FX Moves Delayed by Second Wave

Currency	What's Changed
USD	Election-induced volatility will eventually give way to a weaker greenback over 2021.
CAD	Loonie remains resilient in near term, but a more dovish BoC could see it lose ground in 2021.
EUR	The deterioration in the outlook due to Covid is another reason for euro gains to wait until 2021.
GBP	Brexit deal will provide only temporary relief for GBP, as macro headwinds linger.
JPY	Absent real yields spread moving into positive territory and impacting net bond outflows, we maintain USD/JPY downside targets.
Commodity FX	AUD and NZD underperformance ahead, as RBA and RBNZ have reinforced dovish policy stances.
LATAM FX	With LATAM central banks close to or at the end of easing cycles, carry favours the MXN into 2021.
FX Asia	Gains in the CNH and CNY have exceeded expectations, but the US election may introduce some caution. Other Asian currencies have risen alongside CNY and CNH; we see that continuing.

Currency Outlook

End of Period:	Oct. 28 /20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21	Q2 22	Q4 22
USD/CAD	1.33	1.33	1.32	1.33	1.34	1.36	1.40	1.39
EUR/USD	1.17	1.17	1.18	1.18	1.19	1.20	1.20	1.20
USD/JPY	104	103	101	100	100	99	99	99
GBP/USD	1.30	1.29	1.31	1.31	1.31	1.32	1.32	1.33
USD/CHF	0.91	0.92	0.92	0.92	0.91	0.91	0.90	0.89
USD/SEK	8.85	8.74	8.60	8.52	8.39	8.29	8.21	8.13
AUD/USD	0.71	0.69	0.69	0.70	0.71	0.72	0.74	0.76
NZD/USD	0.66	0.65	0.64	0.63	0.64	0.64	0.66	0.68
USD/NOK	9.34	9.19	8.86	8.80	8.68	8.43	8.22	7.97
USD/ZAR	16.35	16.35	16.20	16.10	16.00	15.95	15.75	15.60
USD/BRL	5.74	5.10	5.00	5.20	5.00	4.50	4.80	4.50
USD/MXN	21.1	21.0	20.0	20.5	20.5	19.5	19.5	19.0
USD/COP	3810	3800	3700	3600	3500	3500	3350	3200
USD/CLP	773	800	820	800	780	750	750	720
USD/CNY	6.73	6.60	6.50	6.45	6.40	6.30	6.10	6.20
USD/KRW	1131	1130	1125	1120	1115	1115	1105	1115
USD/INR	73.9	73.3	73.0	72.8	72.5	71.0	69.0	69.5
USD/SGD	1.36	1.35	1.36	1.35	1.35	1.35	1.34	1.35
USD/TWD	28.7	28.5	28.4	28.3	28.3	28.2	28.1	28.2
USD/MYR	4.15	4.12	4.10	4.05	3.95	3.85	3.65	3.45
USD/IDR	14625	14550	14500	14400	14300	14200	14000	14200

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Other Crosses

End of Period:	Oct. 28 /20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21	Q2 22	Q4 22
CADJPY	78.3	77.4	76.5	75.2	74.6	72.8	70.7	71.2
AUDCAD	0.94	0.92	0.91	0.93	0.95	0.98	1.04	1.06
GBPCAD	1.73	1.72	1.73	1.74	1.76	1.80	1.85	1.85
EURCAD	1.56	1.56	1.56	1.57	1.59	1.63	1.68	1.67
EURJPY	122	121	119	118	119	119	119	119
EURGBP	0.90	0.91	0.90	0.90	0.91	0.91	0.91	0.90
EURCHF	1.07	1.08	1.09	1.09	1.08	1.09	1.08	1.07
EURSEK	10.39	10.23	10.15	10.05	9.98	9.95	9.85	9.76
EURNOK	10.97	10.75	10.45	10.38	10.33	10.12	9.86	9.56

