/q (+2.3% y/y) gain in the fourth quarter of 2018. We expect the economy to grow by 2½% y/y in 2019–20.

China, India, Brazil

Currency Outlook

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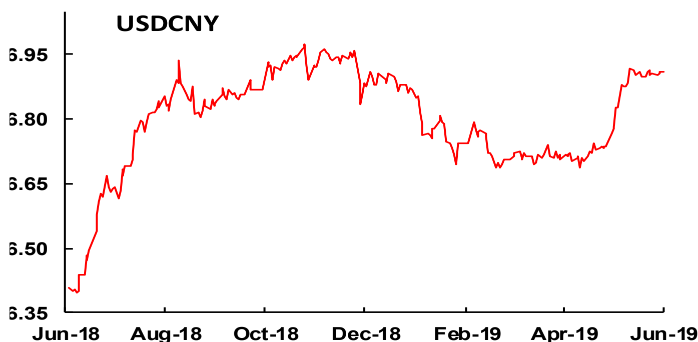
CHINA — The PBoC will keep the yuan basically stable ahead of the G-20 Osaka Summit due 28-29 June, with USDCNY fixing staying below 6.90. If US President Donald Trump and Chinese President Xi Jinping agree to resume their bilateral trade talks in Q3 when they meet in Osaka, dollar/yuan will trade lower towards 6.80 and then 6.70 in Q3. Otherwise, latest comments from former PBoC Governor Zhou Xiaochuan signals the pair will rally through the 7 psychological level finally if needed.

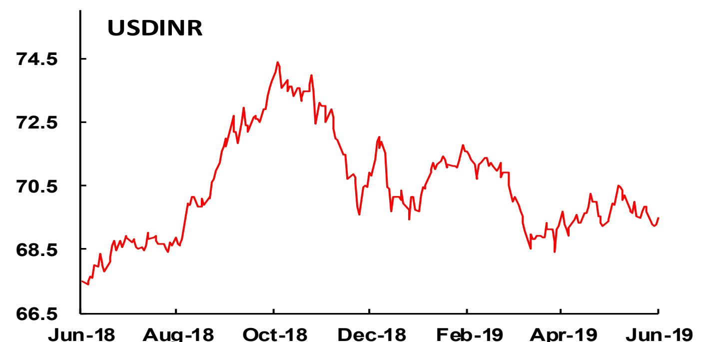
INDIA — The BJP-led National Democratic Alliance (NDA) party retained power for a second consecutive term with a historic landslide re-election victory. It will boost Indian equities and bonds on hopes for more market-oriented reforms and further monetary easing, supportive of the INR in general. We remain bearish on USDINR that is likely to head for the 68 support or even lower levels in the month of June, while keeping a close eye on oil prices and US-China trade tensions.

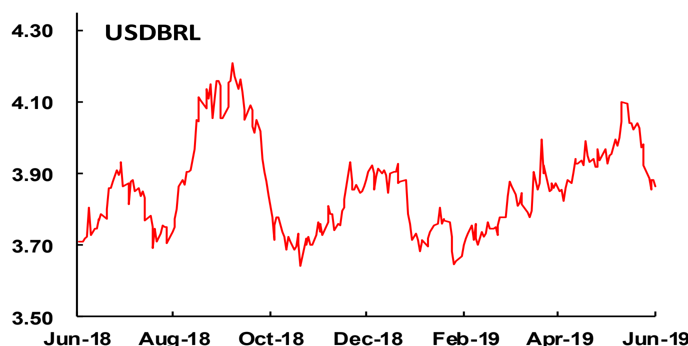
BRAZIL — USDBRL has been quite volatile this quarter, hovering between 3.81 and 4.11, with a combination of internal factors (reform-related strikes, and reform progress uncertainty), alongside external shocks (trade war-mongering and softening commodities) driving the real through a roller-coaster ride. One of the reasons we have the BRL weakening, is the BCB's reluctance to tighten—leading to relatively low carry for the currency, alongside lax monetary and fiscal policy, which should all weigh on the real.

