AMERICAS

The USD has emerged from the global pandemic broadly weaker due to diminished growth and yield advantages; we expect the soft trend to extend. The CAD has under-performed since March but could now catch up with its G10 peers. The MXN has benefitted from a supportive risk backdrop but domestic headwinds may reverse gains into year-end. The CLP has firmed in response to higher commodity prices and domestic pension reforms; we anticipate modest gains into year end.

EUROPE

The EUR is taking advantage of a positive growth outlook following the EU's agreement on the Recovery Fund. The GBP has risen against the weaker USD but is prone to disappointment as UK-EU trade talks are deadlocked.

ASIA-PACIFIC

The CNY is poised to strengthen as a growth-supportive policy mix underpins recovery hopes; US/China tensions remain a risk ahead of the US presidential election, however. The JPY is poised to remain firm against a weak USD as interest rate spreads move in its favour.

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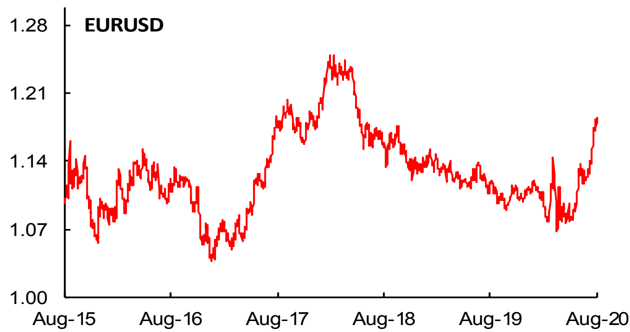
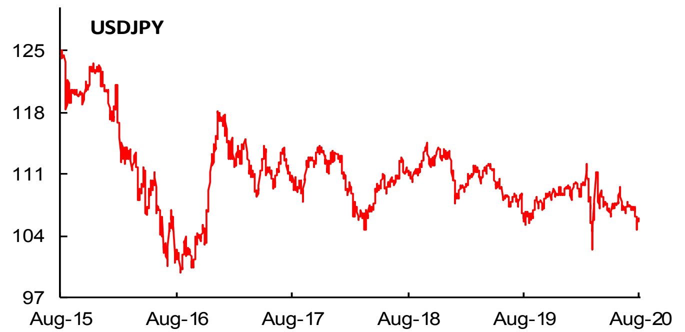
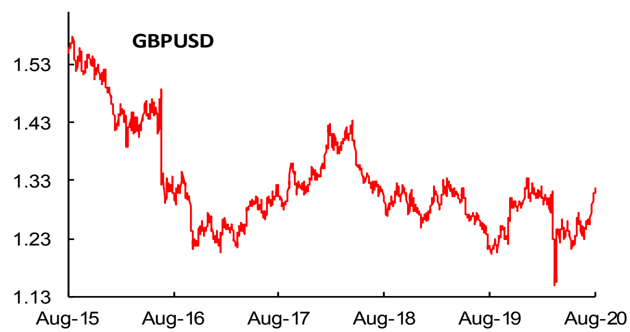
Core Exchange Rates

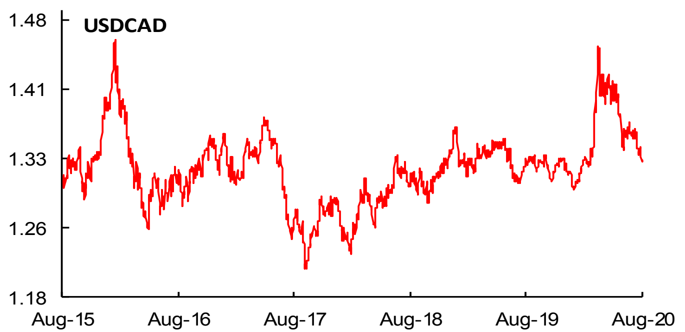
Global Foreign Exchange Outlook

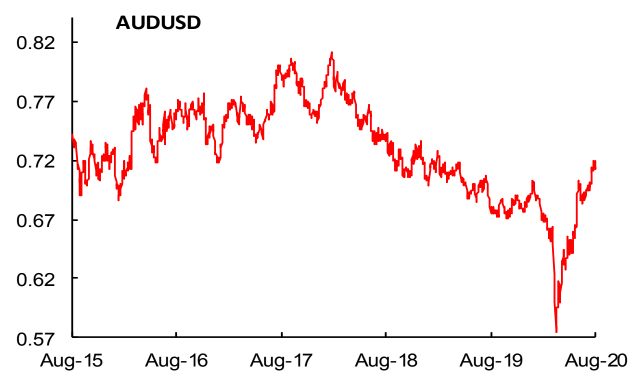
August 6, 2020	Spot	2020f Q1a	2020f Q2a	2020f Q3	2020f Q4	2021f Q1	2021f Q2	2021f Q3	2021f Q4
EURUSD	1.18	1.10	1.12	1.18	1.18	1.20	1.20	1.21	1.21
USDJPY	106	108	108	105	105	104	104	102	102
GBPUSD	1.32	1.24	1.24	1.28	1.29	1.30	1.31	1.32	1.33
USDCAD	1.33	1.41	1.36	1.34	1.32	1.30	1.30	1.28	1.28
AUDUSD	0.72	0.61	0.69	0.71	0.71	0.73	0.73	0.75	0.75
USDMXN	22.45	23.67	22.99	23.52	24.33	24.46	24.29	24.17	24.23

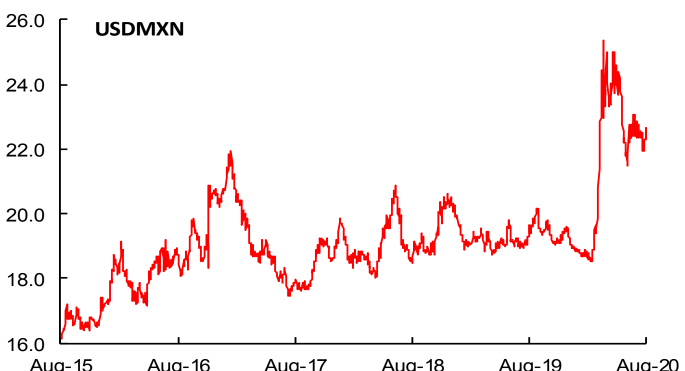












Market Tone & Fundamental Focus

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The US dollar (USD) is emerging from the global pandemic weakened and poised to remain soft, we believe. While financial markets have stabilized, thanks to prompt and aggressive policy action from global central banks (of particular note in this respect was the Fed's decision to provide ample dollar liquidity to its central bank counterparts around the world), the public health crisis has not yet been tamed and some economies, including the US, are clearly struggling with the re-opening and recovery phase.

We think the USD is facing a more challenging period ahead. Aggressive central bank policy action combined with extensive fiscal easing globally should help the world economy out of the COVID-19 growth hole but the process will be slow. The fiscal and monetary policy mix is, however, very supportive for risk assets and should support equity and commodity market valuations. The corollary to a less risk-averse global environment is less safe haven demand for the USD.

In addition, the USD has relied on positive growth and interest rate differentials versus its major currency peers to strengthen over the past couple of years. But growth differentials and spreads have narrowed significantly or disappeared entirely, leaving the USD exposed to traditional structural negatives (rising fiscal and external imbalances) that have dragged it lower in prior bear cycles. We also think the benign investment environment and attractive returns from markets outside of the US will encourage investors to diversify away from the USD.

In effect, we seem to be slipping to the low point of the USD "smile" framework which illustrates how the USD tends to outperform when US growth outperforms or when safe haven/liquidity-related demand for the USD spikes. The midpoint of the "smile"—when the USD typically underperforms—usually reflects a benign risk/liquidity environment, relatively strong non-US growth and the relative outperformance of non-US assets. We have adjusted some of our forecasts to reflect the recent softening in the broader USD trend and our belief that the USD is liable to weaken a little more in the months ahead.

