Monthly FX Outlook

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Currency Strategy Highlights

- The **C$**'s performance hasn't been that stellar despite a spike in oil prices and markets getting a little aggressive with expectations for **Bank of Canada** hikes this year. That leaves room for a weaker Canadian dollar if, as we expect, Governor Poloz moves more cautiously.
- We would be looking for a bigger depreciation in the C$ if not for our call for the US$ to lose ground against other majors. The end of QE in the Eurozone later this year will be seen to presage an eventual turn towards monetary tightening there.

Events to Watch in Coming Month

- Canadian Q1 GDP will be moderate enough to let the **BoC** wait for early Q2 data rather than hiking on **May 30**th.
- The **Fed** will hike again on **June 13**th, and although we see only one further move this year, that won't yet be evident in the messaging from the central bank.
- The Trump administration has so many **trade issues** on its plate (NAFTA, China, Steel/Aluminum, Iran sanctions) that there's bound to be at least some news on that front.

Currency Outlook

End of period:	18-May	2018 II	2018 III	2018 IV	2019 I	2019 II	2019 III	2019 IV
US$ Rates:								
USDCAD	1.29	1.30	1.32	1.31	1.28	1.29	1.31	1.30
EURUSD	1.18	1.20	1.22	1.25	1.27	1.29	1.30	1.32
USDJPY	111	108	106	104	102	102	101	100
GBPUSD	1.35	1.34	1.34	1.39	1.43	1.47	1.48	1.52
USDCHF	1.00	0.98	0.97	0.95	0.94	0.93	0.93	0.92
AUDUSD	0.75	0.75	0.77	0.80	0.81	0.82	0.84	0.85
NZDUSD	0.69	0.69	0.70	0.71	0.73	0.75	0.77	0.78
USDBRL	3.74	3.60	3.70	3.55	3.50	3.45	3.50	3.55
USDMXN	19.91	20.10	19.40	18.90	18.50	18.10	18.40	18.00
USDKRW	1078	1055	1045	1035	1030	1025	1020	1015
USDCNY	6.38	6.20	6.10	6.00	5.95	5.90	5.85	5.80
USDSGD	1.34	1.33	1.32	1.32	1.31	1.31	1.30	1.30
USDTWD	29.9	29.7	29.6	29.5	29.4	29.3	29.2	29.1
USDMYR	3.97	3.80	3.75	3.65	3.65	3.60	3.60	3.55
Other Crosses:								
CADJPY	86	83	80	79	80	79	77	77
AUDCAD	0.97	0.98	1.02	1.05	1.04	1.06	1.10	1.11
GBPCAD	1.74	1.74	1.77	1.82	1.83	1.90	1.94	1.98
EURCAD	1.52	1.56	1.61	1.64	1.63	1.66	1.70	1.72
EURJPY	130	130	129	130	130	132	131	132
EURGBP	0.87	0.90	0.91	0.90	0.89	0.88	0.88	0.87
EURCHF	1.17	1.18	1.18	1.19	1.19	1.20	1.21	1.22
EURSEK	10.31	10.00	9.95	9.80	9.60	9.50	9.40	9.30
EURNOK	9.56	9.55	9.45	9.25	9.10	8.95	8.85	8.80

