Scotiabank.

GLOBAL ECONOMICS & FX STRATEGY

FOREIGN EXCHANGE OUTLOOK

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Market Tone

USD strength is persisting for longer than we anticipated, prompting some further revisions to our near-term forecasts for the US dollar (USD) last month. Inflationary pressures in the US—and around the world—remain intense (notwithstanding the softer than expected July CPI report). This is entailing sustained upward pressure on US yields despite US GDP data suggesting the economy is experiencing a "recession lite". The fallout from the ongoing Ukraine conflict and other challenges are curbing scope for higher rates in Europe, despite surging prices, while Japanese policy makers see no urgency to alter domestic policy settings, ensuring the yen (JPY), which is the weakest performing major currency this year, remains soft.

Continued on next page ...

FX Forecasts

		2021	2022f	2023f	2022f Q1a	2022f Q2a	2022f Q3	2022f Q4	2023f Q1	2023f Q2	2023f Q3	2023f Q4
Major Currencies												
Japan	USDJPY	115	140	133	122	136	140	140	138	138	133	133
Euro zone	EURUSD	1.14	0.95	1.05	1.11	1.05	0.97	0.95	1.00	1.02	1.05	1.05
	EURJPY	131	133	140	135	142	136	133	138	141	140	140
UK	GBPUSD	1.35	1.15	1.22	1.31	1.22	1.16	1.15	1.18	1.20	1.20	1.22
	EURGBP	0.84	0.83	0.86	0.84	0.86	0.84	0.83	0.85	0.85	0.88	0.86
Switzerland	USDCHF	0.91	1.01	0.97	0.92	0.96	1.00	1.01	0.98	0.97	0.96	0.97
	EURCHF	1.04	0.96	1.02	1.02	1.00	0.97	0.96	0.98	0.99	1.01	1.02
Americas												
Canada	USDCAD	1.26	1.27	1.23	1.25	1.29	1.27	1.27	1.25	1.25	1.23	1.23
	CADUSD	0.79	0.79	0.81	0.80	0.78	0.79	0.79	0.80	0.80	0.81	0.81
Mexico	USDMXN	20.53	20.97	22.08	19.87	20.12	20.44	20.97	21.33	21.82	21.84	22.08
	CADMXN	16.23	16.51	17.95	15.89	15.62	16.09	16.51	17.06	17.46	17.76	17.95
Brazil	USDBRL	5.58	4.90	4.69	4.74	5.26	5.05	4.90	4.70	4.63	4.67	4.69
Chile	USDCLP	852	870	800	786	918	900	870	850	830	820	800
Colombia	USDCOP	4,080	3,960	3,951	3,771	4,155	3,957	3,960	3,887	3,835	3,884	3,951
Peru	USDPEN	4.00	3.95	3.95	3.68	3.83	3.90	3.95	4.00	3.95	3.90	3.95
Argentina	USDARS	102.7	155.0	250.0	111.0	125.2	140.0	155.0	172.0	190.0	220.0	250.0
Asia-Pacific												
Australia	AUDUSD	0.73	0.65	0.68	0.75	0.69	0.65	0.65	0.66	0.66	0.68	0.68
China	USDCNY	6.36	6.60	6.40	6.34	6.70	6.70	6.60	6.50	6.50	6.40	6.40
Hong Kong	USDHKD	7.80	7.84	7.82	7.83	7.85	7.85	7.84	7.83	7.83	7.82	7.82
India	USDINR	74.3	79.0	77.0	75.8	79.0	80.0	79.0	78.0	78.0	77.0	77.0
Indonesia	USDIDR	14,253	14,800	14,400	14,369	14,898	15,000	14,800	14,600	14,600	14,400	14,400
Malaysia	USDMYR	4.17	4.40	4.30	4.20	4.41	4.45	4.40	4.35	4.35	4.30	4.30
New Zealand	NZDUSD	0.68	0.60	0.64	0.69	0.62	0.60	0.60	0.62	0.62	0.64	0.64
Philippines	USDPHP	51.0	54.0	50.0	51.8	55.0	56.0	54.0	52.0	52.0	50.0	50.0
Singapore	USDSGD	1.35	1.38	1.34	1.35	1.39	1.40	1.38	1.36	1.36	1.34	1.34
South Korea	USDKRW	1,189	1,280	1,240	1,212	1,299	1,300	1,280	1,260	1,260	1,240	1,240
Taiwan	USDTWD	27.7	29.6	29.2	28.6	29.7	29.8	29.6	29.4	29.4	29.2	29.2
Thailand	USDTHB	33.4	35.0	33.0	33.3	35.4	36.0	35.0	34.0	34.0	33.0	33.0

