December 16, 2020

AMERICAS

USD weakness has extended more rapidly than we expected but we see little chance of a reprieve in the coming year. Relatively slower growth and low interest rates will continue to drive investors towards alternatives. The CAD will remain firm, supported by rising commodity prices. Latam currencies should benefit modestly from rebounding growth, low inflation and some fiscal consolidation.

EUROPE

Near-term prospects for both the EUR and GBP will be influenced by seemingly never-ending Brexit talks. The EUR is, however, benefitting from USD outflows amid positive growth prospects while a lot of bad news is already factored in to the GBP.

ASIA-PACIFIC

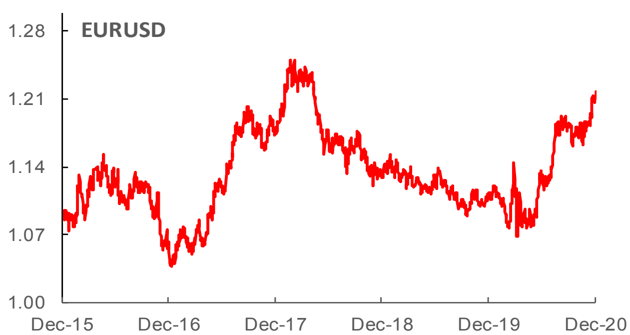
China's economic recovery remains intact and supports the outlook for additional CNY gains. Rebounding global growth will support regional exporters' currencies. We see modest upside potential for the JPY through 2021.

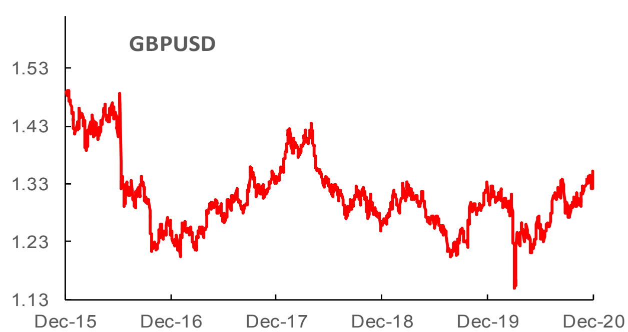
CONTENTS

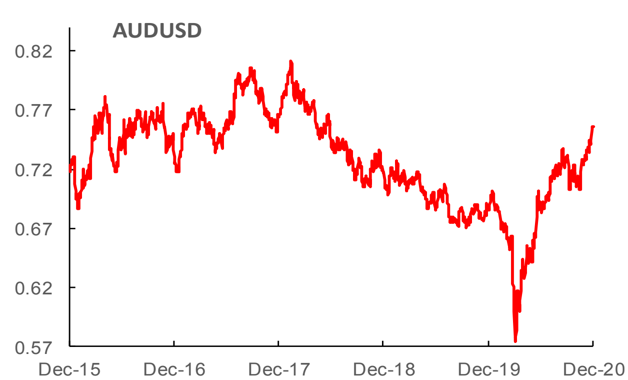
Core Exchange Rates

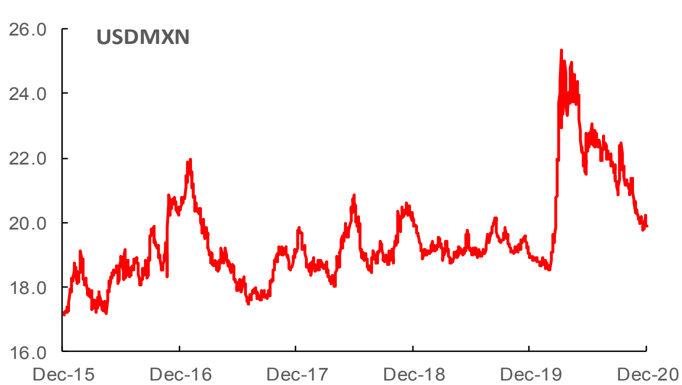
Global Foreign Exchange Outlook

December 16, 2020	Spot	2020f Q1a	2020f Q2a	2020f Q3a	2020f Q4	2021f Q1	2021f Q2	2021f Q3	2021f Q4
EURUSD	1.22	1.10	1.12	1.17	1.18	1.20	1.20	1.21	1.21
USDJPY	104	108	108	105	105	104	104	102	102
GBPUSD	1.35	1.24	1.24	1.29	1.29	1.30	1.31	1.32	1.33
USDCAD	1.27	1.41	1.36	1.33	1.32	1.30	1.30	1.28	1.28
AUDUSD	0.76	0.61	0.69	0.72	0.71	0.73	0.73	0.75	0.75
USDMXN	19.86	23.67	22.99	22.11	20.75	21.90	22.69	23.53	23.86









Market Tone & Fundamental Focus

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The US dollar (USD) is finishing a tumultuous 2020 on the defensive. USD losses have accelerated in the wake of the US Presidential election, partly reflecting reduced demand for safety as US equity markets have reached record highs despite some of the residual uncertainties that the election outcome produced. The US Presidential election result has prompted hopes that global trade and geo-political tensions will abate—although that is perhaps not a given, in the immediate future, at least—adding to pressure on the USD. Relatively slow growth and low domestic (real and nominal) interest rates remain a drag on the USD—and a threat to its longer run outlook, especially as structural (current account and budget deficit) challenges may re-emerge in the months and years ahead.

The sharp USD sell-off has taken some key currencies to levels last seen two years or more ago and to points we had not anticipated them reaching until the end of next year. The rapid USD decline through Q4 (nearly 5% in broad terms) leaves it looking somewhat oversold in the short run. Currency appreciation is also a challenge for central banks outside of the US that are trying to steer their own economies out of the COVID-19-driven slump. It is possible that the USD decline moderates, or even reverses somewhat, through the turn of the year but we expect the general softness to persist in the longer run and feel that modest USD gains through Q1 2021 will quickly give way to renewed losses. We will review our FX forecasts early next year.

Strengthening risk appetite and expectations that economic normalization will follow, as vaccines are rolled out in the coming year, are supporting commodity prices and commodity-related FX. Oil prices are firm and industrial metals prices (copper, iron ore) have risen strongly, reflecting the strengthening growth in China. The CAD has benefitted from these trends through Q4, rising to its highest point against the USD since early 2018, and more or less in line with the Australian dollar (AUD). The New Zealand dollar (NZD) is the top G10 performer through Q4 so far. The CAD has, however, lagged behind its major currency peers and, while the CAD rebound against the USD is impressive relative to the March low near 1.47, it has only gained modestly in YTD terms. We expect the CAD to remain firm in the coming year, putting it at risk of strengthening beyond our current end-2021 target of 1.28.

