Scotiabank

GLOBAL ECONOMICS & FX STRATEGY

FOREIGN EXCHANGE OUTLOOK

November 9, 2021

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Market Tone

We remain constructive on the outlook for the US dollar (USD). The Fed has commenced tapering asset purchases as a prelude to raising interest rates next year. Inflation is proving stickier and perhaps less transitory than policy makers had anticipated and the prospect of—eventually—more US government spending will likely keep prices better supported moving forward. That suggests some risk that policy tightening could come sooner than policy makers are currently indicating. While the Federal Reserve (Fed) is not the first of the major central banks to start its policy normalization process, it will lead many of its major central bank peers. We expect a modest tightening in US interest rates in late 2022, taking the Fed Funds target rate to 0.50%, with an additional 100 bps of tightening in 2023.

Continued on next page...

FX Forecasts

		2020	2021f	2022f	2023f	2021f				2022f				2023f			
Major Currencies						Q1a	Q2a	Q3a	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Japan	USDJPY	103	113	116	110	111	111	111	113	113	115	115	116	115	112	113	110
Euro zone	EURUSD	1.22	1.15	1.12	1.18	1.17	1.19	1.16	1.15	1.15	1.14	1.14	1.12	1.15	1.15	1.18	1.18
	EURJPY	126	130	130	130	130	132	129	130	130	131	131	130	132	129	133	130
UK	GBPUSD	1.37	1.38	1.42	1.45	1.38	1.38	1.35	1.38	1.40	1.40	1.42	1.42	1.43	1.43	1.45	1.45
	EURGBP	0.89	0.83	0.79	0.81	0.85	0.86	0.86	0.83	0.82	0.81	0.80	0.79	0.80	0.80	0.81	0.81
Switzerland	USDCHF	0.89	0.94	0.97	0.94	0.94	0.93	0.93	0.94	0.94	0.95	0.96	0.97	0.96	0.96	0.94	0.94
	EURCHF	1.08	1.08	1.09	1.11	1.11	1.10	1.08	1.08	1.08	1.08	1.09	1.09	1.10	1.10	1.11	1.11
Americas																	
Canada	USDCAD	1.27	1.22	1.20	1.23	1.26	1.24	1.27	1.22	1.22	1.22	1.20	1.20	1.22	1.22	1.23	1.23
	CADUSD	0.79	0.82	0.83	0.81	0.80	0.81	0.79	0.82	0.82	0.82	0.83	0.83	0.82	0.82	0.81	0.81
Mexico	USDMXN	19.91	20.54	21.45	21.78	20.43	19.94	20.64	20.54	20.76	21.03	21.27	21.45	21.38	21.51	21.62	21.78
	CADMXN	15.63	16.84	17.88	17.71	16.28	16.08	16.28	16.84	17.02	17.24	17.73	17.88	17.52	17.63	17.58	17.71
Brazil	USDBRL	5.19	4.88	4.92	4.63	5.63	4.97	5.44	4.88	4.85	4.81	4.85	4.92	4.85	4.77	4.70	4.63
Chile	USDCLP	711	800	700	680	719	734	810	800	760	740	720	700	680	680	680	680
Colombia	USDCOP	3,428	3,760	3,655	3,712	3,663	3,755	3,809	3,760	3,804	3,683	3,670	3,655	3,698	3,712	3,712	3,712
Peru	USDPEN	3.62	4.15	4.25	4.25	3.74	3.87	4.13	4.15	4.15	4.20	4.20	4.25	4.25	4.25	4.25	4.25
Argentina	USDARS	84.1	105.0	140.1	131.0	92.0	95.7	98.7	105.0	111.5	124.6	143.5	140.1	138.0	135.0	132.0	131.0
Asia-Pacific																	
Australia	AUDUSD	0.77	0.74	0.72	0.75	0.76	0.75	0.72	0.74	0.74	0.74	0.72	0.72	0.73	0.73	0.75	0.75
China	USDCNY	6.53	6.40	6.30	6.10	6.55	6.46	6.44	6.40	6.30	6.40	6.50	6.30	6.20	6.20	6.10	6.10
Hong Kong	USDHKD	7.75	7.77	7.76	7.75	7.77	7.77	7.79	7.77	7.76	7.77	7.78	7.76	7.75	7.75	7.75	7.75
India	USDINR	73.1	74.0	72.0	68.0	73.1	74.3	74.2	74.0	72.0	74.0	76.0	72.0	70.0	70.0	68.0	68.0
Indonesia	USDIDR	14,050	14,200	14,000	13,600	14,525	14,500	14,313	14,200	14,000	14,200	14,400	14,000	13,800	13,800	13,600	13,600
Malaysia	USDMYR	4.02	4.15	4.10	4.00	4.15	4.15	4.19	4.15	4.10	4.15	4.20	4.10	4.05	4.05	4.00	4.00
New Zealand	NZDUSD	0.72	0.70	0.71	0.70	0.70	0.70	0.69	0.70	0.70	0.70	0.71	0.71	0.71	0.71	0.70	0.70
Philippines	USDPHP	48.0	50.0	49.0	47.0	48.5	48.8	51.0	50.0	49.0	50.0	51.0	49.0	48.0	48.0	47.0	47.0
Singapore	USDSGD	1.32	1.34	1.32	1.28	1.34	1.35	1.36	1.34	1.32	1.34	1.36	1.32	1.30	1.30	1.28	1.28
South Korea	USDKRW	1,087	1,160	1,140	1,100	1,132	1,126	1,184	1,160	1,140	1,160	1,180	1,140	1,120	1,120	1,100	1,100
Taiwan	USDTWD	28.1	28.0	27.8	27.4	28.5	27.9	27.8	28.0	27.8	28.0	28.2	27.8	27.6	27.6	27.4	27.4
Thailand	USDTHB	30.0	33.0	31.5	28.5	31.2	32.0	33.7	33.0	31.5	33.0	34.5	31.5	30.0	30.0	28.5	28.5

