FX Themes and Trades
Monthly Outlook
October 17, 2018

Macro Strategy
Economics
FX Desk Strategy

Change of Year, Change of Course

Currency	Summary	What's Changed
USD	DXY strength has been limited, and with the market fully priced for the Fed in 2019, a wide current account deficit should weigh on the dollar as overseas central banks tighten.	DXY is still on track to soften over the forecast horizon.
CAD	The post-USMCA Canadian dollar rally proved short-lived as we expected, but as markets recalibrate expectations towards a January BoC hike, USDCAD should return to 1.28.	A bit of strength added to the loonie in late 2018 and early 2019.
EUR	EUR bulls will need to stay patient for a few more months as political risks in Italy and Germany, including the state elections and the CDU party vote, keep price action choppy.	Forecast unchanged as strategic tailwinds still favour a 1.20+ EURUSD in 2019.
GBP	Brexit discussions will continue to guide Sterling movements in the short-term but solid domestic fundamentals remain supportive of a stronger GBP in 2019.	Additional strength built in for GBP.
JPY	Yen bulls will be further rewarded in the months ahead as the BoJ signals that the removal of monetary policy stimulus in 2019.	Forecast unchanged.
Commodity FX	The combination of rising global yields and slow growth portend trouble ahead. Still, excessive short builds in AUD and NZD support near-term tactical rallies. NOK is benefitting from a bullish Norges Bank and positive core inflation surprises.	NOK strength amplified in H1 2019 owing to stronger inflationary pressures.
LATAM FX	MXN volatility should be reduced by the USMCA, while a Bolsonaro win would bolster BRL strength in the months ahead due to policy continuity with the current administration.	BRL profile stronger, in line with recent appreciation.
FX Asia	USD/Asia pairs remain firm and will extend until broader DXY weakness is more material. Medium-term impacts of trade tariffs are unclear and many external demand leveraged economies in Asia have caution priced via weaker currencies. Higher global interest rates are a catalyst for portfolio withdrawals which will weigh notably on economies with current account deficits.	Currency targets have been weakened; recoveries will be shallower and take longer as global growth slows.

Currency Outlook

End of Period:	Oct. 17/18	Q4 18	Q1 19	Q2 19	Q3 19	Q4 19	Q2 20	Q4 20
USD/CAD	1.30	1.28	1.29	1.31	1.32	1.34	1.32	1.30
EUR/USD	1.15	1.18	1.20	1.23	1.25	1.28	1.30	1.30
USD/JPY	112	110	108	106	105	104	102	100
GBP/USD	1.31	1.33	1.35	1.39	1.42	1.46	1.50	1.51
USD/CHF	0.99	0.97	0.96	0.94	0.94	0.92	0.91	0.89
USD/SEK	8.94	8.77	8.46	8.13	7.92	7.66	7.38	7.42
AUD/USD	0.71	0.74	0.75	0.76	0.77	0.78	0.79	0.80
NZD/USD	0.66	0.64	0.64	0.64	0.65	0.67	0.69	0.70
USD/NOK	8.18	8.01	7.79	7.48	7.28	7.07	6.77	6.69
USD/ZAR	14.25	15.40	15.30	15.20	15.15	15.10	14.70	14.40
USD/BRL	3.71	3.65	3.80	3.85	3.95	4.05	4.15	4.05
USD/MXN	18.83	19.40	19.10	18.90	18.80	19.50	19.40	20.30
USD/COP	3053	3230	3200	3100	3150	3000	2950	3250
USD/CLP	670	670	650	650	660	690	670	700
USD/CNY	6.93	6.98	6.88	6.83	6.80	6.75	6.65	6.55
USD/KRW	1127	1140	1130	1120	1110	1105	1085	1065
USD/INR	73.6	75	74.5	74	73.5	73	72	71
USD/SGD	1.38	1.39	1.38	1.38	1.37	1.36	1.35	1.34
USD/TWD	31	31.15	30.98	30.75	30.5	30.25	29.75	29.25
USD/MYR	4.15	4.20	4.10	3.95	3.90	3.85	3.75	3.65
USD/IDR	15150	15500	15250	15000	14800	14600	14200	14000

New Trade Recommendations

Buy USD/CNH 1Y Forward

USD/CNH upside will be slowed by official action. But with trade uncertainty persisting and the USD outperforming, risk remains to the topside for USD/China. Positioning has been preferred via long USD/CNH 1-year forward points, as withdrawal of liquidity and/or bearish currency sentiment will drive wider levels. We recently took profit and look to re-enter on a pullback to support and a former break point, target is the consolidation level of late 2017.

Spot reference: 732bps
Entry: 895bps
Target: 1,500bps
Stop: on close below 685bps

Open Trade Recommendations

Sell USD/KRW

1,150 is significant resistance in USD/KRW and we look to use opportunity of further USD strength to set shorts. The target is our Q4 '19 forecast and the stop above previous major highs.