For the Canadian dollar, however, there is no change in the outlook; the CAD has under-performed in recent weeks, declining more or less in line with the USD against its G10 currency counterparts. The CAD has not been able to differentiate itself from its big dollar neighbour despite relatively firm (and stable) crude oil prices and signs from the latest domestic data that a strong economic recovery is developing through mid-year. The recovery bolsters the idea that the Bank of Canada is unlikely to ease policy any further, lifting domestic yields a little above US interest rates at the short end of the yield curve. Fiscal and current account deficits are potential drags on the CAD's outlook but we feel imbalances do not necessarily disfavour the CAD over the USD, given significant US structural imbalances. We expect the CAD to make modest headway against the USD to reach 1.32 by year end.

In Europe, the euro (EUR) has firmed significantly in the past three months while the Swiss franc (CHF) and British pound (GBP) have lagged behind somewhat. The EUR's performance reflects enhanced recovery prospects that evolved around the proposal and eventual agreement on the EUR 750 bn Recovery Fund which will help the EU tackle the impact of the pandemic. While the funds will not reach the real economy for some months, the EUR benefited immediately because the bulk of the monies will go to the peripheral Eurozone economies. This served to ease longer-term concerns about the EUR project's viability and narrow peripheral sovereign bond spreads over core (German bund) yields. Eurozone equity market returns picked up significantly through late spring as the Recovery Fund was being discussed, attracting foreign investment inflows to take advantage of the brighter outlook and the strengthening EUR. We look for EURUSD to retain its mid-year gains and end 2020 at 1.18.

The GBP has risen on the back of the EUR's coattails to a large extent. While it also seems likely to retain the bulk of its recent gains against the USD (we look for GBPUSD to end 2020 at 1.29), the UK government's rather muddled handling of the COVID-19 situation, the risk of EU-UK trade talks resulting in no agreement on a post-Brexit trade arrangement, and speculation that the Bank of England might ease policy settings again suggest the GBP trend may be subject to setbacks.

We remain cautiously constructive on the Japanese yen (JPY) and have upgraded our year-end forecast to 105. The JPY may benefit from improving real domestic bond market yields which may slow outflows to foreign markets where yields have weakened significantly. We expect the USD to remain well-supported versus other Asian currencies generally in the short run on fears that US-China tensions will increase ahead of the US presidential election.

Among the Pacific Alliance currencies, rising metals prices and pension reforms (allowing contributors to withdraw from savings schemes) have helped lift the Chilean peso (CLP) against the USD to near the CLP 750 level. The Peruvian sol (PEN) should also benefit from improving terms of trade while the Colombian peso (COP) may be subject to downward pressure amid slow growth and concerns about fiscal sustainability. Improving risk sentiment has helped the Mexican peso (MXN) to strengthen against the USD in the past few weeks but we expect the MXN to edge back to the low 24 region towards the end of the year as local rates ease.

Canada
Currency Outlook

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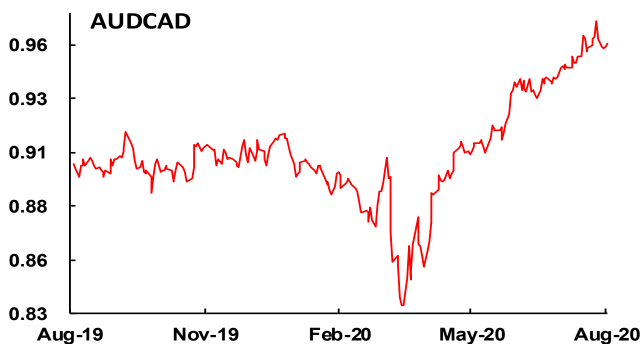
The CAD has under-performed broadly since March as markets navigated the emerging global pandemic and resulting market volatility. It is, in fact, little changed against the USD since the start of March, in contrast to the strong gains chalked up by its commodity peers, such as the AUD and NZD. More recently, it has under-performed against the likes of the EUR and GBP, with investors tying the CAD's fate to the USD to a large extent, it would appear.

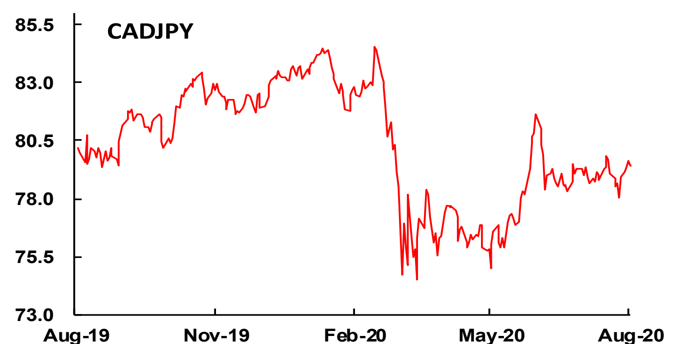
Speculative traders have maintained short exposures on the CAD consistently in recent weeks, ignoring the rebound in crude oil prices, better than expected domestic data releases and a firm line from the Bank of Canada on 0.25% representing the effective lower bound for the bank's benchmark rate. This contrasts with markets leaning towards the—still very unlikely, we think—risk of the Fed easing policy in the coming months but short term rate differentials, however meagre, have widened against the USD.

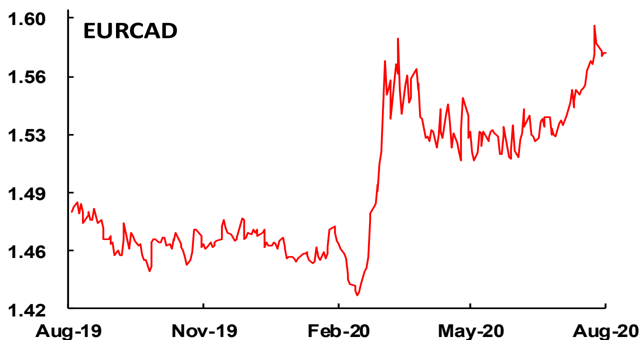
We think the CAD has a little catching up to do generally as positioning adjusts; improving terms of trade and signs of a strong domestic recovery underway are supportive in the near term. Broader pressure on the USD, which we expect to remain a factor for markets in the months ahead, should limit scope for CAD softness. The USD's loss of support in the low 1.33 area indicates more downside potential opening up for USDCAD in the next few weeks, possibly towards 1.29/1.30 late in Q3 or early Q4 before year-end demand for USD liquidity provides some support for the big dollar.

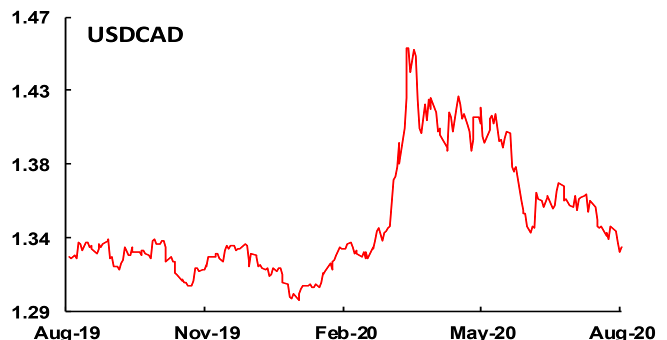
Canadian Dollar Cross-Currency Trends

FX Rate	Spot 06-Aug	20Q1a	20Q2a	20Q3f	20Q4f	21Q1f	21Q2f	21Q3f	21Q4f
AUDCAD	0.96	0.86	0.94	0.95	0.94	0.95	0.95	0.96	0.96
CADJPY	79.4	76.5	79.5	78.4	79.5	80.0	80.0	79.7	79.7
EURCAD	1.57	1.55	1.53	1.58	1.56	1.56	1.56	1.55	1.55
USDCAD	1.33	1.41	1.36	1.34	1.32	1.30	1.30	1.28	1.28









United States and Canada

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Fundamental Commentary

UNITED STATES — Our macroeconomic outlook for the US remains dominated by progress, or lack thereof, in containing the COVID-19 pandemic. Although most numbers clearly show that we have passed the nadir of the "great lockdown" and data for Q2-2020 and early Q3-2020 have generally been stronger than we previously expected, the resurgence in COVID-19 case numbers across the US has prompted us to scale back the extent and speed of the rebound we forecast for the remainder of the year. As a result, our most recent forecasts for 2020 look hardly changed from our June update: real GDP is expected to contract by -4.7% y/y in 2020, marginally worse than the 4.5% y/y we anticipated in June, while the rebound in 2020 has been dampened from 6.7% y/y to 5.4% y/y. Headline inflation is expected to end 2020 at 0.6% y/y and climb to 2.4% y/y by end-2021. Political pressures in this election year compound the risks presented by the public-health crisis. The White House appears to be embarking on a more confrontational path across a range of issues, which is contributing to delays in the extension and enhancement of fiscal aid to the states, businesses, and households. Substantial further hold-ups represent the main downside risks to our current outlook.

