FX Themes and Trades
Monthly Outlook
November 26, 2020

Economics
FICC Strategy

FX Markets Pause to Regroup

Currency — What's Changed

USD Second waves of Covid to stall USD depreciation through the first half of 2021.

CAD Loonie is likely rangebound, until it becomes clear that BoC will lag the Fed on hikes.

EUR The euro should hold up well, but is not the best bet for gains vs. the USD.

GBP A Brexit deal won't solve the economic shortcomings that have been compounded by Covid.

JPY Yen gains likely to continue as real yield spreads remain under pressure.

Commodity FX Revised forecasts for AUD & NZD to stronger levels. NOK is a favoured regional currency for 2021.

LATAM FX Vaccine prospects and dissipation of external political uncertainties favour high beta positions.

FX Asia Gains in the CNH and CNY continue as economic outperformance and investor appetite for Chinese assets hold sway. Other Asian currencies should continue to track CNY and CNH to stronger levels.

Currency Outlook

End of Period:	Nov. 26/20	Q1 21	Q2 21	Q3 21	Q4 21	Q2 22	Q4 22
USD/CAD	1.30	1.32	1.33	1.34	1.36	1.40	1.39
EUR/USD	1.19	1.18	1.18	1.19	1.20	1.20	1.20
USD/JPY	104	101	100	100	99	99	99
GBP/USD	1.33	1.31	1.31	1.31	1.32	1.32	1.33
USD/CHF	0.91	0.92	0.92	0.91	0.91	0.90	0.89
USD/SEK	8.54	8.47	8.39	8.24	8.08	8.00	7.92
AUD/USD	0.74	0.76	0.77	0.78	0.78	0.79	0.81
NZD/USD	0.70	0.72	0.72	0.73	0.73	0.75	0.77
USD/NOK	8.88	8.81	8.64	8.40	8.25	8.08	7.92
USD/ZAR	15.22	15.15	15.10	14.95	14.95	14.85	14.75
USD/BRL	5.33	5.00	5.20	5.00	4.50	4.80	4.50
USD/MXN	20.0	20.0	20.5	20.0	19.5	19.5	19.0
USD/COP	3620	3700	3600	3500	3500	3350	3200
USD/CLP	766	800	800	780	750	750	720
USD/CNY	6.58	6.40	6.35	6.30	6.20	6.05	5.90
USD/KRW	1104	1100	1095	1090	1080	1065	1055
USD/INR	73.9	73.0	72.8	72.5	71.0	69.0	69.5
USD/SGD	1.34	1.34	1.33	1.33	1.32	1.31	1.30
USD/TWD	28.7	28.4	28.3	28.3	28.2	28.1	28.1
USD/MYR	4.07	4.00	3.95	3.90	3.85	3.75	3.65
USD/IDR	14100	14200	14100	14050	14000	13800	13700

Other Crosses

End of Period:	Nov. 26/20	Q1 21	Q2 21	Q3 21	Q4 21	Q2 22	Q4 22
CADJPY	80.2	76.5	75.2	74.6	72.8	70.7	71.2
AUDCAD	0.96	1.00	1.02	1.04	1.06	1.11	1.13
GBPCAD	1.73	1.73	1.74	1.76	1.80	1.85	1.85
EURCAD	1.55	1.56	1.57	1.59	1.63	1.68	1.67
EURJPY	124	119	118	119	119	119	119
EURGBP	0.89	0.90	0.90	0.91	0.91	0.91	0.90
EURCHF	1.08	1.09	1.09	1.08	1.09	1.08	1.07
EURSEK	10.16	9.99	9.90	9.81	9.70	9.60	9.50
EURNOK	10.57	10.40	10.20	10.00	9.90	9.70	9.50