f: forecast a: actual

CAD FX Forecasts

Canadian Dollar Cross-Currency Trends

FX Rate	Spot 09-Nov	21Q1a	21Q2a	21Q3a	21Q4f	22Q1f	22Q2f	22Q3f	22Q4f
AUDCAD	0.92	0.95	0.93	0.92	0.90	0.90	0.90	0.86	0.86
CADJPY	90.9	88.1	89.6	87.8	92.6	92.6	94.3	95.8	96.7
EURCAD	1.44	1.47	1.47	1.47	1.40	1.40	1.39	1.37	1.34
USDCAD	1.25	1.26	1.24	1.27	1.22	1.22	1.22	1.20	1.20

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The outlook for rising interest rates in 2022 will provide the USD with broad underpinning in the coming months. The North American economy is poised to grow more strongly than its peers in Europe and Japan this year and next, adding to the attractiveness of the USD. In effect, we see the USD climbing up the positive or bullish slope of the "USD smile" framework which helps define how the USD performs during differing economic and market cycles.

While we are constructive on the USD, we are relatively more bullish on the outlook for the CAD. The Bank of Canada (BoC) is close to winding down completely its asset purchase programme and suggested at its late October policy meeting that interest rates could rise more quickly than it had previously indicated, with inflationary pressures evident. We expect the BoC to raise rates 100 bps from the second half of next year and a further 100 bps in 2023, taking the overnight target rate to 2.25%. That would sustain a policy rate premium of 75 bps over the Fed's key target rate through our forecast horizon. However, markets are pricing an earlier start to lift off and nearly 125 bps of tightening next year, which implies a policy rate spread of 100 bps—very wide by recent, historical standards.

That might be too much but the BoC is still likely to initiate its tightening cycle well ahead of its peers and this will drive the CAD higher against the USD, as well as the EUR and JPY, for example. We expect commodity prices to remain relatively well-supported as the global economy re-opens and supply disruptions maintain a premium on certain raw materials. Backwardation in the crude oil curve suggests that elevated crude oil prices are not expected to last but firm prices for commodities generally and improving Canadian terms of trade do provide a further tailwind for the CAD. We see limited downside risks for the CAD in the near-term (but concede that volatility around year-end may favour the USD) and we continue to forecast USDCAD reaching 1.20 next year, primarily as a reflection of the BoC's monetary policy stance.

With some central banks in motion while others remain resolutely sidelined, we expect the policy divergence theme will be an important driver of movement in the major currencies over the coming year. Interest in core currency carry trades is rising as carry returns improve in the G10 space. The major currencies provide relatively attractive, risk-adjusted returns compared with their more volatile developing market counterparts. We expect this trend to favour the likes of the New Zealand and Canadian dollars (NZD, CAD), USD and the pound (GBP) where central banks have already started to normalize monetary policy settings, or are close to that point, versus the low or negative short-term rate "funding" currencies, such as the yen, Swiss franc and euro (JPY, CHF, EUR respectively) where there is currently little or no risk—as reflected in market pricing—of policy rate increases in next year or even into 2023. We expect EURUSD to depreciate to 1.12 next year but EUR losses risk developing more quickly and extending more deeply if the Fed tightening timeline accelerates. Similar downside risks face the JPY (we target USDJPY rising to 116 next year) and the negative terms of trade implications of high or higher energy prices could amplify headwinds for the JPY.

Rising US interest rates, a generally stronger USD and idiosyncratic risks are key headwinds for regional and developing market currencies. For the Mexican peso (MXN), a pick-up in US growth and rising energy prices have helped temper some of those pressures, as has the central bank's steady tightening of monetary policy in the face of rising inflationary pressures. We look for a mostly stable MXN in the next few quarters. Aggressive interest rate increases to combat inflation have been implemented in Chile, helping steady the peso (CLP) amid choppy copper prices, concerns over further pension fund withdrawals and focus on political risks ahead of the November 21 presidential election. A calmer domestic political backdrop in Peru and tighter monetary policy have combined to stabilize the sol (PEN), meanwhile. The Colombian peso (COP) has found some support from firmer crude oil prices and tighter central bank policy; here too, however, focus may soon shift to the domestic election cycle.