CANADA — Canada's data tell two stories: major indicators reflect a sharp improvement in economic activity, but at the same time, many business sectors, regions, and households are still struggling. Aggregate numbers elide over some big shifts in the composition of economic activity: while auto sales have roared back powerfully and high-frequency data show that aggregate consumer and business transactions have returned to pre-COVID-19 levels, winners in the grocery and hardware sectors, for instance, are only just offsetting continued pain in travel, tourism, and hospitality. As a result, we still expect the Canadian economy to contract by -6.6% y/y in 2020, only a bit better than the -7.3% y/y downturn in our June forecast; our 2021 rebound has been pared from 6.6% y/y to 5.4% y/y. Inflation typically follows demand downturns with a lag, and we project headline CPI growth to end 2020 at 0.2% y/y before rising to only 2.1% by end-2021.

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Monetary Policy Commentary

UNITED STATES — We forecast the Fed funds target rate range and interest on excess reserves to be held at 0–0.25% and 0.10% respectively throughout our 2020-21 print forecast horizon—and likely far beyond 2021. The pace of balance sheet expansion is running below what we had previously anticipated. Several credit and liquidity facilities are marked by modest utilization rates. This reflects the degree to which market conditions have been repaired. Nevertheless, Chair Powell recently noted that such repair has not fully satisfied the Fed. He noted that "we have substantially, not fully restored functioning markets" through its asset purchase programs. This is highly debatable, but it implies that the next leg of providing stimulus—beyond simply repairing markets—still lies ahead. Indeed, in the face of downside risks to the economy, Powell emphasized "don't look to us to cut back on facilities or policy for a very, very long time." Striking and implementing a material fiscal stimulus deal as a last chance until the new Congress in January is likely more important to the outlook than anything the Fed can do from here. The entire rates complex has been squashed flat and risk asset pricing has bloomed. Strengthening language around when to tighten policy and under what conditions matters little relative to the Fed's dot plot that projects a hold through to at least 2022 and relative to market pricing. Shifting more formally toward an average inflation targeting regime would yield little incremental value over its current emphasis upon a symmetrical 2% target. Yield curve control would likely backfire across long-term maturities and thus the Fed is biased toward nearer term controls, but again, such a move—at least under current market conditions—would be largely meaningless. The main tools therefore remain large scale asset purchases and flooding the system with greater liquidity should downside risks become amplified.

CANADA — The Bank of Canada (BoC) overnight rate is forecast to remain at 0.25% throughout 2020–21—and likely well beyond. Policy is now focused upon continuing to inject stimulus primarily through purchases of Government of Canada bonds. The flow rate of at least CAD 5 bn per week is accompanied by vague condition-based guidance to keep buying until the economic recovery is "well underway." Governor Macklem has defined this to be sometime after the initial period of recovery but before estimated spare capacity has been exhausted. That could mean incremental purchases within a very wide range of between about CAD 200–600 bn from here through to either fairly early in 2021 or well into 2022. The BoC has made it clear that it will align purchases with lengthened issuance maturity which resembles outright monetization of public debt. The goals are to increase liquidity to offset the liquidity drain from higher issuance and to inject net stimulus that attempts to keep borrowing costs low, although the BoC may find this challenging beyond the shorter end of the curve. Other purchase and liquidity programs are either being reversed or proceeding very slowly as market conditions have improved. They are nevertheless being retained as insurance backstops. Future possible efforts could include yield curve control targets, but the BoC has ruled out a negative policy rate. It is also unlikely to alter its inflation targeting approach that is flexibly centered around a 2% midpoint of a 1-3% band.

G10

Currency Outlook

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EUROZONE — The Eurozone faces encouraging recovery prospects—thanks to agreement on an EU Recovery Fund and effective virus containment—that have lifted the EUR to its highest mark since May 2018. We expect that the EUR will remain steady through the rest of 2020 to close near current levels—though with an upward bias—as the USD's decline on stimulus delays is curbed and the US economy plays catch-up. With net long contracts on the EUR sitting at an all-time high, the euro's outlook is firmly bullish although the EUR appears technically stretched and will likely face strong resistance at the 1.20 mark.

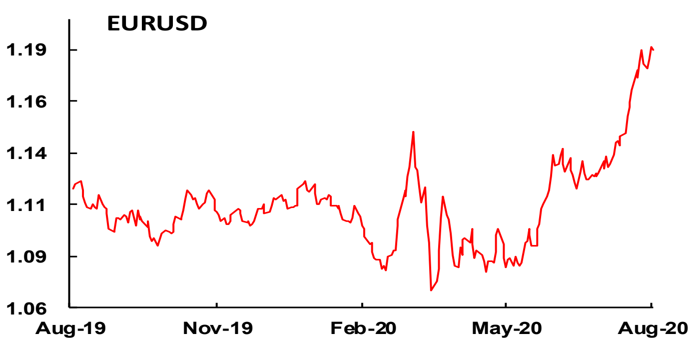
UNITED KINGDOM — The GBP has strongly rebounded from late-June to trade above 1.30, but maintains a year-to-date loss against the USD as the government's flawed approach to COVID-19 exerts a drag on the UK economy. Cable is liable to correct its push above 1.30—and end 2020 near 1.28—as no-trade-deal risks re-surface with EU-UK negotiations at a manifest impasse. The transition period could lapse without a goods trade deal, but certain ties may be preserved, e.g. access to the EU on specific financial services. Continued USD weakness into 2021 will act as a tailwind for the GBP; we project an end-2021 rate of 1.33.

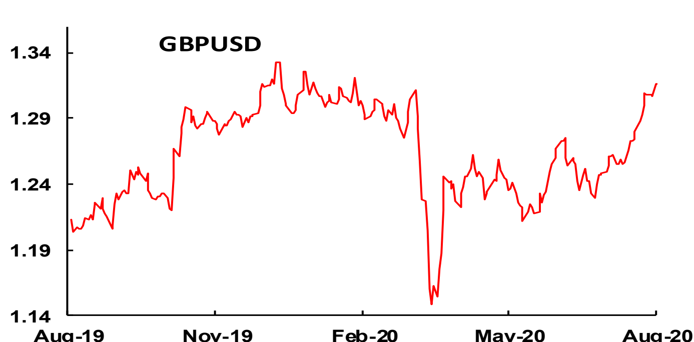
JAPAN — With the exception of an early-June upswing USDJPY had remained bound between 106 and 108 until the yen's most recent climb to its strongest point since March amid little to no adverse reaction to the market's risk-on mood as it benefits from broad USD-negative flows and a narrowing of the US's yield advantage. Risks ahead of the US presidential election and escalating China-US tensions should keep the JPY supported toward an end-2020 rate of 105 per USD.

