Phase One, Complete

Currency What’s Changed

USD  Look for broad-based US$ weakening on the back of recovering global sentiment
CAD  A rangebound C$ could weaken, following a potential rate cut by the BoC in Q1 next year
EUR  Improving global sentiment and prospects of economic stabilization should see the euro strengthen
GBP  Expect limited movement in Sterling as the Brexit process is negotiated
JPY  Fiscal stimulus and stronger growth prospects support JPY strengthening in 2020

Commodity FX  A better global growth outlook should underpin near-term AUD, NZD and NOK strengthening

LATAM FX  Sentiment is improving on subsiding protests, but ongoing issues could still see elevated volatility in 2020

FX Asia  Look for modest yuan appreciation, with a Phase One deal complete and the Chinese economy beginning to show signs of recovery

Currency Outlook

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<th>Dec. 19/19</th>
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Currency Summary

USD
With the Fed on hold, improving global sentiment should see the greenback give back some strength to other major currencies.

CAD
While we expect the C$ to remain rangebound in the near-term, weaker macro fundamentals in Q4 and soft employment growth could drive a rate cut by the BoC by the end of Q1, in turn seeing CAD depreciate against the USD.

EUR
We’re beginning to see stabilization in the Eurozone economy, and we’re optimistic on macro fundamentals as global sentiment continues to improve. That should see upside for the euro over the course of next year.

GBP
The new Conservative majority provides the UK with a path to move forward with trade negotiations and a formal withdrawal bill. Look for limited sterling movements in the near-term, but for a potential rally as Brexit terms become formalized.

JPY
In a turn away from monetary policy, significant fiscal stimulus measures prompted the BoJ to upgrade its economic outlook, and as such, supports a strengthening yen over the coming year.

Commodity FX
The AUD could face headwinds as a result of relatively weaker domestic fundamentals, but expect the RBA to remain on hold in the near-term. Nevertheless, improved global sentiment has benefitted the AUD, as well as the NZD and NOK, so far this quarter.

LATAM FX
Reforms, privatization and a trade opening agenda should benefit the BRL against the other regional currencies, as Chile battles social unrest and expectations of further monetary policy easing have yet to diminish in Mexico.

FX Asia
Progress in US-China trade relations should see modest appreciation of CNY & CNH against the USD, while other regional currencies should recoup lost ground next year (most of which can be attributed to repercussions of the US-China trade war).
CAD
Avery Shenfeld | Taylor Rochwerg

Stronger Isn’t Always Better
Q1 20: 1.33 | Q3 20: 1.36 (USDCAD)

Canada’s economy weathered the worst of the global storm, but labour market participants could be feeling a bit less merry this holiday season. The November employment print was the worst monthly dive since the recession. While that could be simply an outlier, the trend in private sector hiring since August this year has also been unimpressive.

Still, upward revisions to prior GDP quarters, as well as improving measures for wage rates, suggest that the starting point for the economy is firmer than it appeared back in October. With essentially no output gap, and on-target inflation, the Bank of Canada will need some additional soft news on activity or jobs to concede that a rate cut is needed, and we’ve pushed back our target date for the lone quarter point cut in our 2020 forecast from January until March or perhaps April. That move would send the currency weaker, with USDCAD hovering in in the 1.33 to 1.34 range next spring.

Longer term, a weaker loonie will be a necessary ingredient to rebalance more growth towards exports and thereby reduce the reliance on rising household debt. The recent pick up in exports was attributed to gold, which can come from inventories, and to art, with weakness in more sustainable sources of demand. A China-US trade pact could actually worsen that situation if Beijing agrees to divert more of its agricultural imports to US suppliers.

Stateside, Canada has been steadily losing market share to other sources of US imports (Chart). We look for the drag on the currency from adverse trade flows to push USDCAD to reach 1.38 by the end of 2020.

Chart 1: Canadian Exports Have Lost US Import Market Share in Recent Years

USD
Avery Shenfeld | Taylor Rochwerg

Losing Steam Ahead
Q1 20: 95.5 | Q3 20: 93.4 (DXY)

The US dollar has managed to rally in the past year, despite a dose of Fed rate cuts and an adverse current account balance that protectionism has not addressed. After what looks to be a softer Q4 pace, the US looks poised to pick up in early 2020 on improved interest sensitive demand, particularly in housing.