Spot reference: 1,127
Entry: 1,149
Target: 1,105
Stop: on close above 1,163

Trade Book

Trade	Entry date	Entry level	Target	Stop	Current P/L
Long USD/INR	13-Sep-18	72.18	75.00	72.18	+1.80%
Long USD/INR 3m NDF	13-Sep-18	72.79	76.15	72.79	+2.20%
Short USD/KRW 1Y RR	31-Oct-17				0.0%
Closed Trades					
Long AUD/CAD	24-Sep-18	0.9395	0.9930	0.9190	-2.18%
Long USD/CNH 1Y DF	13-Sep-18	725	1180	550	+1.88%
Short CAD/SEK	9-Sep-18	6.875	6.61	7.04	-2.34%
Short EUR/SEK	17-Aug-18	10.475	10.14	10.58	-0.99%
Short USD/CAD	3-Aug-18	1.2980	1.2600	1.3150	-1.29%
Short GBP/NOK	2-Aug-18	10.77	10.42	10.86	-0.83%
Short USD/CHF	29-Jul-18	0.9945	0.96	1.009	0.00%
Short USD/CNH	20-Jul-18	6.8350	6.5000	6.9050	-1.01%
Short USD/SEK	8-Jul-18	8.7250	8.20	8.95	-2.51%
Short CAD/CHF	11-Jun-18	0.7595	0.7300	0.7745	-0.61%
Long EUR/USD	6-Jun-18	1.1755	1.2095	1.162	-1.15%
Short JPY/KRW	23-May-18	9.83	9.44	9.92	-0.91%
Short USD/CHF	22-May-18	0.9950	0.9500	1.0085	-0.20%
Short USD/KRW	18-May-18	1083	1031	1103	-1.81%
Short CAD/CHF	15-May-18	0.7770	0.7500	0.7905	-0.16%
Short EUR/SEK	9-May-18	10.39	10.05	10.55	+1.76%
Short USD/CNH	2-May-18	6.37	6.15	6.45	-0.65%
Short GBP/JPY	2-May-18	148.20	140.00	150.91	+1.00%
Long AUD/NZD	25-Apr-18	1.0705	1.12	1.047	+1.84%
Short USD/KRW 1m NDF	25-Apr-18	1082	1030	1102	+0.38%
Short USD/CNH 12m DF	6-Apr-18	6.40	6.10	6.52	-1.38%
Short USD/CAD	8-Apr-18	1.2775	1.2485	1.2775	0.00%
Short GBP/JPY	28-Feb-18	147.00	130.00	151.75	-3.13%

Short USD/INR	23-Feb-18	65.00	63.30	65.60	-0.91%
Long USD/CAD 6m c/ps	15-Nov-17				-0.29%
Long AUD/MXN	16-Mar-18	14.55	15.44	14.08	-3.23%
Short EUR/NOK	15-Mar-18	9.519	9.22	9.67	-1.56%
Long CNH vs. tw basket	23-Feb-18	6.41	6.25	6.46	+1.70%
Short USD/INR 1m NDF	23-Feb-18	65.25	63.55	65.85	+0.37%
Short EUR/SEK	22-Feb-18	10.01	9.720	10.085	-0.74%
Short USD/CHF	19-Feb-18	0.9290	0.8700	0.9510	-2.31%
Short CAD/JPY	8-Feb-18	86.70	80.00	89.15	+5.24%
Short CHF/JPY	15-Dec-17	113.69	108.79	115.75	-1.78%
Short USD/SEK	15-Dec-17	8.5000	7.9805	8.5476	+6.56%
Short AUD/NZD	11-Dec-17	1.0900	1.0400	1.1155	+1.30%
Short USD/INR	13-Nov-17	65.30	64.00	66.00	+2.03%
Long CNH vs. tw basket	10-Nov-17	6.5150	6.4200	6.5500	+1.48%
Short USD/INR 1m NDF	10-Nov-17	65.65	64.35	66.35	+1.84%
Short EUR/SEK	31-Oct-17	9.74	9.45	9.8210	-0.82%
Short CAD/JPY	25-Oct-17	88.89	85.60	90.20	-1.45%
Long EUR/GBP	2-Oct-17	0.8817	0.9265	0.8600	+1.30%
Short USD/CNH 1Y RR	26-Sep-17				+1.10%
Long SEK/JPY	21-Sep-17	14.0900	14.7000	13.8500	-1.70%
Long EUR/CAD	18-Sep-17	1.4530	1.4900	1.4370	+1.22%
Long CAD/MXN	17-Aug-17 (revised Oct 18)	14.00	15.50	14.35	+7.43%
Long CAD/MXN 3m RKO	17-Aug-17	14.00	14.2460	15.45	+4.87%
Long AUD/USD	18-Jul-17 (revised Sep 12)	0.8000	0.8350	0.7850	-1.88%
Short USD/JPY	11-Sep-17	108.40	104.50	110.35	-1.77%
Short USD/KRW	6-Apr-17 (revised Aug 15)	1145.0000	1115.0000	1145.0000	0.00%
Long EUR/USD	28-Jul-17	1.1065	1.2050	1.0650	+8.90%
Short GBP/SEK	21-Jul-17	10.72	10.22	10.72	0.00%
Short GBP/AUD	10-Jul-17	1.694	1.662	1.714	+1.93%
Short USD/CNH 2m NDF	15-Jun-17	6.8350	6.7500	6.8650	-0.54%
Long EUR/USD	16-May-17	1.1065	1.1800	1.0720	+6.20%
Long EUR/GBP	15-May-17	0.8475	0.8850	0.8345	+4.43%
Short USD/INR 3m NDF	9-May-17	65.2000	63.2000	65.8000	+2.18%
Short USD/INR	9-May-17	64.5000	62.5000	65.1000	-0.92%
Short USD/SEK	9-May-17	8.89	8.4300	8.9500	+4.74%
Long USD/COP	24-Apr-17	2870.0000	2950.0000	2830.0000	+3.82%
Short PHP/INR 3m NDF	21-Apr-17	1.3125	1.2675	1.3285	+3.55%
Short PHP/INR	21-Apr-17	1.3050	1.2600	1.3210	+3.57%
Short AUD/CAD	10-Apr-17	1.0045	0.9715	1.0210	-0.50%
Short USD/KRW 3m NDF	6-Apr-17	1143.5000	1088.5000	1160.5000	-1.13%
Long AUD/NZD	2-Mar-17	1.0805	1.1300	1.0575	-1.09%
Short GBP/JPY	2-Mar-17	140.4500	134.0000	143.0000	-2.17%
Short EUR/SEK	2-Mar-17	9.5655	9.4089	9.6100	-0.54%
Short GBP/CAD	2-Feb-17	1.6400	1.5750	1.6605	-1.57%
Short USD/CLP	2-Feb-17	640.0000	604.1000	657.5000	-2.71%
Long USD/KRW	2-Feb-17	1137.9000	1205.0000	1125.0000	-1.56%
Long USD/KRW 3m NDF	2-Feb-17	1136.7000	1205.0000	1125.0000	-2.03%
Long IDR/INR	2-Feb-17	0.5047	0.5170	0.5030	-0.38%
Long USD/CNH 6m forward	17-Jan-17	7.0000	7.1700	6.9200	-1.14%
Long USD/CAD	6-May-16	1.2940	1.3700	1.2940	+2.93%