f: forecast a: actual

CAD FX Forecasts

Canadian Dollar Cross-Currency Trends

FX Rate	Spot 15-Aug	22Q1a	22Q2a	22Q3f	22Q4f	23Q1f	23Q2f	23Q3f	23Q4f
AUDCAD	0.91	0.94	0.89	0.83	0.83	0.83	0.83	0.84	0.84
CADJPY	103.2	97.3	105.4	110.2	110.2	110.4	110.4	108.1	108.1
EURCAD	1.31	1.38	1.35	1.23	1.21	1.25	1.28	1.29	1.29
USDCAD	1.29	1.25	1.29	1.27	1.27	1.25	1.25	1.23	1.23

Market Tone

Our latest USD forecasts imply the USD will remain relatively firm over the balance of the year. The USD withstood a second, successive negative GDP print in Q2, which is typically shorthand for a recession. Policy makers pushed back against the notion of a recession in view of strong labour markets and the July non-farm payroll report showing a 528k gain in jobs tends to support that perspective. Clearly, however, the risk of slowing growth is rising, given tighter policy settings but we expect the Fed to push ahead with rate hikes as it targets a soft landing. Our forecast anticipates the Fed funds target rate reaching—and peaking at—3.25% by year-end but market pricing currently suggests investors expect policy hikes to extend to 3.50–75% into H1 next year. We think the USD bull cycle is looking very extended but USD bears will have to remain patient; absent a major, negative catalyst, firm US yields, broader market uncertainties and the lack of attractive alternatives will keep the USD supported.

The Canadian dollar (CAD) remains the best-performing G10 currency—outside of the USD—so far this year. A resilient economy and a hawkish central bank plus firm commodity prices conferring a positive terms of trade boost to the currency constitute strong supports for the CAD, even if it has struggled to reflect those factors against the USD. The CAD retains a strong profile against other major currencies and seems poised to remain firm as domestic yields push higher. Our forecasts anticipate domestic growth and interest rates outpacing the US this year and next, which should limit the USD's ability to advance beyond the recent range peaks against the CAD and, we believe, push the CAD modestly higher into year-end, especially if the broader risk backdrop improves which will allow the CAD to reflect its positive underlying fundamentals more fully. We expect the Bank of Canada (BoC) to raise the Overnight rate to 3.50% by the end of this year and hold that level through 2023.

In Europe, the consequences of the Ukraine war remain a clear constraint on prospects. European energy security remains a key consideration for the outlook over the next few months. It is not in Russia's best interests to cut off Europe altogether from its natural gas supplies and Europe is doing a decent job of building gas reserves ahead of winter. But supply uncertainty is real and surging energy costs are lifting inflation and curbing discretionary spending and industrial output. Recession risks are rising in the Eurozone and hot summer weather is adding to economic headwinds; low water levels are compromising key logistical routes on the Rhine (which transports around 30% of German energy raw materials). The European Central Bank raised interest rates 50 bps in July but markets expect only modest rate increases over the balance of the year and yield differentials will curb the appeal of the euro (EUR) for now. Negative growth surprises or energy supply disruption would risk pushing the EUR below parity versus the USD, we believe. The unsettled Italian political backdrop, prompting Moody's to downgrade Italy's sovereign outlook, figures as another, nascent risk for the EUR.

In the UK, the cost-of-living crisis—which is being exacerbated by the prospect of another huge jump in household energy prices into the winter—and sluggish growth may impede the Bank of England's ability to confront soaring inflation and satisfy market expectations for tighter policy. This will weigh on the pound (GBP) broadly. Clear challenges for the UK and, especially, the Eurozone suggest the Swiss franc (CHF) is poised to stay relatively firm, particularly as the Swiss National Bank may tolerate a stronger exchange rate to combat sticky domestic inflation.

The rise US yields and a clear lack of urgency to adjust Bank of Japan (BoJ) policy settings has maintained pressure on the yen (JPY). Recent upper house elections in Japan reinforced the political status quo and suggest no pressure on the BoJ to alter its policy trajectory. Wide US-Japan yield differentials will keep the JPY soft for the foreseeable future while high commodity prices represent another, negative impulse on the currency (via a negative terms of trade shock). We do think that USDJPY gains towards the 140 area in H2 may represent a high-water mark, however, with the JPY looking significantly oversold. A weak JPY has kept regional Asian FX trends subdued in recent months but some slowing export momentum, China's strict COVID-19 policies and regional geo-political tensions have also factored into regional FX softness.