Among the Asian currencies, we anticipate a slightly stronger Chinese yuan (CNY) in the next few months as the authorities try to juggle rising inflation and slowing growth. The Indian rupee (INR) should benefit from foreign capital inflows amid attractive interest rates and domestic IPOs.

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Federal Reserve and Bank of Canada Monetary Policy Outlook

Federal Reserve—Early Hikes?

The Federal Reserve is forecast to end Treasury and MBS purchases before transitioning toward reinvestment of maturing flows by early next summer. We currently forecast a rate hike in December 2022 and a path toward a 1.5% fed funds upper target by the end of 2023 but leave open the possibility of raising the fed funds target range by mid-summer. That would leave the policy rate somewhat below the FOMC's estimated 2.5% neutral rate and closer to the Laubach-Williams estimate of ~2% by the end of 2023.

Timing the first interest rate hike of the pandemic depends progress toward the Fed's full employment mandate and generally supportive economic growth. Fed officials have generally indicated they would prefer to reinvest for period of time before raising the fed funds policy rate, unless inflationary pressures fail to subside by next summer. Should wage pressures continue to mount then this could add to concern at the Fed regarding a self-reinforcing wage-price spiral. The November 2022 mid-term elections may be an added consideration given the Fed's traditional desire to avoid being a focal point into elections even when calls for greater oversight are not as loud as at present.

Bank of Canada—Rate Hikes Coming

The Bank of Canada's (BoC) overnight rate is forecast to rise to 1.25% by the end of 2022 and 2.25% by the end of 2023 from 0.25% at present. We had previously (since April) been forecasting two hikes in 2022 starting in July. By the end of 2023, our forecast would put the policy rate well into the Bank of Canada's estimated 1.75–2.75% neutral rate range. There is material risk that the BoC hikes earlier than our prediction with markets pricing a first hike in January.

A confluence of factors may lean against raising the policy rate as soon as markets believe. The BoC has usually met market expectations, but has deviated often enough to merit caution. Governor Macklem has explicitly stated he will hike at one of four meetings starting in April through to September. The Governor has said they will only hike once spare capacity has been exhausted and we don't think that will happen until around mid-year. Macklem has also indicated he wishes to reinvest maturing holdings of Government of Canada bonds for a time before hiking.

To monitor early hike risk, we would recommend assessing wage and price pressures and fiscal policy developments on both sides of the Canada-US border. This includes progress toward a possible USD 2¼ trillion US stimulus package and if the Liberal government executes on election promises into a Fall update and/or Winter budget. The Fed dynamic is an added consideration.

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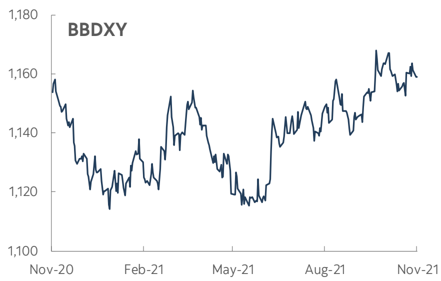
North America

USD

USD to Strengthen as Fed Normalizes **Current spot 1159.90**



Source: Bloomberg.

USD—We expect the USD to appreciate in the coming months in response to firmer domestic interest rates and relatively low interest rates elsewhere in much of the G10 space. Year-end volatility may make for a choppy turn but we expect a fairly robust start to the new calendar year for the USD (January is a seasonally strong month for the DXY dollar index). USD gains may extend 2–3% in broad terms in the next 1–3 months, technical signals suggest, and we expect the Fed's rapid tapering operation to backstop the USD as the overhang of global dollar liquidity is reined back.

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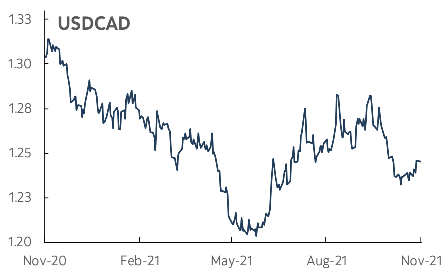
USDCAD

CAD Set to Outperform on BoC Tightening **Current spot 1.2470**



Source: Bloomberg.

USDCAD—We are bullish on the CAD. Year-end trends may be somewhat disruptive for our constructive prognosis but we think the cocktail of an earlier and more aggressive (at least initially) tightening in domestic monetary policy relative to the Fed and firm commodity prices will combine to drive the CAD generally higher in the coming year and push USDCAD to 1.20 through mid-2022. A USDCAD undershoot is a low, but non-negligible risk given the BoC's policy stance. Policy makers showed little concern about recent CAD appreciation and may feel that a somewhat stronger exchange rate will help dampen above target inflation down the road. We expect significant gains on the CAD crosses (EUR, JPY) in the coming months.

