AMERICAS

Aggressive Fed monetary policy action will reduce the appeal of the USD but losses may remain limited versus its G10 peers. Weak commodity prices and slow domestic growth will keep the CAD tone softer for longer. The MXN remains sensitive to risk appetite as well as uncertainty around Pemex’s credit rating. CLP, COP & PEN are influenced by softer commodity prices and risk aversion.

EUROPE

EUR gains on position adjustment rather than fundamentals. Limited scope for BoE rate cuts curb GBP downside risks for now but trade uncertainty remain a constraint on gains. CHF is likely to benefit from refuge demand amid heightened market volatility.

ASIA-PACIFIC

JPY will remain underpinned by safe haven demand and more supportive real yield spreads versus the USD. We anticipate modest gains for the CNY/CNH as the Chinese economy normalizes.
Core Exchange Rates

Global Foreign Exchange Outlook

<table>
<thead>
<tr>
<th>March 6, 2020</th>
<th>2020f</th>
<th>2021f</th>
</tr>
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<tr>
<td></td>
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Market Tone & Fundamental Focus

After a protracted period of slow-moving and low-volatility trading, global currency markets experienced a significant jolt of activity through February and early March. This was driven by the emergence of the coronavirus as a risk for the global economy on the one hand and, on the other, the Fed’s surprise ½ point rate cut on March 3rd in response to “evolving risks to economic activity”. The Fed’s move was followed by a rate cut by the Bank of Canada (BoC) and drove expectations of a broader easing among major central banks, even if the margin for monetary manoeuvre in many developed markets (Europe, Japan primarily) is very limited.

The USD itself has not benefited from the latest bout of market apprehension. Refuge status has been handed back to the yen (JPY) and Swiss franc (CHF) amid a sharp decline in US yields. We also think the USD’s lack of appeal can be explained by market positioning. G10 focused carry trades have been heavily favoured by currency investors in recent months as returns have out-paced those centered on higher-yielding, but riskier, emerging market currencies. The USD’s status as a relatively high yielding currency in the G10 space had seen it (and the Canadian dollar—CAD) benefit from carry trades, funded by lower (or negative) yielding currencies, such as the euro (EUR). The USD has under-performed through the recent bout of market volatility as speculative, long USD positions are likely being reduced.

Markets are pricing in additional easing from the Fed which will likely undercut the USD further; the deeper the Fed has to dive into the (liquidity) toolbox to support markets and growth the greater will be the headwinds facing the USD. We continue to anticipate a softer USD over the balance of 2020 but heightened volatility and uncertainty around the broader outlook prompted us to moderate some of the anticipated gains for some currencies this year.

While the USD has traded mostly lower against the likes of the EUR and JPY through the latest market paroxysm, the commodity currencies have under-performed, reflecting declining raw material prices amid prospects for relatively weaker growth in the more commodity-intensive economies (China) in the next 1-2 quarters at least as the Covid-19 situation plays out. We have downgraded our G10 commodity FX forecasts as a result and now look for USDCAD to end 2020 at 1.31 (USc 76) and 1.28 at the end of next year (USc 78).

In Canada, the slide in crude oil prices compounded growing concerns around the domestic economic outlook after a soft end to 2019. Developments overshadowed what might otherwise have been a CAD-positive widening in US-Canada interest rate differentials around a sharp fall in market-driven US yields, even with the BoC matching the Fed’s 50bps cut. We expect more easing in the weeks ahead and some support for domestic growth from Ottawa via the Federal budget. More expansive fiscal policy and looser monetary policy will underpin expectations that the Canadian economy can get back to near trend growth later this year and into 2021 and should limit longer term damage on the CAD.

We have pared back our forecast for the EUR very slightly this year but maintain a 1.20 forecast versus the USD for 2021. We estimate that the EUR remains undervalued from a fundamental point of view. But potential for a sustained rebound appears limited as fundamentals matter little at the moment. The recent bounce in the EUR is being driven mainly by position adjustment, given that the EUR has been the liability of choice for investors and speculators funding carry trades and heightened volatility has forced speculators to cover those positions. The near-term outlook for the EUR hinges on market volatility, we think. More, but diminishing over time, EUR short-covering will emerge if risk appetite weakens again.

The pound sterling (GBP) has perhaps been less affected by recent uncertainty than other currencies but here too, we are opting to reduce expectations for GBP strength over the balance of the year. The UK and European Union have laid out their opening positions with regard to the impending talks aimed at resolving the UK’s post-Brexit trading arrangements. Unfortunately, the two sides appear far apart and the UK government has indicated it is willing to walk away from talks if progress is not being made by mid-year. Fiscal and monetary stimulus may bolster economic prospects but we expect the risk of a no-trade deal Brexit to weigh against the GBP making more headway in the early part of the year at least.