Key Indicators- Latest Data Point

	Quarterly Real GDP (y/y %)	CPI (y/y %)	Current Acct (% of GDP)	Central Bank Rate (%)
US	-9.1	1.3	-3.5	0.125
Canada	-13.0	0.2	-1.7	0.250
Eurozone	-14.7	-0.2	2.4	0.000
Japan	-9.9	0.2	3.1	-0.100
UK	-21.7	0.2	-3.3	0.100
Switzerland	-9.3	-0.9	9.2	-0.750
Sweden	-7.7	0.8	3.9	0.000
Australia	1.4	-0.3	1.1	0.250
New Zealand	-0.2	1.5	-3.0	0.250
Norway	-4.7	1.7	7.1	0.000
South Africa	-17.1	3.2	-2.4	3.500
Brazil	-11.4	2.4	-2.7	2.000
Mexico	-18.7	4.0	0.0	4.250
Colombia	-15.7	1.9	-4.0	1.750
Chile	-14.1	2.4	-1.9	0.500
China	3.2	2.4	1.1	3.850
South Korea	-2.7	0.7	3.6	0.500
India	-23.9	6.7	-0.9	4.000
Singapore	-13.2	-0.4	16.1	n/a
Taiwan	-0.6	-0.3	11.2	1.125
Malaysia	-17.1	-1.4	2.5	1.750
Indonesia	-5.3	1.3	-2.2	4.000

CAD

Katherine Judge | Avery Shenfeld

Loonie to Hold Ground For Now

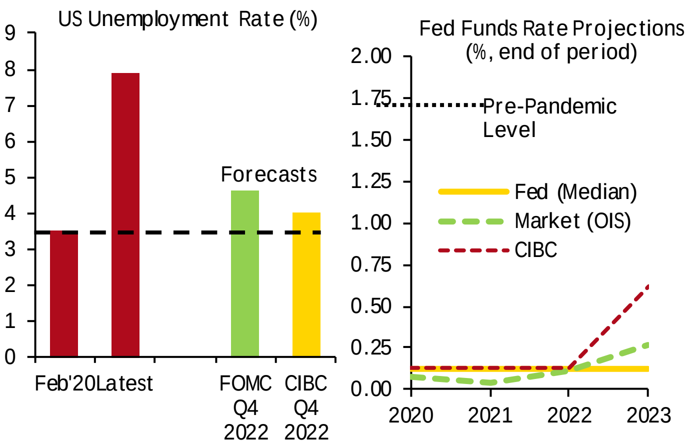
Q4 2020: 1.33 | Q1 2021: 1.32 (USDCAD)

The loonie went full circle in the past month, reacting mostly to global risk sentiment and its impact on the USD. A more pessimistic view on global growth as virus cases escalated and US stimulus was delayed sent USDCAD back to the 1.33 level. That's a weaker CAD than the starting point of the year, but not weak enough to support Canadian exports in the medium term. Look for CAD to remain resilient into the first half of 2021, and then give up ground.

The Bank of Canada's October forecasts showed a less pessimistic view for 2020 growth relative to the July projections, reflecting unexpected strength in the third quarter. However, that is all water under the bridge, as the outlook for the final quarter of the year has deteriorated with the surge in Covid cases. The Bank still sees a negative output gap at the end of 2022, and inflation therefore not sustainably reaching 2% by then.

Our more optimistic forecasts for Canadian and US growth in 2022-23 have both the Fed and the Bank of Canada hiking in 2023. That's not out of line with the Bank of Canada's messaging, but it's a year sooner for the US than what the Fed is signaling or the market expects (Chart 1). Indeed, we see the Bank of Canada letting the Fed take the first move which will work to push US yields above those in Canada and thereby steer the Canadian dollar a bit weaker, to benefit export competitiveness. Look for CAD to soften in the latter half of next year as markets sense that the Bank of Canada can be even more patient than the Fed.

Chart 1: Our More Optimistic Post-Vaccine Growth Forecast Will See Fed Hike Earlier than BoC in 2023



Source: Bloomberg, Federal Reserve, BLS, CIBC

USD

Katherine Judge | Avery Shenfeld

USD Depreciation: Wait Until 2021

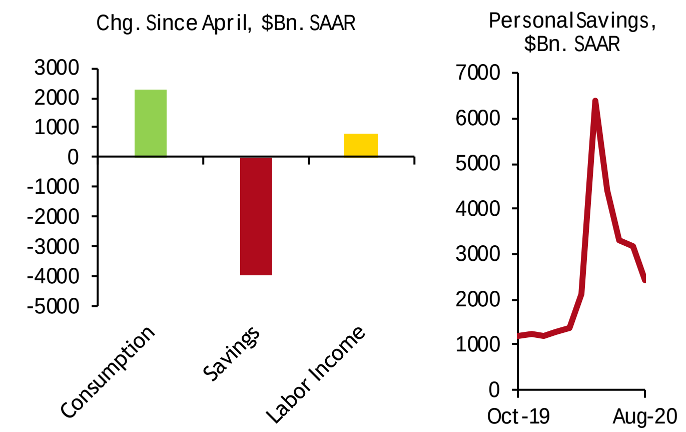
Q4 2020: 93.56 | Q1 2021: 92.55 (DXY)

The USD is still responding to global risk sentiment, weakening when its safe haven status becomes less of an attraction. But rising Covid cases in Europe and North America have helped steady the dollar's hand, and uncertainties over the election result could extend this pause for the greenback. But we still see the USD weakening in the early months of 2021.