Currency Trends

FX Rate	Spot 7-Jun	19Q1a	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
USDCNY	6.91	6.71	6.80	6.70	6.70	6.60	6.60	6.50	6.50
USDINR	69.5	69.2	67.0	68.0	68.0	67.0	67.0	66.0	66.0
USDBRL	3.86	3.92	3.91	3.97	4.18	4.08	4.11	4.07	4.18







China, India, Brazil

Fundamental Commentary

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CHINA — The trade conflict between the US and China has escalated notably following US President Trump's announcement on May 10th that the US will raise tariffs from 10% to 25% on USD200 bn of imports from China. In response, China announced a retaliatory move on May 13th, hiking Chinese tariffs on USD60 bn of imports from the US, effective on June 1st. In addition, technology-related tensions have intensified further. While both the US and China would benefit from a stabilization of the bilateral relationship, we now expect negotiations to continue through the second half of 2019, undermining business confidence globally. Regardless of any trade agreement, the two countries' differing fundamental views regarding the economy and the society at large will remain in place for years to come. Technological rivalry, in particular, will likely continue to create tensions between the two countries. High frequency economic data—such as industrial production, retail sales, exports, fixed investment—show that the Chinese economy continues to be under notable downward pressure. Accordingly, we expect Chinese authorities to unveil further stimulus measures in the near future. Fiscal stimulus will likely include further income tax and fee cuts, thereby assisting the economy's transition toward a consumer-led growth model. Meanwhile, monetary stimulus will likely consist of further targeted cuts to banks' reserve requirement ratios that aim to boost lending to private sector enterprises. We maintain the 2019 and 2020 economic growth forecasts for China at 6.2% and 6.0%, respectively; however, any further escalation in the trade conflict would put downward pressure on our forecasts. Chinese inflationary pressures will remain contained in the foreseeable future despite a recent uptick in headline inflation to 2.5% y/y. Headline inflation will likely hover at the current level over the coming quarters, slightly below the government's target of around 3% y/y. Price pressures further up the distribution chain are much lower with annual producer prices rising by 0.9% y/y. Low inflation allows monetary policy to be accommodative.

INDIA — The Reserve Bank of India (RBI) continues to take further steps to stimulate the Indian economy. Following the Monetary Policy Committee's bimonthly meeting on June 4–6, the benchmark repo rate was cut by 25 bps to 5.75%, marking a third consecutive interest rate reduction. The RBI also shifted its monetary policy stance to accommodative from neutral, signaling possible further rate cuts ahead. Price pressures in India remain manageable for the time being with headline inflation at 3.0% y/y in April, comfortably within the RBA's annual inflation target of 4% ±2%. Core inflation is somewhat elevated, at 4.6% y/y in April, yet it continues to show signs of weakening. The inflation outlook over the second half of the year was revised downward by the RBI. Given the current inflation dynamics and weaker economic growth momentum, we expect the RBI to deliver another 25 bps cut at the August 7 policy meeting. Monetary stimulus will boost India's economic growth momentum. Real GDP growth slowed markedly in the first quarter with output rising by 5.8% y/y, the lowest rate since Q1 2014. Accordingly, we have revised our Indian real GDP growth forecasts down, and now expect the economy to expand by 6½% y/y in 2019 as a whole (vs. our earlier projection of 7.0% growth). India concluded its seven-stage general elections in May. Prime Minister Modi's Bharatiya Janata Party won a single-party majority, securing 303 seats in the 534-seat parliament. The result should allow the BJP to focus on implementing structural reforms; if successfully implemented, they would improve business sentiment and investment in India and underpin the economy's longer-term growth prospects.

BRAZIL — Reaching our base case pension reform rated savings threshold in the BRL500-600bn range over 10 years, should be taken as a moderate positive for markets, but is nowhere near enough what is needed to truly alleviate the country's fragile fiscal stance. The nominal fiscal stance is expected to yield deficits north of 6% of GDP until after 2021. The government's pension reform sought BRL1.2tn in savings over 10 year, now a remote dream. BCB Board members have suggested that strong reform progress could help the BCB cut rates given the softening growth picture, but our sense is that although some pension/fiscal improvement will be achieved, it will be modest—thus shutting the door on rate cuts. Hence, we have the BCB kicking off its rate hike cycle late in 2019, which we'd argue is too late, meaning that the total hike cycle may be a little longer than markets expect, despite sluggish growth. A problem with the BCB is that without meaningful pension and fiscal reform, it will once again be relied upon to compensate for lose fiscal settings, with higher interest rates. On the growth front, we saw some reason to hope that the Bolsonaro administration's positive signals for the business community would boost investment, and with it growth. However, a materialization of that positive scenario remains elusive. Hence, like most market players seem to be doing, we pared back our growth expectations for the country.