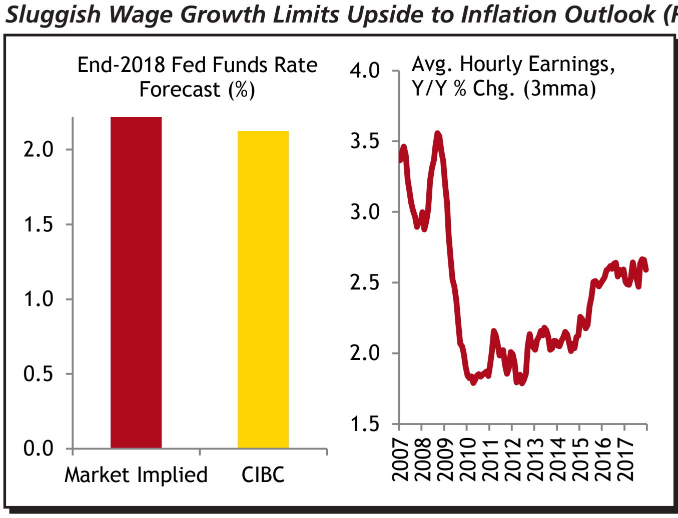
USD: Overseas News Will Move the Needle

While we've pushed back our DXY depreciation targets, the US dollar's rally in recent weeks looks to evaporate in the months ahead. Although Q1 growth surprised to the upside, wage and core price inflation readings are tame enough for the Fed to take a pause to reassess later in the year. If that means only two further quarter-point hikes in 2018, it would be a slightly less hawkish outcome than dollar bulls are assuming, even if a near-3% fed funds rate is still in store for 2019.

In contrast, the news flow could cause markets to shorten the expected horizon for an end to extreme monetary ease overseas, to the benefit of other major currencies. Both growth and inflation readings should firm up in Europe, while Japan, already operating above capacity, is due for at least some lift to prices, particularly if the BoJ's recently upgraded growth outlook is on the mark.

A stubborn current account deficit this year will also keep a lid on USD strength. Imports are set to pour in as investment and consumption respond to tax cuts. All told, we see the US$ depreciating in the coming months as markets readjust to reflect fundamentals.

Chart 1 ***- Markets are Braced for 2 More Hikes this Year (L), Sluggish Wage Growth Limits Upside to Inflation Outlook (R)***



Source: Bloomberg, BLS, CIBC

No Longer a Petro-Loonie

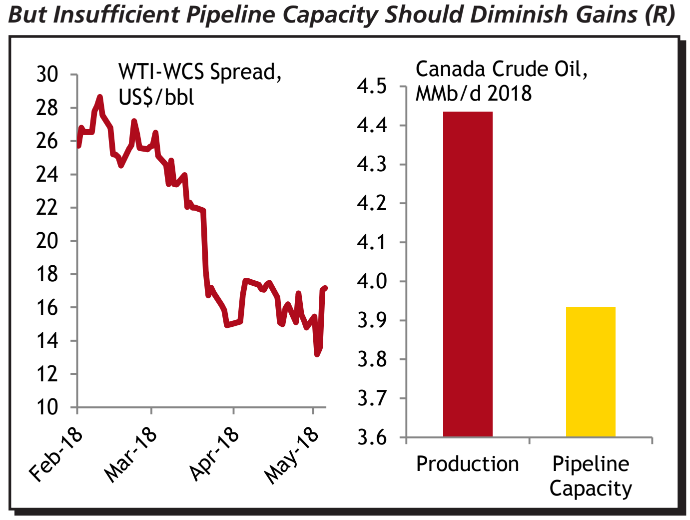
What happened to the petro-loonie? Crude oil's climb just hasn't done much for the Canadian dollar. In part that reflects concerns that pipeline capacity issues and regulatory processes will hold back the potential positives for energy sector capital spending in Canada, as well as the lighter touch on environmental and corporate tax policies being seen in Washington.

Instead of oil's lift to the nominal trade balance, markets focused on the trade hazards associated with drifting NAFTA talks, and an only temporary exemption from US tariffs on steel and aluminum. Although exports picked up late in Q1, a record monthly goods trade deficit reminded loonie-watchers that current trade-related FX flows are a burden on the Canadian currency.

The Bank of Canada's dismissal of some of the recent inflation heat as coming from one-off factors, and the increase in its estimate of potential GDP, have underscored its intention to proceed more cautiously than the US. The economy did exit Q1 with more momentum than it entered, and a follow-up in reports on April would support a BoC hike in July.

But with the economy see-sawing above and below the 2% growth mark, the six-month pause since January looks indicative of what lies ahead. That will have Canadian short rates rising at roughly half the US pace, key to our call for a dollar-Canada climb to 1.32 in upcoming months.