Similar factors—a generally weaker USD and firmer commodity prices—have lent some support to currencies elsewhere in the Americas, although regional exchange rates have failed to recover as quickly from the pandemic-driven losses as their G10 peers. Higher oil prices have lifted the Mexican peso (MXN) and Colombian peso (COP) significantly (more than 10%) in the current quarter, however. Surging copper prices have lifted the Chilean peso (CLP). The Peruvian sol (PEN) has steadied after the political instability seen earlier in the year but may retain a defensive posture ahead of April's elections. We forecast regional growth to rebound in the coming year and expect these currencies to benefit modestly from improving growth, low inflation and gradual fiscal consolidation in a generally soft US dollar environment.

The euro (EUR) has also out-paced our expectations, easily reaching above 1.21 against a weaker USD in the past few weeks. The EUR has benefitted from rebalancing of asset allocations, given the reduced yield and growth support enjoyed by the USD. US investors appear to be increasing investments to Eurozone equities on an unhedged FX basis. While renewed COVID-19 restrictions will dampen growth in early 2021, European Central Bank policy remains highly accommodative and longer run growth prospects remain supported by the European Recovery Fund which also serves to support EUR sentiment in the longer run by strengthening fiscal solidarity and easing Eurozone break up concerns. The outlook for the pound (GBP) remains fluid, with the precise trade framework which will govern the UK's trade relationship with the EU after Brexit at the end of the month still to be determined. It remains unclear whether a trade deal can be reached, however. No deal will be negative for the GBP—and the EUR, to an extent—while a last-minute agreement will leave both sides of The Channel under-prepared for the new regime. We expect any early year EUR softness to remain relatively contained. And we also feel that a lot of bad news is already factored into the GBP, tilting medium term risks towards the topside and suggesting shorter term weakness may be limited to the 1.25/1.27 area.

In Asia, Japan's strong structural position and creditor-nation status will support the yen (JPY), especially while interest rate differentials with the US remain compressed. The JPY will remain in demand in phases of heightened market tensions as a consequence of its strong external balance. China's strong and steady economic recovery from this year's low point—as well as relatively attractive domestic interest rates—has supported a rebound in the yuan (CNY). Expectations that US/China trade relations will drastically improve under President-elect Biden may yet prove premature but the risk of a further ratcheting up of trade tensions has been removed. We remain constructive on the CNY outlook for the coming year and anticipate further gains versus the USD. Economic fundamentals are improving in the other regional, export power-houses and currencies such as the Korean won (KRW), Singapore dollar (SGD) and Taiwanese dollar (TWD) should be supported by strengthening global activity and the rising CNY.

Canada

Currency Outlook

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The rebound in the CAD against the USD has brought the spot rate to just below 1.28, the highest level since April 2018. While the CAD remains heavily influenced by the overall risk backdrop in the short run—and US equity markets rising to record highs are clearly supportive in this context—we think the CAD rally looks more or less justified by broader fundamentals, not least the rebound in commodity prices and the subsequent improvement in Canada terms of trade.

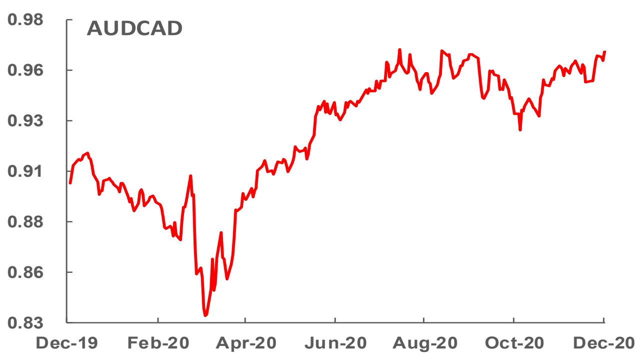
The economic backdrop is mixed; on the one hand, employment trends have been healthy and prices appear somewhat sticky, which may leave the Bank of Canada (BoC) reluctant to ease policy further. On the other, second wave effects risk undermining the economic momentum that developed since mid-year and foreign investors may eye the large (through not unusual, in the current international environment) fiscal imbalances that the Federal government’s support for the economy is producing.

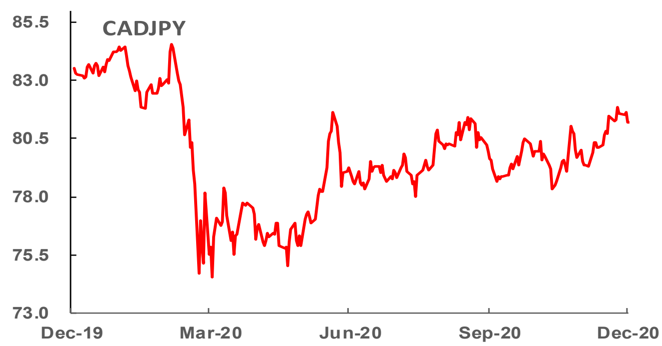
Speculative traders remain bearish on the CAD and have maintained a short position on the currency since the March low, regardless of its steady rebound since. More recently, markets have pondered whether BoC policy makers would push back against the latest uptick in the CAD. We think that is unlikely because CAD gains have been orderly, reflect a general decline in the USD and (as we note above) are broadly supported by the fundamental backdrop.

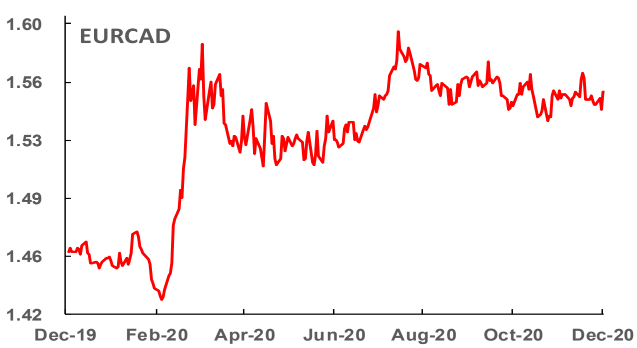
We do think the CAD’s rise may slow or stall over the holiday period and we note an historic tendency for USDCAD to rally somewhat early in Q1 of the calendar year. We think USDCAD rebounds to the 1.29/30 area—if indeed the USD can reach that high—will attract renewed USD selling, however.