Asian FX has been mixed over the past month; the JPY has been volatile but has found support from safe haven demand and we continue to look for modest JPY gains versus the USD over the balance of the year, supported by Japan offering relatively higher real-long term bond yields than the USD. The CNY/CNH may appreciate modestly as the Chinese economy normalizes. The Mexican peso (MXN) and the Pacific Alliance currencies (Peruvian sol, Colombian and Chilean pesos) have been subject to the same forces as the G10 commodity currencies, with risk aversion and weaker commodity prices driving markets lower versus the USD since late January. We look for the MXN to retain a softer bias over the coming year but relatively high yields—even if Banxico eases again—may slow losses if broader market volatility stabilizes.
Canada
Currency Outlook

The near-term outlook for the CAD remains somewhat soft amid weak commodity prices and heightened market volatility. The CAD has retained a soft tone against the USD since the COVID-19 threat first gained real prominence for markets in late January (even if it has out-performed its commodity peers). It also lost ground against the EUR through mid/late February as speculative investors were forced to cover short EUR/long CAD “carry trades” amid a spike in market volatility, driving EURCAD some 5% higher from its mid-month low. More position adjustment is a risk here if market volatility picks up again.

Against the USD, prospects are somewhat mixed but we look for some stabilization in the CAD’s recent losses in the next few weeks. Fundamentally, we estimate that the CAD remains undervalued against the USD from a medium term point of view. We calculate equilibrium to be closer to 1.28/1.29 currently, reflecting much more CAD-favourable US-Canada interest rate differentials. In this respect, BoC easing measures which keep pace with the Fed may be a wash for USDCAD. However, weak crude oil prices provide some counter-balance to CAD-supportive spreads and, in general, markets are trading on emotion and headlines, rather than rational, fundamental judgements at the moment. It may be some time before market sentiment steadies but our commodity strategist colleagues are confident that oil producers will work effectively to lift crude oil prices in the coming months, which will add to CAD support. Recall that the CAD usually hits its “seasonal” stride against the USD in Q2.

From a technical point of view, the USD’s push through the H2 2019 range high around 1.3350 opens the charts up for a little more USD strength towards the May 2019 high (1.3565) potentially. We spot key USD support now at 1.3315. Weakness below here targets a retest of 1.30.

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**Canadian Dollar Cross-Currency Trends**

<table>
<thead>
<tr>
<th>FX Rate</th>
<th>Spot 6-Mar</th>
<th>20Q1f</th>
<th>20Q2f</th>
<th>20Q3f</th>
<th>20Q4f</th>
<th>21Q1f</th>
<th>21Q2f</th>
<th>21Q3f</th>
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<tbody>
<tr>
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<td>0.88</td>
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<tr>
<td>CADJPY</td>
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<td>1.30</td>
<td>1.28</td>
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</tr>
</tbody>
</table>

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**Charts:**

- **AUDCAD**
  - Mar-19 to Mar-20
  - Current level:
  - Mar-19: 0.89
  - May-19: 0.88
  - Jul-19: 0.88
  - Sep-19: 0.88
  - Nov-19: 0.88
  - Jan-20: 0.88
  - Mar-20: 0.88

- **CADJPY**
  - Mar-19 to Mar-20
  - Current level:
  - Mar-20: 85.5
  - Jun-19: 83.0
  - Sep-19: 80.5
  - Dec-19: 78.0

- **EURCAD**
  - Mar-19 to Mar-20
  - Current level:
  - Mar-20: 1.55
  - Jun-19: 1.52
  - Sep-19: 1.50
  - Dec-19: 1.45

- **USDCAD**
  - Mar-19 to Mar-20
  - Current level:
  - Mar-20: 1.34
  - Jun-19: 1.37
  - Sep-19: 1.34
  - Dec-19: 1.29
Global Outlook: 2020 growth has been shaved from 1.7% to 1.6%, with the 2021 expansion market up from 1.8% to 2.0% on the back of stronger consumption and business investment growth. Most of the economic impact of the outbreak is focused in the first half of 2020, with a moderate rebound taking hold thereafter. As the FOMC noted in its March 3 statement, the fundamentals of the US economy remain strong: average household debt-service ratios are at their lowest levels in 40 years, savings rates are high, and labour markets remain sound. While total business debt is elevated compared with GDP, companies’ average debt:asset ratios and interest-coverage ratios are near their decanal averages. The US private sector has an enormous range of resources to employ in support of further growth, although already-stretched public fiscal accounts provide less room to manoeuvre. With fiscal deficits set to remain large, widening trade deficits are likely to continue to tilt the White House toward continued trade protectionism. As a result, uncertainty will remain elevated.

CANADA — Following March 3’s G7 statement and the rate cuts by the Federal Reserve and the Bank of Canada, we expect another 25 bps cut at the Bank’s April meeting. Before then, Finance Minister Morneau will bring down the FY2021 budget and deliver fiscal support that is likely to go beyond the provisions of the Liberal Party’s autumn 2019 election platform in order to cushion the impact of the COVID-19 outbreak, help close Canada’s widening output gap, curry the favour of opposition MPs in Canada’s minority parliament, and limit the need for further monetary easing that could stoke household borrowing, inflame housing markets, and undermine financial stability. With the federal debt:GDP ratio projected at around 31% in 2020, Ottawa has the fiscal space needed to take action. Real GDP growth is now forecast to slow from 1.6% in 2019 to 1.1% in 2020 owing to the COVID-19 outbreak, down from 1.5% in our Q1 Global Outlook. A modest rebound is expected to take hold in late-2020 and boost growth in 2021 to 2.2%. 