Pacific Alliance
Currency Outlook

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MEXICO — Despite the better-than-expected performance in early 2019, we still expect the MXN to come under pressure, now by renewed headwinds coming from both, external and domestic factors. On the domestic side, the prospects on the sovereign debt profile have worsened, while it is likely for the exchange rate to absorb the impact of possible tariffs increase. On the external side, heightened volatility and increased risk aversion could further weaken investors' confidence towards EMEs.

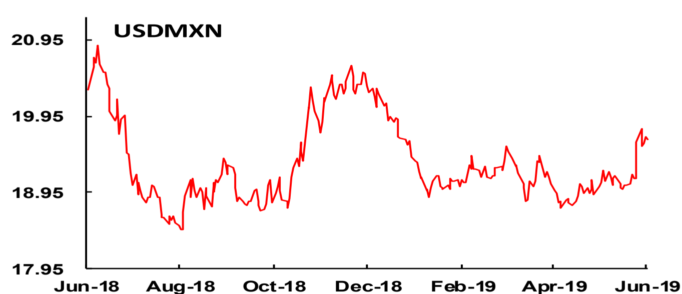
COLOMBIA — The possibility of a downgrade to Colombia's rating due to high external and fiscal imbalances, the recent escalation of trade wars and BanRep's dollar purchases made COP to depreciate to ~COP$3400 in May (~15% y/y). However, the rating agencies kept the sovereign rating at "BBB" and BanRep put on hold dollar purchases which drove an appreciation in the COP to ~COP$3300. Although structural issues on external and fiscal imbalances are far from being solved, there is more certainty on the short run and COP can appreciate a bit more to levels close to 3100-3200. Volatility will likely continue affecting EM currencies.

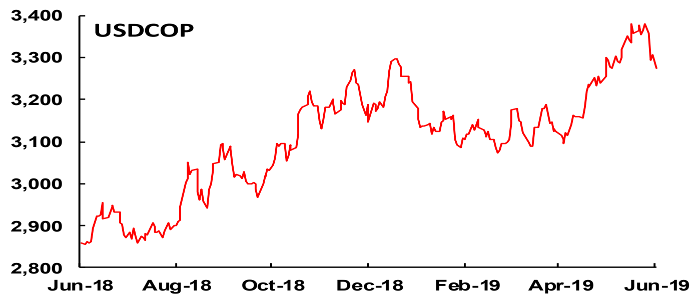
CHILE — Since its strongest level in Feb-2019, Chilean exchange rate has depreciated, pressed by lower copper prices, a stronger USD and increasing risk aversion, to reach its weakest level since early-2016. According to our models, current level (over USDCLP700) reflects a misalignment with respect to its short-term fundamentals and leads us to forecast an appreciation of the CLP towards the end of the year. We maintain our projection of USDCLP645 for Dec-19.

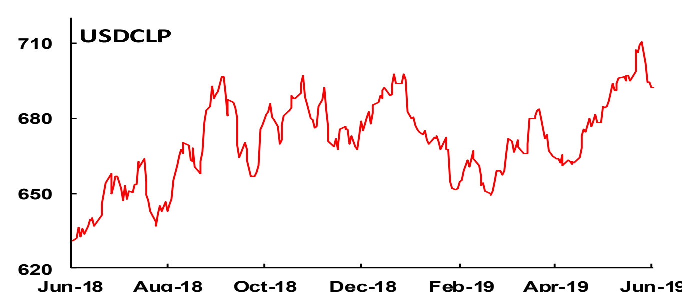
PERU — The PEN has fluctuated between 3.28–3.39 YTD. It's not easy foreseeing the FX rate at year end, but recent events are in line with a higher rate than our 3.30 forecast, which we are raising to 3.35. The strong capital inflows earlier in the year that took the PEN to 3.28, have since slowed and should remain moderate (albeit positive) going forward. At the same time, commodity prices are running well below our original expectations and external accounts will be less positive as a result. All this in an environment in which global backdrop is characterized by a continual stream of risk-charged events. The increase in domestic turmoil and a slowing economy do not help either. We are changing our forecast with some trepidation, however. The future of the PEN will be affected, as always, by the trend of the USD, which is unclear, as it absorbs the opposing impacts of negative global events and changing expectations on Fed monetary policy.