Key Indicators- Latest Data Point

	Quarterly Real GDP (y/y %)	CPI (y/y %)	Current Acct (% of GDP)	Central Bank Rate (%)
US	-2.9	1.2	-3.5	0.125
Canada	-13.0	0.7	-1.7	0.250
Eurozone	-4.4	-0.3	2.2	0.000
Japan	-5.8	-0.4	3.1	-0.100
UK	15.5	0.7	-2.8	0.100
Switzerland	-9.3	-0.6	8.9	-0.750
Sweden	-7.7	0.3	3.9	0.000
Australia	-6.3	0.7	1.8	0.100
New Zealand	-12.4	1.4	-3.0	0.250
Norway	-3.2	1.7	7.1	0.000
South Africa	-17.1	3.0	-1.6	3.500
Brazil	-11.4	3.9	-2.7	2.000
Mexico	-18.7	4.1	0.0	4.250
Colombia	-15.9	1.8	-4.0	1.750
Chile	-14.5	3.0	-1.4	0.500
China	4.9	0.5	1.5	3.850
South Korea	-1.3	0.1	3.6	0.500
India	-23.9	7.6	0.4	4.000
Singapore	-7.0	0.0	16.1	n/a
Taiwan	3.3	-0.3	11.2	1.125
Malaysia	-2.7	-1.4	3.5	1.750
Indonesia	-3.5	1.4	-3.0	3.750

CAD

Katherine Judge | Avery Shenfeld

Loonie Rangebound Until Latter Part of 2021

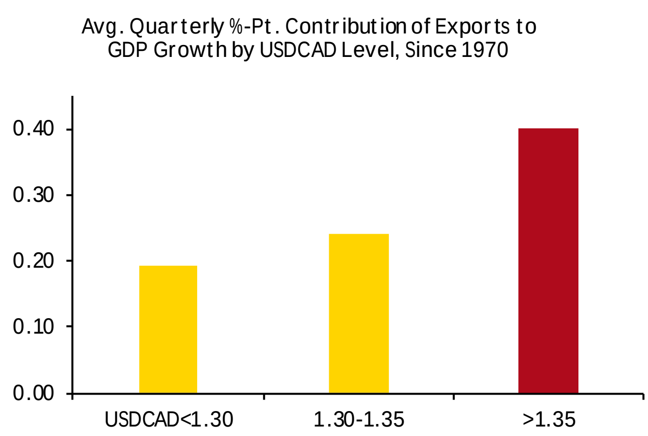
Q1 2021: 1.32 | Q2 2021: 1.33 (USDCAD)

The loonie continues to be pushed and pulled by currencies moving versus the USD, leaving CAD stronger against the greenback over the past month. At 1.30, the C$ is firmer than levels that have historically been consistent with supporting Canadian export growth (Chart 1). With oil prices unlikely to return to earlier heights, that has the C$ starting at an overvalued level on trade fundamentals.

A generally range-bound US dollar in the next couple of quarters will remove one impetus for loonie appreciation. Both Canada and the US will be dealing with second waves of Covid-19, but there are now some questions emerging on whether Canada will have a longer wait for mass vaccination, given its lack of domestic vaccine manufacturing capacity. If the vaccine timeline in Canada lags materially behind its peers, that could compound C$ weakness. The tilt in Canadian resource exports to oil/gas is a negative for the C$ relative to currencies from countries focused on metals, which have seen better price recoveries.

Over the medium term, we look for the loonie to soften, once trade fundamentals are no longer being offset, as they are today, by overnight rates above the US dollar and other majors. Note that markets have been assuming that the BoC will lead the way on rate hikes, which runs counter to the fact that Canada's GDP will have suffered a larger drop in 2020. As the BoC signals it can be very patient, we look for USDCAD to end 2021 at 1.36.