Some Pacific Alliance currencies have shown resilience against broader USD strength and elevated international uncertainty. The Mexican peso (MXN) has experienced bouts of heightened volatility this year but USDMXN has pivoted in a broad range around its 200-day moving average and is currently holding a small gain versus the USD and CAD in year-to-date terms. Sharp rises in domestic interest rates have supported the MXN and we expect policy makers to tighten rates further, holding USDMXN within recent ranges. The Peruvian sol (PEN) is also maintaining a small rise against the USD in year-to-date terms amid rising domestic interest rates but political noise around President Castillo remains intense, lifting uncertainty. Pressure on the Chilean peso (CLP) has abated, thanks to a successful—but costly—deployment of central bank reserves. However, uncertainty over the constitutional reforms persists and surging inflation will entail tighter monetary policy, slowing growth. Scope for CLP gains remains relatively limited ahead. The Colombian peso (COP) outlook is also clouded by domestic politics, international uncertainty and the stronger USD but the July extremes do appear to be an overshoot and we anticipate some modest gains for the COP through year-end.

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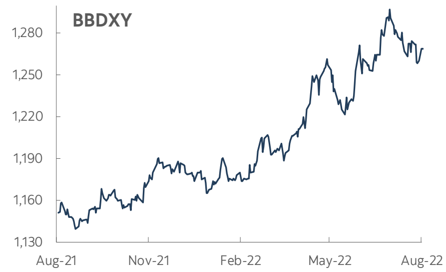
North America

USD

Poised to Remain Firm Amid Few Alternatives **Current spot 1,267.00**



Source: Bloomberg.

USD—Despite the US economy falling into a "technical recession", investors continue to feel that there is no viable alternative to the USD as the Fed pushes ahead with tighter monetary policy. We expect the USD to remain firm in the next few months but significant or sustained gains may be hampered by stretched valuation (the DXY is trading one standard deviation above its 10Y moving average) and stretched USD-bullish positioning among investors. A lot of good news is already priced into the USD and the currency is starting to look overvalued, in our opinion.

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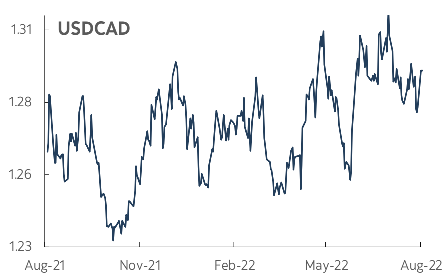
USDCAD

Outlook Revised but Positives Remain **Current spot 1.2890**



Source: Bloomberg.

USDCAD—We have relented on our bullish prognosis for the CAD in H2 2022 and now look for USDCAD to hold near current levels over the balance of the year (ending 2022 at 1.27). We continue to believe that our underlying fundamental story—we are forecasting relatively higher growth and tighter monetary policy in Canada over the US this year and next as well as relatively firm commodity prices—merits a stronger CAD forecast, however. We target USDCAD declining to 1.23 into the end of 2023.

Scotia Forecasts	Q1-22	1.25	Q2-22	1.29	Q3-22	1.27	Q4-22	1.27

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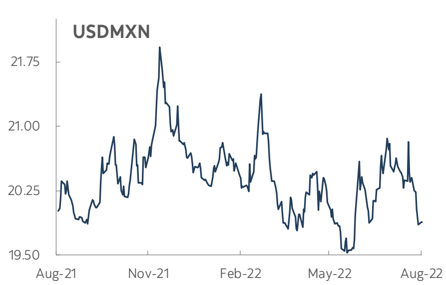
USDMXN

Peso Supported by Tighter Monetary Policy **Current spot 19.8325**



Source: Bloomberg.

USDMXN—MXN had a reasonable month, ranking as the 7th top performer among the major 32 global FX (+2.1% in spot). Banxico's proactive rate hikes are arguably the major factor behind the peso's strength, and we anticipate that for near term, we will continue to see its rate hikes matching the pace set by the Federal Reserve, keeping the interest rate spread between the 2 countries near 600 bps. There are some risks looming on the horizon, such as the USMCA arbitrage against Mexico by Canada and the US due to energy policy, inflation risks to what are so far resilient remittance flows, as well as continued weak foreign investment, but we don't see these being a major headwind for MXN during this calendar year.

