AMERICAS

Risk aversion and US/China trade tensions continue to prop up the USD despite the Fed tilting monetary policy settings towards accommodation. With no end to the trade confrontation in sight, we expect the USD to remain somewhat stronger for a little longer against the major currencies. The CAD has lost some ground through Q3 as the threat to global growth has weighed on commodity prices and growth-sensitive FX but losses are relatively muted versus the USD and the CAD is out-performing its G-10 commodity peers. Regional tensions and weaker commodity prices are weighing on the Pacific Alliance currencies. The MXN remains susceptible to market volatility swings and investor focus on domestic policy.

EUROPE

Brexit risks continue to overshadow the GBP outlook while weak growth and inflation point to more easing from the ECB. Our base case remains that the UK will achieve a negotiated departure from the EU but risks to that outlook remain very significant.

ASIA-PACIFIC

China has allowed the CNY to take the “strain” of the US tariff regime while slower global trade momentum is weighing on the regional exporters, such as the KRW. The JPY will tend to out-perform in periods of market tension and heightened volatility.

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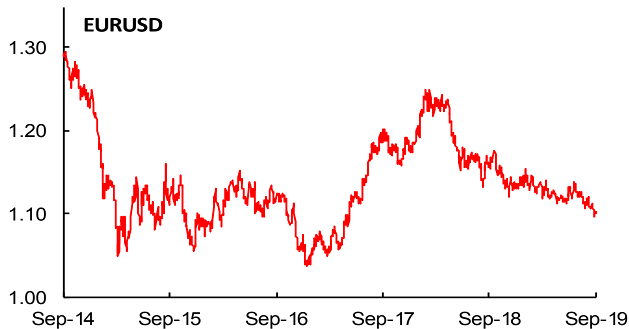
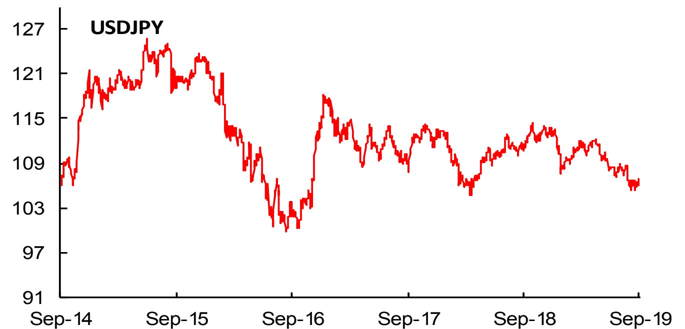
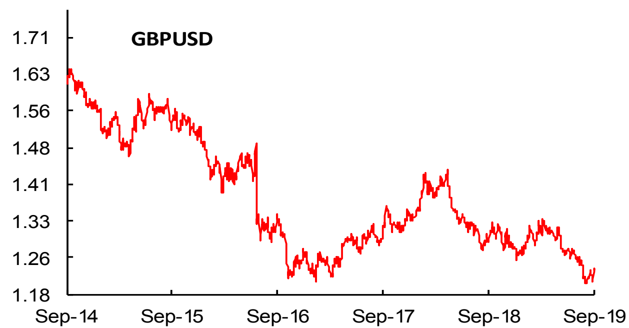
Core Exchange Rates

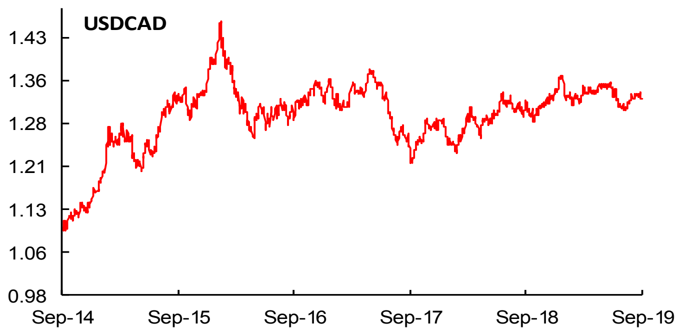
Global Foreign Exchange Outlook

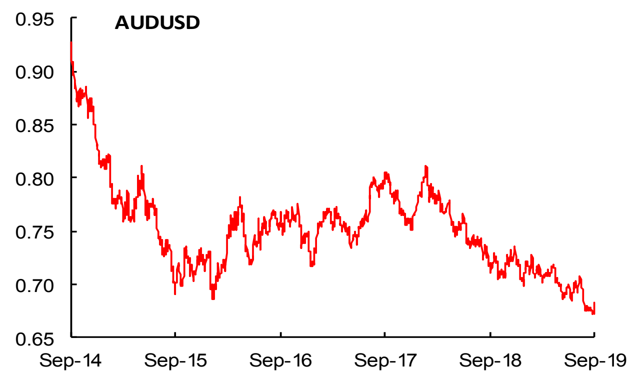
September 6, 2019	Spot	2019f Q1a	2019f Q2a	2019f Q3	2019f Q4	2020f Q1	2020f Q2	2020f Q3	2020f Q4
EURUSD	1.10	1.12	1.14	1.10	1.10	1.12	1.15	1.19	1.20
USDJPY	107	111	108	108	108	107	107	105	105
GBPUSD	1.23	1.30	1.27	1.22	1.22	1.25	1.30	1.32	1.40
USDCAD	1.32	1.33	1.31	1.31	1.30	1.28	1.28	1.25	1.25
AUDUSD	0.68	0.71	0.70	0.68	0.68	0.69	0.70	0.71	0.72
USDMXN	19.65	19.43	19.22	20.21	20.83	21.08	20.93	21.04	21.36











Market Tone & Fundamental Focus

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Currency markets are caught in the middle of the US/China trade dispute. Since the middle of the year, trade tensions have tended to lift the US dollar (USD) broadly, even as the Fed eased monetary policy. Commodity FX has under-performed on weaker global growth prospects (and lower commodity prices) while China has allowed its exchange rate to take the strain of the US tariff regime. The yuan (CNY) has dropped 4% since the end of June, breaching the psychological barrier of 7.00 to the USD and weakening to its lowest level since 2008. Regional Asian currencies, especially those of exporter nations like the Korean won (KRW), have weakened alongside the CNY. Investors have generally moved away from riskier assets and currencies amid higher market volatility, preferring instead classic FX refuges, such as the Japanese yen (JPY), which has out-performed broadly through Q3.

There is little sign that the escalating trade war between the US and China will end any time soon. Aside from ramping up tariffs on Chinese goods and prompting a tit-for-tat response from Beijing, President Trump has taken to openly criticizing the Fed, and Chairman Powell in particular, whilst alluding to the idea that Fed policy, rather than his protectionist agenda, is keeping the USD supported and putting US exporters at a disadvantage. These developments are clouding the outlook for market participants who are unsure when trade tensions might abate, how the Fed will react to political pressure for easier policy and whether the US might try and push the USD. USD strength has persisted for longer than we expected and the firm USD tone seems likely to extend into the foreseeable future. We have adjusted some of our currency forecasts as a result. Trends may change abruptly, however, in the event that a truce is called in the US/China trade war or if the White House adopts a policy of trying to depress the USD. We assess the risk of intervention at this point as quite low (mainly because the USD is not obviously misaligned) but acknowledge that the threat has risen somewhat.