Scotia Forecasts	Q3-21	1.27	Q4-21	1.22	Q1-22	1.22	Q2-22	1.22

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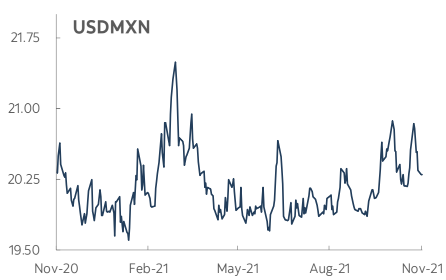
USDMXN

MXN Carry Advantage Weakens as Peers Moves Faster **Current spot 20.29**



Source: Bloomberg.

USDMXN—MXN has been a mid-tier performer year-to-date (-1.9%), propped up by record levels of remittances, but recently weighed down by weakening trade flows. The trade balance, which averaged -USD200 mn the 10 years prior to the pandemic, averaged a USD 5 bn trade surplus in the second half of 2020. In H1-2021, Mexico's trade balance was flat, but the first three months of H2-2021 have seen an average deficit of USD 3 bn. Banxico was conservative relative to its regional peers in cutting rates during the pandemic, making its pace of hikes more modest on the way up, but the MXN's carry advantage within the hemisphere is being unwound by faster hikes elsewhere. .

Scotia Forecasts	Q3-21	20.64	Q4-21	20.54	Q1-22	20.76	Q2-22	21.03

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Major Currencies

EURUSD

Fed/ECB Divergence to Weigh on EUR **Current spot 1.1580**

Source: Bloomberg.

EURUSD—The ECB is widely expected to lag the Fed and the BoE in increasing its policy rates as the bank's new strategy compels it to keep policy looser for longer. The ECB is not expected to increase policy rates until late-2023 at the earliest (and the rate-hiking cycle is set to be slow and narrow), at which point the Fed will likely have hiked by 125bps or more. Further to Fed/ECB divergences, near-term supply and energy issues, and a winter contagions wave pose additional risks to our end-2021 forecast of 1.15. The deployment of the EU's recovery fund in 2022 will support GDP growth in the bloc but longer-run economic prospects are muted in comparison to the US so the EUR will maintain a relative-growth disadvantage over the longer-term.

Scotia Forecasts	Q3-21	1.16	Q4-21	1.15	Q1-22	1.15	Q2-22	1.14

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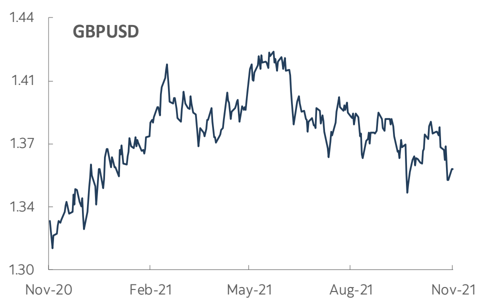
GBPUSD

BoE Hold Diminishes GBP Upside **Current spot 1.3535**



Source: Bloomberg.

GBPUSD—The BoE's dovish hold at its early-November meeting has depressed the GBP to a year-to-date low after gaining support from bets that the BoE would increase rates twice in Q4. Governor Bailey and other BoE policymakers signaled ahead of the meeting that a bank rate increase was near only to leave policy unchanged, push back against market expectations for 2022, and suggest that they will now kick off the tightening cycle in February. While the GBP may rebound against the USD as the BoE moves ahead of the Fed, upside now looks more limited as Fed rates pricing is brought forward in the coming quarters. We think the GBP will most likely appreciate against the likes of the EUR and JPY, however, whose central banks are years away from increasing rates.

Scotia Forecasts	Q3-21	1.35	Q4-21	1.38	Q1-22	1.40	Q2-22	1.40

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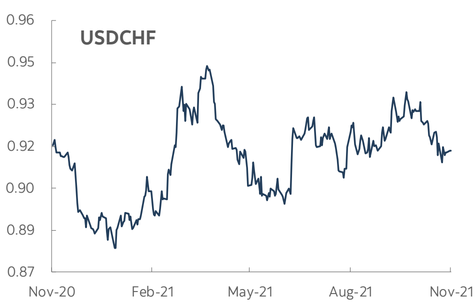
USDCHF

Weak EURCHF May Force SNB into FX Intervention **Current spot 0.9138**



Source: Bloomberg.