CAD

Avery Shenfeld | Katherine Judge

USMCA Brings Fundamentals into Sharper Focus

Q4 18: 1.28 | Q2 19: 1.31 (USDCAD)

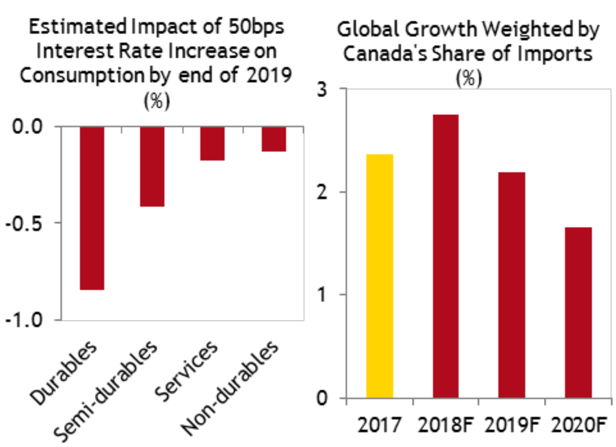
The USMCA trade deal, while a necessary ingredient in our outlook for the Canadian economy, will do little to shift growth into higher gear. For Canada, the new deal is really NAFTA-minus, and leaves US tariffs in place in some key sectors. It therefore won't be enough to materially alter the lacklustre performance seen in exports and investment in capacity since 2000. Slower growth ahead in Canada's trading partners will present an added challenge for exporters, who still face US tariffs in some key sectors.

Markets seem to have recognized that, as reflected in the only short-lived post-USMCA CAD rally to 1.28. A January BoC hike, following up on an October move, could nudge dollar-Canada to 1.28 again, but as in the past, a sustained rally for the loonie doesn't appear to be in the cards.

Given the need to keep exports competitive, and the lagged impacts of higher rates on housing, the BoC is likely to stand in the way of a sustained appreciation by taking an extended pause on rates after January. We will still have a further Fed hike to deal with, pushing the loonie back on its heels towards 1.34 by late 2019.

Oil is unlikely to be helpful to the C$ in 2019. Although the WTI-WCS spread is likely to improve from recent wides, we see WTI easing off in the face of slowing global growth in 2019. The end of fiscal tailwinds in the US in 2020 could be sufficient to allow the Fed to ease up a bit on rates in 2020. If so, look for dollar-Canada to return to the 1.30 level as the lack of a fiscal swing in Canada keeps the Bank of Canada on hold.

Chart 1: Canadian Households Challenged by Higher Rates (L); Exporters Facing Slower Global Growth Ahead (R)



Source: BoC, UN, CIBC

Major Currencies

Avery Shenfeld | Katherine Judge

USD: Cracks in the Foundation

Q4 18: 93.66 | Q2 19: 90.26 (DXY)

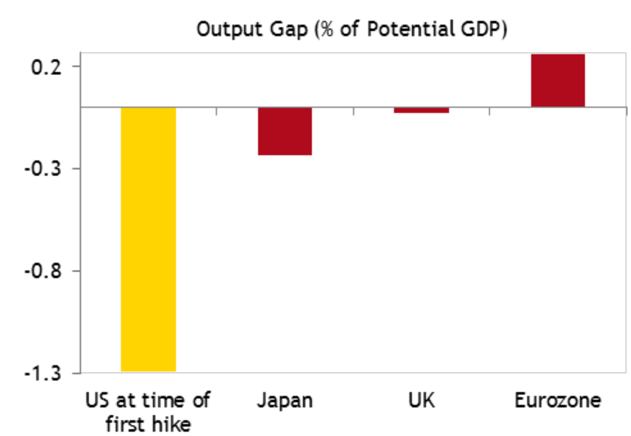
A series of data misses have partly been responsible for limited progress in DXY in October. And while those disappointments may not have staying power, we still expect investors to gravitate away from DXY in the coming quarters.

Weather distortions aside, the most cyclical sectors of the economy are showing signs that the American consumer is feeling the impact of higher interest rates. Auto purchase intentions and new housing activity is on a lower trajectory. While labour shortages and near-target core inflation are enough to keep the Fed on track to meet market expectations for now, that picture could change come 2019.

As we get more clarity on an impending fiscal drag in 2020, both markets and the Fed will likely be recalibrating their rate expectations lower. A slowdown to a hike every other quarter in 2019 would put pressure on a US dollar that is vulnerable given a wide current account gap.

Markets are also underpricing the odds of ECB and BoE tightening in H1 2019, the latter of course requiring a solution to the Brexit impasse. Even Japan could begin to hike before the end of next year, depending on what it does with fiscal policy. Progress on trade talks with other nations would also reverse flight to safety flows that have buttressed the greenback. Overall, look for USD strength to fade against most other majors.

Chart 2: Output Gap in Major Non-US Economies Signalling Tighter Monetary Policy is Imminent



Source: IMF, CIBC

Jeremy Stretch | Bipan Rai

For EUR Bulls, Patience is a Virtue

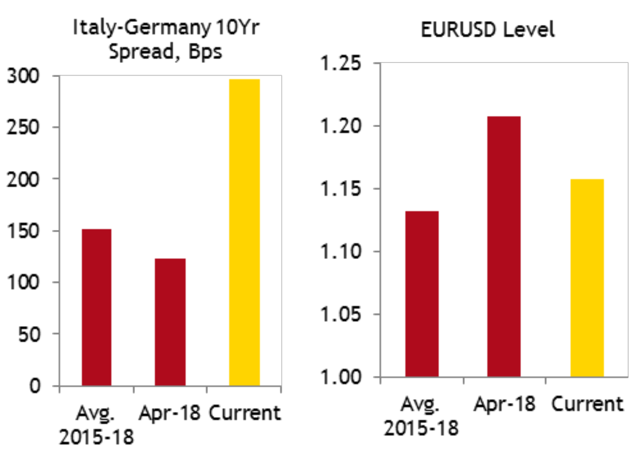
Q4 18: 1.18 | Q2 19: 1.23 (EURUSD)

Our message to EUR bulls is simple –patience is a virtue. We've been on record for some time now with our call that the EUR rally is likely on hold until early 2019. That's reflective of the ongoing divergence between US and European growth outlooks, and the softness in Euro core CPI. Additionally, the situation in Italy should continue to drag on for a few months as the EU Commission is expected to deem Italy's budget as non-compliant, leading to a few months of negotiating, infighting and headlines that widen BTP-Bund spreads.