That should see the Fed put away the rate cut tool for good, which on its own would be supportive for the dollar. But we see that overridden by a gradual reduction in global uncertainty over the course of the coming year, which will lean towards a partial reversal of some of the flight to safety gains for the dollar.

We enter the year with a US-China trade deal waiting to be tested, lingering uncertainties over post-Brexit UK-EU trade talks, and pockets of overseas economic weakness still evident. The lagged impacts of earlier monetary stimulus (Chart), clarity on some of the trade files over time, and fiscal stimulus in Japan, and potentially down the road in Europe, could see the world exit 2020 with an improving tone overseas. That risk-on environment should allow recoveries for the euro and Sterling, and superior current account balances in Europe and Japan (Chart) should also favour their currencies against the dollar.

Chart 2: Inferior US Current Account Balance Should See the USD Continue to Weaken

Current Account (% of GDP)

Source: OECD, CIBC
Jeremy Stretch  |  Bipan Rai

**EUR: Lagarde Sees Stabilization in the Cards**

**Q1 20: 1.12 | Q3 20: 1.15 (EURUSD)**

The stars are starting to align for EUR bulls. While monetary policy is still relatively very loose, manufacturing sentiment is beginning to recover—especially in Germany, following two quarters of sluggish growth. On the trade front, global sentiment is improving, and the Trump Administration has extended the final decision about auto tariffs into May 2020. Additionally, with the sweep of the UK Tories in last week’s election, the withdrawal agreement should finally pass before the January 31st deadline, setting the stage for trade talks between the UK and the EU.

Lagarde’s first press conference also saw a bit more optimism on the domestic picture. The new President of the ECB pointed out signs of stabilization in the Eurozone economy, and that there were initial signs of increases in underlying prices (Chart). But, that doesn’t mean that the ECB is any closer to paring back its sizeable stimulus program, not least as the Bank will only begin reviewing its strategy next month. Still, given these themes, and with the USD expected to come under pressure in the near-term, EUR topside is looking more attractive.

**Chart 3: Outlook is Improving, With Uptick in Eurozone Prices (L) and German Business Sentiment (R)**

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Jeremy Stretch  |  Bipan Rai

**GBP: Stability as Brexit Process Moves Forward**

**Q1 20: 1.33 | Q3 20: 1.35 (GBPUSD)**

The overwhelming Conservative majority win, which was at least someone unexpected, provides the pathway for the UK to move forward with the EU Withdrawal bill. After three years of political paralysis and three missed Brexit deadlines in 2019 alone, the election of a government with a large stable majority suggests that investors can expect the UK to leave the EU on January 31st. While the election victory allows the Prime Minister to facilitate the UK exiting the EU, this merely shifts the process to negotiating a new trade agreement between the two parties.

For the PM, the scale of the majority is important because it allows for more policy latitude, albeit in the near-term, hopes of an extension for the implementation period have been pared back, unwinding initial post-election GBP gains. Unlike his predecessor, PM Boris Johnson won’t be beholden to Conservative hardliners. As such, the risks of a hard Brexit have marginally retreated. But, having seen Sterling rally around 13% since no-deal Brexit fears peaked in early September, don’t expect a quick run for GBP gains towards the 1.40 area, as the market refocuses on the narrow window for UK-EU trade negotiations.
Removing election risk and adding near-term Brexit certainty to the equation is supportive for consumption, thereby easing concerns of BoE policy stimulus in H1 2020. However, trade negotiation headwinds still present a barrier to foreign direct investment in the near-term. As such, look for sub-trend growth and constrained investment inflows to slow the pace for further GBP gains in H1 2020 (Chart).

Chart 4: Sterling Gained on Putting No-Deal Brexit to Rest (L), but Could See Limited Upside via Sub-Trend Growth (R)

Source: Bloomberg, CIBC

Jeremy Stretch  |  Bipan Rai

CHF: Stability is the Name of the Game
Q1 20: 1.09 | Q3 20: 1.11 (EURCHF)

For twenty months now, the realized volatility for USD/CHF has been negligible. Moreover, the pair has essentially been oscillating around par for the better part of the last four years. That sleepy trend for CHF looks likely to continue.