That comes despite the sharp, consumer-led rebound in economic activity in the US in the third quarter. That relied on a drawdown in savings (Chart 2) that had in part been funded by fiscal stimulus, the next round of which has been delayed by a political stalemate. Both the US and Europe are now also clouded by an uptrend in the virus. A troubling economic picture for Q4 in the US and abroad will keep risk appetites constrained, helping the dollar hold ground against other majors.

Further out, a post-election US stimulus bill, and some progress against the virus and towards a vaccine, should renew the general risk-on environment that leans towards a weaker USD against selected majors. It's the dollar that needs steady capital inflows given America's current account gap, so anything that slows the flight to safety bid still leaves room for it to soften on underlying trade fundamentals, given that the yield gap is no longer as generous as it was pre-Covid.

Chart 2: Drawdown of Savings Fueling Spending (L), But That Won't Last Forever Without More Stimulus (R)



Source: BEA, CIBC

EUR

Jeremy Stretch

Market Mispricing Further ECB Action

Q4 2020: 1.17 | Q1 2021: 1.18 (EURUSD)

The last two months have seen real money and leveraged investors paring back net EUR positions. Despite the correction, positioning remains sizeable, as real money longs registered all-time highs as recently as late August. Notwithstanding the modest unwind in EUR holdings, the trade weighted EUR has remained broadly unchanged. Currently, it appears the market remains mindful of the fact that the ECB remains concerned over EUR valuations, not because of any explicit FX target, but rather due to the dampening impact of a firmer euro on import prices and inflation expectations.

The ECB may be somewhat relieved that long-run inflation expectations (five years ahead) have ticked higher since mid-October lows near 1.10%. However, it's still far enough below the current policy target (inflation rates below but close to 2% over the medium term) that markets still believe that a further ECB ease is in play.

True, despite an increasing global reliance upon fiscal expansion to alleviate Covid-related economic weakness, there remains a role for the ECB. Still, unlike the market, which is pricing in a 75% chance of a rate cut by July, we do not expect the ECB to dive further into negative territory. If it stands pat on the policy rate, the euro should have room to rally into the second half of 2021. Rather than taking rates further negative, we expect the ECB to look to increase their emergency bond purchase programme in December, likely extending the term until the end of 2021, while increasing the size of potential bond purchases, by up to €500bn.

Action prior to year-end comes as updated staff macro-economic forecasts will reflect the impact of the rising tide of Covid cases. More QE seems almost an inevitability, this is especially the case should the disbursement of EU rescue funds risk being delayed due to issues related to governance in various EU states. Any delay to expected EU fund disbursement will act to contain EUR gains, alongside ongoing ECB rhetoric, into year end.

JPY

Jeremy Stretch

Yen on Upward Trajectory

Q4 2020: 103 | Q1 2021: 101 (USDJPY)

We expect the Japanese economy to contract by around 5.5% in calendar year 2020. The modest bounce in the quarterly Tankan business survey from pandemic lows is indicative of a steady, rather than spectacular, rebound into 2021. Overall business confidence remains far below pre-pandemic levels, and business investment intentions remain weak. With the BoJ set to maintain a steady policy bias, an extension of the BoJ special funds operation may be pushed towards year end. It appears increasingly likely that the new Suga-led administration will look to ease fiscal policy. Odds are growing for a supplementary budget in December. Additional fiscal easing will leave gross government debt at around two and a half times GDP. Absent continued strong domestic buying interest, such levels of debt would be a major course for concern.

Although we have seen 10 year UST-JGB spreads push wider since troughing at around 50bp in early August, we have yet to see spread moves have a material influence on JPY valuations. There are several key influences at play here. Firstly, the cost of hedging for Japanese investors has diminished sharply as short-term rate differentials have collapsed. Secondly, the destination of bond purchases has changed, away from the US, with Australia proving to be a major beneficiary. Finally, although nominal yield spreads may be widening, when inflation is taken into account, real spreads at both the front and longer ends (2yr and 10yr) have moved sharply into negative territory. Absent real yields spread moving back into positive territory and impacting potential net bond outflows, we maintain USD/JPY downside targets.