Chart 1: Canadian Export Competitiveness Boosted When USDCAD Exceeds 1.35



Source: StatCan, CIBC

USD

Katherine Judge | Avery Shenfeld

Second Covid Waves to Bolster USD Resilience

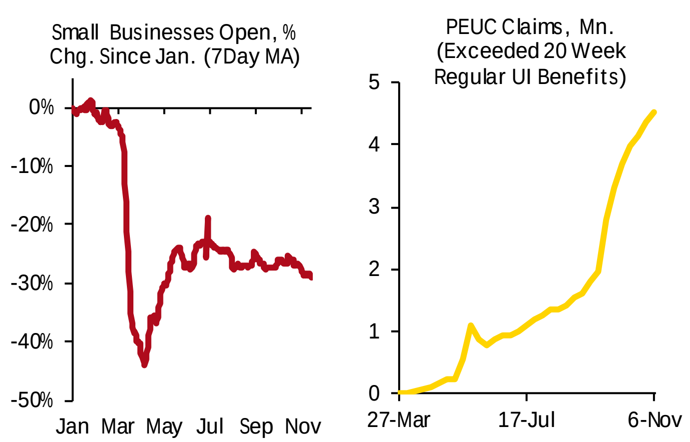
Q1 2021: 92.5 | Q2 2021: 92.4 (DXY)

With second waves of Covid still spreading, USD depreciation could stall as its safe-haven currency status is restored into the early months of 2021. Indeed, USD depreciation slowed slightly in the past month, and it's likely that the greenback will see inflows as the winter months prove particularly challenging in terms of keeping a lid on Covid cases. It won't be until closer to mid-2021 when mass vaccination starts to become a reality, and the USD unwinds gains.

The election had little impact on the USD, which is slightly weaker since then. A failure to pass a new stimulus bill could push the Fed into a more aggressive stance on QE, a potential negative for the greenback, but we're assuming that a moderately scaled fiscal package will be approved by Congress in either December or soon after the January inauguration. The Fed might opt to follow the Bank of Canada's lead at some point, by reducing the volume of QE but lengthening the maturity of its asset purchases to maintain the effective level of stimulus.

So far, the US economy has remained resilient, but it's likely that the impact of the second wave reveals itself in the months ahead and in early 2021, as data is showing signs of turning (Chart 2). That could keep risk appetites contained and lift the USD. Progress on vaccine distribution towards mid-year could help shift the narrative to a risk-on environment, with the USD giving up any risk-off gains.

Chart 2: Small Businesses Closing Again (L), Unemployment Spells Becoming Longer (R)



Source: TracktheRecovery.org, Bloomberg, CIBC

EUR

Jeremy Stretch

ECB Gearing Up to Add Accommodation

Q1 2021: 1.18 | Q2 2021: 1.18 (EURUSD)

Following the October ECB meeting, President Lagarde left the market in no doubt that come December 10th, the central bank is ready to act. The ECB is often reluctant to sanction policy change in the absence of a material shift in ECB staff macro forecast projections. However, with the outlook being compromised by renewed lockdown restrictions, while long-run inflation expectations remain well below the ECB target threshold, the fundamentals warrant action.

The key element in last month's statement underlined that "the Governing Council will recalibrate its instruments… to ensure that financing conditions remain favourable to support the economic recovery and counteract the negative impact of the pandemic on the projected inflation path." Despite the ECB pledging to analyse all policy options available, it seems most likely that the December ECB meeting will see the bank still using the 2020 ECB playbook.

That implies an increase in size and extension in duration of the emergency bond programme (PEPP). Credit and funding issues will be met via an adjustment to the targeted long-term refinancing operations (TLTROs). Immediately following the October meeting, the market attempted to price in the prospect of a 10bp cut by June, but such assumptions have dissipated as the ECB appears intent on limiting any tightening in credit conditions, as highlighted in the latest ECB lending survey, via TLTROs. We would also note that Lagarde highlighted not only the level of financing but also its duration, suggesting a long TLTRO extension, perhaps well into 2022.

While additional ECB easing is largely discounted we have seen real money and leveraged investors paring back long EUR positions, albeit from all-time highs in late August. A slower growth backdrop, easier monetary policy, and political concerns are set to weigh on EUR performance. The combination of factors suggests that while we expect the EUR to hold up against the USD, it may struggle versus currencies more directly risk and growth correlated in 2021.