Canadian Dollar Cross-Currency Trends

FX Rate	Spot 16-Dec	20Q1a	20Q2a	20Q3a	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	81.2	76.5	79.5	79.2	79.5	80.0	80.0	79.7	79.7
EURCAD	1.55	1.55	1.53	1.56	1.56	1.56	1.56	1.55	1.55
USDCAD	1.27	1.41	1.36	1.33	1.32	1.30	1.30	1.28	1.28







United States and Canada

Fundamental Commentary

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UNITED STATES — The so-called "inevitable" second wave of COVID-19 continues to roll through the US and appears some way from cresting. We expect public-health restrictions to dampen growth in Q4-2020 and Q1-2021 before wide-spread vaccine distribution adds a boost to the recovery in Q2-2021 and Q3-2021. Even with new contagion-control measures, we have raised our 2020 growth forecast from -3.9% y/y in our October projections to -3.6% y/y in our December outlook; similarly, our expectation for the recovery in 2021 has edged up from 4.0% y/y to our current forecast of 4.1% y/y. Our baseline scenario for 2021 reflects an assumption that a government shutdown is avoided, and a basic COVID-19 relief package on the order of at least USD 500 bn is agreed during the lame-duck session. Possible additional fiscal support to households and businesses in the coming days and after January's Presidential inauguration presents an upside risk. Inflation is expected to remain steady and end 2020 at 1.7% y/y, before rising gently to 2.1% y/y at end-2021.

CANADA — After Q3-2020's 40.5% q/q saar expansion, growth is expected to fall to 1.5% q/q saar in Q4-2020 owing to the revival of lockdown measures; the boost from vaccines is unlikely to be felt until Q2-2021. Compared with our October forecasts, our real GDP projection for 2020 still contemplates a contraction of -5.7% y/y, but looking toward 2021, our December outlook sees the rebound coming in a hair less robustly at 4.0% y/y versus 4.1% y/y previously. The additional spending measures announced in the Fall Economic Statement and those foreshadowed for the spring 2021 Federal Budget are forecast to lift activity only in the latter part of 2021. We expect employment to lag the broader gains in economic output as labour-intensive services are likely to be the last segments to re-open fully: unemployment rates are set to remain above pre-pandemic levels until end-2022. Headline inflation is projected to end 2020 at 0.8% y/y, though core inflation should remain higher at 1.7% y/y; we see headline inflation heading up to 1.9% y/y at 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 2020-22 print forecast horizon. The fact that the Fed—unlike others such as the BoC—has shifted toward allowing a modest inflation overshoot for some time after achieving the 2% target probably means that policy tightening will be delayed compared to past cycles. How the Fed guides potential alterations to its US$80B/month Treasury and US$40B/month MBS purchase programs is likely to be influential to global markets over the coming year. Guidance has transitioned from fostering only "smooth market functioning" toward this goal plus keying purchases off qualitative assessments of economic conditions including the path to full employment and a mild and temporary overshoot of its 2% inflation target. We think the Fed will likely begin to taper its purchases by late 2021 or early 2022 and move toward ceasing purchases and reinvesting about one year later. Striking and implementing a material fiscal stimulus deal as a last chance until the new Congress convenes in January is likely more important to the outlook than anything the Fed can do from here. At the moment, we maintain a favourable outlook toward the prospects for a material deal followed by additional stimulus in 2021H1.

CANADA — The Bank of Canada overnight rate is forecast to remain at 0.25% throughout 2020-22 but with rising risk that hike guidance may be brought forward into 2022 along with earlier tapering of bond purchases. Speculation has risen toward a token 10-15bps rate cut early in 2021 that, while not impossible, appears to be unlikely at this point. The BoC has stated that such a move would require developments to take "a more persistent turn for the worse" and that the idea is "not something that is at the forefront yet, it's just a possibility." It would require the BoC to once again revisit its definition of the effective lower bound after prior communications have caused confusion. Parallels are drawn to the RBA after it cut by 15bps to 0.1% in early November in a move that pre-dated vaccine optimism, but Australian core inflation is much further beneath a higher headline target range than is the case for the Bank of Canada. The RBA's decision was followed by ongoing appreciation of the A$ as other currency drivers have dominated so that a modest rate cut has been ineffective at softening the currency. Further, Canada's winter federal budget is likely to add further stimulus after Canada has already generously extended COVID-19 support programs. A probable order of operations is expected to drive a further reduction of the BoC's C$4B/week Government of Canada bond purchase program by mid-2021 and additional tapering on the path toward ending purchases sometime in late 2021 or early 2022 and then shifting to reinvestment of coupon and maturing flows. This would be consistent with the output gap measure of spare capacity closing around mid-2022 and hence earlier than the BoC guided before vaccines, given guidance that purchases would end before such a point. This framework would be consistent with hiking the policy rate around mid-2022 which would be earlier than the BoC's now stale projections indicated in October.

G10

Currency Outlook

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EUROZONE — The shared currency's gains through Q4 have pushed it to its highest mark since April 2018 while lagging most of its major peers through the quarter amid regional virus restrictions and as commodity currencies play catch-up. Recent price action suggests the EUR is in a brief consolidation phase as the currency bobs around 'overbought' across various technical studies but ultimately looks set to resume its upward trajectory past 1.22 and into its early-2018 congestion band capped at ~1.2500.

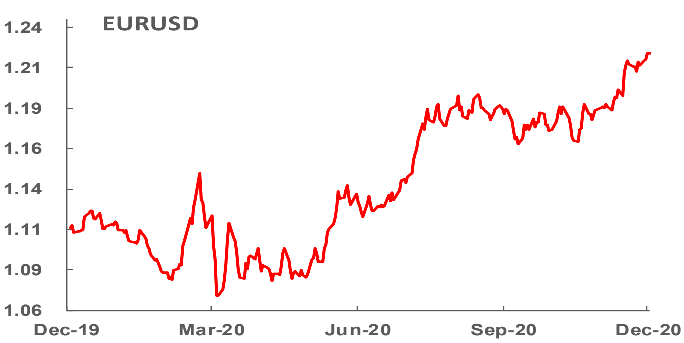
UNITED KINGDOM — The GBP remains at risk of sharp moves to close out the year with EU-UK negotiations showing limited signs of heading toward a trade agreement. Sterling volatility currently stands at its highest since the height of market panic in March and will likely remain elevated until year-end as deadlines quickly approach. We believe the GBP is gearing up for a sharp decline toward or below the 1.30 mark upon a final announcement that trade discussions have concluded without a deal; upside remains limited (1.36) given the still-low odds of a deal.