Chart 2 ***- WTI-WCS Differential has Narrowed Recently (L), But Insufficient Pipeline Capacity Should Diminish Gains (R)***



Source: Bloomberg, CAPP, CIBC

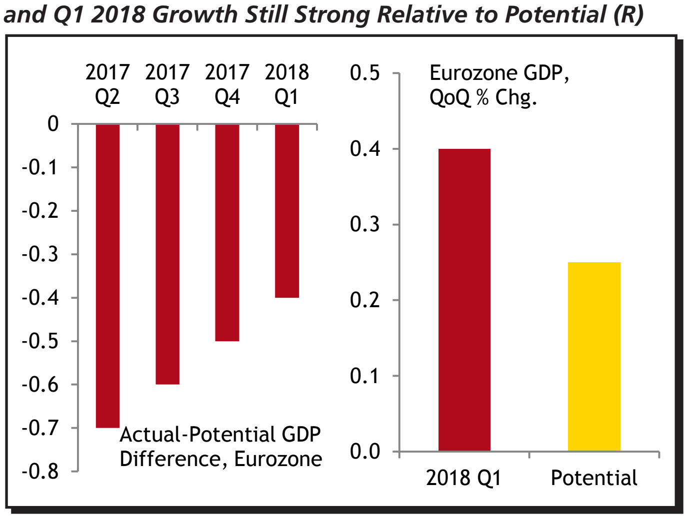
Eurovision—Taking the Long Euro View

Eurozone growth and inflation disappointed thus far in 2018 , but with sights set a little lower now, it won't take much to have markets impressed enough to provide another leg higher in the single currency. Long positions have been pared back from recent extremes to something closer to the one-year moving average, suggesting positioning isn't as heavily skewed as it was. That change in positioning, combined with wider Treasury-Bund spreads, has contributed to the recent pull-back in the euro.

The Eurozone economic surprise index fell sharply from elevated levels in Q4 to lows not seen since the Eurozone crisis in late 2011. However, the 0.4% unannualized growth pace in Q1 is still a little above the Eurozone's longer-term potential, and PMI readings, while off their highs, remain suggestive of solid growth. The ECB may be right in putting some of the blame on that frequent excuse, the weather.

Medium-term economic data are likely to remain positive enough to gradually squeeze out economic slack. ECB hawks will also gain solace from the fact that inflation expectations have held up, with the 5Y5Y inflation swap picking up again towards three-month highs. While the majority of ECB members will want to see some momentum in core inflation as well as evidence that the Q1 slowdown in growth was transitory before saying much, look for further signals of stimulus withdrawal to come at the June 19-20th symposium or July 26th meeting.

Chart 3 ***- Eurozone Output Gap Getting Narrower (L) and Q1 2018 Growth Still Strong Relative to Potential (R)***



Source: Bloomberg, CIBC

At that time, we should see the euro making gains against the US$, with EURUSD reaching 1.25 by the end of the year and 1.32 by December 2019.

GBP Takes a "Pounding" From Reduced Rate Expectations

Disappointing CPI and GDP figures turned what at one point appeared a sure thing into a non-event, as the Bank of England kept interest rates on hold in May. Although the BoE argues that the slowdown in Q1 growth to a mere 0.1% unannualized pace is likely to be either weather-distorted or even revised away, its updated projections suggest policymakers are unsure if rate hikes will be warranted. The downward revision to 1.4% growth this year, from 1.8% previously, is a significant move and suggests an economy growing only in line with its long-run potential.

As such, even though the BoE continues to talk about gradual rate hikes, we suspect that they are likely to remain on the sidelines until at least November. While real wage growth has turned positive for the first time in over a year in March, that's unlikely to prove a significant boost to consumer spending or rate hike expectations unless wage settlements extend towards the BoE's lofty targets, which sit well in excess of 3%.

Politics are also a burden for sterling, as the UK Cabinet struggles to find a common position on the UK's post-Brexit customs arrangements. That failure constrains substantive trade negotiations with Europe, in the process enhancing the risks of a hard Brexit.

Expect sterling to remain on the defensive, particularly against the euro in the near term. A pick-up could be in store towards the end of the year as we finally see BoE rate hikes, and hopefully, have a little more clarity regarding Brexit agreements.