JPY

Jeremy Stretch

Yield Spreads Favor Yen Appreciation

Q1 2021: 101 | Q2 2021: 100 (USDJPY)

The Japanese economy rebounded at a faster trajectory than expected in Q3, as GDP advanced by 5.0% Q/Q. However, the weaker than expected contribution from private sector consumption, combined with the third drop in three quarters in non-residential investment, underlines the rationale for an additional supplementary budget. With Covid cases continuing to advance across the country and with monetary policy already largely tapped out, we can expect a third supplementary budget, scheduled for next month. Look for the fiscal boost to be scaled up to provide an additional fiscal impulse in an effort to offset reductions in broad consumer sentiment.

A material uptick in leveraged JPY longs, with holdings extending to levels not seen in a little over a year, allied to a compression in UST-JGB spreads, from near 95bp into mid-November, have together kept USD/JPY on the defensive. Should real yield spreads remain pressured, we can expect Japanese investors to remain reticent regarding exporting capital, or at least channelling fund flows into USD. Under such a scenario this continues to favor maintaining a bias towards JPY gains, at least against a subdued USD.

While Finance Minister Aso warned of the potential difficulties faced by exporters should the USD continue to weaken, it seems that, for now at least, the authorities remain more in a listening mode. If, as we expect, the cross to test 2020 lows into Q1, towards 101, the authorities may find it harder resist verbal attempts to try to restrain JPY impetus.

GBP

Jeremy Stretch

Brexit Deal to be Overshadowed by Weak Macro Fundamentals, Weighing On GBP

Q1 2021: 1.31 | Q2 2021: 1.31 (GBPUSD)

Brexit negotiations have entered overtime. While a succession of deadlines and ultimatums have been breached, one date remains unaltered, December 31st. This marks the end of the implementation or transition period. As the clock ticks down, the question remains: Is there sufficient time left to conclude a deal?

We still expect a deal to be reached, but we will need to see a degree of statecraft (political concessions) in order to clear the remaining negotiating redlines. Hence, only once both sides are content about achieving their defensive interests, should we expect a final agreement.

Amidst tight deadlines, there remains the risk of an unintended political consequence, namely a systemic breakdown in talks. However, our central case scenario remains a deal being brokered before month end, notably ahead of the final scheduled EU Parliament session of the year, from December 14-17. However, a deal is not the end of the process. Rapid ratification, within necessary protocols, risks becoming a concern.

Post-Brexit headwinds, as the ease of doing business is undermined by costly and time consuming customs checks, allied to the perpetuation of low productivity and weak business investment, suggests that any post-deal GBP rallies will prove short-lived.

A near 20% Q/Q decline in Q2 GDP has been only partially retraced in Q3, and the economy remains around 9% smaller than year ago levels. Fresh lockdown restrictions suggest the economy is set to weaken again in Q4, with the BoE assuming 2.0% Q/Q contraction in GDP. Record levels of redundancies in the three months to September risk weighing upon consumer sentiment, constraining growth assumptions. We assume the UK economy will not make up lost output until early 2023. We remain more pessimistic than the BoE, as they assume lost output will be made up by Q1 2022.

A modest recovery phase, as the UK adapts to operating under a new trading regime, suggests that, without an unexpectedly early clearance from Covid restrictions, the BoE will remain active and Sterling will struggle for traction.

CHF

Jeremy Stretch

SNB On Hold While ECB On the Move

Q1 2021: 1.09 | Q2 2021: 1.09 (EURCHF)

The upcoming ECB policy recalibration, code for more stimulus (see EUR section for more details), could risk putting more pressure on the SNB, especially were the ECB to surprise and look to take rates further into negative territory. However, as such an outcome remains a low probability scenario, we do not anticipate that the SNB will have to materially dial up the scale of intervention. This comes as recent weekly sight deposit data reveals a substantial moderation in activity compared to July/August.

Although ECB policy action may not necessitate the SNB accelerating their intervention, we can expect the quarterly SNB policy update on December 17th to see the central bank maintaining their willingness to intervene against what the bank continue to view as a highly valued CHF. Of course, the perpetuation of intervention is not without risk as the central bank balance sheet continues to balloon while the country remains at risk of being labelled a currency manipulator by the US Treasury.