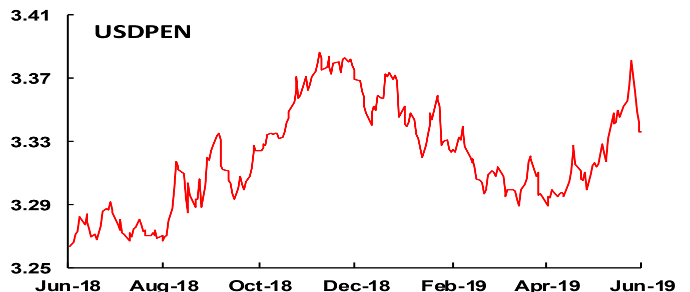
Currency Trends

FX Rate	Spot 7-Jun	19Q1a	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
USDMXN	19.64	19.43	19.90	20.48	21.26	21.40	21.26	21.36	21.71
USDCOP	3275	3189	3105	3150	3120	3050	3100	3182	3167
USDCLP	692	680	670	658	645	643	643	647	639
USDPEN	3.34	3.32	3.37	3.34	3.35	3.36	3.32	3.33	3.30









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Fundamental Commentary

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MEXICO — Weakening signs in economic activity are proliferating, and growth prospects have deteriorated on the back of a more challenging backdrop. Even though economic activity was expected to recover slightly after a deep slowdown during the first quarter of 2019, the macro environment has turned more adverse and uncertain amid growing risks on the outlook. Downside risks to economic activity have increased prompted by both, the White House threat to impose tariffs on Mexican goods if the government does not stop the flow of migrants into the US, as well as the deterioration on Mexico's debt profile after Fitch chopped the sovereign by one notch and downgraded Pemex to junk territory, while Moody's lowered its rating outlook. In view of these events, we are in the process of revising our forecasts, which will be presented later on the next Global Outlook report. We anticipate weaker growth in consumption and job creation stemmed from heightened domestic uncertainty and undermined confidence, while it is foreseeable for investment to keep contracting on the heels of dented business sentiment. Moreover, we expect Banxico to maintain a prudent monetary policy stance and hold interest rates through the year, while inflation will remain above the official target for more time than previously expected.

COLOMBIA — 1Q19 GDP growth showed that Colombia's economic activity recovery continues being gradual and is still growing below potential. Economic activity grew 2.8% in 1Q19 similar to 4Q18 and FY18 (2.7% y/y and 2.6% respectively). Having said that, domestic demand has been steadily growing above GDP the last five quarters due to a higher pace in the recovery in private consumption and some investment pickup. We still think that low interest rates, higher than expected terms of trade due to higher oil prices, steady FDI and countercyclical public expenditure—due to last year's regional campaigning—will continue to support economic activity recovery this year. Therefore, we keep our FY19 GDP growth forecast of 3.4%. Although fiscal policy and a wider current account deficit continue to be the main concerns for long run economic sustainability, the recent decision from Moody's and Fitch to maintain Colombia's rating brought some relief to markets regarding the short run outlook and lowered pressure on the exchange rate. Additionally, financial officials have indicated that the government will do whatever it takes to keep the initial 2.4% of GDP fiscal deficit target for this year despite the fiscal rule committee allowing the government room for the deficit to rise to 2.7% of GDP this year due to the Venezuela immigration crisis. Additionally, Minister Carrasquilla has confirmed the plan to privatize publicly owned companies to raise additional resources and reduce debt needs. Although this solves some immediate problems, it does not resolve longer run fiscal sustainability questions. A still negative output gap, moderate inflation, and limited FX pass-through despite recent depreciation in the peso, have allowed the central bank to keep an expansionary MPR at 4.25% for the last thirteen months to help foster a recovery in economic activity. Accommodative, developed market central bank policies have also helped BanRep to maintain its expansionary stance for longer.