The Canadian dollar (CAD) has lost ground so far in Q3 but losses have been relatively limited (-1.8% versus the USD) compared to its commodity peers, such as the Australian dollar (AUD, down 3.3%) or the New Zealand dollar (NZD, down 5.4%). Economic growth strengthened significantly in Q2—mainly on the back of a rebound in energy exports while household consumption slowed—but the uncertain trade backdrop suggests headwinds for the domestic economy will increase in the coming months. The looming Federal election may also increase uncertainty for market participants in the short term. While the CAD will struggle to battle back against the USD in the short run, we think the CAD remains somewhat undervalued considering the significant narrowing in US/Canada interest rate differentials and relatively well-supported crude oil prices. Even if the Bank of Canada eases monetary policy modestly in the coming months, interest rate settings will remain relatively tighter than many of the CAD's G-10 peers and we expect growth to remain somewhat more resilient. This will support relative CAD strength against the major currencies—and especially against its commodity bloc peers such as the Australian and New Zealand dollars.

The euro (EUR) and British pound (GBP) have failed to improve—or even stabilize—in the way that we had imagined earlier this year (on the expectation of improved global trade relations and a conclusion to Brexit) and the relative weakness has compelled us to revise our forecasts lower for EUR (to USD1.10) for the end of this year (from 1.15 previously) and 1.20 (from 1.24) for the end of 2020. Persistent growth and inflation disappointments and an expectation for further monetary stimulus from the European Central Bank account for much of the EUR's weaker outlook. For the GBP, we now forecast 1.22 for year-end (versus 1.25 previously). However, near and longer run prospects for the GBP hinge quite evidently on the outcome of the UK's Brexit process. We continue to assume a negotiated Brexit will emerge but risks to that outlook are significant. We expect the JPY to remain firm as trade tensions persist and longer-term US yields slide. Domestic challenges—in the form of persistently low inflation and soft domestic demand and a relatively firm exchange rate—suggest that the Bank of Japan may have to increase its stimulus measures at some point in the coming months. We maintain a year-end forecast of 108 for USDJPY.

Outside of the major currencies, investors have shunned developing market and less liquid currencies over Q3 so far. The Brazilian real (BRL) has fallen more than 6.7% since the end of June on weaker commodity prices, regional strains and soft domestic growth prospects. Pacific Alliance currencies have fallen broadly over the period for similar reasons. The Peruvian sol (PEN) is holding up relatively better than the Chilean and Colombian pesos (CLP and COP, respectively) as domestic data point to healthy growth amid a mild deceleration in consumer prices. The CLP has weakened to its lowest level since early 2016, largely as a reflection of the 16% drop in copper prices seen from the March high as trade fears weigh on global growth expectations and commodity prices.

The Mexican peso (MXN) breached the 20 level versus the USD following the mid-August Banxico rate cut. The policy easing came earlier than many market participants had forecast and prompted expectations that more accommodation might follow. The MXN remains a high-yielding currency in a low-yielding world. That is not an obvious plus in times of rising volatility, when investors typically shun risk and the MXN by proxy, but should mitigate longer run pressure on the currency to an extent. Slowing domestic growth momentum and weak price pressures alongside focus on fiscal policy strains suggest limited potential for the MXN to recover at present.

Canada

Currency Outlook

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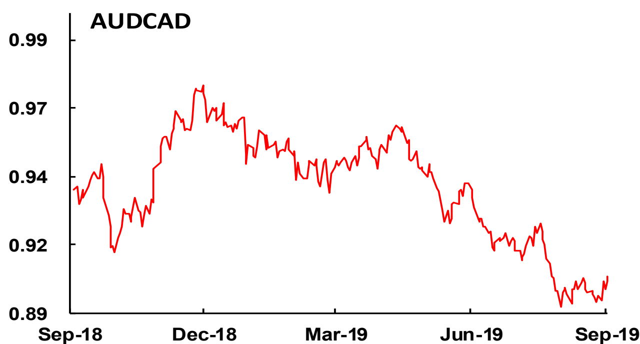
The CAD has been able to resist the general USD advance made under the cloud of rising global trade tensions since mid-year better than most of its peers. Arguably, the CAD should be trading a lot higher still against the USD, given the narrowing in US/ Canada interest rate differentials at the short end of the yield curve. The 2-year cash bond spread dropped to just 11bps, following the neutral-sounding policy statement delivered by the BoC at the September policy meeting. The yield spread represents the narrowest yield premium for the USD over the CAD in nearly two years. The last time the gap was this small, USDCAD was trading nearer 1.26.

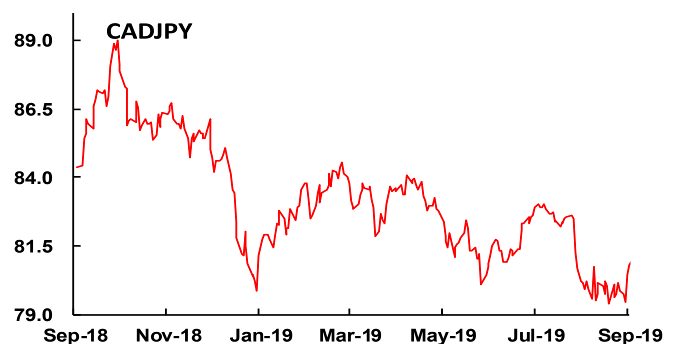
Interest rate spreads have lost a lot of traction with currency performance generally since the summer as the US/China trade war has combined with sporadic bouts of risk aversion to drive the USD higher. All else being equal, our work on longer run spot regressions with interest rate differentials and crude oil prices suggests USDCAD should be trading below 1.25 currently. It is difficult to factor trade tensions into an exchange rate model but even allowing for heightened market volatility and risk aversion, our regression modeling suggests the CAD is undervalued; we estimate equilibrium (which attempts to account for some of these risk factors) to be near 1.31 at writing.

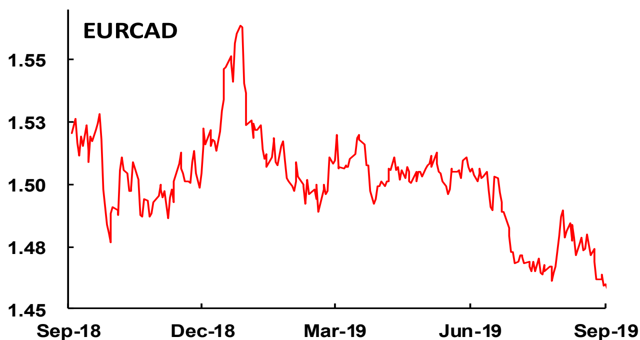
We have adjusted our year end call for USDCAD up slightly to CAD1.30 (USc 77) on account of the persistent strength of the USD but we still rather think a modest and gradual reduction in BoC policy settings in the next few months should not stand in the way of a small rise in the CAD into Q4 from current levels. Note that we also forecast the Fed will ease policy by 25bps in Q4.