Monetary Policy Commentary

UNITED STATES — Scotiabank Economics forecasts that the Federal Reserve will cut its fed funds target range by another 50bps to 0.75% at the March 18th meeting. At this point, we are not prepared to mark-to-market for subsequent meetings notwithstanding pricing that implies a return toward the lower bound by later this year. Nor are we prepared to embrace talk of unconventional easing such as QE4. There are several reasons why we are hesitant to chase markets:

- We don’t think fed funds futures traders are epidemiologists! Nor are we.
- The US economy into this shock is near full employment conditions.
- Other central banks are expected to ease and alleviate some of the burden on the Fed.
- Households are getting a significant infusion of market-derived stimulus through the drop in the 30 year mortgage rate, lower gasoline prices and moderate wage gains.
- The financial system is sound given present conditions and excessive easing carries uncertain effects upon financial stability.

That said, clearly the risk is tilted more toward additional easing than less and this forecast round is expressed very tentatively. The Fed rarely disappoints markets. Inflation is sub-target and market-derived inflation expectations have fallen. The Fed will roll-out its strategic review this summer and we expect more emphasis upon average inflation targeting. The Fed also likely faces the higher burden of acting alone as a material fiscal response is unlikely in this Congress within an election year.

CANADA — Scotiabank Economics forecasts at least one more quarter-point rate cut by the Bank of Canada at the April 15th policy meeting. That would drop the policy rate to 1%. The goal is to address pre-existing economic slack and the incremental negative impact of COVID-19. Markets have priced about a full rate cut for the BoC’s April meeting and one more over the summer.

There are several reasons why we are hesitant to go further and predict more easing at this juncture while leaving the door wide open to reconsidering as developments unfold.

- How the virus and its macroeconomic effects may evolve is highly uncertain.
- We assume a mild economic rebound.
- The combination of demand and supply shocks to global supply chains through trade and virus effects makes the impact upon inflation uncertain.
- Unlike the US, the BoC is expected to get some help from fiscal stimulus.
- The flexible exchange rate is serving as a partial shock absorber.
- There is a limit to the extent to which the BoC courts financial stability risks in housing.
- Core inflation remains around target and wage gains remain solid with moderate downside risk.

That said, clearly the risk is tilted more toward additional easing than less and this forecast round is expressed very tentatively. The Fed rarely disappoints markets. Inflation is sub-target and market-derived inflation expectations have fallen. The Fed will roll-out its strategic review this summer and we expect more emphasis upon average inflation targeting. The Fed also likely faces the higher burden of acting alone as a material fiscal response is unlikely in this Congress within an election year.
G10
Currency Outlook

EUROZONE — Despite a steep increase in COVID-19 cases in Italy, the EUR has outperformed most major currencies in recent weeks after a nine-day stretch in oversold territory. The EUR has been lifted by unwinding carry positions—using the EUR as a funding currency—amid heightened market volatility and reduced risk appetite. Carry activity may rebound, with a negative impact on EUR, as volatility falls off a four-year high and we think the EUR will have to make a clear break above 1.12 before we’re confident in calling for continued EUR gains. Being modestly stretched from a technical perspective, the EUR may weaken in the near term before gradually trending towards our year-end target of 1.14 on the back of more favourable rate differentials.

UNITED KINGDOM — Cable has jumped across a series of trading bands since the EU and the UK announced an exit agreement in October with the pound’s latest leg down on rising no-trade-deal risks pushing it to trade around the 1.28/1.29 mark. The PM’s hard stance in talks with the EU—threatening to cancel negotiations in June absent material progress—will cap the currency during the first half of the year. For the moment, we expect that negotiations will survive the June test and the GBP will close the year at 1.32 and strengthen further to end 2021 at 1.38.

JAPAN — After reaching a ten-month low on fears over the spread of the coronavirus in Japan, the yen has again taken on clear safe-haven status amid heightened risk while also gaining on the Fed’s aggressive cut in contrast to BoJ inaction. While near-term expectations for the yen are muddied by weak growth domestically the longer-term trend as well as Japan’s favourable external accounts position and improved yield spreads point to a continued appreciation of the JPY, which we forecast to end 2020 at 106.