USDCHF—After reaching a six-month low in late-September, the CHF has since recovered against the USD amid declining Treasury yields and the franc has strongly appreciated versus the EUR since mid-September to its strongest level since May 2020. The EURCHF is nearing the key 1.05 level that will likely motivate SNB intervention in currency markets in the coming weeks—to result in broad CHF losses. We think the recent decline in US yields is temporary and the beginning of the Fed's tapering cycle and the rising chance of multiple Fed rate increases in 2022 will weigh on the CHF against the USD. Given the ECB's ultra-dovish stance, however, the SNB may have to resort to increased FX interventions through 2022.

Scotia Forecasts	Q3-21	0.93	Q4-21	0.94	Q1-22	0.94	Q2-22	0.95

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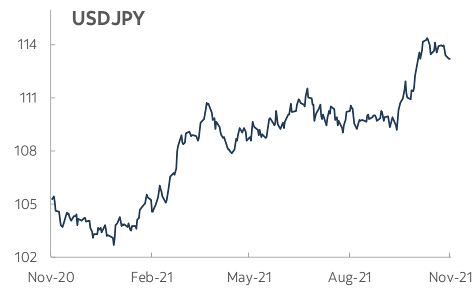
Major Currencies Continued...

USDJPY

Negative JPY Outlook on Rising US Yields **Current spot 112.95**



Source: Bloomberg.

USDJPY—The JPY recently split from the 110 zone that held it through most of 2021 with markets preparing for the beginning of the Fed's tapering while surging energy prices have damaged the minor support that Japan's positive trade balance provided to the JPY. Economists and markets forecast that the BoJ will stick to its ultra-dovish monetary policy stance for at least a few more years and thus widening rate differentials against the US will exert a significant negative pull on the JPY. A correction in energy prices from temporarily elevated levels may help to offset some of the JPY's losses on monetary policy prospects but we still anticipate that the JPY will reach a five-year low in 2022.

Scotia Forecasts	Q3-21	111	Q4-21	113	Q1-22	113	Q2-22	115

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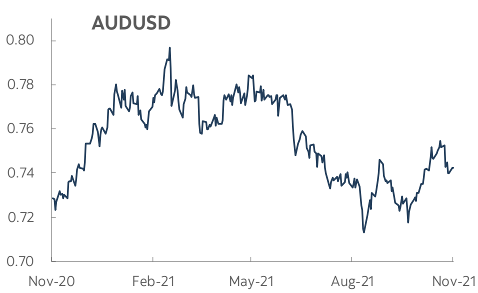
AUDUSD

AUD Upside on Earlier RBA Hike **Current spot 0.7375**



Source: Bloomberg.

AUDUSD—The AUD's prospects have improved recently as the RBA may hike sooner than expected (after dropping its 3-yr yield target). The economy is set to rebound through the rest of the year and into 2022, implying that a cautious adjustment to ultra-loose RBA policy is justified. With inflation expected to be within target over the foreseeable future and wage inflation gradually rising, we expect the RBA to start hiking in Q3-23, with risks skewed toward earlier hikes (though market pricing for 2022 hikes is overambitious). The re-pricing of overdone RBA expectations and the lead-up to the Fed's first hike in H2-22 will weigh on the AUD, in addition to weakening prices for Australian commodities (principally iron ore amid China's real estate slowdown).

Scotia Forecasts	Q3-21	0.72	Q4-21	0.74	Q1-22	0.74	Q2-22	0.74

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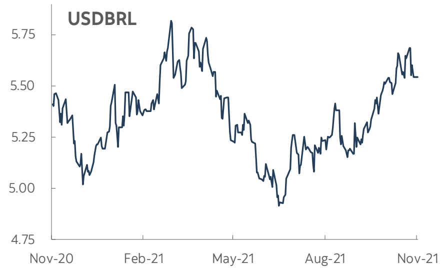
Latin America

USDBRL

Political and Fiscal Woes Weigh on BRL **Current spot 5.4900**



Source: Bloomberg.

USDBRL—Political uncertainty and continued fiscal slippage have not only put undue pressure on the BCB but have also made the real one of the worst performing global currencies. Over the past month, the BRL is 3rd worst among the top 32 currencies, losing -2.0%, and it's also in the bottom third of major FX year-to-date (-5.1%). At the center of investor concerns are plans to introduce new rounds of stimulus ahead of the 2022 presidential elections, which could further undermine the country's fiscal sustainability framework. In addition, the BCB is being forced to overcompensate for fiscal looseness, hiking rates at a faster than 100 bps rate per meeting.

Scotia Forecasts	Q3-21	5.44	Q4-21	4.88	Q1-22	4.85	Q2-22	4.81

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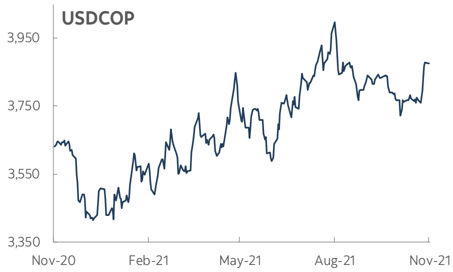
USDCOP

COP Range-bound as External and Domestic Drivers Clash **Current spot 3,878.50**



Source: Bloomberg.