Scotia Forecasts	Q1-22	19.87	Q2-22	20.12	Q3-22	20.44	Q4-22	20.97

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Major Currencies

EURUSD

Downside Risks Remain Amid Uncertainties **Current spot 1.0178**

Source: Bloomberg.

EURUSD—The EUR failed to benefit from the ECB's surprise 50 bps hike in July, given weak guidance about future rate moves and still widely negative interest rate spreads over the USD. Economic prospects remain questionable, given the risk of high energy prices disrupting discretionary spending or, worse, curtailed natural gas supplies from Russia. In the event of severe energy supply disruption, EUR losses are likely to extend below parity. About the only thing in the EUR's favour is that markets are already aggressively short the currency.

Scotia Forecasts	Q1-22	1.11	Q2-22	1.05	Q3-22	0.97	Q4-22	0.95

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GBPUSD

Negative Outlook on Surging Inflation **Current spot 1.2076**

Source: Bloomberg.

GBPUSD—Sterling's outlook is negative and sentiment and positioning remain appropriately bearish. The BoE is likely to tighten policy again in September (50 bps) to curb surging inflation but weak growth prospects and the growing cost-of-living crisis as UK households face further, significant increases in energy costs in the coming months, suggest that there is only so much the economy can bear. Market pricing may be over-estimating how much more tightening beyond September can be implemented (+125 bps of additional hikes priced in through H1 2023 which is about 50 bps too much, in our opinion). We expect Cable to trade below 1.20 into year-end.

Scotia Forecasts	Q1-22	1.31	Q2-22	1.22	Q3-22	1.16	Q4-22	1.15

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USDCHF

Persistent Strength on Sticky Inflation **Current spot 0.9452**

Source: Bloomberg.

USDCHF—The SNB's June decision to raise interest rates (+50 bps, taking the key policy rate to -0.25%) and allow the CHF to appreciate reflects the central bank's concern that inflationary pressures, while low by international standards, are proving harder than expected to control. An "active" approach to CHF management now allows the SNB to support the CHF if it weakens too far as well as curb strength. The SNB policy rate is likely to rise a little more in the coming weeks and we look for the CHF to strengthen modestly against the EUR to 0.96 into Q4 as policy makers leverage the exchange rate to curb domestic prices.

Scotia Forecasts	Q1-22	0.92	Q2-22	0.96	Q3-22	1.00	Q4-22	1.01

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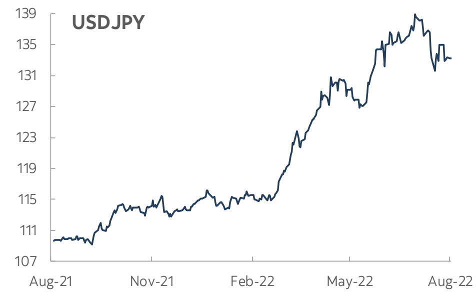
Major Currencies *(continued…)*

USDJPY

Negative Yield Spreads Curb Upside **Current spot 133.24**



Source: Bloomberg.

USDJPY—Despite the JPY's rebound against the USD since mid-July, we see little reason for optimism on the near-term outlook. With BoJ policy set to remain highly accommodative, rising interest rates elsewhere—especially in North America—will keep the JPY on the defensive. High commodity prices continue to deliver a negative terms of trade shock on the economy and have undermined Japan's traditionally strong external accounts position at least temporarily, adding to JPY-negative forces. We expect USDJPY to remain around the 140 level through year-end.

Scotia Forecasts	Q1-22	122	Q2-22	136	Q3-22	140	Q4-22	140

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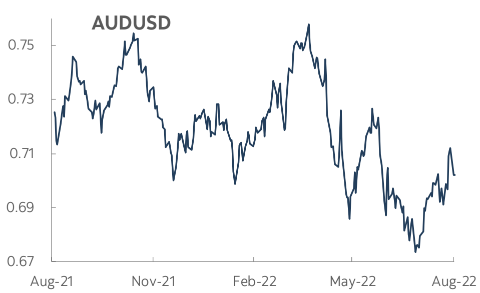
AUDUSD

Rally Fades as Metals Prices Fall **Current spot 0.7039**



Source: Bloomberg.