CHILE — Compared to 2018, Chilean economy is facing lower growth and higher inflation this year. Incoming data for 1Q2019 surprised to the downside, mainly due to negative supply shocks in agriculture, fishery and mining. However, core-activity remains solid and is still consistent with GDP growth between 3.0-3.2% for 2019. We are optimistic about the effects of investment in the second half of the year, but an early agreement on the tax reform, which is currently being discussed in Congress, is crucial to improve confidence. Investment increased 2.9% y/y in 1Q2019, and projects in the pipeline to materialize during 2019-2022 were adjusted upwards once again in March. In the mining sector, most projects are already under construction. Private consumption confirms a strong dynamism in services, in contrast with a lower performance of goods. Recovery in job creation and wages should be the main driver of a stabilization in retail sales from mid-year on. The deterioration in the labour market seems to have concluded. The Unemployment rate remained at 6.9% in April, due to a greater dynamism in the labour force. Employment creation remains solid, mainly in self-employed and public sector jobs. But private sector growth is sluggish Additionally, inflationary pressures in services should increase in the coming months. Lower GDP growth, together with a challenging external scenario, support the maintenance of stimulative monetary policy for a longer period of time. However, we still expect the normalization of the MPR to continue in 4Q19 or 1Q20 due to the closing output gap.

PERU — The first quarter was very weak, with GDP growth of 2.3%, and the second quarter is not shaping up to be much better. Our main concern is private investment (non-mining), which fell 0.5% in 1Q19. This is normally a leading indicator, and one that, currently, does not bode well. Even though mining investment was up a strong 37%, it weighs little and current projects will not come on stream in force before 2021. Public investment, down 11% in 1Q, should decline most of the year, as new regional authorities learn how to spend. Thus, consumption is the only thing holding up the economy. Macro balances are strong, though, with a 3.6% of GDP fiscal surplus in 1Q, which may lead to a full-year deficit even lower than our 2% of GDP forecast. In addition, there is an ample trade surplus and inflation is within the target range. However, these positive macro balances are just not feeding into growth, largely due to a seemingly continual stream of negative global events and domestic political developments. We do expect GDP to perform better in 2H19, but YTD weakness and a riskier political and global environment, don't add up to our 4% GDP growth forecast for 2019, which we have put under review. We are also modifying our view on monetary policy. We continue to expect the Central Bank to keep its policy rate stable, but now see downside risk, rather than upside risk, over the next twelve months.

Developing Economies
Currency Outlook

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SOUTH KOREA — The BoK will maintain its pro-growth stance amid mounting risks of economic slowdown and disinflation, but with no rush to deliver a rate cut for now. The KRW will remain susceptible to the Fed's policy stance, the US-China trade talks and geopolitical situation. USDKRW will trade lower towards 1,180 and then 1,160 if there is positive progress in the US-China trade negotiations. However, if the trade talks break down, the pair will rally through 1,200 and jump further.

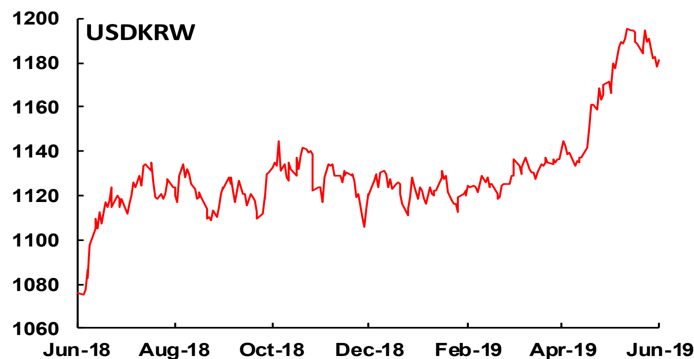
THAILAND — BoT Governor Veerathai Santiprabhob said last week that Thailand can't be complacent even though it avoided inclusion in the latest US watchlist of national currency policies. In our opinion, central bank chief's comments would be supportive of the THB should risk-on sentiment resume, together with fading political uncertainty. USDTHB is expected to trade between 31.0 and 32.0 in June, with a downward bias towards the lower bound.