AUSTRALIA — With yield spreads and market risk driving AUD movements in recent years, the Fed’s latest 50 bps cut in contrast to the RBA’s 25 bps cut has provided a temporary boost to the AUD as an offset to the cautious tone in markets. We expect that in H2-20, the AUD will benefit from declining uncertainty and improving growth in China. However, AUD may struggle to break out of its downward trend since early-2018 and we currently project that AUD will close 2020 at 0.67 per dollar.
G10

Fundamental Commentary

EUROZONE — On March 2, Pres. Lagarde stated that the ECB was “ready to take appropriate and targeted measures, as necessary and commensurate with the underlying risks,” which only weakly echoed the Fed’s own foreshadowing of the FOMC’s inter-meeting 50 bps cut. The next ECB Governing Council monetary policy meeting on March 12 will have little hard data on COVID-19’s economic impact on the Eurozone. Policy rates are already at record lows and further small cuts would provide little beyond a signalling effect. Nevertheless, a symbolic cut now looks unavoidable to prevent a tightening of financial conditions; hence, we now expect a reduction in the deposit rate on March 12 from 0.5% to 0.6%, with the possibility of a further move later this year. The ECB may also: (1) expand its low-cost credit facilities and (2) beef up its EUR 20 bn/month asset purchase programme (APP). The ECB will also reiterate its calls for Eurozone governments to use more of their fiscal space. Italy is seeking flexibility on the Eurozone’s budget targets, while Germany may bring forward approved business-tax reforms, short-term liquidity support to business, and even a relaxation of its “debt brake” that curtails public deficits. Eurozone-wide growth has been marked down in 2020 from the Q1 Global Outlook’s 1.1% to 1.0%, with a mild pick-up to 1.2% forecast for 2021.

UNITED KINGDOM — Although the Bank of England’s (BoE) Monetary Policy Committee (MPC) voted 7-2 on January 30 to hold its bank rate unchanged, it did so accompanied by softer forward guidance and the January Monetary Policy Review’s (MPR) weaker economic forecast. The COVID-19 outbreak has since dampened prospects further, while the Fed’s 50 bps cut on March 3 created new pressure on the BoE to follow. Gov. Carney’s recent statement and testimony to the UK Parliament’s Treasury Select Committee hinted that the BoE is prepared to cut interest rates. Action by the BoE remains contingent, however, on the scale and scope of the Johnson government’s first budget due on March 11. A (likely highly stimulative) budget and the end of Gov. Carney’s term on March 15 fall just ahead of the next scheduled MPC meeting on March 26 and mitigate against an inter-meeting move. Whether delivered by Gov. Carney or his successor Andrew Bailey, we expect the BoE to compliment the government’s budget with bridge financing for small companies, forbearance so that banks can draw down some of their countercyclical buffers, and new forward guidance, with the (still low) possibility of additional quantitative easing. On a possible rate cut, incoming Gov. Bailey has cautioned that the “US market context is different” from the shocks faced by the UK, and may not deliver on the cut that markets have priced. Nevertheless, we now forecast a 25 bps cut on March 26, with a possibility of 50 bps then or a second 25 bps cut thereafter.

JAPAN — The Japanese economy was hit hard by the impact of Typhoon Hagibis and the consumption tax rate increase in October 2019 when the levy was raised from 8% to 10%. As a result, the country’s real GDP contracted by 1.6% q/q (non-annualized) in Q4 2019, led by substantial declines in private consumption and business spending. The Japanese economy expanded by 0.8% in 2019 as a whole. While activity would typically recover fairly quickly after an initial tax-induced shock, the COVID-19 outbreak will dampen the rebound. We expect the Japanese economy to expand by only 1.2% in 2020 as a whole. The Japanese government is preparing additional fiscal measures to support the weak economy. According to Prime Minister Shinzo Abe, the stimulus package will be finalized on March 10. Meanwhile, the Bank of Japan (BoJ) is set to maintain highly accommodative monetary conditions in the foreseeable future. Should the virus outbreak extend well beyond the first quarter of 2020, the likelihood of the BoJ unveiling further monetary stimulus would rise significantly. BoJ Governor Haruhiko Kuroda has emphasized that the central bank will take necessary steps to stabilize financial markets and provide sufficient liquidity. Japan will continue to struggle with low inflation and (2) beef up its EUR 20 bn/month asset purchase programme (APP). The ECB will also

AUSTRALIA — Australia’s economic challenges mount as the COVID-19 outbreak and the impact of bushfires weigh on sentiment and economic activity. We forecast Australia’s real GDP to expand by 1.9% y/y this year, compared with our earlier projection of 2.1%. Nevertheless, we note that risks remain on the downside. On March 3, the Reserve Bank of Australia (RBA) cut the benchmark cash rate by 25 bps to 0.50%; the cut follows rate reductions of 75 bps over the course of 2019. The RBA assessed that the virus outbreak will delay Australia’s progress toward reaching full employment and meeting the 2–3% y/y inflation target; hence looser monetary policy is justified. The RBA also indicated that it is prepared to ease monetary policy further if needed. While we expect the RBA to stay on hold over the coming months, we note that further rate cuts are possible if the virus outbreak worsens. We also highlight the fact that RBA Governor Philip Lowe has previously indicated that the central bank would consider quantitative easing—i.e. purchasing of government bonds in the secondary market—in a situation where the benchmark interest rate had reached 0.25%. Muted inflationary pressures will allow the RBA to maintain accommodative monetary conditions in the foreseeable future. Australia’s headline inflation remains below the RBA’s 2–3% inflation target, with prices rising by 1.8% y/y in Q4 2019. Demand-driven price pressures will likely remain largely absent in the foreseeable future, with headline inflation hovering around the lower end of the RBA’s target range through 2021.
China, India, Brazil
Currency Outlook

CHINA — While the number of COVID-19 cases in China is falling due to the nation’s bold approach, it seems the coronavirus outbreak cannot be stopped from spreading globally. China’s official manufacturing PMI slumped to a record low in February but is expected to rally substantially this month with more companies having returned to work. A rebound in output and the prospect of easier still Fed policy implies downside risks for USDCNH. We believe USDCNH may fall to 6.85 in the coming weeks.