In terms of the endogenous backdrop, the SNB appears to be far from shifting policy. In its last meeting, the Bank noted that its negative policy rate is offsetting the upward impact of its current account on the CHF. But in addition, prolonged low rates are also having an effect on Switzerland’s mortgage and real estate markets. As a result, expect any potential policy changes to be focused on interest rate tiering and bank capital rather than explicit rate hikes, which the Bank will likely forego, unless rate differentials with the Eurozone widen out further.

Jeremy Stretch  |  Bipan Rai

Potential SEK Upside on Tightening Monetary Conditions Next Year
Q1 20: 10.35 | Q3 20: 10.20 (EURSEK)

Despite still-softer fundamentals, as suggested by weaker survey data, the SEK has been a material outperformer versus both the EUR and the USD, only outperformed by Sterling. The aggressive correction in SEK valuations came as the domestic economic surprise index moved higher, albeit it remains negative territory (and has since July). As a small open economy leveraged to Germany and global trade, the modest improvement in macro sentiment looks set to continue providing SEK impetus.

We’ve recently witnessed positive SEK dynamics, despite the fact that inflation expectations surveyed reveal a more moderate correction in medium-run inflation assumptions (looking ahead five years). Market participants and purchasing managers downgraded their CPI targets by 0.1% to 1.8% - further below the 2% target threshold. However, as November CPIF came in line with the Riksbank’s assumptions at 1.7% y/y, it was unsurprising that the central bank has become the first CB to exit negative rates, after five years.

We continue to believe that the current monetary policy setting is still rather loose. Having exited negative rates, the Bank assume that rates will remain at current levels in ‘coming years’, and as such, we expect a gradual strengthening in the SEK. Positive external dynamics allied to an uptick in consumer spending supports our bias towards continued SEK impetus through next year.

Commodity FX

Jeremy Stretch  |  Bipan Rai

NOK to Benefit on Growth, as the Norges Bank Steps Aside
Q1 20: 10.05 | Q3 20: 9.90 (EURNOK)

The Norges Bank’s regional business outlook survey in November revealed expectations of easing lower to 0.96 over the next six months. That monthly retreat was the largest since 2011. Nevertheless, we remain cautiously optimistic about the macro outlook and the NOK trajectory. Despite that the retreat in regional business sentiment is consistent with overall macro activity continuing to moderate, we note the distinction between that of the mainland economy and the overall level of activity.

Mainland growth, excluding the oil sector, remains in relatively robust health. Contingent to that resilience is underlying labour market tightness. Elevated levels of fixed investment in the non-energy sector is supportive for ongoing productivity gains, thereby supporting higher
wages. With annual average earnings having registered a new cyclical high in Q3 of 3.5% y/y, we look for consumption to be a source of resilience into next year, even despite the aggressive monetary policy tightening by the central bank.

After seeing the Norges Bank tighten four separate times since Q3 2018, we expect the retreat in business survey expectations to foreshadow policy inertia in the year ahead. Despite the projected moderation in the current account surplus and underperformance in the energy-orientated part of the economy, we note that the correlation between the NOK and oil prices remains well below 2016 cyclical extremes. We expect moderate NOK strengthening over the course of the year, driven in large part by momentum in the mainland economy.

Jeremy Stretch | Bipan Rai

AUD: Shifting Focus to Domestic Fundamentals
Q1 20: 0.71 | Q3 20: 0.74 (AUDUSD)

The moderation in tensions between the US and China has benefitted the AUD so far this quarter (versus the USD). Still, a patchy domestic backdrop is one reason why the AUD continues to struggle on the crosses - especially against its smaller neighbour to the east, the NZD.

Thus, while the macro sails are shifting in a favourable manner, domestic concerns remain focused on lacklustre wage gains in a household sector that’s already relatively overleveraged. That’s the main reason for the Bank leaving its bias towards further easing in its last statement. However, note that the last statement also emphasized the lagged nature of prior easing as a reason for standing pat this time around. That’s a subtle signal that the Bank may be on hold for a while, and at odds with our expectations, of a cut early next year. Again, the focus should remain on incoming consumer data and sentiment in order to determine whether the RBA is correct in its thinking. If so, the AUD could be in for a rebound next quarter.