GBP

Jeremy Stretch

Future Brexit Deal to Offer Only Temporary Relief for Sterling

Q4 2020: 1.29 | Q1 2021: 1.31 (GBPUSD)

The near-term Sterling outlook continues to be dominated by late-stage Brexit negotiations, rather than fundamentals. In terms of Brexit, the UK's self-imposed October 15th deadline was missed, as expected. After a brief hiatus, the talks have now moved into an intensified state. The two sides are working on the legal text that will underpin an agreement, which will need to be ratified by the UK and EU parliaments. Due to timelines around the ratification process, this suggests that the deadline for an agreement is likely to be the second week in November. As both sides recognise that a no-deal scenario will compound increasing Covid headwinds, we put the probability of an agreement at around 75%.

Should a deal be agreed to, removing the threat of tariffs and quotas, expect a potential GBP relief rally. Speculative investors have recently rebuilt negative Sterling positions as Brexit uncertainties have persisted. Expect a free trade arrangement, albeit limited in scope, excluding the key services sector, to encourage an unwind in Sterling speculative shorts, boosting short-term GBP valuations.

However, we would not expect any immediate GBP gains to prove durable. Although any free trade deal would obviate the risks of tariffs and quotas, the UK is still set to face the prospect of significant trade frictions, via new customs restrictions. Trade flows will prove compromised by rising UK business costs, which are estimated to increase by up to £7bn.

Avoiding a no-deal EU exit will encourage short-term Sterling gains as speculative shorts are cleared. However, with the realisation of ongoing trade frictions being compounded by weakening economic performance, alongside the rising tide of Covid cases, the UK economy remains highly exposed to a retreat in service sector activity. Consequently, we expect more BoE QE in November, providing reason as to why any post-Brexit GBP gains will prove short-lived.

CHF

Jeremy Stretch

SNB Keeping A Lid On CHF

Q4 2020: 1.08 | Q1 2021: 1.09 (EURCHF)

Although the central bank continues to view the CHF as "highly valued", we have seen evidence of a paring back in the accumulation in sight deposits in recent weeks. Since the start of September, weekly sight deposits, a proxy for ongoing intervention, have increased on just two occasions. However, the brief EUR/CHF flirtation below the 1.07 threshold in the middle of October likely reminded the SNB that they need to remain vigilant, especially should global reflation hopes and risk appetite prove to be challenged through Q4.

Ahead of the next quarterly update from the central bank, due on December 17th, expect the central bank to continue to look to limit downside risks in EUR/CHF. We continue to consider 1.07 as a potential trigger point for action. While the SNB is of course keen to remain out of the cross hairs of the US Treasury, via currency manipulation charges, we can expect the central bank to remain active as long-run inflation expectations continue to run below zero.

The September SNB monetary policy report detailed CPI at just 0.4% at the end of the forecast horizon in 2023. Consequently, with price pressures set to remain well below the 2% target, we can expect SNB pro-activity to persist, especially should CHF gains again prove evident. The SNB will also remain mindful of the actions of the ECB. We expect the ECB to avoid taking rates further into negative territory, rather using additional QE, leaving the SNB to use intervention as their primary policy tool. However, as hopes for global reflation are fanned in 2021 by progress towards a vaccine, that should ease the CHF risk premium, allowing the SNB to be somewhat more hands off as EURCHF gradually grinds higher.

SEK

Jeremy Stretch

Rate Expectations Recalibration Favors SEK Appreciation

Q4 2020: 10.23 | Q1 2021: 10.15 (EURSEK)

As a pro-cyclical currency, we expect SEK valuations to remain well supported should global reflation hopes remain in place into 2021. Forward looking survey evidence, in the form of manufacturing and services PMIs, continue to point towards ongoing macro-economic resilience, with the uptick in the 3-month average in both manufacturing and services activity, back to 2019 levels, underlining that the recovery remains on track. We also view the sharp uptick in the economic tendency survey, back towards February extremes, as consistent with increasingly solid underpinnings.