INDIA — Slowing credit growth has cast a shadow on the Indian economy. The RBI’s long-term repo operations (LTROs) are aimed at improving the monetary transmission mechanism and lowering funding costs for the real economy. With emerging concerns over the coronavirus spreading in India, the INR is now playing catch-up with recent losses in regional peers such as the IDR. Although India’s massive foreign reserves could provide a buffer, USDINR will likely head for the 74 level this month.

BRAZIL — USD/BRL has had a rough quarter, dropping from a low of 4.0 at the start of the year, to above 4.60 at the start of March. The combination of too-low a carry embedded in the currency, combined with both domestic and global uncertainty, have precipitated the real’s drop. Brazil’s FX-inflation pass-through is somewhere in the 20-30% range, suggesting there is some risk of higher IPCA if the real’s weakness persists. We see the real dropping a bit further before it bounces back.
China, India, Brazil
Fundamental Commentary

CHINA — The Chinese economy is facing significant downward pressure as it fights the COVID-19 outbreak. The reduction in activity across China has been unprecedented across the services and industrial sectors. We estimate that China’s real GDP growth will dip to 3.5% y/y in Q1. Assuming that the outbreak will start stabilising in Q2, a gradual rebound is expected from then onwards, assisted by decisive policy support. We estimate that the Chinese economy will expand by 5.0% in 2020 as a whole. Tourism, transportation and any consumer spending-related sectors will be hit the hardest as people stay at home due to fear of infection and the authorities’ containment measures. Meanwhile, the strict measures have hobbled industrial production and disrupted regional supply chains as workers’ activities are restricted. Chinese policymakers have promised significant support measures to underpin the weak economy. The People's Bank of China (PBoC) has rolled out monetary stimulus by lowering interest rates; on February 17, the central bank lowered the 1-Year Medium-term Lending Facility rate by 10 bps to 3.15%. Subsequently on February 20, the benchmark one-year Loan Prime Rate was lowered by 10 bps to 4.05%. We expect additional rate cuts, complemented by lower bank reserve requirement ratios, in the very near future. According to the PBoC’s monetary policy implementation report, the flexibility of the PBoC’s monetary policy tools will be improved, ample liquidity in the banking system will be maintained, and credit availability will be increased. The central bank is also guiding banks to increase credit support to small private sector companies, the manufacturing industry, and industries that are directly either affected by the virus or involved in the control of the epidemic. Additional fiscal stimulus is also underway, despite the fact that China’s annual parliamentary gathering, the National People’s Congress—scheduled to start on March 5—has been postponed due to the outbreak. The government has promised tax cuts, higher spending financed by local government special purpose bonds, as well as targeted measures for businesses and sectors that are affected the most.

INDIA — India’s current economic growth performance is soft, highlighting the need for continued fiscal and monetary stimulus efforts. Real GDP grew by 4.7% y/y in Q4, following a revised 5.1% gain in Q3. India’s output advanced by 5.3% in 2019 on the whole. While we expect a slight pickup in the months ahead, the economy’s growth momentum remains subdued on the back of anemic consumer spending and fixed investment growth. The COVID-19 outbreak adds to the economy’s challenges as weaker consumer confidence is expected to delay any meaningful recovery in household spending. We expect India’s real GDP growth to average 5.8% in 2020. India’s inflation dynamics have become more complex recently with headline inflation accelerating sharply. Inflation rose to 7.6% y/y in January from 2.0% in early 2019, mostly driven by higher food prices. Headline inflation will likely hover near the upper limit of the Reserve Bank of India’s (RBI) annual target of 4% ±2% over the coming months. Meanwhile, core inflation, at 4.2% y/y in January, remains close to the mid-point of the RBI’s target. We expect the current headline price pressures to be transitory. The RBI left the benchmark repo rate unchanged at 5.15% in February, yet the central bank maintained its “accommodative” policy stance. In 2019, the benchmark repo rate was reduced in five consecutive policy meetings by a total of 135 bps. The RBI’s policymakers have emphasized that the central bank’s main objective is inflation-targeting; accordingly, they want to have greater clarity on inflationary developments before stimulating the economy further. We assess that once transitory inflationary pressures start abating the RBI will act to stimulate the economy. India’s Union Budget for Fiscal Year 2020–21 (April–March) was presented on February 1. The Budget focuses on rural demand and infrastructure investment, yet fiscal measures seem inadequate to address the economy’s weakness. The estimate for the central government’s fiscal deficit in the current fiscal year was revised to 3.8% of GDP vs. the targeted 3.3% as economic softness has led to muted tax revenue. Following the fiscal slippage this year, the government aims to narrow the shortfall to 3.5% of GDP in the FY21. This highlights the administration’s challenge in balancing between stimulating the economy and promoting investor confidence on India’s fiscal sustainability.