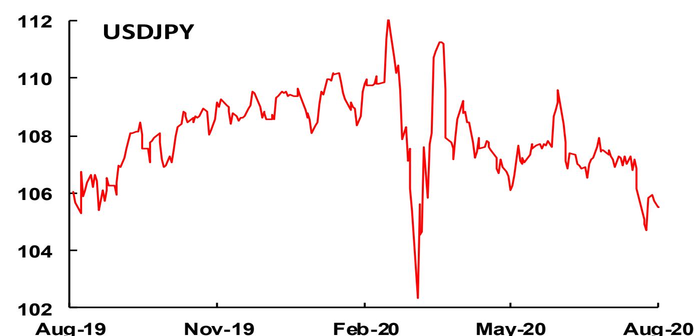
AUSTRALIA — The re-imposition of lockdown measures in Victoria amid a jump in contagions has had little obvious impact on the AUD, which remains the only major commodity currency to gain against the USD in 2020—to its highest mark since early 2019—thanks to strong price gains for silver, gold, and iron ore in contrast to weaker energy prices. We expect that the AUD will close out 2020 around current levels as USD headwinds ease somewhat but momentum is tilted toward continued Aussie gains into next year for an end-2021 rate of 0.75.

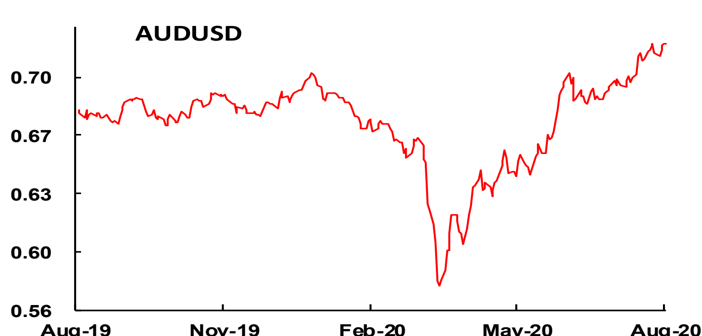
Currency Trends

FX Rate	Spot 06-Aug	20Q1a	20Q2a	20Q3f	20Q4f	21Q1f	21Q2f	21Q3f	21Q4f
EURUSD	1.18	1.10	1.12	1.18	1.18	1.20	1.20	1.21	1.21
GBPUSD	1.32	1.24	1.24	1.28	1.29	1.30	1.31	1.32	1.33
USDJPY	106	108	108	105	105	104	104	102	102
AUDUSD	0.66	0.61	0.69	0.71	0.71	0.73	0.73	0.75	0.75









G10

Fundamental Commentary

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EUROZONE — Notwithstanding justified enthusiasm surrounding agreement on the Recovery Fund, the prospect of mutualized debt, progress on containing COVID-19, rebounding PMIs, and favourable equity market developments, the Eurozone's economic outlook, outside of Germany, has softened since our June global forecasts. We now see Eurozone-wide real GDP contacting by -8.3% y/y compared with -8.1% y/y in our June projections owing to a deeper downturn in France, currently expected to reach -9.7% y/y versus our June forecast of -8.9% y/y, and softer prospects in the periphery. Eurozone-wide HICP inflation is forecast to end the year at only 0.5% y/y and rise to only 1.0% y/y by end-2021. Inflation, combined with recent progress on joint European measures to cushion the pandemic-induced downturn, should keep ECB rates on hold well into 2022.

UNITED KINGDOM — As expected, the Bank of England's monetary policy committee (MPC) voted unanimously at its August 6 meeting to keep the official bank rate unchanged at 0.1% and maintain its target stock of asset purchases at GBP 745 bn without any modifications. But the MPC did note that gilt purchases would be "completed by the turn of the year", which implies that the present pace of purchases at GBP 6.9 bn per week, already down from GBP 13.5 bn at the start of the program, would be lowered to around GBP 4.4 bn. Markets were looking for fresh guidance on whether negative rates could be on the horizon. The Bank didn't bring forward the results of its review of the effective lower bound for the bank rate. Instead, the Monetary Policy Rate reflected continuing debate between views that see the potential for negative rates to provide a boost to the economy against others that question the effectiveness of negative rates when banks' balance sheets are already improving. Although markets have priced the possibility of negative rates from Q1-2021, we expect the Bank to eschew them, though it could cut the bank rate another -10 bps to 0%, and we anticipate an autumn move by the BoE to step up its quantitative easing efforts. In its forecasts, the BoE now sees real GDP contracting by -9.5% y/y in 2020, versus -14% y/y in its May scenario, and our forecast of -9.4% y/y; for 2021 the BoE foresees an expansion of 9% y/y in 2021, compared with 15% y/y in May, and our 6.1% y/y forecast. Under the BoE's baseline, GDP gets back to pre-pandemic levels by mid-2021 and inflation gets back to the 2% target by mid-2022. Our forecasts imply longer waits on both fronts.

JAPAN — The Japanese economy is set to record a third consecutive quarterly contraction in Q2 as high frequency indicators for both external and domestic demand remain drastically below year-earlier levels. We expect Japan's real GDP to contract by 4.2% in 2020, followed by a 2% gain in 2021. According to media reports, the Japanese government is planning to put together another fiscal stimulus package in the fall to support the economy's recovery. Two supplementary budgets for the current fiscal year were unveiled in April and May, taking direct fiscal spending (i.e. measures such as lending programs are excluded) related to the COVID-19 shock to over 11% of GDP. The Bank of Japan's (BoJ) monetary policy stance will stay highly growth-supportive for an extended period of time. Following the July 15 monetary policy meeting, the BoJ maintained the policy rate at -0.1% and continued its policy of "Quantitative and Qualitative Monetary Easing with Yield Curve Control", which aims to keep the 10-year JGB yield at around 0% via unlimited government bond purchases. The BoJ's support measures for corporations (including the zero-interest loan program and corporate bond purchases) total JPY 110 trillion. The central bank maintains a dovish bias and stands ready to support the economy further if needed; it has pointed out that it expects short- and long-term policy interest rates to remain at their present or lower level for the time being. Japan's decades-long struggle with low inflation—or outright deflation—will continue over the foreseeable future. The BoJ's 2% annual inflation target seems unattainable. The CPI excl. fresh food—the BoJ's preferred inflation measure—was zero in y/y terms in June.

AUSTRALIA — Australia is poised to dip into recession in 2020 for the first time in almost 30 years. In Q1, real GDP contracted by 0.3% q/q (+1.4% y/y). We expect a larger drop in Q2. With some leading indicators starting to show signs of gradual improvement, the economy is set to recover in the second half of the year. Nevertheless, real GDP is expected to contract by 3.6% in 2020 as a whole. Growth will likely rebound to 2.7% in 2021 on the back of a global demand recovery, pent-up demand, and base effects. We note that there are substantial uncertainties regarding the forecast, with second waves of infections across the country posing notable downside risks to the outlook. The Australian government unveiled a "mini-budget" on July 23, which laid out the nation's fiscal roadmap. The federal budget for the current fiscal year was delayed until October due to the virus outbreak. The July update showed that the underlying cash deficit for fiscal year 2019-20 (June-July) reached AUD 85.8 bn, equivalent to 4.3% of GDP, compared to the government's pre-pandemic goal of reaching a small surplus. The shortfall will get bigger in the current fiscal year, reaching AUD 184.5 bn, equivalent to 9.7% of GDP. The Reserve Bank of Australia's (RBA) benchmark cash rate has been lowered by a total of 125 bps since June 2019 to 0.25%, with the latest cut having taken place in March. The RBA has also adopted yield targeting, aiming to keep the 3-year Australian government bond yield at around 0.25% by buying government bonds in the secondary market across the yield curve as needed. We do not foresee any changes to the RBA's monetary policy stance over the coming months.

China, India, Brazil
Currency Outlook

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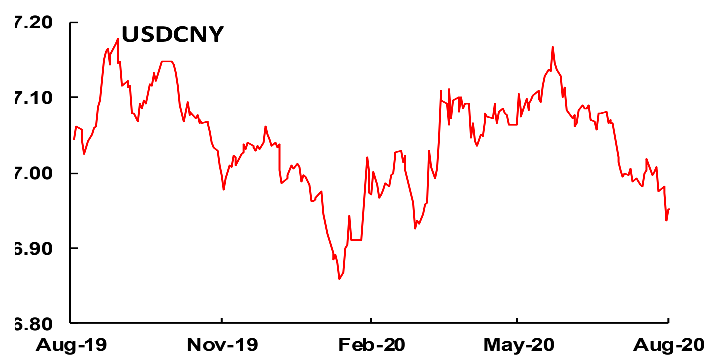
CHINA — China's official manufacturing PMI rose further to 51.1 in July from 50.9 the previous month, expanding for the fifth month and beating market expectations for 50.8. The nation's monetary policy will be more flexible and targeted and its fiscal policy will be more proactive, according to a Politburo meeting chaired by President Xi Jinping on July 30. USDCNY is likely to slide further towards 6.95 and then 6.90 after breaching the 7 level, while remaining susceptible to the US-China tensions.