The Riksbank is mindful of inflationary pressures remaining well below target. Deputy Governor Floden recently underlined that the current downward pressure on inflation is unfortunate, while the Deputy Governor highlighted that maintaining confidence in the 2% inflation target remains critical. The central bank will likely be relieved that the long-term (Prospera) inflation expectations survey revealed price expectations remaining at 1.7% over five years, suggesting that confidence in the central bank's inflation target is not currently threatened.

In the absence of negative inflation uncertainties, we continue to expect that the central bank will utilise its QE programme rather than consider a return to negative rates. With the market still currently pricing a modest risk of a reversal back into negative rates, any eventual realisation that the next move in rates will be up, rather than down, will support SEK impetus. While the SEK may not be as undervalued as the NOK, we expect a modest uptrend in SEK valuations to persist, and we have upgraded our SEK forecast profile slightly.

Commodity FX

NOK

Jeremy Stretch

NOK Undervalued Based on Fundamentals

Q4 2020: 10.75 | Q1 2021: 10.45 (EURNOK)

The Norwegian Krone is the worst performing G10 currency this year, versus the USD and EUR. Since the start of the year, the NOK has depreciated by 5.1% vs the USD and 10% versus the EUR. That is a result of risk uncertainty impacting oil revenue assumptions and capital expenditure expectations, combined with weak domestic data. However, we view the NOK as having become increasingly cheap against the backdrop of a central bank currently intent on maintaining its policy stance, a relatively virtuous fiscal position and a comparatively shallow economic contraction. As a result, we look for a positive NOK backdrop to play out into 2021.

We expect the Norges bank to maintain rates at zero at their November 5th policy meeting, ahead of their next Monetary Policy Report on December 17th. We look for the central bank to maintain that monetary conditions need to remain easy well into 2021. However, the market may be forced to consider policy action coming earlier than current Norges assumptions (end of 2022), should upcoming real economic data remain constructive. The September MPR saw the Norges Bank revise up its rate assumptions to 0.1% at the end of 2022.

Continued labour market gains remain supportive of underlying consumer spending. Despite a sizeable correction in August retail volumes due to a reduction in food sales, overall spending remains a healthy 8.2% above year-ago levels. The combination of supportive domestic dynamics, helped by a rapid fiscal expansion, points towards the economy regaining pre-Covid levels by H2 2021. The expectation of a quick return to fiscal surpluses, combined with the prospect of a tightening monetary policy backdrop, underlines that the NOK looks increasingly cheap in REER terms.

AUD

Patrick Bennett

RBA Easing Will Cap AUD

Q4 2020: 0.69 | Q1 2021: 0.69 (AUDUSD)

AUD remains an underperformer in recent weeks, although is still firmer against the USD by around 0.7%, which predominately reflects a weaker USD overall. We anticipate headwinds for the currency in the coming weeks and into the next year, via a path of challenged economic activity, and RBA easing.

RBA Governor Lowe and other members of the central bank have gone to lengths to prepare the market for easing at the next meeting. When the RBA meets on November 3rd, we expect a combination of measures to be announced. We see the cash rate target being cut from the current 25bps to 10bps and the YCC target on 3-year bonds to be reduced to the same 10bps. The rate on the term funding facility (TFF) will also likely be cut to 10bps.

Amongst challenges for the AUD, a deterioration in trade with China is concerning. Chinese economic activity, including trade, have rebounded strongly, but trade with Australia has not. Chinese imports in September from all countries expanded by 13.2% y/y, while imports from Australia fell 9.5% y/y and are 7.4% lower ytd y/y.

NZD

Patrick Bennett

RBNZ Prepares Market for Negative Rates

Q4 2020: 0.65 | Q1 2021: 0.64 (NZDUSD)

Our outlook for the NZD into the end of the year alongside the introduction of negative cash rates, potentially in Q1, is for further weakness against the USD and on major crosses, including JPY and CAD. New Zealand 2-year bond yields remain negative, and with further policy announcements to be made at the RBNZ meeting on November 11th, any residual yield advantage for the NZD continues to be eroded.

The election result was a win for PM Arden and the Labour party and was somewhat stronger than expected, but far from a surprise. NZ markets saw little impact. Economic challenges remain, in particular as subsidies and support programs run out. RBNZ will do their part with easier policy. As elsewhere, capacity to get infrastructure spending going will be watched closely.