While the SNB may be forced to adjust their GDP forecasts down, while CPI is set to remain well below target until 2023, we do not expect the SNB to ramp up the policy stance. As regards the CPI profile, a cheapening in the CHF would boost imported prices and boost CPI expectations. The prospect of a more constructive macro outlook in 2021, predicated upon a vaccine supporting a macro recovery, points towards leveraged CHF long positions, from near six-year highs, being unwound. The position reversal will allow SNB activity to be progressively reduced, this comes as EURCHF should head back towards 1.10 for the first time since November 2019.

SEK

Jeremy Stretch

SEK Gains in 2021 Supported by Expectations For Swift Recovery

Q1 2021: 9.99 | Q2 2021: 9.90 (EURSEK)

Since the start of H2, only the MXN and ZAR have outperformed the SEK. The relatively limited GDP contraction, at least by comparison, allied to an early rebound, as PMI indices moved back into expansionary territory in July, have supported SEK impetus.

Sweden, like the rest of the continent, is undergoing a Covid second wave. As a result, the government is enforcing greater domestic restrictions than the first time around, the bulk of which remain voluntary. Tightening restrictions will weigh on Q4 activity. To offset growth headwinds, we have seen the government announce sizeable fiscal stimulus measures for both 2021 and 2022, worth roughly SEK105bn and SEK85bn, respectively.

In terms of monetary policy, the Riksbank appear intent on mimicking the potential actions of the ECB, in terms of expanding and extending QE. However, despite the QE envelope being extended to December 2021 and the amount of purchases increasing by SEK200bn, to SEK500bn, we would be wary of assuming that the bank will fully utilise their expanded policy stance. Nevertheless, the Riksbank remain keen to stress that comprehensive monetary support will remain in place as long as needed. Note the bank have not considered a return to negative rates.

The Riksbank statement acknowledged that demand returned quickly over the summer. Consequently, should our macro assumptions prove correct, expect an uptick in activity and an easing in asset purchases. The SEK remains a currency which reflects broad external risk dynamics. With domestic growth expectations likely to be revised up in 2021, should Covid second wave effects dissipate, this underlines maintaining a positive SEK bias versus both the USD and EUR into 2021.

Commodity FX

NOK

Jeremy Stretch

Norges Bank Likely to Hike Early, Supporting NOK

Q1 2021: 10.40 | Q2 2021: 10.20 (EURNOK)

The NOK is a favoured regional currency for 2021. The Norges bank has long been slated to be the first major central bank to hike rates, as they currently project hikes by the end of 2022. However, as core CPI remains above the 2% target threshold at 3.4%, should growth expectations into next year prove to be boosted via a global reflation bias, expect rate hike expectations to be pulled forward, boosting the NOK.

Domestic consumer sentiment edged lower in Q4, with the slide coming as the recent decline in the number of unemployed stalled in November. While the sentiment retreat may compromise retail activity in Q4, we remain constructive on medium-run underlying fundamentals. A solid fiscal stance, expect a surplus of around 2% of GDP, underlines that the government is not reliant upon central bank balance sheet expansion to support ongoing fiscal impetus.

The scale of the post-crisis fiscal support helped moderate the scale of the downturn. After the Q2 drop in GDP of 6.0%, the economy saw a solid 5.2% bounce in Q3, with activity powered by a 9.5% quarterly surge in household consumption. With wage growth expected to remain solid in 2021, consumption growth should be supported ahead.

High levels of household debt and high property prices remain the key financial sector vulnerabilities according the latest Financial Stability Report, in addition to Covid impacts. However, with a large fiscal safety net and the prospect of a vaccine-inspired recovery phase in 2021, we assume financial sector vulnerabilities will remain contained and the NOK will benefit from the recalibration in rate expectations.

AUD

Patrick Bennett

RBA Easing Supports Activity, Assets, and AUD

Q1 2021: 0.76 | Q2 2021: 0.77 (AUDUSD)

The AUD tops the league table for major currency gains against the USD over the last month, having added 5.2%. The rebound comes after a period of underperformance, that itself was validated by a confluence of headwinds. AUD/USD is now within striking distance of the year's highs, and the currency has also gained against the CAD and JPY. We expect further gains into the new year.