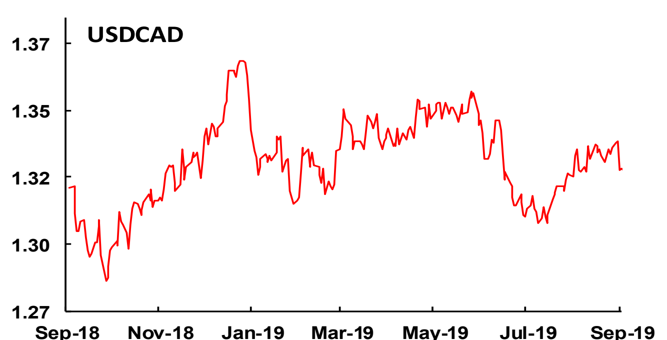
Canadian Dollar Cross-Currency Trends

FX Rate	Spot 6-Sep	19Q1a	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
AUDCAD	0.90	0.95	0.92	0.89	0.88	0.88	0.90	0.89	0.90
CADJPY	80.9	83.0	82.4	82.4	83.1	83.6	83.6	84.0	84.0
EURCAD	1.46	1.50	1.49	1.44	1.43	1.43	1.47	1.49	1.50
USDCAD	1.32	1.33	1.31	1.31	1.30	1.28	1.28	1.25	1.25









United States and Canada

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Fundamental Commentary

UNITED STATES — Q2 real GDP growth was 2.1% q/q SAAR, with consumer spending up 4.7%, reflecting strong labour markets, solid wage gains, and the lowest household debt-service ratios in 40 years. Hiring is set to benefit from the US census, but household spending growth is likely to soften as President Trump's erratic trade war saps consumer and business confidence. The August ISM manufacturing sentiment index has already gone into contractionary territory for the first time in three years, with the index of new export orders at its weakest since 2009. September 1st marked a major turning point as the White House imposed taxes on Chinese consumer goods that had previously escaped taxes as the Trump Administration sought to avoid hitting the pocket books of its base. It's now clear that President Trump's erratic trade policies will remain a chronic feature of the remainder of his term: we don't expect a lift from any near-term resumption in talks between Washington and Beijing. Accordingly, we have downgraded our growth forecast from 2.5% to 2.3% in 2019 and from 1.6% to 1.4% in 2020, raising the possibility of a Trump technical recession in 2020. Inflation is forecast to remain below target into 2020 and we still expect two more cuts from the Fed before end-2019.

CANADA — Q2's strong 3.7% q/q SAAR real GDP growth, well above the Bank of Canada's 2.3% forecast, was driven mainly by transitory boosts in exports that papered over softer details in Canada's economy. Draws on swollen inventories began to exert a meaningful drag on new activity, while business investment contracted, household consumption growth was the slowest in seven years, and imports shrank. Still, other bright spots—inflation near target, stabilizing housing markets, renewed residential investment growth, upward trends in household credit growth, and the fastest gains in average hourly earnings in a decade amidst strong hiring—would all augur for Canadian monetary policy to remain unchanged were it not for the damage being inflicted on global growth by President Trump's tariffs. We expect the Bank of Canada to deliver "insurance cuts" in October 2019 and Q1-2020 to guard against a Trump-induced recession. USMCA ratification remains delayed as Congress searches for an understanding on labour, environmental, and pharmaceutical intellectual-property protections. At this point, it is unlikely that USMCA will enter into force by its intended January 1st, 2020 start date. In the meantime, NAFTA's terms would continue to govern North American trade.

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Monetary Policy Commentary

UNITED STATES — Scotiabank Economics expects two more rate cuts by year-end with the fed funds target rate range ending 2019 at 1.5-1.75%. The principal current focus of monetary policy is to offer insurance against downside risks significantly emanating from trade tensions with the flexibility offered by soft inflation relative to policy goals. We don't view easing as a step against major downside risks to demand given excellent consumer fundamentals. Fed funds futures are judged to be overpricing cut risks next year as distorted sovereign bond curves over price recession risk that is absent in credit and equity markets. A reinforcing cycle of protectionism and monetary easing could well add to rate cuts next year, but monetary easing courts moral hazard challenges insofar as the Trump administration's trade policies are concerned.

CANADA — Scotiabank Economics forecasts a pair of rate cuts starting in the fourth quarter of 2019 and followed by another in the first quarter of 2020. Ahead of a Federal election, the Bank of Canada is not sounding terribly open to monetary easing, but there is scope for this dynamic to change into the fourth quarter. The BoC cites inflation that is on-target, with little if any spare capacity in the economy and accompanied by accelerating wage pressures. That makes for differences to easing in 2015, but the policy rate was also considerably lower then. Governor Poloz views the policy rate as below neutral—and still negative in real terms—as a contrasting shock absorber to the situation in the United States in the context of the flip side of dollar strength that the Fed is facing. Nevertheless, the BoC does flag greater risks than it has previously judged and we expect downward forecast revisions to global and domestic growth and inflation upon release of the next decision and Monetary Policy Report on October 30th. We view trade tensions as persisting if not escalating further, while domestic growth wanes following a distorted second quarter. There are also limits to the extent to which the BoC can stand idly by while the Federal Reserve is easing and without impairing Canadian export competitiveness.

G10

Currency Outlook

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EUROZONE — We anticipate that EUR will remain weak around current levels of ~1.10 per USD for the remainder of 2019 as no-deal Brexit risks, albeit moderating recently, continue to cloud the outlook. The ECB's meeting next week will also play a major role in EUR pricing over the near-to-medium term as the magnitude and start date of a new QE round remains unclear with policymakers from France and Germany, among others, calling for caution over its resumption.

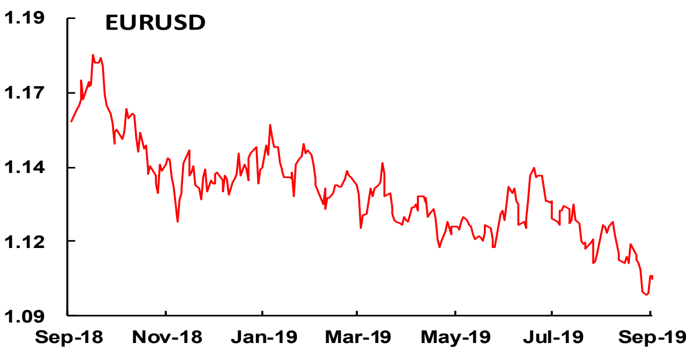
UNITED KINGDOM — Sterling has rebounded in early-Sep on the back of developments in Parliament that have lowered the odds that the UK stumbles out the EU on October 31st. We anticipate some near term gains for cable ahead of a likely extension to Brexit although political fraction is likely to persist for the remainder of 2019, leading to bouts of volatility and headwinds to GBP. Our year-end forecast calls for 1.22 USD per GBP, which would represent no net additional gains from recent levels over the course of Q3/Q4.

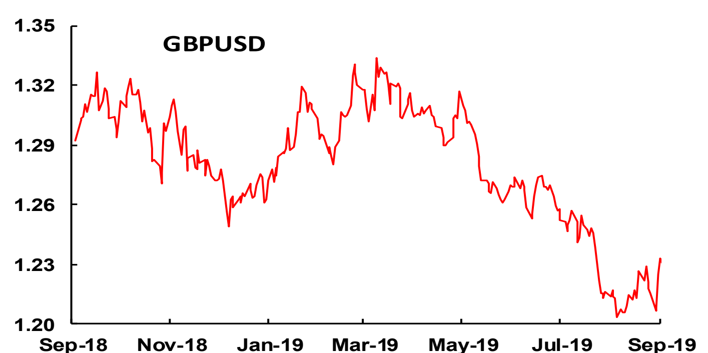
JAPAN — With China/US talks set to resume in October and an easing of political tension in Hong Kong, we expect JPY to give back some recent overbought gains in the near-term. Given Washington's erratic trade stance, we remain skeptical that much will come out of planned meetings between the US and China. As such, global trade uncertainty is expected to provide safe-haven support for the JPY. We forecast an end-2019 rate of 108 JPY per USD, with further gains into 2020.