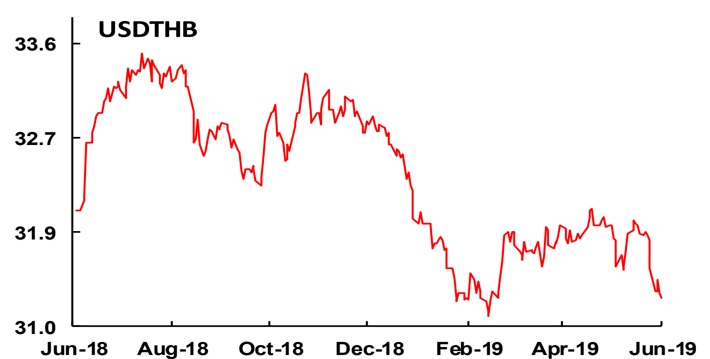
TAIWAN — Taiwan's weightings cut by global index provider MSCI has taken effect from May 28th. USDTWD could slide amid risk -on sentiment but rally again approaching the island's dividend season from late June to early September. The pair could range trade between 31.0 and 32.0 in June. We maintain our short TWDKRW cross position with a target of 36.0 and a stop of 39.0, while staying vigilant on cross-strait relations that could weigh on the TWD in H2.

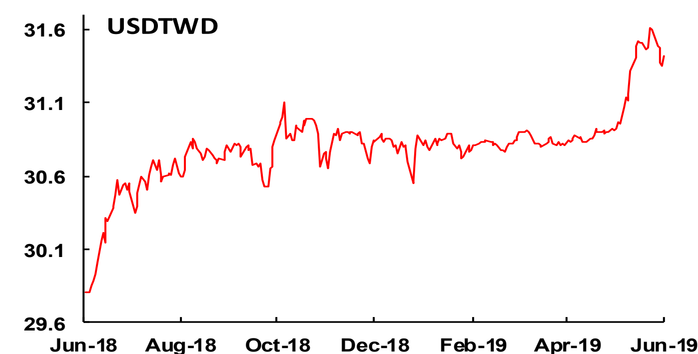
MALAYSIA — The BNM is expected to maintain accommodative stance after delivering a rate cut on May 7th. Surging likelihood of future Fed rate cuts will bring a relief to EM Asian currencies including the MYR. USDMYR is likely to stay below the 4.20 resistance in the month of June, while following a broader market tone. Meanwhile, the MYR will remain vulnerable to FTSE Russell's decision due in September on the WGBI eligibility of Malaysian government bonds.

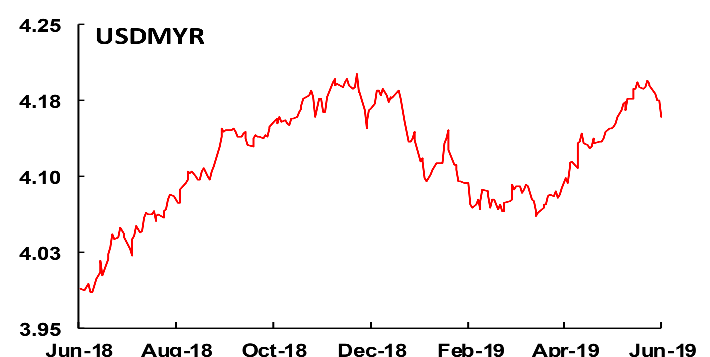
Currency Trends

FX Rate	Spot 7-Jun	19Q1a	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
USDKRW	1181	1135	1160	1140	1140	1120	1120	1100	1100
USDTHB	31.3	31.7	31.6	31.8	31.8	31.6	31.6	31.4	31.4
USDTWD	31.4	30.8	31.2	31.4	31.4	31.2	31.2	30.0	30.0
USDMYR	4.16	4.08	4.15	4.10	4.10	4.05	4.05	4.00	4.00