ZAR

Jeremy Stretch

ZAR Attractive Amidst Elevated Returns

Q4 2020: 16.35 | Q1 2021: 16.20 (USDZAR)

On a total return basis, including rate differentials, only the MXN has performed better than the ZAR versus the USD since the start of H2. The near 8% gain in ZAR comes as domestic rates remain at 3.50%, while expectations of another SARB cut in September proved misplaced. After a split vote, the central bank looks set to have ended the easing cycle at 300bp. The end of the rate cutting cycle comes despite growth assumptions being revised down and inflation expectations remaining well below the target threshold. In a world of ultra-easy monetary policy and the end of the easing cycle, SARB are looking towards a reversal in late 2021, providing attraction reason for yield hungry investors.

We have seen growth expectations continue to capitulate, with the central bank assuming a contraction of 8.2% this year. Risks are increasingly biased towards a near 10% slide, should Covid-19 continue to spread in Q4. Nevertheless, the currency continues to remain attractive, in line with cyclically correlated EM currencies.

Sliding growth dynamics are set to continue to weigh upon government finances. The supplementary budget on June 24th raised the deficit target for the 2020/21 fiscal year to 14.6% of GDP, from 6.8% in February. However, the full deterioration in the public finances has yet to be seen. Of course, an aggressive spike in the deficit is in no way unique and unlike other episodes of South African fiscal deterioration, there is not an impending ratings agency decision which could compromise ZAR sentiment. The Moody's downgrade in March, which took the country below investment grade, prompted the removal of the country from the global bond indices. Although South Africa is facing a deteriorating fiscal balance as growth expectations continue to be compromised by Covid concerns, elevated nominal and real returns suggest that, should global reflation hopes be maintained into 2021, the ZAR will continue to prove attractive.

LATAM FX

MXN

Luis Hurtado

Awaiting Better Entry Points for Long MXN Position

Q4 20: 21.0 | Q1 21: 20.0 (USDMXN)

The latest round of monetary policy decisions in the region improved the MXN's status as the carry trade of 2021. In the near term, however, we recommend proceeding with caution on the recent MXN impetus. Speculative net long positions in the MXN have remained shallow despite the carry prospects. This situation is in part explained by the uncertain US electoral cycle, as seen by the inverted USD/MXN vol curve. We would highlight that, despite the moderation in implied volatility over the last week, we do not discount the possibility of its resurgence, as the potential for further political uncertainty in the US remains.

On the local front, the Ministry of Finance released a document listing 39 infrastructure projects worth MXN297bln (US$13.8bln). The announcement stemmed from the need to boost both economic activity in the uncertain environment and fiscal support. Although an auspicious step, 50% of the program is expected to be financed by private investment – an optimistic assumption considering the substantial red tape involved and the economic uncertainties resulting from the pandemic. Moreover, fiscal risks remain as revenue stabilization funds are depleted and the government maintains its optimistic growth and oil production assumptions into 2021. Our base case scenario continues to contemplate a sustained but slow fiscal deterioration, with Mexico keeping its investment grade status next year.

We continue to see value in short USD/MXN positions into 2021 but would wait for better entry points amid the uncertainties related to the US electoral cycle and the possibility of a final 25 bps rate cut this year. Remember that Banxico characterized the latest spike in inflation as temporary, while stating that a large output gap is expected throughout the monetary policy horizon.

BRL

Luis Hurtado

Short USD/BRL Positions Attractive Above 5.60

Q4 20: 5.10 | Q1 21: 5.00 (USDBRL)

Political headlines have clouded any support the BRL gained from the improvement of the external environment since the end of April. As Chart 1 shows, events such as the resignations of the Ministers of Justice and Health in April/May and impeachment concerns pushed USD/BRL to the 6.00 mark. However, the dissipation of impeachment concerns, together with the affirmation of support for Finance Minister Guedes within the economic team, prompted a quick reversal of that trend, and the BRL appreciated 15.5% against the dollar in less than a month. We see a similar situation taking shape in Q4. The government's alliance with centrist parties, President Bolsonaro's stable approval ratings, and the prudence shown in not enacting permanent changes to the spending cap highlight our view of a supportive environment for the BRL into late Q4 as 2021 Budget discussions come to an end. Hence, we maintain our preference for short USD/BRL positions at 5.6 with a 5.1 target and a 5.8 stop loss.

On the economy, the BCB admitted it has very little space for further cuts and signalled that the SELIC rate will remain at historical lows throughout 2021. The better-than-expected uptick in economic activity has certainly contributed to recent expectations for an end to the easing cycle, limiting downside risks for the BRL. Moreover, data such as industrial production and retail sales appear to show the worst of the crisis is over, with a strong rebound since the end of April. The latest inflation numbers showed an uptick in prices driven by food costs, but downside pressures from the still-large output gap are likely to keep prices below the BCB's inflation target for the remainder of 2020 and 2021.