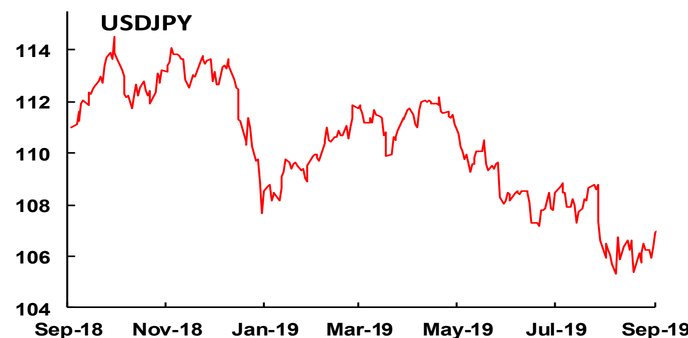
AUSTRALIA — Aussie has dropped to a post-financial crisis low after the RBA's 50 bps policy rate cut in July as global trade uncertainty and falling commodity prices take a toll on the Australian economy. As trade risks persist into Q4, we expect currency weakness to continue and close 2019 at around its current level of around 68 USc per AUD.

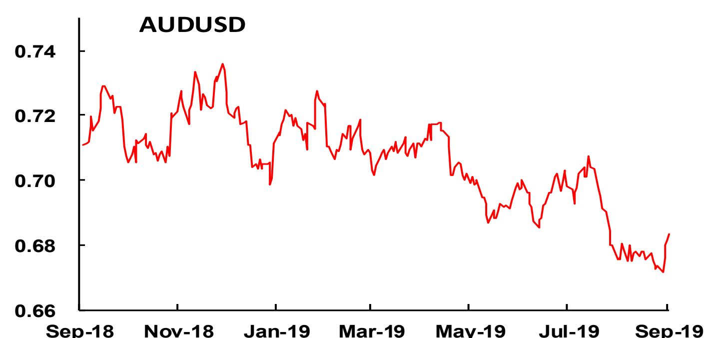
Currency Trends

FX Rate	Spot 6-Sep	19Q1a	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
EURUSD	1.10	1.12	1.14	1.10	1.10	1.12	1.15	1.19	1.20
GBPUSD	1.23	1.30	1.27	1.22	1.22	1.25	1.30	1.32	1.40
USDJPY	107	111	108	108	108	107	107	105	105
AUDUSD	0.64	0.71	0.70	0.68	0.68	0.69	0.70	0.71	0.72









G10

Fundamental Commentary

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EUROZONE — In 2019, the Eurozone is slated to record its slowest expansion in seven years owing to the prevailing risk of a no-deal Brexit and the threat of escalating trade protectionism out of Washington. We maintain little optimism that the EU and the UK will come to a compromise before the first half of 2020 while the European auto sector remains at the mercy of tariffs on its exports to the US. The European manufacturing sector has felt the brunt of the damage caused by the uncertain Brexit environment—with the German industrial sector hit hardest—from declining trade volumes to the UK and subdued demand for capital goods as European firms postpone investment plans; industrial production in Germany is on track for its sharpest annual contraction since 2008. Italian politics continue to have a negative impact on the country's economy, alongside spillovers to the rest of Europe, with division at the helm of the government and the prospect of yet another election in the fall. The ECB is expected to lower its deposit facility rate at its September 12 meeting from -0.40% to -0.50% as well as outline its plans for a new round of quantitative easing. However, the magnitude of the ECB's next move may also be limited as policymakers in Germany and France have voiced concerns over a prompt comeback of QE.

UNITED KINGDOM — UK economic growth will remain on a below-potential trajectory in the foreseeable future as Brexit risks continue to heavily dampen business investment in Britain. Domestic output has been supported by the household sector thanks to steady job gains and a steep acceleration in wages growth. While the strong decline in business sentiment has led to a deep slump in capital outlays, household spending gains remain relatively solid despite downcast consumer confidence. No-deal Brexit odds have eased recently after Parliament passed a motion which would force PM Johnson to seek a Brexit deadline extension from Brussels three months beyond the current October 31 cut-off. The PM is expected to pursue the idea of a snap general election but the odds of success appear remote at this point and time is running very short to hold an election by mid-October, the government's preferred date. We continue to expect that the UK and the EU will come to an agreement for a managed separation although its timing is still highly elusive—likely in H1-2020. The Bank of England is forecast to keep its policy rate on hold at 0.75% through our forecast horizon and while we believe that the BoE will cut rates were a hard-Brexit to materialise, the Bank's official position remains that its policy rate may move in either direction depending on the net impact on prices from sterling depreciation against the impact of depressed demand on price.

JAPAN — The Japanese economy performed relatively well in Q2 2019, with real GDP growing by 0.4% q/q (non-annualized) and 1.8% y/y. Activity was supported by domestic demand, with household spending, investment outlays, and public spending recording decent gains. The external sector was a drag on growth. We expect growth to remain reasonably buoyant in Q3 as spending is brought forward in anticipation of the October consumption tax rate increase. Nevertheless, activity will likely contract in the final months of the year taking the average real GDP growth to 0.8% in 2019 as a whole. Inflationary pressures are set to remain low in the foreseeable future, yet the headline metric will register a temporary pickup following the consumption tax rate increase. The CPI excl. fresh food—the Bank of Japan's (BoJ) preferred inflation measure—currently hovers at ⅔% y/y. A potential pickup in global risk aversion, safe-haven flows into Japanese assets, and an associated strengthening bias of the Japanese yen complicate the inflation outlook. Should the yen appreciate further against the US dollar below the USDJPY 105 mark, the BoJ's policymakers would likely start feeling increasingly uncomfortable about the currency's strength and its disinflationary consequences. The BoJ will likely maintain highly accommodative monetary conditions through 2020 and beyond. We expect the central bank to stand ready to provide further monetary stimulus if the economy weakens notably and inflationary dynamics soften.

AUSTRALIA — The Australian economy is shifting to a lower economic growth trajectory on the back of global growth concerns, weaker international trade dynamics, and softer domestic demand momentum. Real GDP grew by 1.4% y/y (+0.5% q/q non-annualized) in Q2 following a 1.7% y/y gain (+0.5 q/q) in Q1. Given the persistently challenging global economic environment, we have revised our growth forecast for Australia and now expect real GDP to expand by 1.8% in 2019 (vs. the earlier projection of 2.3%). Nevertheless, we assess that Australia has solid economic fundamentals and adequate policy levers to address even significant economic softness. Accordingly, we consider that the likelihood of the Australian economy skidding into a recession in the foreseeable future remains low. We expect the Reserve Bank of Australia (RBA) to continue taking decisive steps to support the economy. The policy interest rate was cut by 25 bps in June and July, taking the rate from 1.50% to 1.0%—a record low. While the RBA opted to keep policy on hold in early-September in order to assess the impact of the prior cuts, we believe that further monetary easing is in the cards, with the RBA likely cutting the benchmark rate as soon as in October. Australia's headline inflation hovers below the RBA's 2–3% annual inflation target, with prices rising by 1.6% y/y in Q2, yet inflationary pressures intensified slightly from the Q1 reading of 1.3% y/y.