BRAZIL — Brazil closed 2019 showing a gradual rebound in activity, with 19Q4 GDP printing at +1.7% y/y, but PMIs for February (both services and composite) dropped from above 52 to slightly above 50, and the more timely data suggest growth risks have tilted to the downside. The deterioration of data to kick off the year, combined with concerns over trade disruptions due to 2019-nCoV’s impact on the Chinese economy, have prompted a fairly sharp reversal in BCB policy expectations. After DI rates kicked off the year pricing in about 60bps in rate hikes over the coming 12 months, we’ve seen a 180 degree reversal to now price in 175bps of rate cuts over the same span. We’re not sure that with local yields at 2.5% (the priced in terminal rate) the BRL can remain anchored, but that is currently what markets are expecting. For now, due to the recent bout of negative news on both the growth front but also due to very high uncertainty, we have made a sharp change in our BCB call, but will wait until we have more clarity before matching the market’s aggressive shift. Among other things, IPCA is rising fast. We expect the BCB to cut 50bps in its next COPOM meeting, followed by 2X 25bps downward moves, but at this stage we were not ready to call for all that’s currently priced into DIs.

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Pacific Alliance
Currency Outlook

MEXICO — Tensions generated globally by the coronavirus epidemic are likely to produce a jumpy environment in financial markets. After the 50 bps reduction by the US Fed, we think Banco de Mexico will follow with a similar cut, which will infuse higher sensitivity on the MXN. Special attention should be paid on Pemex’s Q1 results and federal tax collection figures, which could tilt the balance on Mexico credit ratings and add pressure on the MXN.

COLOMBIA — Colombian fundamentals tilt USDCOP to a mild appreciation this year to levels around $3280-$3300 on average due to structural twin deficits that are well financed. Increasing uncertainty due to COVID-19 makes USDCOP prone to higher levels. We think, as long as coronavirus risks continue, EM FX will continue to show high volatility. Having said that, our base case scenario is that COVID-19 fears are temporary, and markets will return to a risk-taking mood in 2H2020, thus leaving our end-2020 forecast unchanged at $3250-$3300.

CHILE — The Chilean peso is heading back to its historical lows as we approach the date of the referendum to modify the Constitution amid lower appetite for risk assets related to the effects of COVID-19. On the other hand, the Central Bank could resume its FX interventions if idiosyncratic volatility rises. These factors will push the CLP away from its short-term fundamentals, but we still expect an appreciation of CLP toward 740 by year-end, as copper prices stabilize and global and local uncertainties dissipate.

PERU — After fluctuating for nearly two years in a 3.28 to 3.42 range, the PEN has moved into a new range, with a higher, albeit probably temporary, ceiling outlined by the Central Bank at 3.45-3.46. Even if there is a rebound in Chinese growth and metal prices before the end of the year, the new technical range suggests that the FX rate will likely end 2020 higher than expected. We are nudging our forecast up to 3.40, from 3.35.

<table>
<thead>
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MEXICO — Headwinds from abroad and on the domestic front have produced a weak and stagnant economy, as evidenced by a 0.1% contraction in GDP in 2019. Our growth forecast for 2020 has been revised to 0.6% from 1.0%, since the main engines of growth—private consumption and investment—are not generating enough traction; and now we face the negative effects of the coronavirus epidemic, which will be of a still unknown magnitude. Uncertainty regarding public policy, concerns about security and the Rule of Law and the growing threat of a credit rating downgrade are curbing private investment. Poor and weakening job creation and a lack of a clear outlook for income growth are producing have led to extremely cautious consumers. In this environment, and after the recent Fed decision, it now seems highly likely that Banco de Mexico will follow and cut its reference interest rate by 50 bps at its next scheduled decision, and will cut once more in the first half of the year by 25 bps cuts. The looser monetary stance will likely add to the sensitivity of the exchange rate, leading to a weaker and more volatile MXN. Inflation is expected to rise modestly but remain within the Bank’s acceptable range, below 4%; even though there are some doubts about the possible effects of the 20% minimum wage increase, especially on the core component of the CPI. It is worth noting that a downward bias persists on the growth outlook, however.