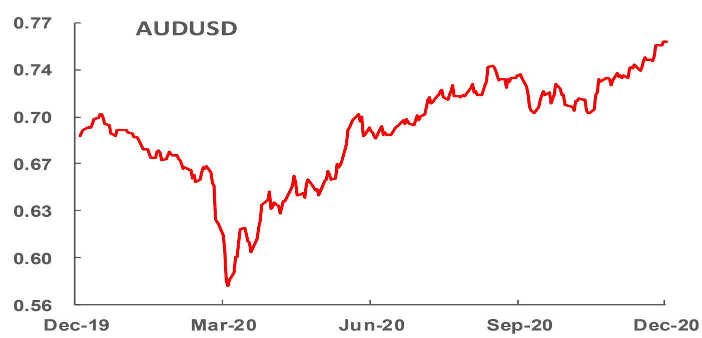
JAPAN — The yen's strengthening trajectory since April has recently stalled as USDJPY crosses below 104, with the mark (and high 103s) likely to keep a grip on the JPY in the short-term before gains resume. The JPY is on track to post the smallest increase versus the USD for the quarter as haven-driven flows fade but the broad shift away from the USD (with a reduced yield advantage) is set to prolong the yen's long-term run toward the 100 level.

AUSTRALIA — The AUD has surged above the 75 cents mark on the vaccine-led revival in risk appetite and a spike in raw material prices with increased global demand (namely China). Strong economic growth in Asia Pacific and a well-contained outbreak at home have increased the appeal of the AUD while the RBA expresses little concern over the currency's valuation. We expect that the AUD's gains will extend next year in line with a continued rise in commodity prices and a broad risk-motivated move away from the USD.

Currency Trends

FX Rate	Spot 16-Dec	20Q1a	20Q2a	20Q3a	20Q4f	21Q1f	21Q2f	21Q3f	21Q4f
EURUSD	1.22	1.10	1.12	1.17	1.18	1.20	1.20	1.21	1.21
GBPUSD	1.35	1.24	1.24	1.29	1.29	1.30	1.31	1.32	1.33
USDJPY	104	108	108	105	105	104	104	102	102
AUDUSD	0.76	0.61	0.69	0.72	0.71	0.73	0.73	0.75	0.75





G10

Fundamental Commentary

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EUROZONE — The Eurozone's macroeconomic outlook has waxed and waned with the retreat and resurgence of the COVID-19 pandemic on the continent, but its 2020 growth prospects have broadly trended upward over the last few months, validated most recently by a strong gain in December PMIs. While our October outlook foresaw a contraction of -8.3% y/y in real Eurozone GDP during 2020, our December forecasts pared this loss to -7.5% y/y. But what our forecasts gained in 2020, they gave back in projections for 2021, where our expected rebound was shaved from 5.3% y/y to 4.8% y/y. Our outlook for inflation is barely changed with 0.4% y/y pencilled in for end-2020 and 0.9% y/y at end-2021. A so-called "skinny" free-trade agreement with the United Kingdom is likely to leave unresolved some frictions in goods trade and more substantial barriers to cross-Channel services trade. Nevertheless, any drag on future growth would be more substantial for the UK than the Eurozone: about 45% of British goods exports go to the EU, while only about 5% of EU goods exports are typically destined for the UK, with France and Germany amongst the European economies most tied to UK demand.

UNITED KINGDOM — We've never had high hopes for this year's Brexit negotiations, and these low expectations have been more than realized: a fully-fledged trade compact with Europe and a settlement on the status of Northern Ireland are likely to remain pending agenda items into 2021 even if initial deals are concluded before the holidays. With trade, the devil is always in the details. This dim view of the UK's prospects is compounded by Westminster's uneven response to the COVID-19 pandemic. We already anticipated in our October forecasts a nearly double-digit -9.7% y/y real contraction in the UK's economy during 2020; with recent developments and data, we marked this forecast down further to -11.1% y/y in our December outlook. Despite the rollout of vaccines ahead of earlier expectations, we've also shaved the 2021 rebound from 5.9% y/y to 5.2% y/y in a reflection of our sense that underlying potential has taken a deeper hit than we previously expected from the Brexit saga and the pandemic. These growth prospects could prompt additional fiscal measures. Price pressures are set to remain muted, with headline inflation ending 2020 at 0.8% y/y, followed by a rise to only 1.3% y/y by end-2021.

AUSTRALIA — An economic recovery is underway in Australia following a recession in the first half of 2020. Real GDP grew by 3.3% q/q (non-annualized) in Q3 following a 7.0% drop in the prior quarter. Consumer spending was the key driver of activity, while fixed investment remained weak. Business outlays will play a critical role in taking Australia's recovery onto a sustainable footing. Net exports were a drag on growth in Q3. Escalating tensions with China pose one of the main downside risks to the Australian outlook as China is Australia's most important export market. We estimate that Australia's real GDP will decline by 3.1% in 2020, followed by growth rates of 2.8% and 2.6% in 2021 and 2022, respectively. The Reserve Bank of Australia (RBA) kept monetary policy on hold following its most recent policy meeting on December 1. At the November meeting, the RBA unveiled additional stimulus by cutting the benchmark cash rate by 15 bps to 0.10% and lowering the target for the 3-year Australian government bond yield and the Term Funding Facility rate by the same magnitude to 0.10%. Moreover, the RBA announced a new element to its stimulus program; the central bank will purchase AUD 100 bn of government bonds of maturities around 5-10 years over the following six-month period. The RBA will continue its yield targeting, buying bonds "in whatever quantity" to achieve the 0.10% target. These purchases are complemented by the pledge to buy longer-dated bonds, making its bond purchase program more in line with quantitative easing efforts conducted in various other advanced economies. We do not expect any further policy adjustments over the coming months.

JAPAN — The Japanese economy is recovering. Real GDP rebounded by 5.3% q/q (non-annualized) in Q3, following an 8.3% decline in Q2. In year-over-year terms, activity contracted by 5.7% after a 10.3% decline in Q2. Consumer spending, public outlays, and net exports recorded solid gains while fixed investment growth remained negative. The economy will likely shrink by 4.9% in 2020 and rebound by 3.0% y/y and 1.0% in 2021 and 2022, respectively. The Bank of Japan's (BoJ) ultra-accommodative monetary policies will remain in place over the foreseeable future. The policy rate is expected to stay at -0.1% while "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control" will be continued, keeping the 10-year JGB yield at around 0% via the BoJ's government bond purchases. The central bank has stated that it expects short- and long-term policy interest rates to remain at their present or lower level for the time being. Simultaneously, fiscal policy is supportive; the government approved a fresh stimulus package of ¥73.6 trillion on December 8. Deflation has recently re-emerged and will likely remain in place over the coming months. We assess that the BoJ's 2% annual inflation target is unachievable in 2021-2022 on the back of a strengthening yen, low international energy prices as well as weak demand-driven price pressures that result from significant economic slack and low wage gains. The CPI excl. fresh food—the BoJ's preferred inflation measure—declined by 0.7% y/y in October.