China, India, Brazil

Currency Outlook

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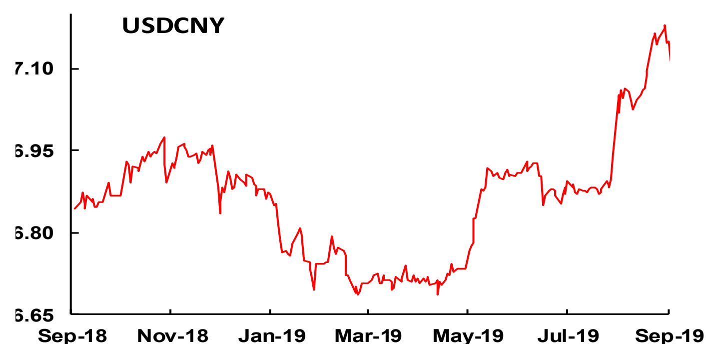
CHINA — China has released a slew of measures to boost domestic consumption, showing the nation has prepared contingency plans in case of a no-deal scenario. The PBoC has stepped up efforts to keep the yuan basically stable, setting onshore USDCNY fixing with a downward bias and tightening offshore CNH funding cost. The dollar/yuan is anticipated to trade in a range of 7.1-7.2 at the moment and will move in a stepped way in response to developments in the renewed US-China trade negotiations.

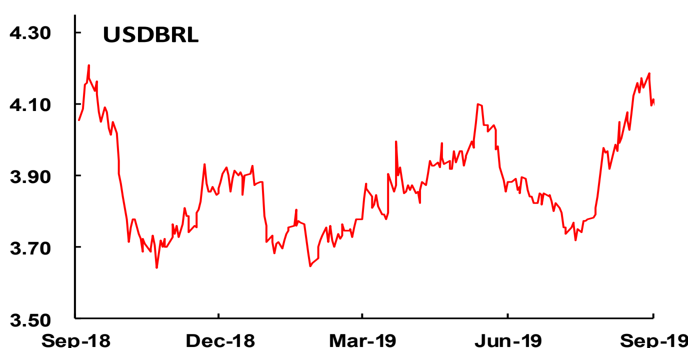
INDIA — The RBI said in its annual report that reviving consumption demand and private investment has assumed the top priority in the current fiscal year. While the rollback of the super-rich tax on FPIs could revive equity inflows, the RBI's INR 1.76tn transfer to the government could prompt foreign investors to pour more funds into local bond markets for higher returns. USDINR is likely trade between 71 and 73 in September, remaining susceptible to the US-China trade disputes.

BRAZIL — The Brazilian real (BRL) had a rough couple of months, depreciating vs the greenback from a low of 3.71 in early July, to just under 4.20 in late August. The moves were mostly driven by external factors such as global trade frictions and growth uncertainties—as well as problems in Argentina, a major trade partner. However, despite the problems being external, the BRL was still the second worst performing FX among the expanded majors (-6.23%) since June, only underperformed by the Argentine peso. As the domestic legislative period resumes, there is potential for real appreciation as pension reform momentum seems to remain positive.

Currency Trends

FX Rate	Spot 6-Sep	19Q1a	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
USDCNY	7.11	6.71	6.87	7.10	6.90	6.80	6.80	6.70	6.70
USDINR	71.7	69.2	69.0	71.0	68.0	67.0	67.0	66.0	66.0
USDBRL	4.09	3.92	3.85	3.97	4.18	4.08	4.11	4.07	4.18





China, India, Brazil

Fundamental Commentary

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CHINA — The US-China trade conflict has escalated further and broken well beyond the trade truce agreed between US President Donald Trump and Chinese President Xi at the end of June. Additional set of US import tariffs on Chinese goods became effective on September 1, joined by a round of Chinese retaliatory tariffs. Further levies are set to take effect in October and December. With every escalation, a resolution to the conflict is becoming increasingly difficult to achieve. Given the persistent unrest in Hong Kong, we assess that the Chinese leadership cannot afford looking weak domestically as it deals with its US counterpart; accordingly, China will likely remain firm during the trade negotiations, which we now expect to drag on for months—most likely through Trump's presidency. Reflecting the challenging economic backdrop, Chinese high frequency data weakened further in July, both in terms of retail sales and industrial sector momentum. This implies that the Chinese government will need to unveil further stimulus in order to maintain economic growth above 6% y/y and to promote social stability. Indeed, in early September, the State Council indicated that further stimulus is forthcoming. We expect the government to unveil measures that specifically target the Chinese consumer, private sector enterprises, as well as infrastructure. We maintain our 2019 and 2020 real GDP growth forecasts for China at 6.2% and 6.0%, respectively, though we note that the risks are tilted to the downside. We expect the People's Bank of China (PBoC) to roll out some additional monetary stimulus in the near term, in the form of lower interest rates and reserve requirement ratios. Moreover, the country's policymakers remain committed to taking further financial market reform steps, as demonstrated by the August interest rate reform that will improve monetary policy transmission. The new market-oriented Loan Prime Rate—set at 4.25%, 10 bps below the former 1-year benchmark lending rate—will now be used as a reference rate for new lending and is set to reflect changes in the PBoC's medium-term lending facility rate.

INDIA — Indian monetary authorities continue to take steps aimed at reversing the sharp slowdown in India's economic activity. Following the August 5–7 monetary policy meeting, the Reserve Bank of India (RBI) lowered the benchmark repo and reverse repo rates by 35 basis points to 5.40% and 5.15%, respectively. The unconventional increment was defended as Goldilocks solution: 25 bps was deemed inadequate in view of evolving global and domestic economic developments, while 50 bps was considered excessive, particularly in light of actions already taken. The August cut was the fourth consecutive interest rate reduction, bringing the benchmark rate to its lowest since 2010. The RBI maintained its accommodative monetary policy stance; we expect the RBI to cut rates further at the October 4 policy meeting. At 3.2% y/y in July, headline inflation remains comfortably within the RBI's annual inflation target of 4% ±2%, allowing for further monetary stimulus. Given restrained public finances, the RBI will be responsible for most of India's economic revival efforts. The country's real GDP growth slowed notably in Q2 2019 with output expanding by 5.0% y/y, vs. 5.8% in Q1 and 7.4% in 2018 as a whole. Domestic demand, particularly a significant slowdown in private consumption, explained the weakness. Accordingly, we have revised our Indian real GDP growth forecast down and estimate that output gains will average 5.8% this year.

BRAZIL — It's a tricky time to adjust Brazil macro forecasts (as we just did), given that the economy showed a little more dynamism in Q2 than was expected (GDP +1.0% y/y vs +0.8% y/y expected by consensus), and the BRL just took a 6% drop vs the greenback in a country with an FX-inflation pass-through in the 20%-30% range. Both of these (less so the first, as 1% growth is hardly spectacular—but it still reduces slack vs a potential growth that is around 2%) should work to reduce the need for additional cuts by the BCB. However, the BCB seems set on easing a little further, and for now, IPCA inflation remains anchored and at comfortable levels (3.42%). As long as the BRL pressures don't translate into upward inflation, the BCB should be able to deliver. Our concern is that the pension reform is just one of several important changes that are necessary to solve Brazil's fiscal problems, with the fiscal deficit still expected at around 7% of GDP, and an ambitious scenario on pension reform only saving about 10% of GDP—over 10 years. The annual savings through fiscal reform could be eroded just from an interest rate spike (Brazil has gross public debt over 80% of GDP with an average maturity of only about 4 years), if the BCB allows inflation to become unanchored. If reform momentum doesn't remain post-pensions, and market sentiment turns, current Brazilian rates may just be low enough to allow a repeat of the bad inflation spiral we saw a few years ago.

Pacific Alliance
Currency Outlook

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MEXICO — High volatility is expected in coming months due to the convergence of several factors. On the external front, USA-China trade tensions, a slowing global economy, Brexit proximity and the eventual ratification of USMCA would affect the currency. On the internal front, federal budget for 2020 will be released and will be closely assessed by market participants and rating agencies, and we will see if a new downgrade on the sovereign rating could be avoided.