Despite all of this, investors shouldn't pull the plug on the EUR just yet. For one, core CPI should shift higher in the coming months given the move in the output gap and firmness in negotiated wage rates of late. Even if Italian spreads widen, there's little appetite in Italy to exit the monetary union; 'Quitaly' is not happening. Given the massive sovereign debt overhang and the potential costs of ballooning spreads, the governing coalition in Rome is limited in how far it can fight the EU on the budget. The market is taking note as well with EUR/USD sensitivity to widening spreads now on the decline.

Sure, there are risk events to watch for. State elections in Germany along with a CDU party vote on Merkel on December 6th will keep things dicey. Nonetheless, longer-term tailwinds from a healthy current account and a future ECB monetary tightening should keep EUR risks to the upside.

Chart 3: Italian Government Woes (L) Haven't Scared Investors Away from the Euro (R)



Source: Bloomberg, CIBC

Jeremy Stretch | Bipan Rai

Buy the Yen in the Land of the Rising Sun

Q4 18: 110 | Q2 19: 106 (USDJPY)

We underlined last month three key reasons why we remain constructive on the JPY outlook: Japan's large current account surplus, its net-creditor status and the BoJ's stealth tapering. All of these represent a land of the rising sun for the yen in terms of a medium term appreciation ahead.

The recent uptick in risk aversion could also see domestic investors stay within Japan in order to earn a return. Speculative JPY shorts have reached eight month highs, suggesting that there is scope for a short covering rally, which would lend further support to the yen.

Although the 10-year UST-JGB spread has widened beyond 300bp recently, the BoJ's stealth tapering could see a narrowing ahead, which would also support yen gains. In terms of the signalling of any policy change, BoJ Governor Kuroda has underlined that allowing yield-curve control targets to drift higher is a definitive signal of a policy shift.

While next October's increase in the sales tax rate might give the BoJ pause, increasing evidence of rising price pressures will act to alleviate some of the associated uncertainty. Amidst reports of labour shortages, which suggest that higher wage inflation may be on the horizon, BoJ officials have become more open in discussing a policy change. Most recently, BoJ member Sakurai detailed that bond market distortions are the by-product of ultra-low rates. That adds to the narrative that while monetary policy tightening may not be urgent, it is forthcoming. That should lead the yen stronger, with USDJPY falling below 110 in early 2019.

Jeremy Stretch | Bipan Rai

GBP Strong Despite Brexit Headwinds

Q4 18: 1.33 | Q2 19: 1.39 (GBPUSD)

Let's face it: until a deal is signed, sealed and delivered, UK economic data are going to take a back seat to Brexit negotiations in Sterling's gyrations. On the economic front, it's a mixed bag, since tight labour markets are pushing wages above 3%, but consumers appear reluctant to make major purchases. That, and all the Brexit noise, suggests that even if there's an upside surprise in Q3 GDP relative to the BoE's forecast, monetary policy won't come back into play as a currency driver until Brexit is resolved.

With less than six months to go, a successful resolution of withdrawal discussions appears predicated upon the UK and EU agreeing on a time-limited extension of customs union membership. Any such deal will minimize tail risks scenarios, including a cliff-edge exit in March 2019.

While the EU might come on board, a deal requires passage through the UK parliament, which looks increasingly like the greatest challenge. There may be as many as 40 hard line Brexiters within the Conservative party who would oppose a softer version. With the Irish DUP party (10MPs) also threatening to stand aside from supporting the PM, any deal may only survive with opposition lawmaker support.

Much like we did during the Canadian trade negotiations, we have long assumed that pragmatism will eventually prevail, with MPs voting for a deal. Still, during these final months, threats of another election or a hard cliff-edge exit will be used as political leverage. Those threats could readily generate significant Sterling gyrations, suggesting that Sterling implied volatility is too low.

Sterling could nudge higher against the dollar, but will trail the euro until a Brexit deal is reached. Only then will markets start to price in additional monetary tightening, which would drive a breach of $1.35, the mid-point of the year-to-date trading range.

Jeremy Stretch | Bipan Rai

'Highly Valued' Franc to Lag Euro

Q4 18: 0.97 | Q2 19: 0.94 (USDCHF)

We have seen both sight deposits and FX reserves move higher over the last month, coinciding with EURCHF briefly trading below the 1.12 threshold. However, as the slide in EURCHF proved relatively short lived, it appears the SNB are happy to maintain the use of largely verbal intervention in an attempt to cap CHF gains.

For now, the central bank has characterized the Franc as remaining 'highly valued'. Indeed, unless the cross were to trade below 1.12 for a prolonged period, negatively impacting Swiss inflation expectations, we can expect the bank to continue to remain relatively sanguine.

Central bankers will still be keeping a watchful eye on broad risk sentiment in relation to budgetary pressures in Italy, and EM strains in the likes of Turkey and South Africa. Should risk tensions prove to dissipate, expect the recent unwind in CHF shorts to persist into 2019, capping EURCHF. With prospective policy action from the ECB likely coming in H1 2019, well ahead of the SNB, expect a modest EURCHF uptrend to persist in 2019, with a return to 1.16 into mid-year.

Jeremy Stretch | Bipan Rai

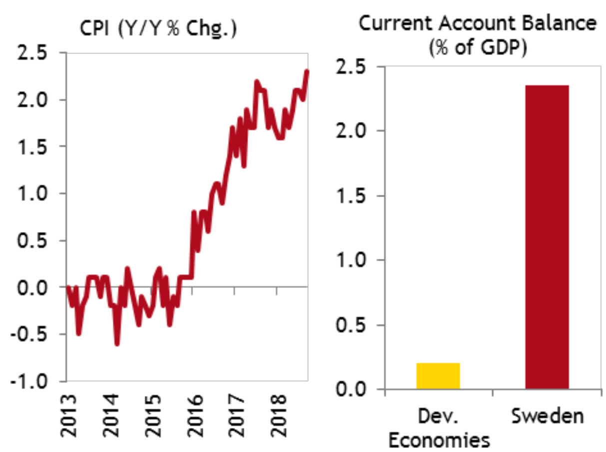
Riksbank Risks Favor Stronger SEK

Q4 18: 8.77 | Q2 19: 8.13 (USDSEK)

Markets have been punishing the SEK for months given the Riksbank reluctance to start raising rates. Indeed, the Bank appears to be on the fence as to whether to lift off in December, or February. However, the September CPI result might force the Bank's hand given that consumer prices are now increasing at the fastest pace in seven years. Additionally, the CPIF measure (which uses fixed mortgage rates) is above the Bank's target and the core measure that excludes energy is the highest it's been in 2018.