China, India, Brazil
Currency Outlook

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CHINA — China will continue leading the global economic recovery into the first quarter of 2021, with factory activity expanding for the ninth consecutive month in November. We are still bullish on the yuan and anticipate further weakness in the USD In the months ahead towards 6.40. China announced on 11 December that the macro-prudential policy adjustment parameter for banks and non-banking financial institutions' cross-border financing has been lowered to 1.00% from 1.25% previously which may slow CNY gains somewhat.

INDIA — India's economic recovery is gaining momentum and will accelerate next year, fuelling more equity inflows. Meanwhile, the nation's inflation is expected to fall back into the RBI-mandated 2-6% range in the coming months, which would raise real yields of rupee-denominated bonds. The central bank may tolerate more rupee appreciation amid a broad dollar weakness after replenishing the nation's foreign reserves. USDINR is likely to break below the 73.5 level before sliding further towards 73.0.

BRAZIL — BRL reached its strongest level since June this month, with its USD cross threatening to break below 5.00. We have USDBRL trading sideways for the coming 12-months but see downside risks to the cross—if fiscal reform gets traction. The priced-in hike cycle for the BCB gives BRL carry support (570 bps over 3yrs). Issues we need clarity on before pulling the trigger on revisions are who the Legislative heads will be and whether we can expect support for reforms.

Currency Trends

FX Rate	Spot 16-Dec	20Q1a	20Q2a	20Q3a	20Q4f	21Q1f	21Q2f	21Q3f	21Q4f
USDCNY	6.53	7.08	7.07	6.79	6.50	6.40	6.40	6.30	6.30
USDINR	73.6	75.6	75.5	73.8	73.0	72.0	72.0	70.0	70.0
USDBRL	5.09	5.21	5.47	5.61	5.11	5.02	4.96	5.07	5.03

China, India, Brazil

Fundamental Commentary

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CHINA — The Regional Comprehensive Economic Partnership (RCEP) was signed on November 15 and will be ratified by the member countries over the course of 2021. The RCEP consists of China, Japan, South Korea, Australia, New Zealand, as well as the ten ASEAN countries. The RCEP is the largest free trade agreement in the world, encompassing about 30% of the world's GDP and population. We expect the pact to increase China's influence in regional trade and geopolitical affairs over the coming years. The Chinese economy continues to be the frontrunner in the global recovery. China's early rebound has been driven by the industrial sector; however, in recent months consumer confidence has strengthened and we are now seeing broader momentum in the economy. This implies that the country's growth outlook is on a more solid footing. We expect China's real GDP to increase by around 2% in 2020 as a whole; the economy will continue to gain momentum in 2021 with output growth expected to average 8.3% y/y next year. In 2022, real GDP gains will likely return to a more sustainable trajectory of around 6% y/y. As the Chinese economy remains firmly on a recovery path, we assess that the People's Bank of China (PBoC) will not unveil further monetary easing measures over the coming months. Chinese benchmark Loan Prime Rates (LPR) have remained unchanged since April when the 1-year LPR was lowered by 20 bps to 3.85%. Similarly, we expect banks' reserve requirement ratios (RRR) to remain unchanged over the coming months. Monetary policy is set to remain growth-supportive, focusing on underpinning enterprises and employment. At the same time, Chinese policymakers will pay increased attention to addressing financial risks and preventing a buildup of imbalances that could emerge as a result of inefficient allocation of credit to projects that are not economically viable.

INDIA — The Indian economy has passed the worst of the pandemic. Activity is strengthening, as demonstrated by recent industrial output and confidence indicators, for example. Nevertheless, major downside risks persist as COVID-19 is not yet under control. We forecast India's real GDP to contract by around 8% in 2020, followed by advances of 7.0% and 7.2% in 2021 and 2022, respectively. The economy rebounded in Q3, yet activity remained 7.5% below year-earlier levels. Nevertheless, the data show a notable improvement from the Q2 contraction of 23.9% y/y. India is in a weaker position than many other countries in the region, given that the nation's authorities have limited monetary and fiscal policy space. India's weak public finances prevent the government from unveiling significant fiscal stimulus. The administration has been able to inject direct fiscal stimulus worth only about 2% of GDP. At the same time, inflation is high, which is forcing the RBI to stay on hold even though the economy would need additional monetary stimulus. The Reserve Bank of India (RBI) has lowered the benchmark repo rate by 115 bps so far this year to 4.0%; the latest rate cut took place in May. The RBI has highlighted that its primary mandate is to achieve the medium-term inflation target of 2–6% y/y. In recent months, India's headline inflation has been significantly above the target, yet we expect inflationary pressures to prove transitory. Consumer prices rose by 6.9% y/y in November vs. the 7.6% advance in the prior month. We expect headline inflation to ease further over the next few months. As soon as inflation returns towards the target range, the RBI will likely provide additional easing; we expect the central bank to cut the benchmark repo rate by 50 bps in early 2021.

BRAZIL — Brazil's economy rebounded strongly from the COVID-19 shock, with retail sales showing positive y/y growth since June 2020. Behind this rebound was strong consumer-focus stimulus by the government, which spent over 4 percentage points of GDP in household support measures. By October, retail sales were showing +8.3% y/y growth. Besides impacting the economic recovery, the government's crisis response seems to have helped support the President's approval rating. The latest poll by Data Folha has Bolsonaro's approval at 37% (its highest level since he took power), while only 32% reject him. Approval rates don't necessarily mean he will have support for his reform agenda but should certainly help. Rapid reform progress is key, as the country's fiscal position is shaky (gross general government debt expected to top 100% of GDP in 2020). Of the country's public debt, only 1/3 is fixed rate (36% is floating, 6% foreign currency, and 25% inflation indexed). Hence, about 2/3 of the country's public debt will become costlier under adverse scenarios. In addition, about 25% of the government's debt has <1-year maturities, so a scenario where risk premia see an adverse repricing could lead to a tough negative spiral for public finances. It is because of these reasons that we think the BCB seems particularly focused on risk premia and fiscal consolidation to determine what its next steps on the monetary front are. Ultimately, if fiscal consolidation fails, stabilizing financial markets could require a more aggressive rate hike cycle by the BCB, leading to economy-damaging pro-cyclical monetary policy.