JPY: Primed for Appreciation

The yen has been losing ground to the greenback this year, but an improving Japanese macroeconomic backdrop should see a reversal in course. Central bankers in Japan recently upgraded their GDP estimates for both fiscal year 2018 and 2019 to 1.6% and 0.8%, from 1.4% and 0.7% previously. The Q1 growth disappointment looks to be transitory, with its weakness in consumption unlikely to persist given the spending power being built by nascent wage pressures.

Although core inflation may struggle to advance well beyond 1% prior to the end of Q3, we continue to anticipate those wage pick-ups, and a positive output gap, will lead core prices higher, resulting in a more hawkish stance from the BoJ. With USDJPY well linked to government bond spreads in the last two years, the yen should be a beneficiary of any upward pressure on JGBs emanating from a less-dovish tone at the BoJ.

Indeed, after seeing net JPY shorts advance for five straight weeks into early May, a scenario not seen since 2016, we remain wary of recent flows running out of momentum. That should also help fuel a correction in USDJPY, adding to ammunition from anticipated positive economic developments. Overall, we target USDJPY reaching 104 by the end of the year.

CHF to Maintain Laggard Status

Swiss central bankers have progressively rolled back their rhetoric on the franc, moving away from calling it 'significantly overvalued' to 'highly valued' in the most recent policy communication in mid-March.

Indeed, the temporary depreciation of the franc to 1.20 per EUR, the level that the central bank stepped away from in 2015, reflects the laggard status of the SNB. And despite a cheapening in the trade-weighted CHF since the last SNB meeting, we expect the policymakers to remain reluctant to underline anything other than a continuation of current accommodative monetary policies in communications.

Headline inflation has struggled to break above the highs seen at the end of 2017, and although business sentiment remains well above the post-crisis average, the SNB should maintain its reference to the need for "the negative interest rate and the SNB's willingness to intervene in the foreign exchange market".

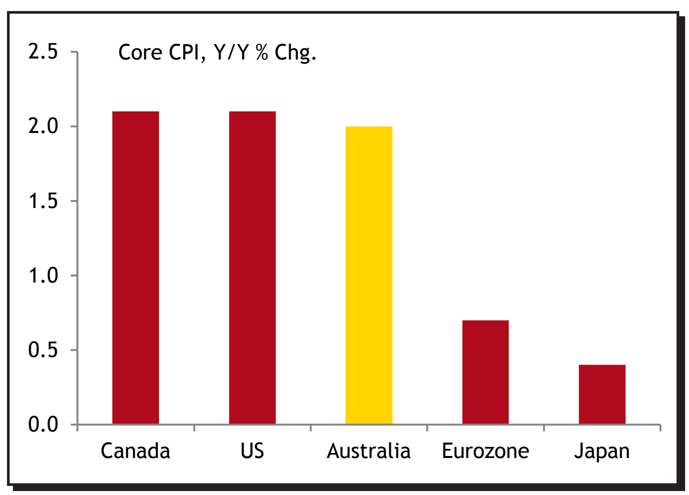
With the SNB disinclined to discuss policy stimulus withdrawal, look for a stabilization in the CHF before a gradual depreciation, with EURCHF hitting 1.20 again at the beginning of 2019.

AUD on the Upswing

The odds of the RBA delivering a rate hike in November have retreated, but we consider the improving macroeconomic backdrop a catalyst for AUD strength. The probability of a hike coming in conjunction with the November Statement on Monetary Policy has fallen from nearly 80% three months ago to now stand at a little over 20%. But policymakers remain confident in the economy, stating that "progress on both inflation and unemployment is expected".

April's jobs report didn't disappoint on the employment front, as full-time positions and hours worked jumped. At the same time, wage growth remained subdued, aligning with central bankers' expectations for progress to occur only gradually.

Chart 4 - ***Australia Middle of the Pack in Terms of Price Pressures***



Source: Bloomberg, CIBC

The push back in rate expectations has led short AUD positions to approach year-to-date extremes. An ensuing correction should lead AUD to outperform relative to its regional peer, with a strong wage report needed to provide ammunition for a reversal as the labour market strengthens over the remainder of the year. That should see AUDUSD rise to 0.80 by the end of the year.