Developing Economies

Fundamental Commentary

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SOUTH KOREA — The Bank of Korea (BoK) will maintain an accommodative monetary policy stance through 2020 as demand-driven inflationary pressures are set to remain absent. We assess that the likelihood of the next monetary policy move being a cut has increased recently, yet we do not expect any near-term monetary easing by the BoK given that maintaining financial stability has become a priority for the central bank. The Korean won is facing notable weakening pressure amidst elevated global trade-related uncertainties and higher risk aversion. South Korea's inflation is expected to remain contained in the foreseeable future. Price pressures at the headline level have surprised on the downside; inflation was at 0.7% y/y in May after being in line with the BoK's 2% inflation target as recently as in November. Weaker inflation reflects lower energy costs and stagnant government-administered prices (related to public transportation and communications, for instance). We expect headline inflation to rebound somewhat in the second half of 2019, closing the year at a still-low level of 1.3% y/y. Real GDP declined by 0.4% q/q (+1.7% y/y) in the first quarter of 2019 following a 0.9% q/q (+3.1% y/y) advance in Q4 2018. Soft momentum was fairly broadly-based. Against this background, fiscal policy will likely play a key role in supporting the economy. Indeed, the economy will likely receive a boost from additional public spending in the near future. We expect South Korean output to grow by 2.2% in 2019 as a whole.

THAILAND — The Bank of Thailand (BoT) will likely keep its policy interest rate unchanged at 1.75% through 2019. Following the most recent policy meeting on May 8, the country's monetary authorities pointed out that various global and domestic uncertainties warrant a wait-and-see approach to monetary policy, with an accommodative monetary policy stance remaining appropriate. Inflation remains manageable, with headline inflation at 1.2% y/y in May. We expect price pressures to rebound slightly over the course of the year, with inflation reaching 1½% y/y by year-end. Real GDP grew by 2.8% y/y in Q1 2019 following a 3.7% advance in Q4, driven by strong private consumption and investment. We expect the Thai economy to expand by 3½% y/y in 2019–20.

TAIWAN — The export-oriented Taiwanese economy is feeling the adverse impact of persisting global trade uncertainties. Manufacturing sector sentiment is weak exports and export orders are declining from year-earlier levels. Real GDP grew by 1.7% y/y in the first quarter, decelerating only slightly from the fourth quarter pace of 1.8% but falling short of the average growth of 2.7% in 2018 as a whole. Given challenging global demand conditions, activity will be driven by domestic demand, which is underpinned by accommodative monetary policy. Stable labour market conditions will support private spending prospects while public investment outlays are boosted by the government's Forward-Looking Infrastructure Development Program. The outlook for private investment remains highly uncertain and dependent on global trade developments and their impact on business sentiment. We expect Taiwan's real GDP to grow by 2% in 2019. Taiwan's monetary policy stance will remain accommodative through 2020. Following the most recent quarterly monetary policy meeting on March 21, the central bank left the benchmark interest rate unchanged at 1.375%. Monetary authorities pointed out that the economy is growing at a below-potential rate while inflationary pressures are subdued. We assess that likelihood for a rate cut by the central bank has increased in recent months. Inflation remains low in Taiwan, yet a modest rebound is expected in the second half of 2019. We expect the headline inflation rate to pick up from the May level of 0.9% y/y to 1½% y/y by year-end. Core inflation is equally muted, at 0.6% y/y in May.