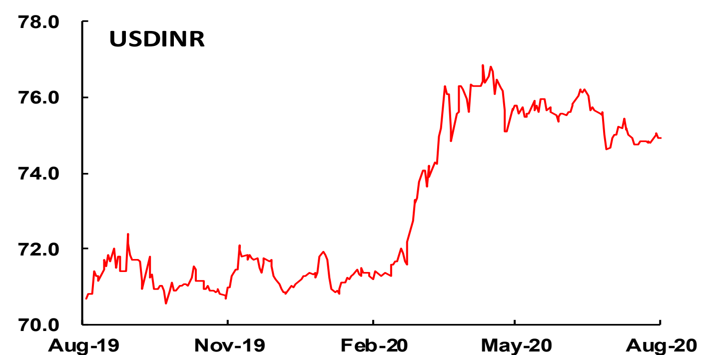
INDIA — The INR has been relatively steady despite continued equity inflows, attributable to the central bank smoothing excessive rupee exchange-rate swings in both directions. India's foreign reserves have been steadily increasing and hit an all-time high of USD 522.63 bn as of July 24, pumping massive rupee liquidity to the banking system in the meantime. USDINR is now trading in a range of 74.5–75.5 but will likely slide gradually, providing some steady carry returns to investors chasing rupee-denominated assets.

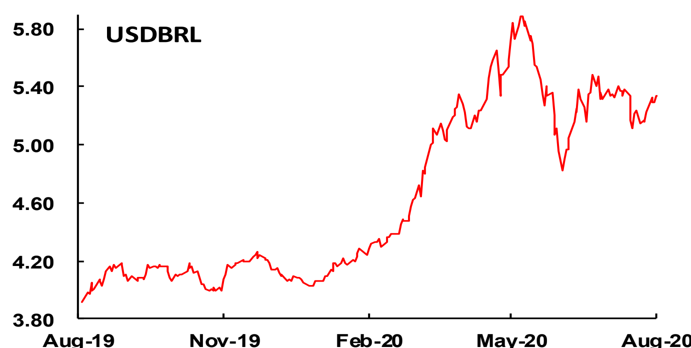
BRAZIL — After a H1-2020, which saw USDBRL trade in a very wide 4.01 to 5.97 range, the cross has settled into a narrower 5.09 to 5.47 range in July–August. For the rest of the year, we expect the cross to move sideways in this range, with the topside limited by already cheap valuations for the BRL based on the REER, and moves to the downside enabled by the absence of any material positive news to offset the very weak fiscal position and the relatively low carry in Brazilian assets relative to both risk and expected inflation dynamics.

Currency Trends

FX Rate	Spot 06-Aug	20Q1a	20Q2a	20Q3f	20Q4f	21Q1f	21Q2f	21Q3f	21Q4f
USDCNY	6.95	7.08	7.07	7.05	7.05	7.00	7.00	6.90	6.90
USDINR	74.9	75.6	75.5	74.0	74.0	73.0	73.0	72.0	72.0
USDBRL	5.34	5.21	5.47	5.31	5.26	4.88	4.96	5.07	5.03







China, India, Brazil

Fundamental Commentary

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CHINA — The Chinese economy continues its recovery after the first quarter slump caused by the COVID-19 pandemic. Real GDP returned to expansionary territory in Q2 with output rising by 3.2% y/y following a 6.8% drop in Q1. In q/q terms the economy more than offset the Q1 declines. The sectoral breakdown reveals that the secondary sector—i.e. industry—was driving the rebound with a 4.7% y/y growth while the tertiary sector—i.e. services—recorded a more muted gain of 1.9% y/y. We expect China's economic recovery to continue in the second half of 2020 with the nation's real GDP growth forecasted to average 2.1% this year. Pent-up demand and base effects will likely push output gains to 8.5% y/y in 2021. Nevertheless, another large wave of infections continues to be a significant risk considering persistent challenges to contain the virus outbreak in many parts of the world. Meanwhile, the bilateral China-US relationship has continued to deteriorate following China's decision to impose the National Security Law on Hong Kong. We expect tensions to remain elevated ahead of the US presidential election in November 2020. Given the challenging economic backdrop, we assess that it will be difficult for China to meet its purchase commitment of US goods as agreed in the "phase one" trade deal in mid-January. The People's Bank of China will likely maintain an accommodative monetary policy stance for an extended period of time, yet the Loan Prime Rates are likely to stay on hold for now. If Chinese policymakers see need for further monetary stimulus over the coming months, we expect it to come in the form of a cut to banks' reserve requirement ratios. Meanwhile, credit growth has picked up significantly in recent months, while fiscal policy, particularly infrastructure outlays, is supporting growth. China's headline inflation has eased notably; annual inflation was 2.5% y/y in June compared with the January peak of 5.4%. We expect consumer price pressures to remain weak through 2020 with headline inflation expected to close 2020 at 1.7% y/y. Moreover, inflation further up the distribution chain remains non-existent, with annual producer price gains currently residing in negative territory; the producer price index declined by 3.0% y/y in June.

INDIA — India's economic outlook remains weak as the country continues to struggle to contain the COVID-19 outbreak. Indeed, India has become the third-hardest hit country globally, after the US and Brazil. Rural and urban demand has collapsed and various sectors continue to experience acute stress despite the fact that several monetary and fiscal stimulus measures have been unveiled in recent months. Early signs of revival have started to emerge after India's lockdown was lifted in June, yet economic activity and confidence will likely remain muted by historical standards for months to come as the virus continues to spread fast in the country. Weak economic prospects raise concerns about the health of India's banking system, which was already under significant downward pressure before the COVID-19 pandemic. We have revised our 2020 growth forecast for India downward and now expect real GDP to contract by 5.2% in 2020. Loose monetary policy will continue to provide support to the economy as India has limited room for additional fiscal spending. The Reserve Bank of India (RBI) unleashed further monetary stimulus in May when it cut the benchmark repo rate by 40 bps to 4.0%, yet monetary policy was kept on hold in August due to inflation concerns. The RBI maintains an accommodative policy stance, implying that policymakers are open for further monetary stimulus once inflation starts easing. Prior to the May decision, the key rate had been lowered by 75 bps in March and by 135 bps over the course of 2019. We expect the RBI to take the benchmark repo rate to 3.50% by year-end. A pickup in inflationary pressures complicates the RBI's efforts to stimulate the economy. In June, headline inflation picked up to 6.1% y/y, climbing above the RBI's 2–6% inflation target band on the back of higher food price inflation. Nevertheless, we expect the pickup to be transitory and foresee inflation easing in the near future given muted demand-driven price pressures.

BRAZIL — The last month's data releases provided us with several positive surprises. On the inflation front, IPCA-15 came in materially lower than consensus expected, printing 2.13% y/y versus consensus 2.36% y/y. On the growth front, the pace of job losses declined from 330k in May to 110k in June, and industrial production improved from -27% y/y in April to -22% y/y in May. In addition, PMIs imply that manufacturing growth was back in positive territory in both June and July. Overall, our read is that the economy continued to contract into July, but the pace of contraction slowed. The combination of a benign inflation environment (for now) and an economy in recession still gives the BCB room to loosen rates marginally further in our view, but the main risk is the continued weakness in public finances. Continued subdued inflation has now led DI rates to price in fully one more -25 bps cut, and a 1/8th probability of a follow-up -25 bps move. Our base case is that the BCB will deliver these two additional -25 bps Selic rate cuts. The government's proposed tax reform helps on the margin, but even with the proposed merger of the PIS-Cofins taxes, and expected charges on the digital economy, Brazil's public finances should remain shaky. With this in mind, once growth starts picking up, we believe that the BCB will likely need to jump start a more aggressive tightening cycle than consensus anticipates in order to avoid destabilizing the country's financial markets, but this is a 2021 story.