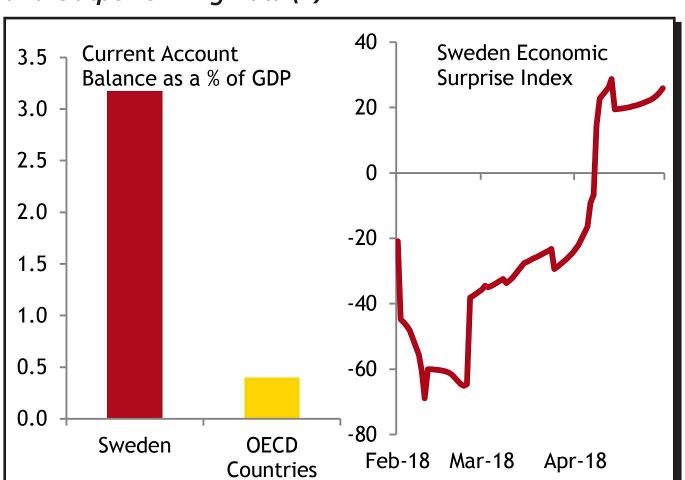
SEK Propped up by Impressive Fundamentals

We continue to believe that the SEK is oversold relative to fundamentals and that a rebound is in the cards. Central bankers echoed this sentiment in the publication of the April Riksbank minutes, also citing rate differentials as a signal for a stronger krona.

That helped the SEK gain momentum in recent weeks, bolstered by better-than-expected data that had the economic surprise index hovering near year-to-date highs. Despite inflation currently below the 2% target, we still expect the Riksbank to adjust policy prior to year-end as a cheap currency should boost exports in the interim, propping up an already elevated current account surplus.

That should help overcome recent Swedish central banker concerns over weaker inflation prints and manufacturing PMI data. Overall, SEK should appreciate over the remainder of the year, with EURSEK falling to 9.80.

Chart 5 - ***SEK Backed by Healthy Current Account Surplus (L) and Outperforming Data (R)***



Source: Bank of England, Bloomberg CIBC

NOK Supported by Hawkish Signals

The tone of the Norges Bank is becoming increasingly hawkish. Central bankers left their message broadly unchanged at their May meeting despite a contraction in industrial production for three consecutive months and a lower path of underlying inflation. With updated forecasts being released at the next Norges Bank meeting on June 21st, investors will be looking for further indications of the probability of a rate hike by the end of Q3.

Economic data ahead should further support expectations for a hawkish shift in rhetoric as the rebound in the energy sector translates to stronger growth. A rebound in the price of oil should support gross fixed investment expectations while boosting the fiscal balance.

That leaves the Norges Bank on course for monetary policy tightening around the end of Q3. Combined with stronger growth prospects, that should lead EURNOK down to 9.25 by the end of the year as NOK advances.

RBNZ Dovish Stance in Jeopardy

The underlying fundamentals of the New Zealand economy remain positive, but the new monetary regime appears resistant to a policy change in the foreseeable future. The first forecast update from new central bank Governor Orr resulted in the timing of the first hike and the attainment of the 2% CPI target being pushed back by a quarter, to Q3 2019 and Q4 2020, respectively.

That said, Orr most recently spoke of the risks of a cut or a hike being evenly balanced. While the bank noted growth in the labour market, the uptick in Q1 quarterly average earnings suggests that the RBNZ is unlikely to remain on the sidelines until Q3 2019. Indeed, signs that the economy is running slightly above potential signal the end of a dovish RBNZ stance in the near future.

The RBNZ will end up being more aggressive than its Australian counterpart, suggesting relative underperformance versus the AUD. Even so, we expect positive commodity demand dynamics and supportive fundamentals to lead an appreciation in NZD against the greenback in the back half of the year, with NZDUSD reaching 0.71 by then.