MALAYSIA — Malaysia's monetary policy cycle has turned. On May 7, Bank Negara Malaysia (BNM) lowered the Overnight Policy Rate by 25 bps to 3.00%, marking the first cut since July 2016 and reversing the January 2018 hike. We expect the BNM to keep the benchmark interest rate on hold over the coming quarters as monetary authorities assess the health of domestic and global economic growth momentum and the need for further policy support. In our view, the BNM's decision to loosen monetary policy was a pre-emptive move to provide support to the domestic economy, given that global growth prospects face downside risks due to persisting trade uncertainties. The BNM pointed out that the rate cut is intended to preserve the accommodative monetary policy stance following some recent tightening in financial conditions. Malaysian inflationary pressures remain contained. Reflecting changes to consumption tax policies and lower energy prices, headline inflation has eased significantly, hovering at 0.2% y/y in April. Nevertheless, the impact of the tax rate changes will start fading away in the second half of 2019, prompting a rebound in inflation. We expect the headline inflation rate to close 2019 at 1¾% y/y. Nevertheless, strong demand-driven price pressures remain absent, allowing the BNM to maintain its accommodative monetary policy stance over the foreseeable future. Malaysian real GDP grew by 4.5% y/y in Q1 2019, following a 4.7% gain in the prior quarter. Output growth will likely decelerate further over the coming quarters on the back of weaker demand conditions globally, which will be reflected in Malaysia's export sector performance. Meanwhile, economic activity will likely be driven by domestic demand; favourable employment and income developments will continue to support household spending prospects while various multi-year projects will underpin investment activity. We expect Malaysia's real GDP growth to average 4⅓% y/y in 2019–20.

Global Currency Forecast (end of period)

		2019f	2020f	2019f				2020f			
Major Currencies				Q1a	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Japan	USDJPY	108	105	111	110	108	108	107	107	105	105
Euro zone	EURUSD	1.15	1.24	1.12	1.12	1.13	1.15	1.19	1.22	1.24	1.24
	EURJPY	124	130	124	123	122	124	127	131	130	130
UK	GBPUSD	1.25	1.40	1.30	1.26	1.25	1.25	1.28	1.30	1.32	1.40
	EURGBP	0.92	0.89	0.86	0.89	0.90	0.92	0.93	0.94	0.94	0.89
Switzerland	USDCHF	0.97	0.97	1.00	0.99	0.98	0.97	0.94	0.93	0.93	0.97
	EURCHF	1.12	1.20	1.12	1.11	1.11	1.12	1.12	1.13	1.15	1.20
Americas											
Canada	USDCAD	1.30	1.25	1.33	1.35	1.33	1.30	1.28	1.28	1.25	1.25
	CADUSD	0.77	0.80	0.75	0.74	0.75	0.77	0.78	0.78	0.80	0.80
Mexico	USDMXN	21.26	21.71	19.43	19.90	20.48	21.26	21.40	21.26	21.36	21.71
	CADMXN	16.35	17.36	14.55	14.74	15.40	16.35	16.72	16.61	17.09	17.36
Brazil	USDBRL	4.18	4.18	3.92	3.91	3.97	4.18	4.08	4.11	4.07	4.18
Chile	USDCLP	645	639	680	670	658	645	643	643	647	639
Colombia	USDCOP	3120	3167	3189	3105	3150	3120	3050	3100	3182	3167
Peru	USDPEN	3.35	3.30	3.32	3.37	3.34	3.35	3.36	3.32	3.33	3.30
Asia-Pacific											
Australia	AUDUSD	0.71	0.73	0.71	0.70	0.70	0.71	0.72	0.72	0.73	0.73
China	USDCNY	6.70	6.50	6.71	6.80	6.70	6.70	6.60	6.60	6.50	6.50
Hong Kong	USDHKD	7.82	7.80	7.85	7.84	7.82	7.82	7.80	7.80	7.80	7.80
India	USDINR	68.0	66.0	69.2	67.0	68.0	68.0	67.0	67.0	66.0	66.0
Indonesia	USDIDR	14200	13800	14243	14000	14200	14200	14000	14000	13800	13800
Malaysia	USDMYR	4.10	4.00	4.08	4.15	4.10	4.10	4.05	4.05	4.00	4.00
New Zealand	NZDUSD	0.66	0.68	0.68	0.66	0.66	0.66	0.67	0.67	0.68	0.68
Philippines	USDPHP	51.5	50.0	52.6	51.0	51.5	51.5	51.0	51.0	50.0	50.0
Singapore	USDSGD	1.35	1.33	1.36	1.34	1.35	1.35	1.34	1.34	1.33	1.33
South Korea	USDKRW	1140	1100	1135	1160	1140	1140	1120	1120	1100	1100
Taiwan	USDTWD	31.4	30.0	30.8	31.2	31.4	31.4	31.2	31.2	30.0	30.0
Thailand	USDTHB	31.8	31.4	31.7	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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