AUDUSD—The AUD has given back around half of the rebound made in the wake of the March 2020 pandemic low. Losses reflect a sharp (30% plus) fall in iron ore prices in the past few months as China's economy has struggled to gain momentum. RBA tightening expectations have also been repriced following the launch of its tightening cycle in May but may need to adjust further. We see the RBA key rate reaching 2.50% by year-end (from 1.85% currently) whereas swaps are pricing in the policy rate near 3.25%. As a result, we see some downside risk in the AUD outlook over the balance of the year and forecast 0.65 for Q4.

Scotia Forecasts	Q1-22	0.75	Q2-22	0.69	Q3-22	0.65	Q4-22	0.65

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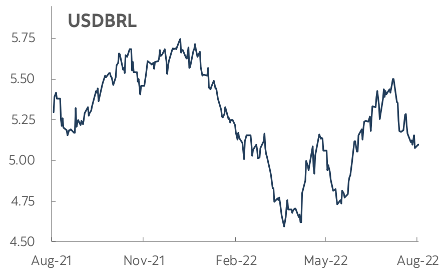
Latin America

USDBRL

Gains Underpinned by Aggressive Hikes — **Current spot 5.0802**



Source: Bloomberg.

USDBRL—The BRL has lost some shine after kicking the year off as the top performing major global currency, with concerns over fiscal risks in a higher interest rate environment, commodity prices losing steam, and political uncertainty hurting its performance in the early summer. However, the month of July was again good for the real, seeing it gain +5.1% versus the US dollar. The BCB's aggressive rate hikes (SELIC sits at 13.75%) have likely been the real's top support, but we've also seen Presidential campaign front runner Lula make some decisions that eased politics related pressures (including choosing a moderate running mate—Alkmin). The electoral race is in its last leg, with the first round set for October 2, and the runoff for October 30.

Scotia Forecasts	Q1-22	4.74	Q2-22	5.26	Q3-22	5.05	Q4-22	4.90

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USDCOP

Steadies After Record High — **Current spot 4,162.00**

Source: Bloomberg.

USDCOP—In July, USDCOP reached an all time high of 4,680 pesos, as US recession fears stoked risk aversion while central banks maintained their hawkish policy approach. The international stress coincided with the local presidential elections results, which led to a month of moderate liquidity and sudden intraday movements. Our macro model points out that even under a negative scenario, USDCOP should not consistently trade above 4,300 pesos. In August, pressures eased, but the USDCOP is expected to continue operating under a highly volatile context, awaiting central banks' actions in September. We expect the COP to oscillate between 4,000 and 4,300 at worst but we are maintaining our call of USDCOP closing around 3,950 by the end of this year.

Scotia Forecasts	Q1-22	3,771	Q2-22	4,155	Q3-22	3,957	Q4-22	3,960

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USDCLP

Weaker Copper Prices Weigh — **Current spot 879.97**

Source: Bloomberg.

USDCLP—Since the beginning of May, the CLP has depreciated about 4%, driven by a fall in copper prices (15%) and the global appreciation of the DXY (2%), but contained by the daily intervention of the central bank, that it will run from mid-July to the end of September. In the short term, the CLP will continue to be determined by external factors but conditioned by internal political developments after the exit referendum (Sept. 4th). Looking ahead, we revised upward our forecast for the exchange rate to reach 870 in December once external risks dissipate, still reflecting a discount compared to its emerging market peers.

Scotia Forecasts	Q1-22	786	Q2-22	918	Q3-22	900	Q4-22	870

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Latin America *(continued…)*

USDPEN

Upside Limited Amid Strong USD, Uncertainty | **Current spot 3.8458**

Source: Bloomberg.

USDPEN—The PEN posted an appreciation of 3.1% YTD driven by a greater supply of dollars from offshore investors, attracted by the high yields of Peru's sovereign bonds, and from pension funds, who need liquidity in soles to meet the sixth withdrawal of private pension funds. These flows are partially offset by higher corporate demand—which reacts to greater local political noise—and by maturities of BCRP derivative instruments, which have been partially renewed. Our forecast is close to 3.95 at year-end, in view of a strong dollar globally and higher domestic inflation. Uncertainty remains high, however. The degrees of uncertainty remain high. External fundamentals have weakened due to the deterioration in the terms of trade, but a trade surplus remains, at least double the pre-pandemic level.

Scotia Forecasts	Q1-22	3.68	Q2-22	3.83	Q3-22	3.90	Q4-22	3.95

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Asia

USDCNY

Downside Limited due to Inflationary Pressures **Current spot 6.7735**

Source: Bloomberg.