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Pacific Alliance
Currency Outlook

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MEXICO — Although the Mexican peso has benefited from the high levels of global liquidity this year, the coming months could present a challenging environment for the currency as the next stage of the COVID-19 pandemic unfolds, economic recovery falters, and anxiety naturally surges in global financial markets. On the domestic front, pressures on public finances will accumulate from falling tax collections and PEMEX's troubles, which could renew expectations of a downgrade in the sovereign's credit ratings. In this environment, we anticipate a significant depreciation of the peso to USDMXN 24.33 by year-end.

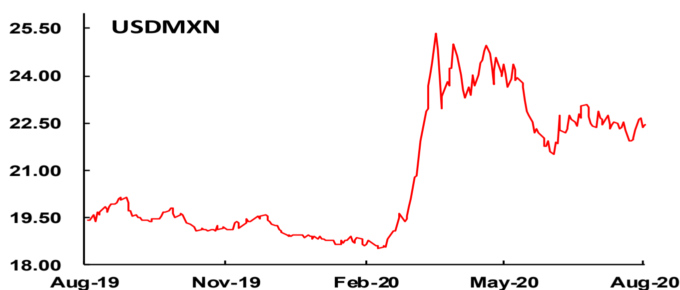
COLOMBIA — The terms of trade bottomed in June and imports have followed the downward dynamic in exports, which means that the trade balance is no longer putting pressure on the COP. Additionally, government external borrowing should be enough to finance the current account deficit. However, on the financial side, heightened concerns regarding the global economic recovery and EM debt sustainability have led to some recent EM FX weakness despite greater external liquidity stemming from DM central banks' monetary easing. We anticipate unsettled international markets and ongoing concerns about fiscal sustainability in Colombia; although our models point to some stability in the USDCOP cross in the 3650–3720 range, our bias is toward greater volatility in the COP.

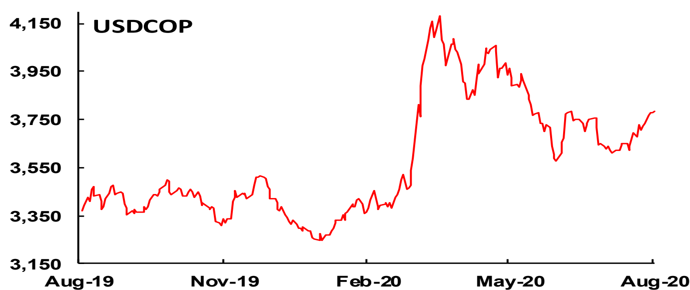
CHILE — The Chilean peso is heading back to this year's highs as signs of recovery in China push copper prices up to levels close to 2.9 USD/lb. Pension fund managers have started to sell offshore holdings and bring assets back to Chile, which is providing some additional support to the CLP. Assuming that (1) the health crisis starts to fade during Q3-2020; (2) the AFPs' flows begin to normalize toward the end of the year; and (3) uncertainty related to the constitutional referendum in October comes to the fore, we expect the Chilean peso to close the year around USDCLP 750.

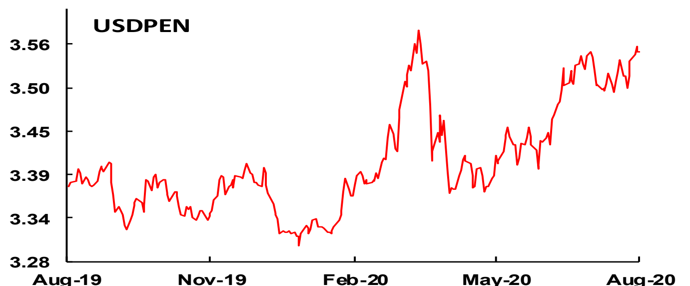
PERU — The Peruvian sol has spent appreciable time above USDPEN 3.50, despite broader US dollar weakness. The demand for USDs does not come from outflows offshore nor local pension funds, but, instead, is linked to the huge PEN-denominated resources coming from the REACTIVA program. Parts of these resources are being used by local interests to purchase USDs and re-establish a balance between the two currencies, but this should not last. Although political events give us some pause, with Peru's terms of trade strengthening we are maintaining our year-end forecast at USDPEN 3.45.

Currency Trends

FX Rate	Spot 06-Aug	20Q1a	20Q2a	20Q3f	20Q4f	21Q1f	21Q2f	21Q3f	21Q4f
USDMXN	22.45	23.67	22.99	23.52	24.33	24.46	24.29	24.17	24.23
USDCOP	3785	4065	3758	3709	3654	3473	3465	3458	3450
USDCLP	784	854	821	740	750	740	740	730	720
USDPEN	3.54	3.43	3.54	3.47	3.45	3.47	3.52	3.46	3.40







Pacific Alliance

Fundamental Commentary

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MEXICO — Even before concerns about the COVID-19 pandemic began, various economic indicators published in Q1-2020 were weaker than expected. Later, in Q2-2020, economic activity shrank strongly (-18.9% y/y) following lockdown measures in April and May. In particular, industrial activity declined for a seventh quarter (-26.0% y/y), services contracted for a fifth time (-15.6%), and agriculture dropped mildly (-0.7% y/y). Mexico lost 921k formal jobs during H1-2020, largely due to the impact of COVID-19 control measures. Additionally, in April, private consumption printed its weakest growth rate on record since 1993 (-22.3% y/y) and gross fixed investment fell for a 15th consecutive month (-36.9% y/y). These results reaffirm our outlook for weak consumption and investment growth during 2020 as high uncertainty and negative income shocks are likely to foster cautious consumer and investor behaviour. In sum, despite the re-opening of some sectors, most aspects of economic activity continue showing strong deteriorations. Therefore, we foresee a GDP contraction of -9.1% y/y in 2020 and a mild upturn of 3.1% y/y in 2021 as the pandemic and related uncertainty effects last through all of 2020. We also foresee a sharp decrease in job creation that will leave 1.6 mn in formal job loses in 2020. Finally, annual headline inflation should remain close to the upper bound of the Banco de Mexico's tolerance range for end-2020 and end-2021 at 3.7% y/y and 3.9% y/y, respectively, while core inflation should also show some persistence with 3.7% y/y projected for end-2020.

COLOMBIA — The government's response to the COVID-19 shock in Colombia has been strong and the country has now passed through more than 120 days of lockdown with slow re-opening strategies being implemented from April. Unfortunately, the toll on economic activity is huge and could imply a -7.5% y/y fall in GDP during 2020 and a possible gradual rebound of around 5% y/y in 2021. Lower tax collections and higher social expenditures have led the government to suspend the fiscal rule and take the target public deficit to -8.1% of GDP this year and a projected -5.2% of GDP next year. This implies that the debt to GDP ratio will increase to around 65% of GDP in 2020. In the meantime, BanRep has reduced its policy rate to 2.25% and has taken liquidity measures to ensure financial system stability. We think liquidity measures will continue, while the space for further cuts is limited. Recent BanRep communications are in line with one more -25 bps cut in the policy rate to 2.00% with a long hold afterward. We expect the current dip in inflation to be temporary and we anticipate that the headline rate will rebound to around 1.9% y/y by end-2020 and 3.1% by end-2021 as economic activity next year begins to close the output gap. To keep markets and investors calm, Colombia will need to pass a significant fiscal reform that improves next year's primary balance by at least 2 ppts of GDP, but we don't discount the possibility that Colombia could anyway lose investment-grade status next year.