Watch for the schism to widen amongst Riksbank board members at the October meeting to set up a December rate hike. A favourable external balance along with rate hikes sets up a stronger SEK versus the EUR and the USD in the months to come.

Chart 4: Price Pressures Escalating (L); with Trade Fundamentals Remaining Supportive (R)



Source: OECD, Bloomberg, CIBC

Commodity FX

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Norges Bank Signals Flashing Green

Q4 18: 8.01 | Q2 19: 7.48 (USDNOK)

Over the last month, the NOK has been the top-performing major versus both the EUR and USD. That owes to a combination of solid fundamentals and rising rate expectations, in line with the Norges bank raising rates as expected in September.

After hiking rates for the first time since May 2011, continued upside surprises in core CPI suggest that the bank may be forced to revise up its rate path when updated forecasts are released on December 13th. Indeed, the central bank's core CPI forecasts were upgraded in conjunction with September's hike, and a more aggressive rate path would further support the NOK.

Although the NOK's correlation with the price of oil has deteriorated lately, Norway's position as a stable country, relative to other oil-producing regions, bodes well for the Krone. The positive tailwinds suggest that NOK should continue to appreciate, with USDNOK falling faster below 8.00 in early 2019 than previously thought.

Jeremy Stretch | Bipan Rai

Markets Underestimating AUD Upside

Q4 18: 0.74 | Q2 19: 0.76 (AUDUSD)

We're still maintaining our optimistic outlook on the AUD over the next 12 months. Yes, we understand that there are concerns related to the Chinese economy and that domestic wages are still far from levels that would worry the RBA about policy being too loose. Additionally, credit conditions have tightened, causing private sector credit growth to slow.

Still, the market has already priced out the RBA until at least next autumn. Additionally, for all the headlines on trade and a slowing Chinese economy, implied demand for iron ore is still at reasonable levels. The RBA has taken pains to point out that it views wages as having 'troughed' already while domestic growth is expected to be above 3% for both 2018 and 2019.

Markets are extremely short AUD in the proxies that we use. Crowded positions should beget an AUD rally over the coming months with Q3 CPI (October 30th), Wage prices (November 13th) and Q3 GDP (December 4th) among the key risk events to monitor.

Jeremy Stretch | Bipan Rai

NZD Held Back Through 2019

Q4 18: 0.64 | Q2 19: 0.64 (NZDUSD)

The guidance from the RBNZ isn't expected to change in the coming months as the Bank is projected to keep its benchmark rate at its current level at least well into 2019. The Bank is clearly concerned with the trajectory of core tradeables inflation and it will likely wait until there are signs that the decline has stabilized further. Non-tradeables core inflation is still tracking well above the Bank's target and helping to offset that. However, overall CPI is still below 2% which gives the RBNZ some room to lean dovish for the time being.

The market is already very short NZD, so a 'take profit' rally in the kiwi is a risk that bears should be mindful of. Reversion strategies should also benefit from tactical rallies, but a strategic rally is still likely some ways away.

Jeremy Stretch | Bipan Rai

ZAR Fundamentals Spell Trouble Ahead

Q4 18: 15.4 | Q2 19: 15.2 (USDZAR)

Although near-term political uncertainty may have diminished since Tito Mboweni was announced as new Finance Chief, ongoing structural concerns and monetary policy uncertainty underline broad- based ZAR negativity.

Three of the MPC's seven members dissented and voted for an immediate rate hike at their recent meeting, following unanimous decisions in both May and July. For now, the risks to the economy appear to be dominating the SARB's decisions.

Inflationary consequences from the slide in the currency, which has depreciated by 15% versus the USD year to date, have been amplified by a higher price of oil. In Rand terms, the uptrend in the price of Brent crude now exceeds 50%, highlighting price pressures and recession concerns.

With the economy now in a formal recession and fears of negative ratings present along with negative EM sentiment, ZAR will continue to underperform. Structural and political risks in additional to the country's status as an oil importer underline broad negative tendencies, with a weakening Rand sending USDZAR to 15.4 by the end of 2018.

LATAM FX

Mario Robles | Luis Hurtado

MXN: NAFTA is Dead, Long Live USMCA

Q4 18: 19.40 | Q2 19: 18.90 (USDMXN)

Now that Canada has formally joined the USMCA deal, the tone in the market has shifted to positive in regards to North American trade. That's one less thing to worry about for the peso. This event indeed helps to remove the tail risk that not only remained in place for CAD, but also for MXN as we had our doubts of the odds that a bilateral deal would face in US congress.

In essence, we may now start to see a less volatile profile for MXN as the headline risk from US-Canada negotiations should not be an issue anymore. Most of the noise in MXN should come from external markets in the short term. We see MXN avoiding tail-risk scenarios in the medium and long-term, but also acknowledge that the peso has already priced-in much of the good news. This idea should place a cap on MXN strength in the short-term and somewhat place a high bar for further MXN appreciation from here — at least until new positive stories surface. In spite of this, we don't see a significant or long lasting sell-off given the hefty cost of carry that could still go up, which in some sense introduces our next topic; monetary policy.

We think that Banxico should keep the O/N rate unchanged at 7.75% in the months to come as the local yield curve already incorporates some premium and more evidence on what could happen to the fiscal profile is still needed before a decision could be made. It's also worth keeping an eye in the energy components of the CPI basket, particularly electricity, as the subsidy to residential energy prices starts to fade after the summer tariffs come to an end. Gasoline prices continue to be an item under the magnifying glass as well.