COLOMBIA — In 2019, GDP growth reaffirmed Colombia as the PAC country with the highest growth rate as it begins to close the negative output gap. Economic activity grew by 3.3% in 2019 well above 2018 (2.5%). Domestic demand has steadily grown above GDP over the last eight quarters due to higher private consumption and investment. Low interest rates, steady FDI, and civil works (4G infrastructure program) will continue to support domestic demand in 2020. Although external risks tilt economic activity downwards, being a relatively closed economy makes Colombia more resilient to external shocks than its regional peers. Therefore we keep, for now, our FY20 GDP growth forecast of 3.6%, especially on the back of still strong domestic demand. In the fiscal arena, higher Ecopetrol and BanRep earnings gave the central government some fiscal room this year, although structural problems continue (lower tax collection and inflexible expenditures). It is important to keep an eye on the pension reform proposal in the next couple of months. On inflation, supply shocks are vanishing, and FX pass-through continues to be timid. We expect inflation to converge, slowly, to BanRep’s target; we expect inflation to end 2020 at 3.3%. The good news is that core inflation measures are still very close to 3%, although they have increased a bit recently. Stronger economic activity and inflation normalization will push BanRep to normalize its policy rate to the neutral level of 4.5% this year.

CHILE — Locally, the protests after the social outcry of October have increased political uncertainty, affecting business conditions. In addition, the global spread of COVID-19 and its effects on global growth have are a downward risk to the external scenario. Accordingly, we have updated our GDP growth projections to 1.4% and 2.5% for 2020 and 2021, respectively. In the political arena, lawmakers have agreed to an April 2020 referendum on changing the Constitution which has led to an uncertain transition period affecting Chilean financial assets. We have adjusted downward our forecast of investment growth to 1.0% and 3.0% for 2020 and 2021, respectively, due to the lack of incoming projects, especially in real estate. Furthermore, we acknowledge there could be delays in some projects if uncertainty remains high. Additionally, current economic conditions and a weak labour market will probably deepen the deceleration in household consumption, postponing the recovery in domestic demand. Regarding inflation, it will be determined by two key factors: lower inflationary pressures from widening output gaps, and cost-push pressures from the multilateral peso depreciation. We anticipate the first effect will be the dominant. We forecast inflation at 3.0% y/y for December 2020 and 2021. The widening output gap, in a context of controlled inflation, requires a larger monetary stimulus, but monetary policy remains trapped by FX intervention and would not react until the end of 2Q2020. Therefore, we expect the Central Bank to cut rates this year, reaching 1.0% by the end of 2020.

PERU — 2019 ended on a weak note, with the Peruvian economy registering only 2.2% growth during 4Q. What was particularly disappointing was the 7.7% decline in public investment. However, there are promising signs of improvement in public investment in 2020. This is crucial, as greater growth in 2020 will rely mainly on the government investing more. The impact of the coronavirus has, so far, been limited to commodity prices and FX rates and has not been evident on GDP growth... yet. Luckily, terms of trade have remained fairly stable, as lower base metal prices have been compensated by higher precious metal prices, and lower imported oil prices. Nonetheless, it seems a matter of time before there is a more significant impact on growth, especially through exports and tourism, which leaves our GDP forecasts up for revision as a result. We recognize downside risks to our 3.0% growth forecast but, at the same time, the hopeful signs of greater public sector investment seen in January-February may help to compensate. We need harder figures for confirmation, however. Meanwhile, inflation has been contained at 1.9% for months now, with inflationary pressures skewed to the downside. We are, therefore, lowering our inflation forecast for 2020 to 1.8%. With lower growth and inflation, we now expect the Central Bank to fall in line with other CB’s of the world and lower rates by 25bps to 2.00%, probably over the next two months.
Developing Economies

Currency Outlook

SOUTH KOREA — The BoK left its policy rate unchanged at 1.25% on 27 February but will likely follow suit now that the Fed has delivered a 50bps rate cut. Mounting concerns over the community spread of COVID-19 in South Korea will continue rippling through markets and weighing on the KRW. We think that CNHKRW is likely to head to 175, while USDKRW is expected to rally toward the 1.220 mark.

We will stay with our long CNHKRW cross position targeting 175, with USDKRW expected to rally towards the 1.220 mark.

THAILAND — Thai regulators remain concerned about the THB’s strength as the coronavirus outbreak has hurt the nation’s tourism sector. The BoT has increased the threshold for export proceeds that do not need to be repatriated to USD 1mn from the current USD 200,000 to ease the appreciation pressure on the THB. While USDTHB is expected to trade in a range of 31.0-32.0, we think that TWDTHB is set to appreciate toward 1.08.

TAIWAN — The TWD remains resilient despite continued equity outflows, which could be attributed to more investment by local firms returning from mainland China and a steady coronavirus situation on the island. We expect foreign investor to turn net buyers of local shares on Fed policy easing. In addition, ample onshore liquidity will cap upside room for forward/NDF points. USDTWD is likely to trade between 29.8 and 30.4 in the month of March.

MALAYSIA — It will prompt overseas investors to add to their positions in Malaysian government bonds if the nation remains on the World Government Bond Index (WGBI). FTSE Russell said last September that it will provide updates after the interim review in March 2020. The correlation between the MYR and the CNH is expected to resume with domestic political uncertainty easing for now, supportive of the MYR. We expect USDMYR to fall to 4.14 in the coming months.