CHILE — The Chilean economy finished its worst quarter in Q2-2020 with a -14% y/y fall amid strict confinement measures across the country and semi-paralysis in almost half of industrial activities. Retail, construction, and services have been the sectors hit hardest by the pandemic. At the margin, monthly economic activity in June showed the first signs of recovery, with seasonally adjusted sequential growth in non-mining activity of 1.7% m/m, which implies that May saw the worst month for economic activity this year. We forecast a fall of -6.0% y/y in GDP in 2020 and a recovery of 4.4% y/y in 2021. The central bank and the government have acted together to provide significant measures to compensate for pandemic control efforts, including the addition of liquidity to markets and expansions in public expenditure. In addition, the move to allow the withdrawal of 10% of pension funds in individual retirement accounts should also support the recovery as most of these funds are likely to be destined for private consumption. Hence, we put an upward bias on our GDP growth forecast for 2020. In the labour market, the unemployment rate reached 12.2% in June, mainly explained by the sharp drop in employment (-20% y/y) that was mitigated somewhat by the decline in the workforce (-15.4% y/y). We expect the central bank to revise its assessment of the "technical minimum" for the monetary policy rate—currently at 0.5%—and bring the floor down to 0.25% in September. We also project an inflation print of 2.2% y/y for year-end as the economy starts to re-open and consumption starts to pick up as Chileans spend their withdrawn pension funds.

PERU — With the release of economic activity data for April (-40.5%) and May (-32.8% y/y) and the initiation of the unlocking process, we now have enough information to provide more precise real GDP forecasts. For 2020 we now forecast a -11.5% y/y contraction, replacing our previous range of -9% y/y to -14% y/y; our forecast for 2021 is 8.7% y/y real GDP growth. In the nearer term, we expect the level of real GDP in Q3-2020 to be 35% greater than in Q2-2020 as most of the economy has been unlocked. Still, some activities will return more gradually, depending on market demand. Peru's terms of trade provide one significant source of strength: they turned positive in May and continue to improve. With gold prices at record levels and copper moving in a robust range, metal prices should largely compensate for the impact of the lockdown on mining production volumes. Our forecast of a USD 5.3 bn trade surplus for 2020 combined with record net international reserves, currently at USD 75 bn, should provide medium-term fundamental support to the PEN. Inflation ramped up to 1.9% y/y in July, albeit due to a one-off event, which keeps our 1.1% y/y end-2020 forecast in play. The BCRP has maintained its reference rate at 0.25% since April and we don't expect any change until late-2021 at the earliest. Peru faces plenty of risks, but the erratic and confrontational behaviour of Congress dominates our current concerns. In an unprecedented move, Congress denied the newly formed Cateriano Cabinet a vote of confidence. Sadly, there is little reason to believe that political tension will diminish any time soon.

Emerging Economies

Currency Outlook

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SOUTH KOREA — South Korea's exports, one of the most important economic indicators in the world, fell the slowest in four months and beat market expectations. Improving global trade outlook will be supportive of the export-driven KRW. In addition, portfolio flows and trade-related flows will continue dominating daily movements in the KRW exchange rate. USDKRW is likely to head for 1,180 if falling below the 1,190 support level this month.

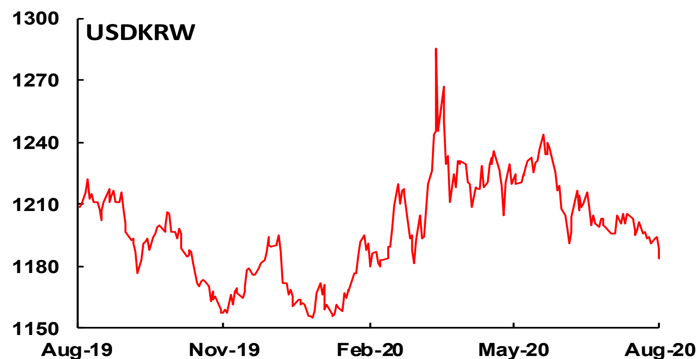
THAILAND — The THB's strength has raised regulators' concerns. The BoT is considering severing the link between gold trading and the baht as one way to curb the currency's gains. In late July, the BoT said that it doesn't manage the currency to gain unfair competitive advantage over the US and intervention has been two-way depending on the intensity of the capital flows. USDTHB is expected to head for 31.0 and to breach this mark in August.

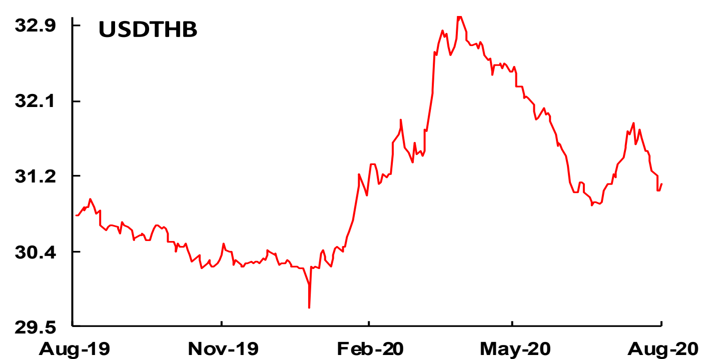
TAIWAN — Taiwan has managed to contain the COVID-19 outbreak better than other economies in the region, supportive of the TWD. The island has been benefiting from increasing demand for some of its products resulting from the pandemic, including online learning and work-from-home needs. We also see continued investment repatriation on concerns over supply chain disruption due to the pandemic and renewed US-China tensions. USDTWD will decline gradually towards 29.2 in August.

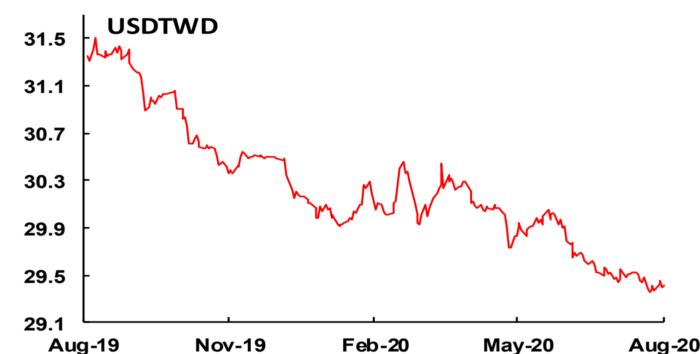
MALAYSIA — The MYR will remain susceptible to a broad market sentiment, following movements in the local equities and the CNH in general. In addition, the BNM data showed foreign holdings of Malaysian government and corporate bonds and bills rose 6.2% to MYR 198.9 bn in June from a month ago. USDMYR is expected to trade towards 4.20 and even lower levels in the rest of the month. Meanwhile, we keep a close eye on domestic political situation.

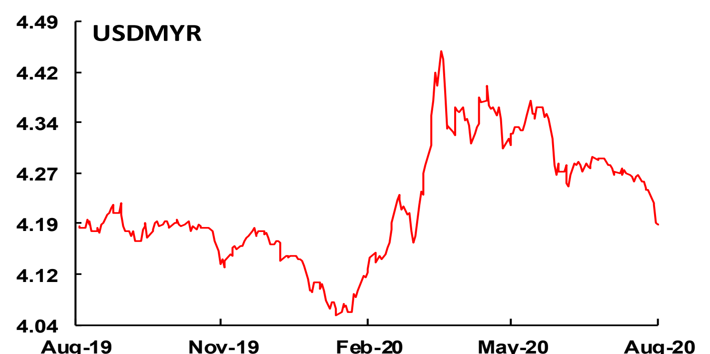
Currency Trends

FX Rate	Spot 06-Aug	20Q1a	20Q2a	20Q3f	20Q4f	21Q1f	21Q2f	21Q3f	21Q4f
USDKRW	1184	1219	1203	1220	1220	1200	1200	1180	1180
USDTHB	31.1	32.8	30.9	31.5	31.5	31.0	31.0	30.0	30.0
USDTWD	29.4	30.3	29.6	29.4	29.4	29.2	29.2	29.0	29.0
USDMYR	4.19	4.32	4.29	4.25	4.25	4.20	4.20	4.10	4.10