Mario Robles | Luis Hurtado

BRL: Reform Prospects are Limited in Most Scenarios

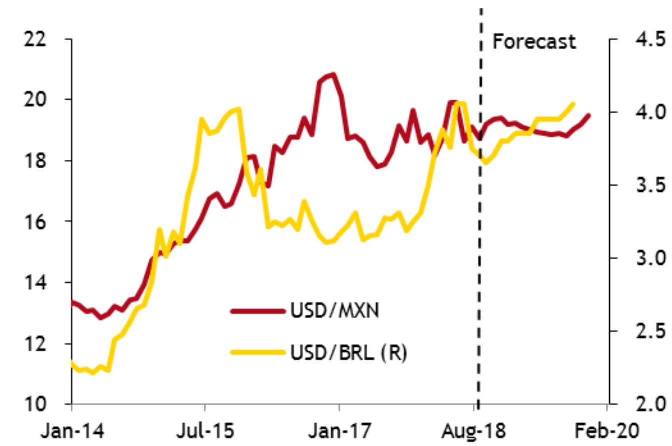
Q4 18: 3.65 | Q2 19: 3.85 (USDBRL)

The run-off election campaign to be concluded on October 28 is now in full force. The first round stage showed that Bolsonaro had around 46% of total votes in comparison to 29% of Haddad. The first post first-round poll for the run-off showed that Bolsonaro has around 58% and Haddad in still far behind at 42%. What is worth noting here is that in spite of Bolsonaro's lead, markets have now turned less optimistic regarding long-term prospects for a significant pension reform that would be enshrined at the constitutional level or one that would represent substantial changes as to modify Brazil's debt dynamics in the years to come.

Bolsonaro, has been lukewarm in this respect of what needs to be done and what is actually politically feasible. Markets are likely to make the interpretation that significant structural changes may not be possible in the medium-term in what may translate into a less optimistic case for BRL in the months and years to come but not likely immediately. In spite of this less optimistic medium and long-term scenario, the short-term is still likely to be good for markets as the more extreme scenarios and tail-risk events are quickly being priced-out. As Bolsonaro consolidates his lead, markets may see it in some aspects (and to some degree too) as a continuation of the current administration and thus the short-term boost to markets.

From a monetary perspective, who ultimately wins the election matters for the Selic monetary policy path in the next months, in our view. We think that under a Bolsonaro victory on October 28th, the next monetary cycle (tightening) could actually start later that what it would under a Haddad victory as BRL would likely be stronger and fiscal measures could probably signal more austerity and thus the need for a less astringent monetary cycle.

Chart 5: USD/MXN and USD/BRL



Source: Bloomberg, CIBC

Mario Robles | Luis Hurtado

COP: Fiscal Reform Concerns could Drag the COP in the Medium Term

Q4 18: 3230 | Q2 19: 3100 (USDCOP)

The COP continues to benefit from the positive oil price trend during the last two weeks. However, USD/COP failed to make a sustained moved below the 3000 mark. As mentioned in our previous publications, concerns regarding stil- sluggish growth, the high current account deficit, and fiscal reform prospects remain high.

On the latter, the government is trying to increase revenue by at least 1.4% of GDP, something it will find hard to achieve without letting go of some of Duque's campaign promises (i.e. to reduce corporate taxes, eliminate exemptions to the VAT). Of course, this does not play well for growth, and could force the government to reduce spending into 2019, and/or increase concerns about the government's ability to meet its fiscal target.

For the COP, it will be all about oil prices until we get a clear picture on the fiscal reform. Nevertheless, keep in mind that the strength in oil prices have been the strongest measure of support for the COP this year. A reversal of such circumstances could inject further jeopardy into the government's ability to meet its fiscal targets, restrain growth, as well as increase downgrade fears. Moreover, BANREP's announcement of a program to accumulate foreign-exchange reserves as it contemplates a possible reduction in an IMF credit line starting in 2020 should also have a transitory and mildly adverse impact on the COP; but in the medium term the fiscal outlook should prevail. The program includes holding the monthly auction of USD400mln dollar put options to accumulate reserves.

Mario Robles | Luis Hurtado

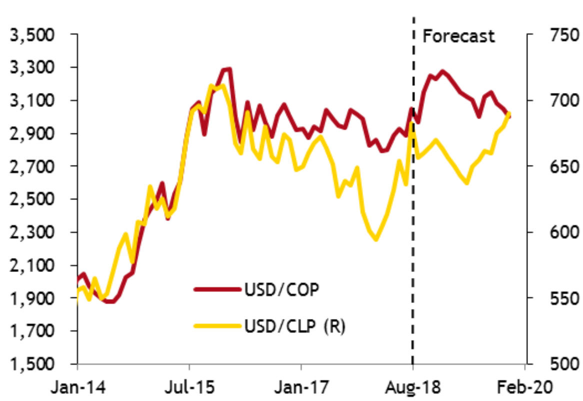
CLP: Strong Fundamentals Support the CLP into 2019 but Beware of Oil

Q4 18: 670 | Q2 19: 650 (USDCLP)

The CLP enjoyed a solid rally since our last publication that was partially spoiled by rising oil prices, one of Chile's main imports. The recovery in copper prices was the main culprit of such recovery. Moreover, solid Chilean institutions and robust recovery underway lit the path for a solid CLP going forward. We would also add the recent government estimates point to growth of 4.1% in 2018 and 3.9% 2019. This supports our view of a hawkish central bank into 2019 with at least one rate hike in the remainder of the current year, and another 3 or 4 hikes by the end next year — in line with the latest central bank's comments hinting on rates reaching the estimated neutral rate of 4.0-4.5% by 2020.

On the fiscal front, the government proposed a US$73.5mln budget, increasing 3.2% y/y, but below the 3.9% increase in 2018 and consistent with Piñera's consolidation efforts. The favourable economic outlook, together with the government's intention to reduce the structural deficit by 0.2 percentage points to reach a deficit of 1.0% of GDP by 2022 also bode well for the CLP

Chart 6: USD/COP and USD/CLP



Source: Bloomberg, CIBC

Asia FX

Patrick Bennett | Joan Pinto

USD/CNY & USD/CNH: Stable Trade-Weighted, Weaker vs. USD

Q4 18: 6.98 | Q2 19: 6.83 (USDCNY)

The trade-weighted value of the yuan has been relatively stable since mid-July after weakening sharply as USD/China rallied from late June to late July. We expect the trade-weighted value to retain a stable to slightly weaker bias, more so for as long as the USD remains firm against all major currencies including CNY and CNH.