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Developing Economies

Fundamental Commentary

SOUTH KOREA — The South Korean economy will be weighed down by the COVID-19 outbreak; the country’s disease alert level has been raised to the highest level. South Korean exporters were facing difficulties already before the virus outbreak, reflecting weak global demand, trade-related uncertainties, and the downturn in the global electronics sector. Now the challenges are further amplified by virus-induced supply-chain disruptions and faltering economic momentum in China, an important export market for South Korea. Meanwhile, Korean domestic demand is set to weaken as the country is fighting the virus at home; a significant drop in consumer confidence in February indicates that households are likely to postpone discretionary spending. The country’s real GDP growth will likely average 1.8% in 2020 as a whole, less than the 2.0% advance in 2019. The Bank of Korea (BoK) left the Base Rate unchanged at 1.25% following the February 27 policy meeting, as it assesses the impact of the outbreak. Given the increasing downward pressure on the South Korean economy, we believe that the BoK will lower the benchmark interest rate by 25 bps to 1.0% at its next meeting in April. In the meantime, we expect fiscal policy to take a leading role in addressing the economy’s weakness; President Moon Jae-in has called for “all possible measures” to be used in order to support the economy. Indeed, a stimulus package of KRW11.7 trillion (USD 9.8 bn), subject to parliamentary approval, was announced in early March. Inflationary pressures are expected to remain contained through 2020; headline inflation rate was 1.1% y/y in February, staying well below the BoK’s 2% target. Price gains at the core level remained muted with the core CPI rising by 0.6% y/y in February.

THAILAND — The Bank of Thailand (BoT) is stepping up its efforts to support the economy as downside pressures on growth intensify. Following the February 5 Monetary Policy Committee Meeting, the BoT lowered the benchmark interest rate by 25 basis points to 1.00%. The policy rate was lowered by the same magnitude in August and November 2019. Given low inflation, the BoT may cut rates further, particularly if coronavirus-related market turmoil and economic hardships intensify. Monetary authorities pointed out that Thailand’s economic growth is set to slow significantly in 2020 due to the COVID-19 outbreak, the delayed enactment of the Annual Budget Expenditure Act, and drought conditions. While domestic demand remains muted, a significant drop in tourism—Thailand is the number one destination for Chinese tourists—and weak export sector performance—due to softness in trading partner economies and regional supply chain disruptions—are amplifying Thailand’s challenges. Accordingly, we expect Thailand’s real GDP to grow by only 1.6% in 2020 following an already weak advance of 2.4% in 2019.

TAIWAN — The Taiwanese economy will be adversely affected by the COVID-19 outbreak through weaker domestic spending and lower tourist arrivals. Moreover, given that Taiwan’s manufacturing sector is tightly connected with that of mainland China, the production shutdowns in China will be felt by Taiwanese electronics manufacturers. The government has pledged fiscal support to cushion the blow on the economy. We expect Taiwanese real GDP to grow by around 1½% in 2020, following a 2.7% advance in 2019. The Taiwanese central bank left the benchmark interest rate unchanged at 1.375% at its most recent monetary policy meeting in December. The next meeting will take place on March 19. Depending on how the virus outbreak and resultant market turmoil evolve over the next couple of weeks the central bank may cut the policy rate to 1.25% in order to complement the government’s fiscal stimulus efforts. Inflation remains manageable in Taiwan, with headline prices rising by 1.85% y/y in January.

MALAYSIA — Malaysia faced elevated political uncertainty following a surprise announcement regarding the resignation of the country’s Prime Minister Mahathir Mohamad on February 24, which was followed by a dissolution of the Cabinet. Subsequently on March 1, Muhyiddin Yassin, was sworn in as Prime Minister. Malaysia’s monetary conditions continue to ease as a response to uncertain economic growth prospects that reflect the COVID-19 outbreak. Following the monetary policy meeting on March 3, Bank Negara Malaysia (BNM) lowered the Overnight Policy Rate by 25 bps to 2.50%, marking a second consecutive cut; the policy rate was lowered by the same magnitude in January 2020. We assess that the BNM has monetary policy space left should the economy need further support. The coronavirus outbreak is a significant downside risk to the Malaysian economy, which will rely on sustained momentum in household spending, as well as the realization of approved private investment projects. We assess that Malaysia is among the most exposed regional economies to demand fluctuations in China, given its proximity to the vast Chinese market and the tightly integrated supply chains. Fiscal outlays will support the economy; the government unveiled a MYR 20 bn (USD 4.7 bn) fiscal stimulus package on February 27 to assist businesses and individuals affected by the COVID-19 outbreak. The country’s real GDP is expected to grow by 3½% in 2020, compared with our prior estimate of 4.2%, yet we note that risks remain to the downside. Malaysian inflationary pressures remain contained despite a modest pickup in January. Headline inflation accelerated to 1.6% y/y in January from 1.0% at end-2019. We assess that demand-driven price pressures will remain largely absent, with headline inflation staying below 2% over the coming quarters, allowing the BNM to focus on supporting the economy.
Global Currency Forecast (end of period)

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f: forecast  a: actual
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