USDCOP—The COP is affected by two opposite forces. On the one hand, external volatility due to higher inflation and a deceleration of economic activity globally have triggered risk aversion, weakening the COP. On the other hand, improved domestic economic activity alongside higher fiscal revenues and somehow under-control inflation should support the COP. On balance, then, the exchange rate is range-bound between COP3700 and COP3780 per USD. Further government monetization should support the COP to minor gains by the end of the year. We expect high volatility to persist through the end of 2021, however, but we think that USDCOP will end 2021 at around 3,750.

Scotia Forecasts	Q3-21	3,809	Q4-21	3,760	Q1-22	3,804	Q2-22	3,683

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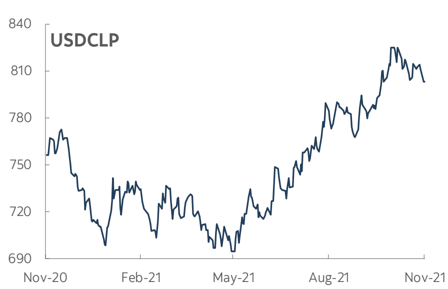
USDCLP

November Election Risks CLP Volatility **Current spot 794.00**



Source: Bloomberg.

USDCLP—Over the past three months, political uncertainty seems to be main driver of the Chilean peso. The CLP has depreciated around 3% despite a 6% rise in copper prices, but alongside a 1% appreciation in the dollar (DXY index). Regarding the political sphere, the passage of a bill in Congress allowing a fourth withdrawal of pension funds and the impeachment process against President Piñera has maintained a political punishment on the CLP. Going forward, we foresee episodes of high volatility ahead of the November 21 election. We forecast USDCLP to close in on 800 towards year-end, depending on the results of the presidential election.

Scotia Forecasts	Q3-21	810	Q4-21	800	Q1-22	760	Q2-22	740

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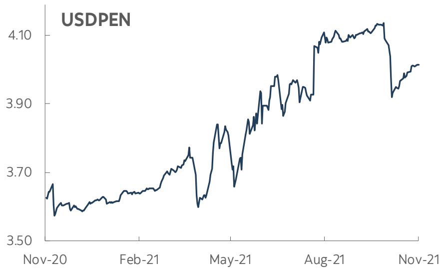
Latin America Continued...

USDPEN

BCRP Pressured to Intervene Amid Weak Sentiment **Current spot 4.0195**



Source: Bloomberg.

USDPEN—The PEN has continued weakening as a lack of confidence in the investment community persists. However, an increase in BCRP USD sales activity in the spot market, suggesting a degree of discomfort when the USDPEN exceeds 4.00, took some pressure off the PEN. Demand for dollars has softened as expectations have adjusted but could find a new driver through increasing inflationary concerns. The supply of dollars comes mainly from foreign investors, mining companies, and BRCP activity. External fundamentals remain positive thanks to the terms of trade surplus and a high level of foreign reserves, as well as the recent issue of global bonds for USD4bn. Going forward, we expect PEN weakening to be less pronounced than in the past.

Scotia Forecasts	Q3-21	Q4-21	Q1-22	Q2-22
	4.13	4.15	4.15	4.20

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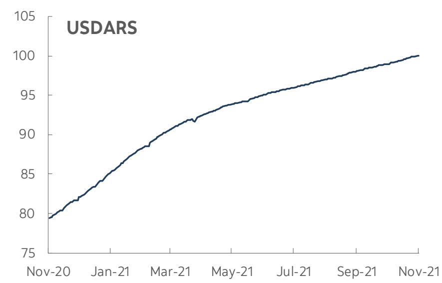
USDARS

ARS on Steady Weakening Path Past 100 **Current spot 100.10**



Source: Bloomberg.

USDARS—The official peso is projected to maintain its gradual depreciation toward USDARS 105 by the end of 2021, consistent with the country's unchanged combination of lax fiscal and monetary policies. The authorities continue to intervene actively in FX markets. On November 4, the BCRA announced that financial institutions would be required to hold their foreign currency positions in USD unchanged until end- November to limit speculation around the November 14 mid-term elections. The BCRA used the ensuing brief respite for the peso to make its largest purchase of dollars in four months, but pressure will remain on reserves and the ARS at least until a new financing agreement is reached with the IMF in the first half of 2022.

Scotia Forecasts	Q3-21	Q4-21	Q1-22	Q2-22
	98.7	105.0	111.5	124.6

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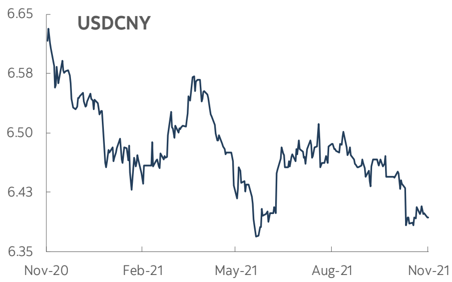
Asia

USDCNY

CNY to Gain on Economic Recovery **Current spot 6.3925**



Source: Bloomberg.