Emerging Economies

Fundamental Commentary

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SOUTH KOREA — South Korea is in recession; real GDP declined by 3.3% q/q in Q2, following a 1.3% drop in the prior quarter. In year-over-year terms, output contracted by 2.9% (versus +1.4% y/y in Q1). We expect the economy to rebound in the second half of 2020, yet the recovery will be gradual given weaker labour market conditions and muted global demand dynamics. We assess that South Korea's real GDP growth for 2020 as a whole will remain in negative territory of around 1½%. South Korea's economic recovery will be underpinned by expansionary policies. We expect near-term policy efforts to focus on fiscal measures instead of monetary stimulus. Fiscal policy is becoming increasingly expansionary; in mid-July, the Korean government announced the "K-New Deal", a stimulus package worth KRW 160 tn (to be spent through 2025) that will seek to create jobs and boost economic growth. The Bank of Korea (BoK) has cut the benchmark interest rate by a total of 75 basis points this year. The latest cut took place following the monetary policy meeting on May 28, when the BoK lowered the Base Rate by 25 bps to 0.50%. On July 16, the BoK left monetary policy on hold. We do not expect any further rate cuts over the foreseeable future; indeed, BoK Governor Lee Ju-yeol has pointed out that the benchmark interest rate is now close to the effective lower bound. Nevertheless, should substantial economic weakness persist, the BoK may later opt to use unconventional policy tools, such as quantitative easing to keep long-term interest rates low. For the time being, the central bank is buying government bonds in the secondary market only to manage bouts of volatility.

THAILAND — The Thai economy is suffering from the adverse impacts of the COVID-19 pandemic as both domestic and external demand conditions remain weak. Tourist arrivals have come to a halt while the country's exports continue to be almost 25% below year-earlier levels. Accordingly, both business and consumer confidence indicators remain weak. We expect a gradual pickup in activity to take place in the second half of 2020 yet the recovery will remain relatively muted until the country's borders will open. We forecast Thailand's real GDP to contract by around 6% in 2020, followed by a rebound to 4.2% in 2021. The Bank of Thailand (BoT) is assisting the economy with accommodative monetary policy. The benchmark interest rate was lowered by 25 bps to 0.50% in May, taking accumulative rate reductions to 100 bps since November 2019. We assess that the BoT's easing cycle may not be over yet; we forecast that the central bank will implement another 25 bps cut following its September meeting, reflecting the fact that deflationary pressures persist on the back of subdued demand conditions; the consumer price index declined by 1.6% y/y in June. Fiscal stimulus complements the BoT's monetary easing; according to the IMF, announced fiscal measures are equivalent to 12% of GDP.

TAIWAN — Compared with most other countries, Taiwan has been able to manage the virus outbreak well, with relatively little damage to the economy. According to preliminary estimates, Taiwan's economy contracted by 0.7% y/y in Q2 following a 1.6% gain in Q1. Consequently, Taiwan may be able to record a positive real GDP growth figure in 2020 as a whole. The Taiwanese central bank will likely leave monetary policy unchanged in the foreseeable future. The benchmark interest rate was lowered by 25 bps to 1.125% in March. We do not foresee further rate cuts over the coming months as the central bank gives priority to preserving policy space for potential future downside shocks. Deflationary pressures have dominated since February, with the consumer price index declining by 0.5% y/y in July.

MALAYSIA — The Malaysian economy has been recovering since early-May when the gradual easing of COVID-19 containment measures began. Nevertheless, real GDP growth will likely prove to be deeply negative in the second quarter of 2020, as the Movement Control Order constrained production and spending while recessionary conditions globally adversely affected the country's exporters. While we expect the economy to recover in the second half of the year, the rebound is unlikely to be strong enough to offset the lost output in the first half. Accordingly, we forecast Malaysia's real GDP to contract by around 4% in 2020 with significant downside risks. In 2021, economic growth will likely rebound to 5½% y/y on the back of base effects, pent-up demand, and the lagged impact of expansionary fiscal and monetary policies. Bank Negara Malaysia (BNM) continues to provide support to the Malaysian economy with additional monetary stimulus. In July, the BNM lowered the Overnight Policy Rate by 25 bps to 1.75%, taking cumulative cuts to 125 bps since January 2020. Headline consumer price index has been in deflationary territory since March, decreasing by 1.9% y/y in June. Low commodity prices and non-existent demand-driven price pressures amid weakening labour market conditions will likely lead to further price declines. Persistent deflation over the coming months will keep the benchmark interest rate elevated in real terms, providing the BNM with additional monetary easing space if needed. We assess that one more interest rate cut of 25 bps is likely before the end of the year.

Global Currency Forecast (end of period)

		2020f	2021f	2020f				2021f			
Major Currencies				Q1a	Q2a	Q3	Q4	Q1	Q2	Q3	Q4
Japan	USDJPY	105	102	108	108	105	105	104	104	102	102
Euro zone	EURUSD	1.18	1.21	1.10	1.12	1.18	1.18	1.20	1.20	1.21	1.21
	EURJPY	124	123	119	121	124	124	125	125	123	123
UK	GBPUSD	1.29	1.33	1.24	1.24	1.28	1.29	1.30	1.31	1.32	1.33
	EURGBP	0.91	0.91	0.89	0.91	0.92	0.91	0.92	0.92	0.92	0.91
Switzerland	USDCHF	0.92	0.91	0.96	0.95	0.92	0.92	0.91	0.91	0.91	0.91
	EURCHF	1.08	1.10	1.06	1.06	1.08	1.08	1.09	1.09	1.10	1.10
Americas											
Canada	USDCAD	1.32	1.28	1.41	1.36	1.34	1.32	1.30	1.30	1.28	1.28
	CADUSD	0.76	0.78	0.71	0.74	0.75	0.76	0.77	0.77	0.78	0.78
Mexico	USDMXN	24.33	24.23	23.67	22.99	23.52	24.33	24.46	24.29	24.17	24.23
	CADMXN	18.43	18.93	16.84	16.95	17.55	18.43	18.82	18.68	18.88	18.93
Brazil	USDBRL	5.26	5.03	5.21	5.47	5.31	5.26	4.88	4.96	5.07	5.03
Chile	USDCLP	750	720	854	821	740	750	740	740	730	720
Colombia	USDCOP	3,654	3,450	4,065	3,758	3,709	3,654	3,473	3,465	3,458	3,450
Peru	USDPEN	3.45	3.40	3.43	3.54	3.47	3.45	3.47	3.52	3.46	3.40
Asia-Pacific											
Australia	AUDUSD	0.71	0.75	0.61	0.69	0.71	0.71	0.73	0.73	0.75	0.75
China	USDCNY	7.05	6.90	7.08	7.07	7.05	7.05	7.00	7.00	6.90	6.90
Hong Kong	USDHKD	7.75	7.80	7.75	7.75	7.75	7.75	7.80	7.80	7.80	7.80
India	USDINR	74.0	72.0	75.6	75.5	74.0	74.0	73.0	73.0	72.0	72.0
Indonesia	USDIDR	15,000	14,000	16,310	14,265	15,000	15,000	14,500	14,500	14,000	14,000
Malaysia	USDMYR	4.25	4.10	4.32	4.29	4.25	4.25	4.20	4.20	4.10	4.10
New Zealand	NZDUSD	0.67	0.70	0.60	0.65	0.67	0.67	0.68	0.68	0.70	0.70
Philippines	USDPHP	49.5	48.0	50.7	49.8	49.5	49.5	49.0	49.0	48.0	48.0
Singapore	USDSGD	1.38	1.34	1.42	1.39	1.38	1.38	1.36	1.36	1.34	1.34
South Korea	USDKRW	1220	1180	1219	1203	1220	1220	1200	1200	1180	1180
Taiwan	USDTWD	29.4	29.0	30.3	29.6	29.4	29.4	29.2	29.2	29.0	29.0
Thailand	USDTHB	31.5	30.0	32.8	30.9	31.5	31.5	31.0	31.0	30.0	30.0

f: forecast a: actual

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