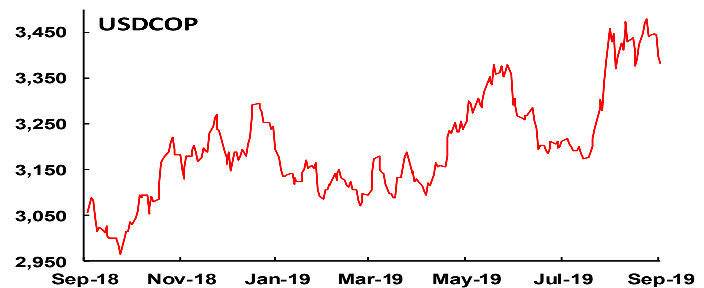
COLOMBIA — Twin deficits fears vanished due to a better tax collection, fiscal expenditure cuts, and imports deceleration while exports continue stagnant. Thus, domestically FX pressure has disappeared. However, trade war fears and a less dovish than expected FED, have trigged EM risk aversion and the Colombian peso has depreciated in line with its peers and has achieved levels close to USDCOP 3500. Although we continue being constructive with COP due to a stronger domestic performance, external risk appetite will continue leading short run dynamics. Therefore we keep our medium-term view of 3100-3200, but with an upward bias.

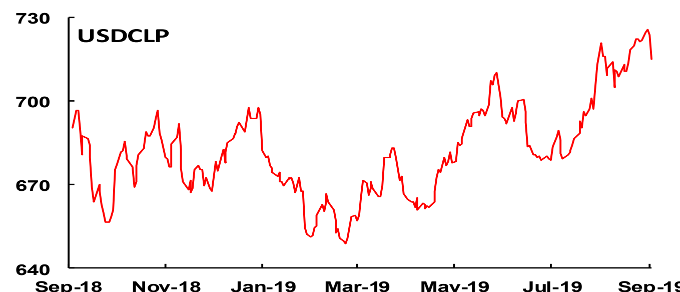
CHILE — The Chilean peso remains at lows since early-2016, pressed by lower copper prices and a stronger US dollar. However, according to our models, current level (over USDCLP 720) shows a misalignment with respect to its fundamentals. We acknowledge the risks from the trade war, and we delay the convergence to equilibrium level by 2020, but we still forecast an appreciation of the peso in the coming months. Now, we forecast USDCLP 670 at the end of 2019 and further appreciation in 2020, towards 640.

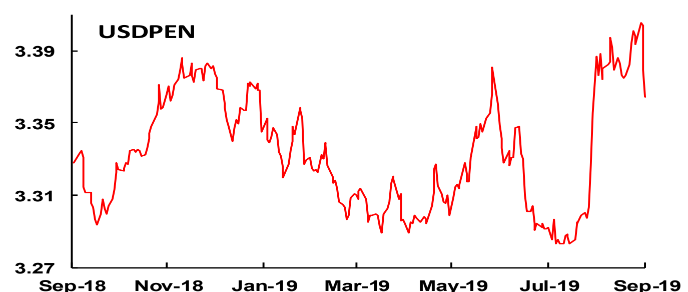
PERU — Throughout 2019 the PEN has ranged between 3.28 and 3.40, largely in sync with the escalation or unwinding of the trade war. Recently, the PEN has been testing 3.40, without CB intervening to set a ceiling. It is unclear if the Central Bank sees +3.40 as temporary, or if it is now allowing the PEN to float up. We are maintaining our FX forecast of 3.35 for year-end 2019, but with upside, and are raising our forecast for 2020 to 3.42, from 3.30.

Currency Trends

FX Rate	Spot 6-Sep	19Q1a	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
USDMXN	19.65	19.43	19.22	20.21	20.83	21.08	20.93	21.04	21.36
USDCOP	3381	3189	3211	3382	3120	3050	3100	3182	3167
USDCLP	715	680	679	700	670	650	645	645	640
USDPEN	3.36	3.32	3.29	3.42	3.35	3.40	3.38	3.43	3.42







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MEXICO — Mexico is passing through a rough road with some headwinds. Economic activity is slowing down faster than expected, with a stagnant GDP in Q2 and industrial production falling 2.9% y/y in June and 1.8% annual in the first semester. High uncertainty is producing a deep contraction in investment of 3.2% annual in January-May and a marked slowdown in consumption, which grew only 1.0% in the same period, both the weakest readings in the decade. The number of jobs created fell to only 436 thousand in July from 860 thousand in May 2018. Banco de Mexico cut its interest rate for the first time in five years, from 8.25% to 8.00%, and is expected to cut again a couple of more times. Consumer Price Index fell 0.08% in the first half of August, a positive surprise that brings the annual reading to 3.29%, but core inflation descended very slowly, reaching 3.77% annual, which is still an elevated number. Growth forecasts keep descending: the average GDP forecast for 2019 in Banco de Mexico's monthly survey fell to 0.8% in July from 2.2% a year ago, while for 2020 the average forecast has fallen to 1.5%. We will revise our macroeconomic scenario in the coming days to incorporate all these new information, and the outlook looks in deed weaker.

COLOMBIA — 1H19 GDP growth showed that Colombia's economic activity recovery continues being gradual and better than its peers, although still below potential. Economic activity grew 3% in 1H19 well above last year (2.6%). Domestic demand has steadily grown above GDP over the previous six quarters due to higher private consumption and investment. We still think low interest rates, steady FDI and still countercyclical public expenditure—due to last year of regional governments and regional campaigning— will continue to support economic activity recovery this year. We keep our FY19 GDP growth forecast of 3.2%. In the fiscal arena, Carrasquilla said that higher tax collection will avoid asset sales this year. Moreover, there is a high likelihood that the last tax reform "Ley de Financiamiento" will be declared illegal. If this happened, the questions are: Does the government have to return taxes already collected? historically no. How will the rating agencies react? We think that although in terms of tax collection this year is not relevant, long-run fiscal vulnerability and Duque's governability will continue being the reason for Fitch to downgrade Colombia to "BBB-" (still investment grade) next year. On inflation, although recent FX depreciation has not, yet, pass-through to domestic prices, supply shock in foodstuff prices have made headline inflation to pick up to 3.7%, and it should maintain at this level until December-2019. The good news is that core inflation measures are still very close to 3%. Gradual economic activity recovery and temporary inflation pick up will keep BanRep on the sidelines and keep the policy rate at 4.25% for the rest of the year.

CHILE — Our call of lower activity and higher inflation this year is now a consensus. After the subdued growth in the first half of 2019, pessimism about the economy has deepened. We also adjust our GDP growth projection to 2.9% for 2019, from a previous range of 3.0-3.2%, but we remain optimistic about the effects of higher investment in the second half of year. Investment was corrected upward in 1Q19 (to 3.2% y/y), and increased a surprising 4.8% y/y in 2Q19. Ongoing investment projects continue to increase and the Government announced a fiscal package to boost investment. All in all, the third quarter would be highly expansive and exceeding expectations, starting with July figures. On the other hand, private consumption confirmed the strong dynamism of services in 2Q19, in contrast with a lower performance of goods. The recovery in job creation and wages would be the main driver of the stabilization in retail sales from mid-year on. Along with that, inflationary pressures would increase in the coming months, especially after the recent real depreciation of the Chilean peso, pointing to normalization in annual inflation towards 2.8% at the end of year. Despite our optimism about the economy in the coming quarters, we acknowledge the Central Bank is on track to ease. We expect a 25 bp cut in the September meeting and probably another in October, leaving the rate at 2%. The lackluster first semester along with the intensification of external risks would be enough to argue a negative real MPR towards the end of the year.