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Currency Outlook

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MEXICO — A wave of optimism from COVID-19 vaccines has flooded global financial markets in recent weeks, along with ample liquidity provided by the major central banks. These factors, coupled with Fitch and Standard & Poors taking no action on Mexico's sovereign rating (or the outlook for it), saw the MXN strengthen notably to levels below 20 pesos per USD at the beginning of December. The MXN performance will depend highly on global markets sentiment in coming weeks/months.

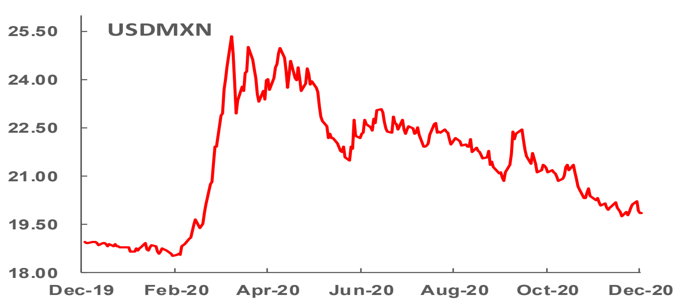
COLOMBIA — Terms of trade and the current account deficit continue to improve, while portfolio investment has increased and now is positive in y/y terms. 5Y CDS consolidated below 100, while Brent crude oil has strengthened to around USD 50. These factors suggest that USDCOP should be trading at COP 3,500-3,600. Additionally, risk appetite has strengthened following the US elections and COVID-19 vaccine news, which has helped the COP. While uncertainty is still very present, we expect the COP to hover around USDCOP 3,400–3,500 in the short run.

CHILE — The CLP has appreciated sharply in the past month, nearing USDCLP 730. This can be explained by the sell-off of USD in order to meet the requirements of the second withdrawal of pension funds, the sell-off of USD by sovereign fund to finance the government expenditure and the improvement in external sentiment, which has copper prices hovering around USD 3.50/lb. The USD sell-off should normalize, taking the exchange rate back to USDCLP 760 by year-end. As the economic recovery continues and health measures stabilize, we expect the CLP to reach 720 by December 2021.

PERU — The PEN is the only major Latam currency not to strengthen against the USD in recent weeks, as businesses continue to use the FX market rather than bank loans to meet their USD needs. At the same time, USD flows from mining companies are still weak and offshore and AFP funds appear unwilling to bet against the local trend. We are maintaining our forecast of 3.60 this year, although with metal prices rising, market dynamics may change early in 2021, as greater USD inflows from mining companies appear.

Currency Trends

FX Rate	Spot 16-Dec	20Q1a	20Q2a	20Q3a	20Q4f	21Q1f	21Q2f	21Q3f	21Q4f
USDMXN	19.86	23.67	22.99	22.11	20.75	21.90	22.69	23.53	23.86
USDCOP	3413	4065	3758	3828	3550	3473	3465	3458	3450
USDCLP	735	854	821	784	760	750	740	730	720
USDPEN	3.58	3.43	3.54	3.60	3.60	3.57	3.56	3.56	3.55



Pacific Alliance
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MEXICO — Winter is coming for Mexico, and it will not be easy, with the spread of COVID-19 contagion raging at its fastest pace of the pandemic and confinement measures being re-established, but in a more careful and moderate way. Note that the negative impact from the new confinement measures is not discounted in our current economic forecasts. Economic indicators show different speeds for the recovery, with exports and manufacturing activity accelerating faster than construction and some services, as the internal engines of growth, mainly private consumption and investment, remain weak and slowly healing. On the bright side, both Fitch Ratings and Standard & Poor's ratified Mexico's sovereign rating and outlook which, coupled with a positive global financial environment, contributed to a strengthening of the MXN. Ms Galia Borja was appointed and confirmed by the Senate to Banco de Mexico's Board, replacing Javier Guzman. Our perception at the moment is that the balance of the Board will tilt toward a more dovish stance, raising the possibility of more cuts to the reference interest rate along 2021. Finally, it should be noted that the Senate approved a bill to change Banco de Mexico's organic law to mandate the central bank to buy excess USDs from Mexican financial institutions, which would undermine Banxico's autonomy and put the financial system at risk. There has been strong opposition to the bill, which has apparently stopped the initiative, but the shadow it has cast over the business environment remains.

COLOMBIA — After the government, back in September, allowed 95% of the economy to operate, economic activity has started to show a gradual recovery. The unemployment rate has fallen 6.7 ppts from its worst level since the pandemic began (May = 21.4%) to 14.7% in October, and GDP increased +8.7% q/q in Q3-2020. We expect another 3.6% q/q gain in Q4-2020. Having said that, uncertainty around a COVID-19 second wave and the speed of vaccine implementation continues; therefore, we haven't changed our forecast. We still think GDP will contract by 7.5% y/y in 2020, followed by a possible gradual rebound of 5% y/y in 2021. The government officialized its higher deficit of 8.9% of GDP in 2020 and 7.6% of GDP next year, which will bring its debt/GDP ratio above 65% of GDP in 2020. In the meantime, BanRep has been in a wait-and-see-mode, keeping its policy rate at 1.75% in the last two meetings. We forecast that the policy rate will remain at 1.75% for at least eight more months despite the recent downward trend in inflation, with inflation expectations remaining close to 3% for 1-Y and 2-Y tenors. We think low y/y inflation will continue up to Q2-2021, when it will start to converge to 3%. For 2020 we expect headline inflation to end at 1.42% and stay low around this level until April next year. For 2021 we expect inflation to end at 2.8%. Finally, to keep markets and investors calm, Colombia will need to pass a significant fiscal reform that rises at least 2 ppts of GDP next year. In fact, Minister Carrasquilla has already said that the government will present the tax reform before Congress during H1-2021.

CHILE — As 2020 comes to an end, economic data confirm that the recovery is advancing. The third quarter showed an expansion of 5.2% q/q sa and for the fourth quarter we expect growth around 9% q/q sa. With approximately 90% of the economy re-opened, Congress approved in early-December a second withdrawal of pension assets, which should send another USD 16 bn of liquidity to households. In addition, the government is working on some measure to boost private investment. Therefore, next year should start with economic momentum coming from strong private consumption growth. However, there are still important risks to consider. The economy will face evolving challenges from the pandemic and the political situation that has followed October 2019's social unrest. The labour market still has wide gaps that are expected to remain open next year in a context where investment has underperformed and the prospects for 2021 are still weak. Full recovery remains a titanic task for the labour market, even more so because of the acceleration in the digitization of work during this year's lockdowns. We may even see the unemployment rate edge up as returns to the labour market could outpace job gains. All in all, we are optimistic about the economic recovery and the evolution of the constitutional process during 2021. The Chilean economy has shown resilience following 2019's social outbreak and the pandemic; additionally, the authorities have provided ample stimulus to support the recovery, which will be maintained as we enter 2021.