USDCNY—We expect China's economy to revive further in the second half with more fiscal stimulus to be rolled out. The Shanghai Composite Index is likely to rebound and prompt more equity inflows. The PBoC has expressed some concerns over the nation's CPI inflation in its Q2 monetary policy report released on August 10. We believe China's central bank will not flood the economy with excessive liquidity and a weaker yuan that makes imports into China more expensive is not in the monetary authority's interest at this stage. USDCNH is expected to trade between 6.7 and 6.8 with downside potential in the weeks ahead.

Scotia Forecasts	Q1-22	6.34	Q2-22	6.70	Q3-22	6.70	Q4-22	6.60

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USDINR

Relief from Falling Commodity Prices **Current spot 79.5363**

Source: Bloomberg.

USDINR—Reserve Bank of India Governor Das said on July 22 that India's inflation appears to have peaked while the outlook on price stability is clouded by external conditions. We believe falling commodity prices could improve the nation's external balance while bringing the nation's inflation under control. The INR will rally in a sustainable way when foreign investors shift their focus to India's growth prospect from the nation's inflation outlook. In addition, foreign investors have turned net buyers of Indian shares since late July, supportive of the INR. USDINR will likely trade between 79 and 80 with downside risks.

Scotia Forecasts	Q1-22	75.8	Q2-22	79.0	Q3-22	80.0	Q4-22	79.0

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USDKRW

Tighter Policy Ahead **Current spot 1,306.13**

Source: Bloomberg.

USDKRW—The Bank of Korea is expected to raise its policy rate again this month to curb inflation. Foreign investors became net buyers of South Korean stocks for the first time in six months in July and continue purchasing local stocks in August. Meanwhile, the nation's external balance remains weak, with trade deficit in first 10 days of August widening to USD 7.68bn from USD 5.53bn for the same period in July. USDKRW is expected to consolidate around the 1,300 level for now, but to trade lower once there is a retracement in the DXY Index post the release of the July FOMC minutes due on August 17.

Scotia Forecasts	Q1-22	1,212	Q2-22	1,299	Q3-22	1,300	Q4-22	1,280

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Asia *(continued…)*

USDTHB

May Gain on Tourism Boost **Current spot 35.489**

Source: Bloomberg.

USDTHB—Thailand expects 3% GDP growth in 2022 if the war in Ukraine doesn't intensify. The Bank of Thailand will continue tightening its monetary policy at a gradual pace to tame CPI inflation while protecting the nascent economic recovery. Thailand said on August 4 that it will implement more promotions and measures through 2023 to attract more overseas tourists, which may see about 30mn overseas travelers in 2023 and generate a total revenue of about THB 1.5 tn. This is expected to improve the nation's current account balance and prop up the THB. USDTHB will likely fall below the 35 level and then trade even lower.

Scotia Forecasts	Q1-22	33.3	Q2-22	35.4	Q3-22	36.0	Q4-22	35.0

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USDTWD

Consolidation as Tensions Ease **Current spot 30.010**

Source: Bloomberg.

USDTWD—We see continued capital outflows for the rest of the month, with dividends-induced dollar buying continuing into August. Foreign investors dumped Taiwanese shares early this month amid escalating tensions across the Strait. China's military said on August 10 that it has completed various tasks around Taiwan, which suggests the market impact arising from US House Speaker Nancy Pelosi's visit has faded away. In addition, external factors including the Fed's tightening path will remain important market influences. USDTWD will likely consolidate between 29.8 and 30.0 in the weeks ahead.

Scotia Forecasts	Q1-22	28.6	Q2-22	29.7	Q3-22	29.8	Q4-22	29.6

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USDSGD

Tracks Major Currencies versus USD **Current spot 1.3774**

Source: Bloomberg.

USDSGD—The MAS tightened S$NEER policy in an off-cycle move on July 14, re-centring the mid-point of the S$NEER policy band up to its prevailing level but keeping the slope and width of the band unchanged. Singapore's economy contracted 0.2% from the previous three months in the second quarter, which prompted the city-state to trim its 2022 growth forecast to a range of 3%–4% from 3%–5% seen before. The SGD will continue running a tight correlation with the EUR, while following a broader market tone. USDSGD could hover around the 1.37 level with odds of sliding towards 1.36.

Scotia Forecasts	Q1-22	1.35	Q2-22	1.39	Q3-22	1.40	Q4-22	1.38

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FOREIGN EXCHANGE STRATEGY

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