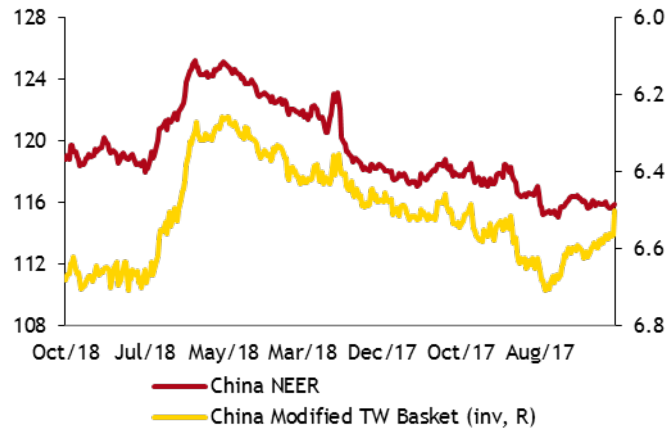
Chinese policymakers have gone to some lengths to state that the currency will not be used as a weapon in the trade dispute and that ongoing reform of the market will be market based. Deliberately weakening the yuan in order to negate the impact of trade tariffs would be shortsighted, run counter to efforts to open the domestic market to international participation and investment, and not least, near certain to increase tensions with the US.

Our view is that further upside for USD/China will continue as long as the USD broadly remains firm. USD/CNY and USD/CNH are now both above 6.90 and gains from present levels will bring the 7.00 level into focus. There is a psychological element to that rate more than anything else, and that alone will be cause for heightened caution. Our favoured trade to position for yuan weakness is being long of the 12mo USD/CNH DF points. We recently took profit on a recommendation in September's FX Monthly and look now to re-enter.

China announced a 100bps cut in banks required reserve ratio (RRR), effective October 15th and the fourth cut this year. The reduction will be used in part to repay maturing medium-term funding facilities to the tune of Y450bln, that out of total liquidity released estimated at Y1.2trln. The liquidity will continue to provide support for the domestic economy that faces headwinds from previous and ongoing efforts at deleveraging – now more targeted to sectors rather than broad-based, and from uncertainty due to trade tariffs. Previous changes in the RRR have been mostly well-correlated with moves in the currency, and we expect the yuan to remain under some pressure against an overall stronger USD.

The aggregate moves in USD/CNH and USD/CNY this year to-date and over the last 1 or 2 years are in line with moves in other major currency pairs. In forecasting an overall softer USD in 2019 we expect the same to be reflected in a lower USD/China.

Chart 7: Yuan Under Pressure



Source: Bloomberg, CIBC

Patrick Bennett | Joan Pinto

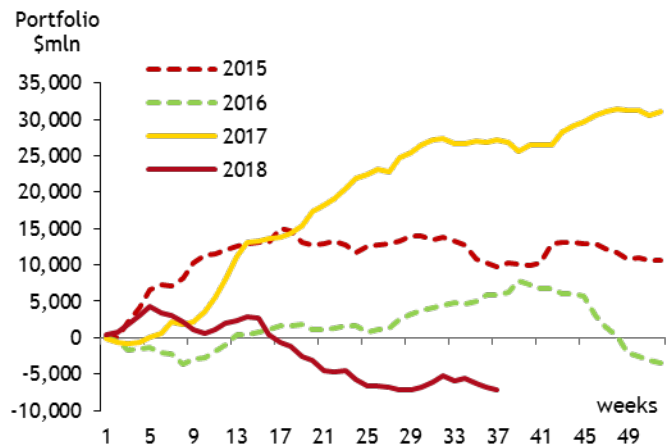
INR: Pressures Yet to Abate

Q4 18: 75 | Q2 19: 74 (USDINR)

RBI passed on an opportunity to raise rates earlier this month, and though the bank shifted to a stance of 'calibrated tightening' a shift may have delivered some respite for the currency when market expectation had been for higher rates. As it stands, the pressure on the INR continues, with key influences remaining the same; namely widening of deficits in the trade, current and fiscal accounts, higher oil prices, global trade uncertainty and rising interest rates. In sum and as we have noted; delivering a perfect storm of pressures. Even at record highs, the outlook is for some further USD/INR upside before a peak is found. The government has announced a numbers of measures to damp pressure on the currency and CPI, including cuts in petrol and diesel prices and increasing tariffs on a number of imports. The fuel price cuts may aid inflation but hurt the fiscal deficit, the import tariffs are correctly considered symbolic rather than substantive.

Ongoing withdrawal of portfolio flows are influenced by rising global rates, though withdrawal to date is still dwarfed by cumulative inflow of the last few years. Outflow from the bond market is currently running at $7.2bln ytd, following $23bln of inflow last year. Bond yields have responded to the outflow, currency weakness and concern for the path of deficits, but are now stabilizing; suggesting the pace of weakness in INR can moderate. The 5yr yield is last 7.98% from 8.15% a month ago and around 7% at the start of the year. To sustainably recover ground, the INR will require improved confidence in global trade, and higher domestic interest rates. In the near-term USD/INR can approach 75.00.

Chart 8: India Total Portfolio Flows



Source: Bloomberg, CIBC

Patrick Bennett | Joan Pinto

KRW: A Solid Performer in Asia

Q4 18: 1140 | Q2 19: 1120 (USDKRW)

Over most time horizons this year the KRW has been one of the better performed of Asian currencies, weaker against a stronger USD, but firmer on trade-weighted measures. The relatively better performance owes to ongoing decent performance of the economy, aided by policy support – both fiscal, and monetarily by keeping rates accommodative. The negatives are mainly those arising from trade uncertainty, and though caution shows in the market, the impact is to-date difficult to accurately quantify.