PERU — As we enter 2021, the economy is mostly unlocked (albeit at lower capacity), the exceptions being education, certain entertainment activities. A host of important sectors are performing at pre-COVID-19 levels, foremost among them is home construction, and 2020 should close near our -11.5% forecast. However, employment is underperforming and having difficulty falling back below 16% of GDP, as private investment continues weak. On the other hand, terms of trade have improved far beyond expectations this year, especially in the latter half. This is good news for Peru's external and fiscal balances. The impact on the country's external accounts is already being felt and the effects on Peru's fiscal accounts will be seen in 2021 and 2022. Inflation is under control at the 2% mid-point of the policy range, and monetary policy has become fairly stable. Politics, unfortunately, have not. Once 2021 begins, campaigning and maneuvering for the April elections will commence in earnest. This may take some of the political limelight off the Sagasti government, or not. Although the path to elections has become less tentative, Congress has not become better behaved, and tension with the Executive around the abundance of questionable congressional initiatives has renewed. Protests have also multiplied lately, which could well continue, as interest groups, at times with the backing of a pliant Congress, attempt to corner the weak Sagasti government into conceding. COVID-19 has receded significantly, but a second wave appears to be in the making. The southern hemisphere summer promises to be a long one for Peru.

Emerging Economies
Currency Outlook

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SOUTH KOREA — South Korea has been showing signs of improved economic fundamentals amid strengthening global trade. The KOSPI share index is nearing a key point at 2,800 but retains a bullish trend. In the meantime, the CNH's sustained strength lays the groundwork for the KRW to appreciate further, with developing market currencies also supported by the growing balance sheets of major central banks. We remain bearish on the outlook for USDKRW.

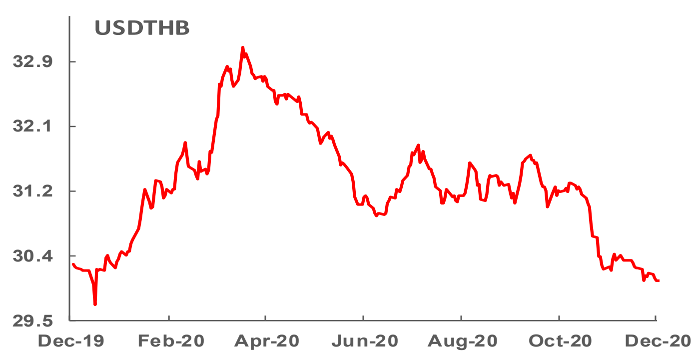
THAILAND — BoT Governor Sethaput Suthiwartnarueput told Thai-language news agency The Standard that the Thai central bank has not been complacent about a strengthening baht and has taken care to ensure that rapid gains don't obstruct economic recovery. While the 30.0 level remains support for USDTHB at the moment, a broadly weaker dollar will very likely see the pair breaching this psychological level going forward.

TAIWAN — The CBC continues smoothing forex market volatility, as suggested by the island's surging foreign reserves. In the meantime, the operations have pumped massive TWD liquidity into the onshore banking system we believe. The TWD is facing mounting appreciation pressure amid continued capital inflows. USDTWD is expected to head for the 28.0 level after closing below the "Perng Fai-nan line" of 28.5. In the years ahead, growing geopolitical risks may have an increasing impact on the TWD.

MALAYSIA — Malaysia's persistent trade surplus, booming oil prices and increasing portfolio inflows are supportive of the MYR. Foreign holdings of Malaysian government and corporate bonds and bills rose 0.9% m/m to MYR 219.4 bn in November. In the meantime, the KLCI share index will likely remain well supported. USDMYR will likely slide and reach the psychological 4.00 level in the near future.

Currency Trends

FX Rate	Spot 16-Dec	20Q1a	20Q2a	20Q3a	20Q4f	21Q1f	21Q2f	21Q3f	21Q4f
USDKRW	1094	1219	1203	1170	1100	1080	1080	1060	1060
USDTHB	30.0	32.8	30.9	31.6	30.2	30.0	30.0	29.8	29.8
USDTWD	28.1	30.3	29.6	29.0	28.6	28.5	28.5	28.4	28.4
USDMYR	4.05	4.32	4.29	4.16	4.10	4.05	4.05	4.00	4.00



Emerging Economies
Fundamental Commentary

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SOUTH KOREA — The South Korean economy continues to recover gradually. Real GDP expanded by 2.1% q/q (non-annualized) in Q3 following a 3.2% drop in the prior quarter. The external sector drove economic activity while domestic demand was subdued. Significant downside risks persist both on the domestic and external sides of the economy. The surge in COVID-19 infections in many advanced economies and renewed restrictions on movement will have an adverse impact on those economies' economic growth momentum and hence on South Korea's export-oriented economy. Meanwhile, confidence domestically is impacted by the new wave of infections and weak labour market conditions, keeping consumers and businesses cautious in their spending decisions. We expect the country's real GDP to contract by 1.2% in 2020, followed by rebounds of 3.0% and 2.8% in 2021 and 2022, respectively. The Bank of Korea (BoK) will likely hold monetary conditions unchanged in the near term as it continues to assess the recovery's strength and sustainability and as fiscal stimulus is working its way through the economy; the government has unveiled four supplementary budgets this year to offset some of the adverse impacts of the pandemic. The BoK's benchmark interest rate is currently at 0.50%; the latest cut took place in May. Given significant downside risks to the economic outlook, the potential for the BoK to consider additional stimulus has risen. Inflationary pressures in South Korea are low (the CPI rose by 0.6% y/y in November). We forecast inflation rate to remain below 1% y/y over the next couple of quarters, before climbing toward the BoK's 2% inflation target by the end of 2021.

THAILAND — The Thai economy rebounded in the third quarter with real GDP growing by 6.5% q/q (non-annualized) after a 9.9% dip in the April-June period. Both the domestic and external sides of the economy recorded strong gains. Regardless, Thailand's output remains 6.4% smaller than in Q3 2019. We expect the economy to shrink by 6.2% in 2020, followed by a rebound of 4-5% y/y in 2021-22. We expect the Bank of Thailand (BoT) to leave the benchmark interest rate unchanged at 0.50% over the coming months as the economy remains on the recovery track. Nevertheless, given the strong baht, persistent deflationary pressures (the CPI was down by 0.4% y/y in November), and significant downside risks to the tourism-oriented economy, the BoT will maintain a dovish bias over the foreseeable future.