PERU — GDP growth in 2Q19 was 1.2%, y/y, taking 1H19 growth to 1.7%. Private investment growth of 5.1% was a pleasant surprise, with non-mining investment at 3.5% rising for the time in four quarters. However, we feel no assurance that this will continue, as business confidence in 2Q had not yet felt the impact of greater global and domestic uncertainty. Private consumption, up 2.5%, underperformed compared to a 2-year trend of 3.2%. Private sector formal employment growth for the quarter was 2.8%, not bad, but below the 4% trend throughout most of 2018-2019. The main drag on growth was exports, down 2.9% in volume, on declining resource sectors, which should normalize over time. These results are mildly lower than what our full-year forecast of 3.1% growth would warrant. Our 2020 forecast of 3.7% GDP growth is at greater risk, not so much due to 2Q19 figures, but, rather, to the escalating global trade war and the significant impact of social conflicts and uncertainty over the call for early presidential elections. We expect inflation to continue hovering about the mid-point of the CB target range, and are mildly reducing our inflation expectations to 2.0% both this year and next (down from 2.2% and 2.4%, respectively). The fiscal deficit was 1.6% in the 12 months to July. This is on track for a 2.0% deficit, or less, for full-year 2019.

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Developing Economies

Currency Outlook

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SOUTH KOREA — The KRW will remain susceptible to the Fed's monetary policy stance, the US-China trade negotiations and the Japan-Korea export talks, while running a tight correlation with the CNH. USD/KRW is likely to range trade between 1,200 and 1,220 in the near term. The pair will breach 1,220 and rally further if the US-China trade tensions escalate again, but would fall below 1,200 should Beijing agree to send a trade delegation to Washington in September.

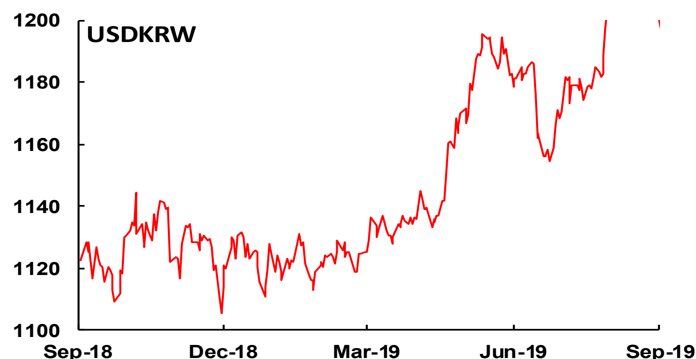
THAILAND — The THB continues to outperform regional peers given the nation's solid current account balance and less exposure to the US-China trade disputes. The BoT said in the minutes of the August 7 policy meeting that the MPC "remained concerned about the baht appreciation against trading partner currencies." USD/THB will trade in a range of 30.5-31.0, with mounting risks of breaching the lower bound. We remain bullish on the THB in the medium term.

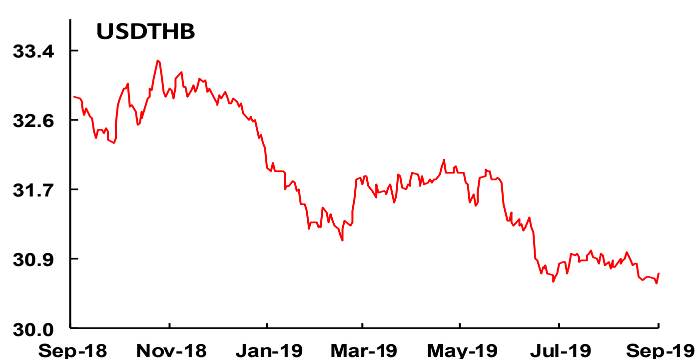
TAIWAN — Official data showed that a total of 123 companies have pledged to invest about TWD 570bn in the island and bring back 50K job opportunities. The TWD has been following movements in the KRW closely amid the ongoing US-China trade disputes. We expect the USD/TWD to trade between 31.0 and 31.6 in the month of September, while keeping a close eye on cross -strait relations.

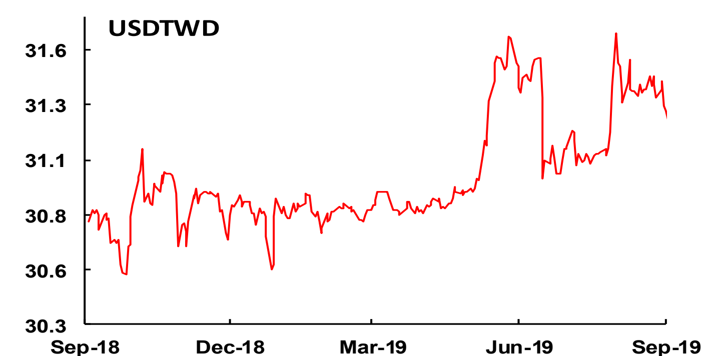
SINGAPORE — The city-state's MAS core inflation eased further to 0.8% yoy in July from 1.2% a month ago, missing market estimate of 1.0%. The S$NEER index is running slightly above the centreline and is anticipated to fall further towards the middle of the lower half of the MAS policy band on hopes for the monetary authority reducing the slope from the current 1% annual pace in mid-October. USD/SGD will likely trade in a range of 1.38-1.40 in September.

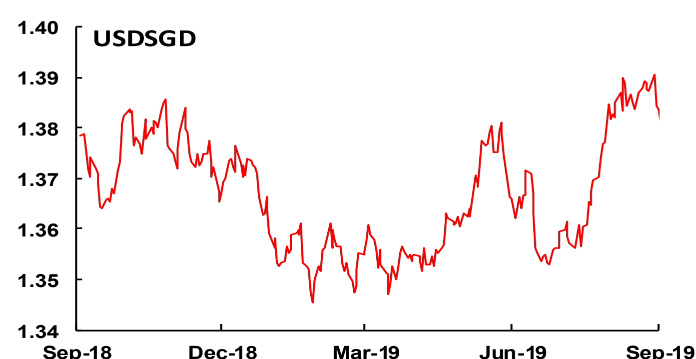
Currency Trends

FX Rate	Spot 6-Sep	19Q1a	19Q2f	19Q3f	19Q4f	20Q1f	20Q2f	20Q3f	20Q4f
USDKRW	1197	1135	1155	1180	1180	1160	1160	1140	1140
USDTHB	30.7	31.7	30.7	31.0	31.0	30.5	30.5	30.0	30.0
USDTWD	31.2	30.8	31.0	31.2	31.0	30.8	30.8	30.6	30.6
USDSGD	1.38	1.36	1.35	1.38	1.37	1.36	1.36	1.35	1.35









Developing Economies

Fundamental Commentary

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SOUTH KOREA — In line with a regional—and increasingly global—trend, the Bank of Korea (BoK) has become increasingly concerned about the economy's outlook, which is weighed down by persistent trade uncertainties. Simultaneously, inflationary pressures remain absent, allowing for looser monetary conditions. Headline inflation eased further in August, reaching 0.0% y/y, far from the BoK's 2% target. The central bank lowered the Base Rate by 25 basis points to 1.50% following the July 18 monetary policy meeting, thereby reversing the November 2018 hike. We expect the BoK to cut the policy rate by another 25 bps at its next policy meeting on October 16. Fiscal stimulus will also support the economy; in early August, the National Assembly passed a supplementary budget of around USD5 bn (equivalent to 0.3% of GDP). The South Korean economy grew by 1.0% q/q (2.0% y/y) in Q2 following a contraction in output in Q1. We expect the nation's real GDP to advance by 1.9% in 2019 as a whole. The export-oriented South Korean economy is adversely impacted by three key considerations: 1) weaker global demand; 2) trade tensions between the US and China; and 3) the ongoing downturn in the global electronics sector. Additionally, there are two key risks to the economy's outlook: 1) The US administration is expected to decide by mid- November whether it will move ahead with tariffs on automobile imports and 2) the escalating Japan-South Korea dispute.