BRL Hinges on Political Developments

The political chess game will continue to dictate moves in BRL. With ex-Justice Barbosa now out of the potential presidential candidate pool, the chances of getting a candidate with centred political views have been severely depleted, with the candidate closest to the centre, Geraldo Alckim, underperforming in the polls. Polls currently suggest that a “moderate” left candidate, Marina Silva, has a good chance of winning, with Jair Bolsonaro, who stands on the right end of the political spectrum, also being a top contender. From a structural reform point of view, Alckim is most likely to push forward structural reforms.

BRL should continue to reflect the volatility associated with political developments. At the same time, the macroeconomic backdrop suggests very limited room for lower rates in the front end of the curve as a weaker exchange rate could reignite some price acceleration in the medium term. We expect BRL to consolidate around current levels (USDBRL 3.60) until we get more news on political developments as Lula is not likely to run but certainly could try to support proxy candidates.

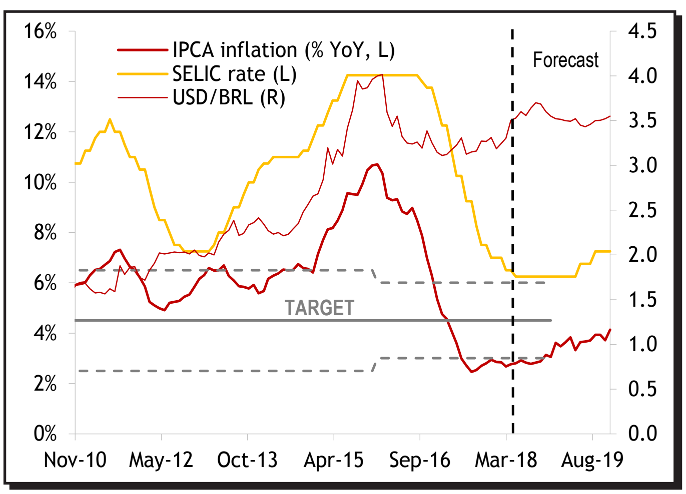
MXN: Searching for Direction

The peso should continue to trade with a volatile tone in light of trade and political issues. While NAFTA surviving in some shape or form is our base-case assumption, the exact timing for an executive agreement in “principle” to be reached and a legislative agenda to be drawn up is difficult to pinpoint. Markets have been operating on the assumption that NAFTA is close to being “agreed” on at the “trade negotiator” level and thus, any delays could spell trouble for MXN.

Political forces will also be front and centre for MXN, with left-leaning Andrés Manuel López Obrador continuing to lead in the polls by a wide margin. While his campaign agenda suggests that government spending should increase, he has not provided a means for increasing government revenues, as he has pledged to not raise taxes. This adds to the NAFTA uncertainty, clouding the MXN outlook.

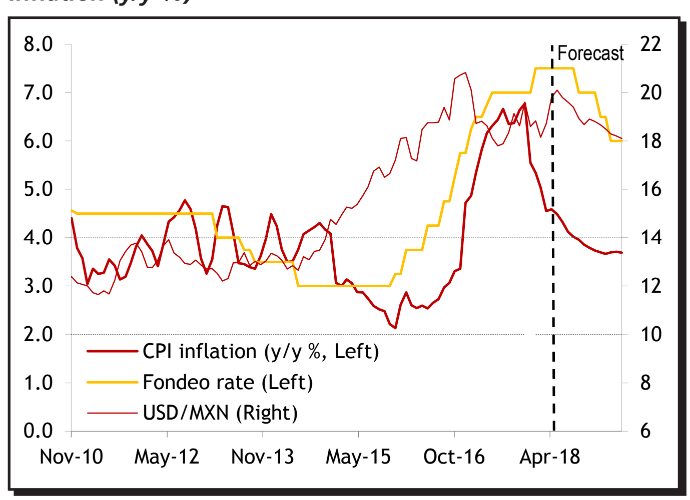
Banxico’s most recent announcement indicated that the bar for an additional rate hike remains high. That being said, the output gap is viewed as being closed as labour costs are seen as a possible threat to the inflation outlook. However, due to uncertainty surrounding NAFTA negotiations and the presidential election, we expect MXN to continue to trade with volatility, while keeping in mind that there are still tail risks that could take USDMXN to test weaker levels.