CLP

Luis Hurtado

Wary of Long CLP Positions Amid Prolonged Local Electoral Cycle and Populist Measures
Q4 20: 800 | Q1 21: 820 (USDCLP)

We expect populist measures in Congress, a prolonged local electoral cycle, the presidential election in the US, and the uncertain evolution of the COVID-19 pandemic to reignite CLP volatility in early November. Moreover, USD/CLP appears to have found significant support at 750. In our view, this level would prove difficult to break as the CLP has already recovered most of the ground it lost late in 2019 and 2020.

As the new constitution vote nears, we expect the prolonged Chilean election cycle to keep investors wary of any appreciation in the CLP. The country will not only embark on a process to write a new constitution next year, but will also face traditional volatility ahead of the 2021 legislative and presidential election cycle. This situation increases the risk of further protest and the possibility of populist measures in Congress. One such measure is the new proposal to allow for an additional 10% withdrawal from pension funds. This bill could force pension funds to liquidate a greater share of local assets, contributing to higher USD/CLP into Q4.

COP

Luis Hurtado

Not Much Juice Left in the COP
Q4 20: 3800 | Q1 21: 3700 (USDCOP)

Banrep cut the overnight rate by 25 bps in its latest rate announcement. Although expected by the market, the split decision suggests we may have reached the end of the cycle. This tone, together with high USD financing needs, provided some support to the COP during the first two weeks of October.

Nevertheless, fiscal risks remain high and we do not discount that the COP could lose ground on the back of downgrade fears as credit rating agencies and the market scrutinize the prospects of fiscal reform during the last 18 months of the Duque administration. Remember that to achieve its fiscal goal in 2022, the country will have to implement a 2% of GDP fiscal adjustment – an ambitious task considering the lack of support from Congress on items such as broadening the range of goods subject to the VAT.

Asia FX

CNY

Patrick Bennett

CNY CNH: Yuan to Extend Gains
Q4 2020: 6.60 | Q1 2021: 6.50 (USDCNY)

The Chinese yuan is the top G10 currency performer this year, having gained around 6.5% against the USD YTD. We assess prospects for further gains as strong, both against the USD and on trade-weighted measures. USD/CNH is poised to reach 6.5000 in early 2021.

Support for CNY and CNH over recent months has come from Chinese economic outperformance – confirmed once more by Q3 GDP and September activity data, and via steady demand for Chinese assets by international investors. The latest Chinese portfolio flow data is for end-June only, but that month showed record inflow of around $60bln. Anecdotal reports since, plus higher frequency data from the China-Hong Kong Stock and Bond Connect, indicate inflows have continued.

The ongoing positive outlook is underscored by expected strong economic performance versus peers, and by China encouraging further foreign investment, while monetary authorities also continue to validate yuan appreciation through the daily fixings of USD/CNY.

On capital inflows, China has regularly announced the opening of sections of the economy to foreign competition. Utilized FDI has been steadily increasing this year, recovering strongly after a slow start. Recent cancelling of the 20% RRR charge on FX forwards was initially feared as a signal against currency appreciation - though that did not transpire. Removing it in fact lowers costs to hedge, thus is positive for investment, rather than having been a potential discouragement.

At times during the last couple of months we have posited whether some consolidation of yuan gains might develop. In the end, periods of consolidation have been no more than fleeting, and the trend lower in USD/China which began in early June, has simply extended. One prompt for the idea of consolidation was simply a sense of caution. US-China trade tensions, and more broadly, US hawkishness toward China and its administration, have at times held back some gains. But in wake of the 'phase one' trade agreement, and as the US election to-date has not been fought specifically on trade, there is somewhat of a 'steady-state' and thus the impact has recently been muted.

That is not to say that threats have disappeared. A win for President Trump would embolden his administration to push even harder than previously. While hawkishness toward China that spreads across the political divide, and includes the targeting of technology companies, China's administration of Hong Kong, and its ambitions in the South China Sea, are not going away anytime soon.

Without US-China tension, there is a valid case that the Chinese yuan would be stronger still than gains that have already been driven by economic performance and asset demand. We recommend selling USD/CNH rallies and adding downside exposure through options.

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