Jeremy Stretch | Bipan Rai

Limited NZD Movements With the RBNZ on Hold
Q1 20: 0.65 | Q3 20: 0.67 (NZDUSD)

The Kiwi has been our top currency pick for this quarter, and the gain of over 5% against the USD vindicates that view. There’s a reasonable argument to be made that the currency will need to consolidate in the coming weeks, as short-term charts point to NZD/USD being overbought. Still, we maintain the view to buy on possible dips, given that the position skew still leans short.

The RBNZ is on hold for the foreseeable future, so defensive price action tied to the central bank’s bias is misplaced in our view.

Jeremy Stretch | Bipan Rai

ZAR: Potential Upside via Improving Global Risk Sentiment
Q1 20: 14.60 | Q3 20: 14.40 (USDZAR)

While the ZAR is on course to be one of the better performing major currencies in Q4 versus the USD, the recent retreat below the 200day MAV belies the scale of volatility seen throughout the quarter. And, despite that the country may have avoided a ratings downgrade, which would’ve placed the country below investment grade, ongoing macro negativity in Q3 revealed a second negative quarter of growth within the last three. In addition, the fiscal backdrop remains compromised by ongoing issues, such as parastatal Eskom, which underlines ongoing reasons for ZAR volatility.

With the fiscal backdrop set to remain under pressure from Eskom, expect the budget shortfall to remain around 6% of GDP. Consequently, any potential boost to macro activity will likely need to come from the central bank. In light of CPI sitting towards the mid-point of the 3-6% target range into 2020, this should allow room for the SARB to ease by up to 50bps. Beyond the potential of modest monetary stimulus, the question remains of whether the economy can generate an uptick in growth given restricted fiscal impulse and limited monetary action. With structural reform measures slow to bear fruit, we expect any ZAR gains to prove largely a function of the de-escalation in broad trade tensions, which benefits risk-orientated currencies, including the ZAR. An improving global backdrop, encouraging a broad risk-on stance, should provide a more constructive ZAR backdrop in the long-run. However, we expect volatility to remain elevated, given that risks of a downgrade next year haven’t entirely diminished.

LATAM FX

Luis Hurtado

MXN: Governed by Prospects of Banxico Easing
Q1 20: 20.1 | Q3 20: 20.6 (USDMXN)

Amid the government’s austerity measures in funding PEMEX and the AMLO’s administration’s major projects, Mexico’s prospects for lower growth will continue to be the main story in 2020. The market is currently pricing 140bps of easing in the year head, including the 25bp cut expected by investors in the rate decision on December 19th. However, we disagree with that estimate, as the output gap continues to increase and consumption
indicators show further signs of deceleration. In line with that, we expect Banxico to accelerate its pace or magnitude of cuts next year, bringing the overnight rate to 5.75% by the end of 2020.

Several arguments support our view of a more aggressive easing cycle by Banxico. First, real rates remain relatively flat, despite the CB cutting rates by 100 bps this year. From that angle, the CB's actions should have little effect on economic growth in the short-term, which compounds the need for an acceleration of the cycle as growth stagnates. Second, persistently high core prices has been Banxico's main argument against dropping rates too quickly. However, that has maintained a slow but consistent downward trend since the start of June, coming in at 3.65% y/y in November, or 0.35 p.p. below the CB's upper band of its target range. Moreover, we’re starting to see an increase in the forward guidance discussion at Banxico’s rate decision meetings. I would point out that two of the five voting members (Heath and Esquivel) are already voting for 50bps of rate cuts - a situation unlikely to dissipate into 2020. Moreover, of the other three members, only Guzman appears to have a strong stance against accelerating the pace of rate cuts, although we don’t have enough data to comment on the last two members’ voting intentions going forward.

The imminent USMCA ratification in the US has pushed USD/MXN closer to the 19.1 mark. Although the news could support the MXN in the near-term, we do not see a prolonged appreciation of the peso, given growth concerns and government austerity measures. We favour buying USD/MXN at 19.1 with a 19.6 target and a 18.8 stop.