Chart 6 - ***USD/BRL Spot, the SELIC Policy Rate and Inflation***



Source: Banco Central do Brasil, IBGE, CIBC

Chart 7 - ***USD/MXN, Rondeo Rate, Headline and Core Inflation (y/y %)***



Source: Banxico, Bloomberg, CIBC

CNH & CNY Set to Grind Higher

Concerns over global trade protectionism and tensions between the US and China look to continue for some time but that won't hold the renminbi back. Negotiations between the two countries have become less contentious recently, with markets less rattled by trade policy developments. Going forward, investors will likely focus on fundamentals.

Attention should turn to strong external surpluses and solid domestic economic activity in China. Along with increasing demand for Chinese assets under the impact of the opening of domestic markets, helped by the recent MSCI inclusion, we anticipate a strengthening CNY and CNH in the coming quarters.

Despite USD/China having moved sideways in recent weeks, the underlying strength of the Chinese currency has been witnessed in the appreciation of the trade-weighted value. However, with that still some 5% below peaks recorded in early-to-mid 2015, we anticipate that ground to be made up over the next one-to-two years, with USDCNY reaching 6.00 by the end of 2018.

KRW: Further Appreciation After Consolidation

The KRW remains near flat versus the USD since the start of the year, with some of the earlier appreciation being undone by the recent USD recovery. However, we anticipate a resumption of appreciation over the coming months as domestic economic performance recovers from a sluggish start to the year.

Exports have lagged recently, but indicators in the latest business and manufacturing surveys point to an impending improvement, which should help improve wide goods and current account deficits.

Recent portfolio withdrawal from South Korea have been overextended in our view. Equity flow has been negative year-to-date, but that follows five years of strong inflow. Portfolio flow to the bond market remains positive, last running at +$18.3bn and ahead of the pace of inflow of the last five years. We therefore maintain our view of USDKRW trading toward 1,000 over the medium term before any return toward even the mid-1,100 range.

Interest Rate and Economic Outlook

End of period:		2018 II	2018 III	2018 IV
Canada	Overnight target rate	1.25	1.50	1.50
	2-Year Gov't Bond	1.90	2.05	2.05
	10-Year Gov't Bond	2.50	2.50	2.50
US	Federal Funds Rate	1.88	2.13	2.13
	2-Year Gov't Note	2.40	2.45	2.50
	10-Year Gov't Note	3.00	2.95	3.05
Eurozone	Refin.operations rate	0.00	0.00	0.00
	2-Year Gov't Bunds	-0.45	-0.35	-0.20
	10-Year Gov't Bunds	0.75	0.85	1.00
UK	Bank rate	0.50	0.50	0.75
	2-Year Gilts	0.75	0.85	1.10
	10-Year Gilts	1.55	1.65	1.75
Japan	Overnight rate	-0.10	-0.10	-0.10
	2-Year Gov't Bond	-0.10	0.00	0.05
	10-Year Gov't Bond	0.10	0.15	0.20

		2017	2018	2019
Canada	Real GDP growth (%)	3.0	2.0	1.6
	Unemployment rate (%)	6.3	5.8	5.7
	CPI (%)	1.6	2.4	2.0
US	Real GDP growth (%)	2.3	2.7	1.9
	Unemployment rate (%)	4.4	3.9	3.7
	CPI (%)	2.1	2.6	2.5
Eurozone	Real GDP growth (%)	2.5	2.1	1.5
	Unemployment rate (%)	9.1	8.4	8.1
	CPI (%)	1.5	1.7	1.9
UK	Real GDP growth (%)	1.8	1.3	1.3
	Unemployment rate (%)	4.4	4.4	4.3
	CPI (%)	2.7	2.6	2.2
Japan	Real GDP growth (%)	1.6	1.2	0.8
	Unemployment rate (%)	2.8	2.5	2.7
	CPI (%)	0.5	1.0	1.1