TAIWAN — The Taiwanese economy is performing well compared with its regional peers. It avoided a recession as it recorded only one quarter of contracting real GDP (in Q2) and has been recovering since. Taiwan's output will likely expand by over 2% in 2020. Momentum is set to strengthen in 2021 with the economy expected to grow by around 3%. 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. Taiwan experienced a period of declining prices between February and October 2020. In November, the period of deflation came to an end, at least temporarily, with the CPI rising by 0.10% y/y. We expect inflation to remain subdued over the coming quarters on the back of low international energy prices and muted demand-driven pressures.

MALAYSIA — Malaysian real GDP rebounded strongly in Q3, increasing by 18.2% q/q (non-annualized), after a 16.5% decline in the second quarter. Both domestic and external sector demand rebounded. The country's output in the third quarter was only 2.7% below year-earlier levels (vs. -17.1% y/y in Q2). Nevertheless, the economy will likely face renewed softness in the fourth quarter due to the renewed surge in COVID-19 cases. We estimate that Malaysia's real GDP will contract by 5.3% in 2020. In 2021, economic growth will likely rebound to 5% y/y on the back of base effects, pent-up demand, and the lagged impact of stimulative fiscal and monetary policies. Malaysia's 2021 Budget, passed by the parliament in November, is expansionary in order to help the economy get back on its feet. The budget's measures include cash assistance, lower income taxes for the middle-income group, wage subsidies, a medical tax relief, infrastructure projects, and further investment incentives. The 2020 fiscal deficit is expected to be 6.0% of GDP and is forecasted to narrow to 5.4% in 2021. Malaysian monetary authorities' latest policy meeting took place on November 3. The Bank Negara Malaysia (BNM) left the benchmark interest rate, the Overnight Policy Rate, unchanged at 1.75%. In July, the BNM lowered the policy rate by 25 bps, taking cumulative cuts to 125 bps since January 2020. The November monetary policy statement highlighted that the BNM's monetary policy stance is now considered to be appropriate and accommodative. Nevertheless, we point out that the benchmark interest rate is elevated in real terms (consumer prices declined by 1.5% y/y in October), providing the BNM with additional monetary easing space should the economy face significant softening in activity.

Global Currency Forecast (end of period)

		2020f	2021f	2022f	2020f		2021f				2022f			
Major Currencies					Q3a	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Japan	USDJPY	105	102	100	105	105	104	104	102	102	101	101	100	100
Euro zone	EURUSD	1.18	1.21	1.24	1.17	1.18	1.20	1.20	1.21	1.21	1.22	1.23	1.24	1.24
	EURJPY	124	123	124	124	124	125	125	123	123	123	124	124	124
UK	GBPUSD	1.29	1.33	1.40	1.29	1.29	1.30	1.31	1.32	1.33	1.35	1.37	1.39	1.40
	EURGBP	0.91	0.91	0.89	0.91	0.91	0.92	0.92	0.92	0.91	0.90	0.90	0.89	0.89
Switzerland	USDCHF	0.92	0.91	0.90	0.92	0.92	0.91	0.91	0.91	0.91	0.91	0.90	0.90	0.90
	EURCHF	1.08	1.10	1.11	1.08	1.08	1.09	1.09	1.10	1.10	1.11	1.11	1.11	1.11
Americas														
Canada	USDCAD	1.32	1.28	1.25	1.33	1.32	1.30	1.30	1.28	1.28	1.27	1.26	1.25	1.25
	CADUSD	0.76	0.78	0.80	0.75	0.76	0.77	0.77	0.78	0.78	0.79	0.79	0.80	0.80
Mexico	USDMXN	20.75	23.86	23.19	22.11	20.75	21.90	22.69	23.53	23.86	23.80	23.34	23.12	23.19
	CADMXN	15.72	18.64	18.55	16.60	15.72	16.85	17.45	18.38	18.64	18.74	18.52	18.50	18.55
Brazil	USDBRL	5.11	5.03	5.01	5.61	5.11	5.02	4.96	5.07	5.03	5.02	5.02	5.05	5.01
Chile	USDCLP	760	720	710	784	760	750	740	730	720	720	720	710	710
Colombia	USDCOP	3,550	3,450	3,400	3,828	3,550	3,473	3,465	3,458	3,450	3,438	3,425	3,413	3,400
Peru	USDPEN	3.60	3.55	3.50	3.60	3.60	3.57	3.56	3.56	3.55	3.52	3.52	3.52	3.50
Asia-Pacific														
Australia	AUDUSD	0.71	0.75	0.77	0.72	0.71	0.73	0.73	0.75	0.75	0.75	0.76	0.77	0.77
China	USDCNY	6.50	6.30	6.10	6.79	6.50	6.40	6.40	6.30	6.30	6.20	6.20	6.10	6.10
Hong Kong	USDHKD	7.75	7.78	7.82	7.75	7.75	7.76	7.76	7.78	7.78	7.80	7.80	7.82	7.82
India	USDINR	73.0	70.0	66.0	73.8	73.0	72.0	72.0	70.0	70.0	68.0	68.0	66.0	66.0
Indonesia	USDIDR	14,000	13,000	12,000	14,880	14,000	13,500	13,500	13,000	13,000	12,500	12,500	12,000	12,000
Malaysia	USDMYR	4.10	4.00	3.90	4.16	4.10	4.05	4.05	4.00	4.00	3.95	3.95	3.90	3.90
New Zealand	NZDUSD	0.67	0.70	0.72	0.66	0.67	0.68	0.68	0.70	0.70	0.71	0.71	0.72	0.72
Philippines	USDPHP	48.0	46.0	44.0	48.5	48.0	47.0	47.0	46.0	46.0	45.0	45.0	44.0	44.0
Singapore	USDSGD	1.34	1.32	1.30	1.37	1.34	1.33	1.33	1.32	1.32	1.31	1.31	1.30	1.30
South Korea	USDKRW	1100	1060	1020	1170	1100	1080	1080	1060	1060	1040	1040	1020	1020
Taiwan	USDTWD	28.6	28.4	28.2	29.0	28.6	28.5	28.5	28.4	28.4	28.3	28.3	28.2	28.2
Thailand	USDTHB	30.2	29.8	29.4	31.6	30.2	30.0	30.0	29.8	29.8	29.6	29.6	29.4	29.4

f: forecast a: actual

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