Trade and current account surpluses, the latter at 4.5% of GDP are buffers that hold the economy in good stead in the region. Portfolio outflows are a weight on a number of Asian currencies, though in the case of South Korea, total inflow (equites + bonds) remains strongly positive, as it has been for the last four years. Equity flows are negative ytd, but are more than compensated by inflow to bonds currently running at the strongest pace on record.

The KRW cannot escape from broad negative emerging/developing market sentiment. Extended USD gains and ongoing trade concern do suggest potential toward 1,150. We maintain a recommendation to use that opportunity to set shorts. As USD strength matures and South Korean fundamentals remain positive, we expect downside for USD/KRW in 2019.

Patrick Bennett | Joan Pinto

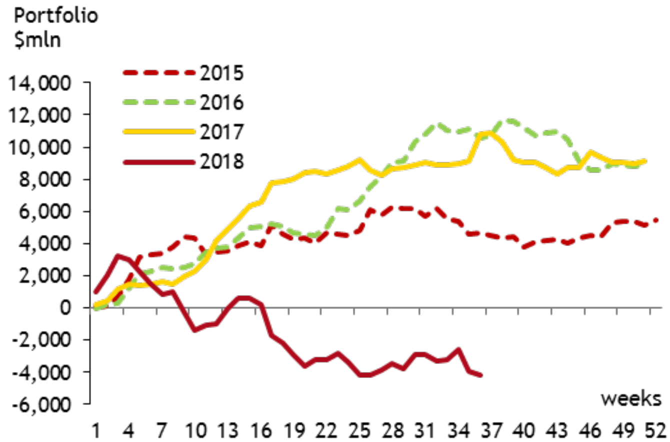
IDR: Higher Yields Not Slowing IDR Yet

Q4 18: 15500 | Q2 19: 15000 (USDIDR)

USD/IDR is close to reaching highs not seen since 1998 of 16,950, the recent high is 15,280. Rate hikes from BI and some sporadic intervention have not yet been enough to turn the tide back in favour of the IDR. As for a number of EM economies, Indonesia faces triple threats in its fiscal at -2.6% of GDP, current -1.7% of GDP, and trade accounts – albeit exports have been positive and the deficit reducing in last months. The overall picture is similar to India and the Philippines. The currencies of those economies are the laggards in Asia, with IDR and INR vying for the weakest over the last 12 months; the IDR has lost 11.4% to the USD in that time, the INR 11.9%. The outlook is for pressure on the IDR to continue, at least while the USD remains strong. Higher yields will eventually work to discourage fresh selling of the currency. Still, that will need to be balanced against the impact on domestic activity from the BI actions.

Total portfolio flows remain negative for the first time in a number of years. Bank Indonesia raising rates and higher bond yields will provide eventual buffer to IDR losses, though we do not believe we are at that inflection point yet. Bank Indonesia has now raised rates three times by 50bps, currently to 5.75%. The 5yr bond yield is around 8.35% from 5.60% in January.

Chart 9: Indonesia Total Portfolio Flows



Source: Bloomberg, CIBC

Key Indicators- Latest Data Point

	Quarterly Real GDP y/y %	Monthly CPI y/y %	Current Acct %GDP	Central Bank Rate
US	2.9	2.3	-2.5	2.125
Canada	1.9	2.8	-3.0	1.500
Eurozone	2.1	2.1	4	0.000
Japan	1.3	1.3	4.0	-0.100
UK	1.2	2.7	-3.9	0.750
Switzerland	3.4	1	13	-0.750
Sweden	2.5	2.5	2	-0.500
Australia	3.4	2.1	-2.9	1.500
New Zealand	2.8	1.5	-3.6	1.750
Norway	3.3	3.4	8.6	0.750
South Africa	0.4	4.9	-5.3	6.500
Brazil	1.0	4.2	-0.7	6.500
Mexico	2.6	4.9	-1.6	7.750
Colombia	2.8	3.1	-3.2	4.250
Chile	5.3	2.6	-1.2	2.500
China	6.7	2.3	0.5	4.400
South Korea	2.8	1.9	4.5	1.500
India	8.2	4.1	-2.4	6.250
Singapore	3.9	0.6	18.9	n/a
Taiwan	3.3	1.5	14.3	1.375
Malaysia	4.5	0.2	3.3	3.250
Indonesia	5.3	2.9	-1.7	5.800

Interest Rate and Economic Outlook

End of period:		2018 IV	2019 I	2019II
Canada	Overnight target rate	1.75	2.00	2.00
	2-Year Gov't Bond	2.30	2.45	2.45
	10-Year Gov't Bond	2.55	2.75	2.75
US	Federal Funds Rate	2.38	2.38	2.63
	2-Year Gov't Note	2.90	3.00	3.20
	10-Year Gov't Note	3.10	3.30	3.45
Eurozone	Refin.operations rate	0.00	0.00	0.10
	2-Year Gov't Bunds	-0.35	0.10	0.30
	10-Year Gov't Bunds	0.55	0.65	0.80
UK	Bank rate	0.75	0.75	1.00
	2-Year Gilts	1.10	1.20	1.30
	10-Year Gilts	1.65	1.75	1.85
Japan	Overnight rate	-0.10	-0.10	-0.10
	2-Year Gov't Bond	-0.05	0.10	0.10
	10-Year Gov't Bond	0.15	0.20	0.20

		2018	2019	2020
Canada	Real GDP growth (%)	2.1	1.8	1.3
	Unemployment rate (%)	5.9	5.8	6.1
	CPI (%)	2.4	2.0	1.9
US	Real GDP growth (%)	2.8	2.2	1.4
	Unemployment rate (%)	3.9	3.7	4.3
	CPI (%)	2.6	2.4	2.0
Eurozone	Real GDP growth (%)	2.0	1.5	1.2
	Unemployment rate (%)	8.4	8.1	7.9
	CPI (%)	1.7	1.9	2.0
UK	Real GDP growth (%)	1.3	1.1	1.3
	Unemployment rate (%)	4.2	4.3	4.4
	CPI (%)	2.6	2.2	2.0
Japan	Real GDP growth (%)	1.0.	0.9	0.9
	Unemployment rate (%)	2.5	2.4	2.2
	CPI (%)	1.0	1.1	1.5

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