THAILAND — The Bank of Thailand (BoT) has joined other regional central banks in monetary easing as downside risks to economic growth increase. Following the August 7 Monetary Policy Committee Meeting, the BoT lowered the benchmark interest rate by 25 basis points to 1.50%, thereby reversing the December 2018 hike. We anticipate another rate cut by early-2020. The country's monetary authorities noted that contracting exports—that reflect a slowdown in trading partners' growth and weak global trade—have started to affect Thailand's domestic demand. Meanwhile, inflationary pressures are expected to remain below the lower bound of the BoT's 1–4% annual inflation target. Indeed, headline inflation eased to 0.5% y/y in August. Thailand's real GDP grew by 2.3% y/y in Q2, following a 2.8% gain in Q1. Activity was mainly driven by consumer spending while the external sector was a drag on growth. We expect the economy to expand by 2.4% in 2019 as a whole, compared with a 4.1% advance in 2018. Given the challenging economic environment, the Thai cabinet approved on August 20 an additional fiscal spending package of around USD10 bn (equivalent to 2% of GDP) in order to complement the BoT's stimulus efforts.

TAIWAN — The export-oriented Taiwanese economy is affected by weaker global momentum and persisting trade uncertainties. Reflecting exporters' challenges, manufacturing sector sentiment remains soft. Given weaker global demand, activity will continue to be driven by domestic demand, particularly investment in machinery equipment and construction outlays that are underpinned by accommodative monetary policy and the government's Forward-Looking Infrastructure Development Program. Despite stable labour market conditions, growth in private spending will likely soften in the near term as thinner corporate profits will impact wage gains and consumer confidence weakens. Real GDP grew by 2.4% y/y in Q2 following a 1.8% y/y gain in Q1. We expect output to advance by 2% in 2019 as a whole. The Taiwanese central bank left the benchmark interest rate unchanged at 1.375% following the most recent quarterly monetary policy meeting on June 20. Monetary authorities pointed out that the economy is growing at a below-potential rate, causing the already-negative output gap to widen while keeping inflationary pressures subdued. We assess that the likelihood for a rate cut by the central bank has increased in recent months and will likely materialize by early 2020. The next policy meeting is scheduled for September 19. Inflation remains low in Taiwan (at 0.4% y/y in July), yet a modest rebound is expected in the second half of 2019 as food prices will likely be lifted by adverse weather conditions.

SINGAPORE — Given the openness of the Singaporean economy, activity is hit rather hard by weaker global growth dynamics, trade uncertainties, and the current downturn in the global semiconductor sector, which in turns reflects weaker demand in China and smartphones' longer replacement cycle. High frequency data show that industrial production and sentiment have been softening notably while exports are contracting at double-digit (y/y) pace, driven by electronics exports. Simultaneously, retail sales growth is negative, despite the fact that labour market conditions remain solid. Accordingly, Singapore's real GDP growth was soft in Q2 2019 with output rising by only 0.1% y/y. In q/q terms, the economy contracted by 3.3% q/q (annualized). The weakness was driven by contracting manufacturing sector activity while the construction and services sectors remained more buoyant. The Ministry of Trade and Industry now forecasts real GDP growth to average 0–1% y/y in 2019 as a whole (vs. the earlier projection of 1.5–2.5%). We estimate that the economy will advance by 0.8% in 2019. The Monetary Authority of Singapore will likely announce monetary easing measures at the next monetary policy meeting in mid-October, which would reverse some of the monetary tightening implemented in April and October 2018. We also note that Singapore's government finances are healthy, allowing the administration to support the economy through fiscal stimulus.

Global Currency Forecast (end of period)

		2019f	2020f	2019f				2020f			
Major Currencies				Q1a	Q2a	Q3	Q4	Q1	Q2	Q3	Q4
Japan	USDJPY	108	105	111	108	108	108	107	107	105	105
Euro zone	EURUSD	1.10	1.20	1.12	1.14	1.10	1.10	1.12	1.15	1.19	1.20
	EURJPY	119	126	124	123	119	119	120	123	125	126
UK	GBPUSD	1.22	1.40	1.30	1.27	1.22	1.22	1.25	1.30	1.32	1.40
	EURGBP	0.90	0.86	0.86	0.90	0.90	0.90	0.90	0.88	0.90	0.86
Switzerland	USDCHF	1.00	0.96	1.00	0.98	1.00	1.00	1.00	1.04	0.97	0.96
	EURCHF	1.10	1.15	1.12	1.11	1.10	1.10	1.12	1.20	1.15	1.15
Americas											
Canada	USDCAD	1.30	1.25	1.33	1.31	1.31	1.30	1.28	1.28	1.25	1.25
	CADUSD	0.77	0.80	0.75	0.76	0.76	0.77	0.78	0.78	0.80	0.80
Mexico	USDMXN	20.83	21.36	19.43	19.22	20.21	20.83	21.08	20.93	21.04	21.36
	CADMXN	16.02	17.09	14.55	14.68	15.43	16.02	16.47	16.35	16.83	17.09
Brazil	USDBRL	4.18	4.18	3.92	3.85	3.97	4.18	4.08	4.11	4.07	4.18
Chile	USDCLP	670	640	680	679	700	670	650	645	645	640
Colombia	USDCOP	3120	3167	3189	3211	3382	3120	3050	3100	3182	3167
Peru	USDPEN	3.35	3.42	3.32	3.29	3.42	3.35	3.40	3.38	3.43	3.42
Asia-Pacific											
Australia	AUDUSD	0.68	0.72	0.71	0.70	0.68	0.68	0.69	0.70	0.71	0.72
China	USDCNY	6.90	6.70	6.71	6.87	7.10	6.90	6.80	6.80	6.70	6.70
Hong Kong	USDHKD	7.82	7.80	7.85	7.81	7.82	7.82	7.80	7.80	7.80	7.80
India	USDINR	68.0	66.0	69.2	69.0	71.0	68.0	67.0	67.0	66.0	66.0
Indonesia	USDIDR	14200	13800	14243	14126	14200	14200	14000	14000	13800	13800
Malaysia	USDMYR	4.10	4.00	4.08	4.13	4.20	4.10	4.05	4.05	4.00	4.00
New Zealand	NZDUSD	0.63	0.65	0.68	0.67	0.63	0.63	0.64	0.64	0.65	0.65
Philippines	USDPHP	51.5	50.0	52.6	51.3	51.5	51.5	51.0	51.0	50.0	50.0
Singapore	USDSGD	1.37	1.35	1.36	1.35	1.38	1.37	1.36	1.36	1.35	1.35
South Korea	USDKRW	1180	1140	1135	1155	1180	1180	1160	1160	1140	1140
Taiwan	USDTWD	31.0	30.6	30.8	31.0	31.2	31.0	30.8	30.8	30.6	30.6
Thailand	USDTHB	31.0	30.0	31.7	30.7	31.0	31.0	30.5	30.5	30.0	30.0

f: forecast a: actual

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