USDCNY—China's credit impulse index and official manufacturing PMI are set to rally late this year or early the next as the two indicators are approaching the bottom of the current credit cycle and the nation will step up efforts to sustain the economic recovery into 2022. In addition, US-China trade relations remains on track to improve, with all eyes on the Biden-Xi virtual summit planned for the near future. USDCNH will likely trade lower towards 6.30 once breaching the 6.35 support level. Meanwhile, the PBoC will continue setting USDCNY with an upward bias if needed to prevent one-sided speculation on yuan appreciation.

Scotia Forecasts	Q3-21	6.44	Q4-21	6.40	Q1-22	6.30	Q2-22	6.40

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USDINR

INR Supported by Solid Growth and Inflation Outlook **Current spot 74.05**

Source: Bloomberg.

USDINR—While India's current account balance is expected to swing back into deficit in the September quarter amid booming oil prices, the nation's trade deficit narrowed in October from the prior month. Indian companies are now seeking to raise more than INR 270 bn through initial public offerings (IPOs) in the first half of November. In the months ahead, India's bright growth prospects and benign inflation outlook augur for higher domestic real returns, supportive of rupee-denominated assets. We are bullish on the INR and forecast spot easing to reach 72 early next year.

Scotia Forecasts	Q3-21	74.2	Q4-21	74.0	Q1-22	72.0	Q2-22	74.0

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USDKRW

BoK Hikes Set to Prevent Further KRW Weakness **Current spot 1,177.00**

Source: Bloomberg.

USDKRW—South Korea's export-driven economy will keep expanding in the months ahead amid an improving global trade outlook. The BoK will raise its policy rate by 25 bps to 1.00% on November 25 in our view, which should be supportive of the KRW in general. However, we remain somewhat cautious ahead of the MSCI equity index review set for November 11 that may result in some equity outflows, similar to May and August this year. We expect the KRW to advance into year-end, assuming that markets do not become overly worried by Fed policy tightening risks, and forecast USDKRW falling to 1,140 early next year.

Scotia Forecasts	Q3-21	1,184	Q4-21	1,160	Q1-22	1,140	Q2-22	1,160

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Asia Continued...

USDTHB

Tourism Reopening to Lift THB **Current spot 32.77**

Source: Bloomberg.

USDTHB—Thailand has been pushing to revive its tourism industry which has been badly affected by the coronavirus pandemic and reopened its borders to vaccinated foreign tourists from more than 60 "low-risk" nations as of November 1. The nation's current account deficit narrowed to USD 1.35 bn in September from USD 2.54 bn in August, compared to a market estimate of a USD 1.83 bn shortfall. The reopening will further improve the nation's external balances and prop up the THB, with current account balance likely to swing back into a surplus in early 2022. USDTHB should trade more decisively lower after breaching the THB 33 support level.

Scotia Forecasts	Q3-21	33.7	Q4-21	33.0	Q1-22	31.5	Q2-22	33.0

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USDTWD

TWD Supported by Global Demand but at Risk of China-Taiwan Tensions **Current spot 27.75**

Source: Bloomberg.

USDTWD—Taiwan's exports and export orders continue their double-digit growth on the back of improving global demand, providing clear fundamental support for the TWD. The island's CPI eased marginally to 2.58% in the October year from September's 2.62%, but will remain elevated for the rest of the year due to base effects. However, the CBC is in no hurry to raise the benchmark interest rate before the Fed starts its own tightening cycle in the second half of 2022. USDTWD will likely fluctuate between 27.8 and 28.0 for now, with odds geared to breaching the lower bound. In the medium term, cross-strait tensions risk weighing on the currency.

Scotia Forecasts	Q3-21	27.8	Q4-21	28.0	Q1-22	27.8	Q2-22	28.0

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USDSGD

MAS Allows Minor SGD Appreciation **Current spot 1.3475**

Source: Bloomberg.

USDSGD—The MAS, which manages the exchange rate as its main monetary tool, increased the slope of its currency band "slightly" on October 14 from zero percent previously. It is now allowing the SGD to appreciate against a basket of currencies in the next six months to counter rising inflationary pressures. The city-state's core inflation will come in near the upper end of the 0–1% forecast range and is projected to increase further to 1–2% in 2022, according to the monetary authority, justifying the October 14 MAS tightening. USDSGD will resume its downward trend towards 1.34 in the weeks ahead after consolidating recently around 1.35 amid a risk-friendly mood.