Luis Hurtado

BRL to Gain on Improving Global and Domestic Growth Prospects

Q1 20: 3.90 | Q3 20: 3.90 (USDBRL)

Unlike in Mexico, market expectations of further rate cuts into 2020 were widespread before the disappointing oil field auctions in early November. Expectations of easing by the central bank saw the BRL depreciate against the USD, with USD/BRL approaching 4.27. But, against recovering global growth and dissipating trade tensions, as well as friendly comments towards the Argentinian government that saw market sentiment improve, that trend has since been reversed throughout the first half of December. Looking ahead, we expect BRL to continue strengthening against the USD into next year.

Investors paid close attention to the Selic rate decision on December 11th, where the CB cut rates by 50 bps, in line with ours and market expectations. In addition, the Bank looked for clues of a possible extension of the easing cycle into 2020. As we’ve previously noted, the CB signalled a cautious approach going forward, as growth green shoots begin to appear, and the BCB assesses the impact of the 200 bps in rate cuts from over the course of this year. Locally, the situation appears to be improving. Fiscal adjustment measures in Congress, including those surrounding pensions, taxes, and administrative reforms, are working to support the endogenous backdrop into 2020. Moreover, we’re expecting significant USD inflows from privatization and concession efforts, which, together with an on hold CB, should add another tailwind for the BRL. We maintain our USD/BRL downward bias towards the 3.90 mark.

Chart 7: USD/MXN and USD/BRL

Source: Bloomberg, CIBC

Luis Hurtado

COP: Hurting From Recent Domestic Social Issues

Q1 20: 3450 | Q3 20: 3400 (USDCOP)

Widespread protests, although less violent than those seen in Chile recently, increased investors’ concerns, as it delayed the congressional agenda and put further pressure on the country’s fiscal accounts. President Duque implemented various measures in response to the list of requests being petitioned, with an estimated cost of up to 0.2% of GDP. This included a 100% VAT rebate for the poorest 20% of the population, as well as three VAT-free days per year, reduced health care contributions for some pensioners, and incentives to reduce youth unemployment.

These measures, together with concessions made by the government in the political arena, quickly altered prevailing sentiment, pushing USD/COP towards 3370, after briefly approaching the 3550 mark at the end of November. The market appears to be complacent with respect to the overall situation in Colombia, as the country is still experiencing one of the highest growth rates in the region, and congress was successful in its first debate.
regarding the 2018 tax reform. Nevertheless, the government still lost significant political capital, and the odds of implementing a new tax reform in the short-term have diminished.

The current situation does not necessarily represent an imminent risk for the country, but it limits the ability of the government to meet its fiscal targets beyond 2021, and should protests continue, does increase the inherent credit and COP risks. Moreover, with the market already pricing in a hike next year, and with limited room for the CB to implement a tightening cycle, expect the COP to lose some ground from current levels and stabilize closer to 3450 into Q1 2020.

Luis Hurtado

CLP Facing Headwinds of Social Unrest

Q1 20: 800 | Q3 20: 820 (USDCLP)

Social unrest in Chile caused substantial damages to public infrastructure, while paralyzing the country, as widespread protests continued throughout November and December. This situation stalled pending tax and pension reforms, as the government assessed required modifications. The main items on the agenda of the protester included better pensions, free and higher quality education, reducing inequality, and a new constitution. In response, the government increased pensions, minimum wages, developed a new social agenda and made several changes to its ministries. Protests and strikes also pushed the government to support a referendum for a new constitution, while the CB intervened in the spot FX market, putting a break to the steep depreciation of the CLP.

On the monetary policy front, the BCCh kept the overnight rate at 1.75% at its meeting on December 4th. The Bank maintained a cautious tone, in line with prevailing uncertainty surrounding inflation expectations, attributed largely to the depreciation of the peso and aggressive fiscal expansion. This should play well for the CLP in the immediate term, as it adds to the spot intervention implemented by the BCCh and the positive developments in the US-China trade deal last week. That being said, the CB’s announcement did not rule out the possibility of rate cuts and pricing hikes. But, that coming as soon as H1 2020, would, in our opinion, be an overreaction. Despite that the announcement could trigger a downwards move towards the 760 mark, it’ll likely be difficult for the CLP to maintain positive momentum, as elections, potential ratings downgrades, slower growth, and ongoing protests remain major concerns.