Scotia Forecasts	Q3-21	1.36	Q4-21	1.34	Q1-22	1.32	Q2-22	1.34

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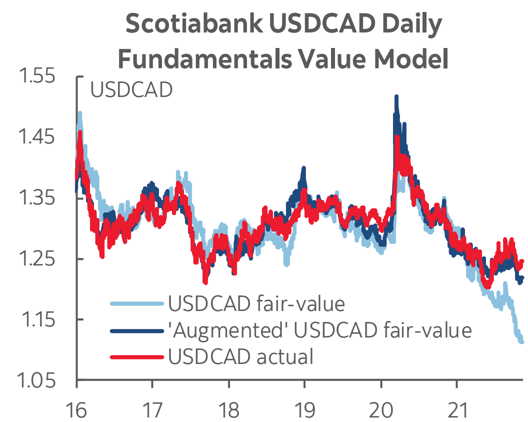
CAD Fair-Value Model: Closer to Target, But Still Undervalued

Our existing fundamentals based USDCAD model shows a 10%+ undervaluation of the Canadian dollar against fair value (chart 1). Despite crude oil prices trading at a seven-year high, elevated metals prices that recently rose to a decade high, and supportive short- and long-term rate differentials between Canadian and US bonds, the CAD has markedly deviated from long-run drivers since summer.

Prior to the current episode of persistent underperformance, the CAD's deviation from our fair-value estimate (post financial crisis) had rarely surpassed 4% and the largest undervaluation between our model and market pricing was 4.7% at the peak of the March 2020 COVID-19 shock (chart 2). Based on the inputs of this model, USDCAD 'should' be trading closer to 1.11/12, or its lowest level since late-2014. Instead, the dollar is between three to five cents stronger.

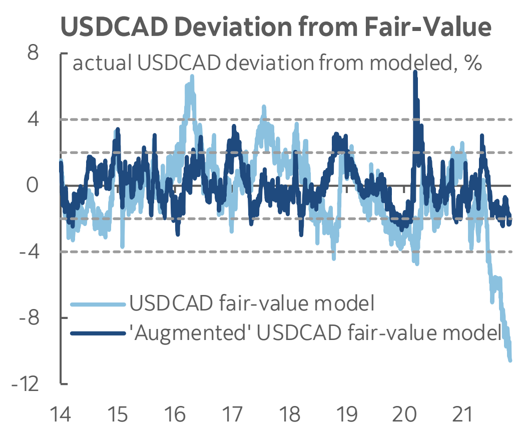
Considering this large divergence, we (alongside our Economics colleague Rene Lalonde in a forthcoming report) have augmented our USDCAD model. We now include variables that account for market volatility (VIX), the diminished reliance of the Canadian economy on oil and the US's reduced dependence on petroleum imports, and a broad measure of the USD that captures the strong pull of broad dollar flows on currency valuations.

Chart 1



Sources: Bloomberg, Scotiabank FICC Strategy, Scotiabank Economics.

Chart 2



Sources: Bloomberg, Scotiabank FICC Strategy, Scotiabank Economics.

The surge in US crude oil production that began roughly a decade ago has more than halved the country's net imports of crude oil, thus reducing the sensitivity of the USD to changes in oil prices. We include a 'dummy' variable in our new model to account for this (equal to 1 starting in 2014). The surge in US petroleum output since 2012 came at the expense of an 85% decline in Western Canadian crude prices between mid-2014 and early-2016. Although WCS prices have recovered since, the Canadian oil patch faces considerable headwinds when compared to lower-cost producers and amid a push for vehicle electrification. Capital expenditures in oil and gas extraction have fallen to roughly a quarter of their total at their 2014 peak (adjusted for inflation) and foreign investor interest in Canadian assets, and thus demand for the CAD, has correspondingly decreased.

The inclusion of the Bloomberg broad dollar index (BBDXY) in the model goes a long way to bridging the gap between the CAD 'fair value' dictated by CAD-specific drivers (oil, commodities, spreads) and the actual market value of the exchange rate. The BBDXY is included to adjust for multilateral drivers of the dollar that represent broad international economic or financial conditions that impact USD demand. This may be a surge in USD liquidity (dollar negative) from large asset purchases programmes by the Fed. A broad move toward the dollar ahead of Fed hiking is another example. Greater integration in global markets also means that the CAD is relatively more sensitive to external rather than intrinsic drivers—such as crude oil prices.

Our new fundamentals-based USDCAD model gives a fair value estimate of 1.22 (chart 1 again), equivalent to a 2% undervaluation of the Canadian dollar—i.e. a fifth of the divergence of our original model. Over our estimation period, the USDCAD has tended to correct its over/undervaluation soon upon breaching a 2–3% threshold, and rarely (and only briefly) does it exceed 4% (chart 2 again). This suggests that the USD may look to re-align with its 'fair value' in coming weeks (all else equal) toward the low 1.20s. However, if our hypothesis is correct, the CAD may linger in a period of persistent undervaluation as the beginning of the Fed's hiking cycle sees broad USD demand—with EUR and JPY weakness significantly weighing on the broad currency complex.

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FOREIGN EXCHANGE STRATEGY

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