Chart 8: USD/COP and USD/CLP

Source: Bloomberg, CIBC

Asia FX

Patrick Bennett | Joan Pinto

CNH & CNY: Phase One, Complete

Q1 20: 7.05 | Q3 20: 6.95 (USDCNY)

Market reaction to news of US-China trade deal of late has been no more positive than on initial headlines, when USD/CNH traded to near 6.9230. Even as more details were confirmed, and we certainly characterize them as a step forward and versus baseline expectations, some of the initial positive tone has been unwound. Best explanation of that is that proof of China agreed agricultural purchases, and commitment in areas of technology transfer and intellectual property, will need to be confirmed. The path by which this deal can be more than a zero-sum game is if business and consumer confidence is bolstered, and stilted business investment returns. We were cautious of the deal initially, but do see the details as erring to the positive. That likely caps USD/China to below recent peaks, even if downside will still be hard won. As a consequence we have revised USD/CNY and USD/CNH forecasts modestly lower.

Latest Chinese activity data (for November) has been notable for reversing the further slowing evident last month. Economic stimulus in the form of targeted spending and reductions in RRR and benchmark rates appear to be working. Add to that the phase one trade deal, and though pressure on the Chinese economy is far from over, a greater sense of confidence (or at least relief) is evident.

Looking ahead to 2020, that some tariffs will be reduced and others that were threatened not introduced, will not simply reverse the impact of tariffs already in place, and the spill-over to curbing production and business investment. As above, the November data offer hope of some recovery, or at least stability. Though the yuan
appears weak, it is simply mid-range of major currencies against a stronger USD this year. Our 2020 outlook is of modest CNY and CNH appreciation against an eventually softer USD, and for some underperformance against other Asian currencies, i.e. to weaken against regional trade partners.

Patrick Bennett | Joan Pinto
KRW: Phase One is Key
Q1 20: 1175 | Q3 20: 1160 (USD/KRW)

The South Korean economy has been amongst the hardest hit by the US-China trade war, with exports having fallen in every month of this year. The hi-beta nature of the South Korean economy to China, and to global risk more generally, has been a weight on the KRW through most of the year. That’s left the KRW as the weakest Asian currency against the USD this year, currently off by 4.5%. But now that we see a calming in tensions via the Phase One deal, we expect to see at least some stabilization and likely a recovery of trade flows into 2020. That should provide subsequent support for the economy and the KRW.

Support will also likely come via GDP growth, as it appears to have bottomed out in 2019, with the outlook for a return to moderate growth in the mid-2% range. The BoK’s easing of policy (50 bps in 2019, to 1.25%) has been positive for underpinning domestic activity. As such, we look for rates to remain on hold throughout next year.

Patrick Bennett | Joan Pinto
INR: Stability Before Recovery
Q1 20: 71.0 | Q3 20: 70.3 (USD/INR)

Q3 GDP came in at 4.5% y/y, the softest reading since Q1 2013, and far from the heady times seen over the last several years. While global growth has been stilted, putting pressure on activities in many global economies, for India, the degree of slowing has come as a surprise to many market participants. But better prospects for global growth and eased risk concerns (largely via developments in US-China trade relations) should lend support to the Indian economy next year. Nevertheless, we’re cautious of being overly optimistic.

Softer growth in 2019 prompted the RBI to ease rates, but appears to have paused, as the Bank didn’t cut rates again at their last meeting, following the cut in November. That move disappointed market expectations, as the Bank said it would hold an accommodative stance for ‘as long as it is necessary’. In that regard, we expect 50 bps of further easing in H1 next year.

Given the softer growth outlook, coupled with higher inflation (likely an additional reason behind the RBI’s pause) and already-low domestic rates, USD/INR has remained in a relatively tight and stable range over the last four months, of 70.50-72.50. Moreover, spot recently tested the lower boundary and held. We expect some modest near-term weakness in the INR, but for it to be contained to recent boundaries.

INR was an underperformer compared to its regional peers throughout 2019, but can recover ground in 2020 against an expected softer USD. The stabilization of bond yields should also help counter risks, but yields are relatively low, and we expect investors to be looking for higher yields and a softer INR to enter longs.
### Key Indicators - Latest Data Point

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### Interest Rate and Economic Outlook

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