In considering the anticipated path of the AUD back in September, we identified factors that aligned against AUD gains from then present levels. They included upcoming RBA easing, which had been well-telegraphed, trade tension with China and weakness in export numbers, and uncertain impacts of the virus spread and lockdowns then occurring in Melbourne.

RBA duly eased earlier this month, and although yields eased and the AUD initially softened, the currency reaction was short-lived. Instead, a rebound in global risk-appetite, related to both the US election, and vaccine progress, have weakened the USD and driven AUD/USD higher.

Though it is not just the USD contribution, as the outlook for the Australian economy has also improved. From the short statement that accompanied the RBA decision: "The combination of the RBA's bond purchases and lower interest rates across the yield curve will assist the recovery by: lowering financing costs for borrowers; contributing to a lower exchange rate than otherwise; and supporting asset prices and balance sheets."

In supporting the economy and assets, the attraction of the AUD to investors is little, if at all diminished. Japanese investors have been strong buyers of Australian bonds this year, and we expect demand to remain. The attraction of the bonds goes beyond the yield, and includes the level of the currency and prospects for asset appreciation. We see those remaining attractive in regard of Australia and the AUD.

The latest trade data with China has also shown a rebound. Further, a change in the US administration may benefit Australian trade, as some of the weakness seen in recent months appears related to Chinese substitution of agricultural product suppliers in order to satisfy the US phase one trade deal. For now, Australia's trade surplus remains healthy, and the lack of inward tourism or education spending is neutralised by a lack of outbound travel. The current account is also in surplus.

NZD

Patrick Bennett

RBNZ Walks Back Pricing for Negative Rates

Q1 2021: 0.72 | Q2 2021: 0.72 (NZDUSD)

The RBNZ met on November 11th and were widely anticipated to keep policy on hold, but to also continue the messaging around preparation for negative rates. In the end, the bank introduced, as expected, a funding for lending program (FLP), to begin in December, but comments from the bank walked back on expectations for rates to be cut to negative. Rates markets backed up sharply and the NZD extended.

Like the AUD, the NZD has been a strong performer against the USD over the last month, gaining 3.5%, and only shaded by is trans-Tasman neighbour. The rebound began before the RBNZ met, and was driven by a pickup in global risk appetite, where the NZD benefits from the nation's control of the virus outbreak, further enhanced on relative comparisons.

RBNZ like the RBA have also revised forecasts for 2021 to less bearish settings, though not without the usual caveats of uncertainty and challenges remaining. We have revised our outlook for the NZD to now show a positive profile, as the near-term challenges are being overcome and although policy may still be eased, it is now viewed, as it is in Australia, as supporting activity and assets, and thus the currency.

Economic challenges haven't been completely extinguished. We keep watch for impacts as subsidies and support programs run out, and capacity to get infrastructure spending going will be watched in 2021.

ZAR

Jeremy Stretch

Elevated Yields and Improved Risk Dynamics to Benefit ZAR

Q1 2021: 15.15 | Q2 2021: 15.10 (USDZAR)

High yielding currencies, which are set to benefit from improving global macro fortunes and are not beset by underlying structural risks, are likely to be those that benefit in 2021. Improved risk dynamics alongside elevated nominal and real yields underlines the rationale for the rapid accumulation of ZAR longs.

Although the weekly correlation between USD/ZAR and the S&P index is barely above half early year peaks, the relationship has grown exponentially of late. The uptick has helped ZAR speculative holdings to levels not seen since the start of the Covid crisis. The accumulation of ZAR speculative positions comes as foreign investors have returned to being net purchasers of domestic bonds. The combination has propelled the ZAR to become the best performing major over the last three months versus the USD, gaining more than 11%.

Although the central bank may adjudge the inflation risks are to the downside, we would not expect that to result in further rate cuts. This year has seen 300bp of cuts. Although the bank may have revised up their GDP estimate for this year to -8.0%, due to a stronger mid-year rebound, the outlook for 2021 and 2022 has been trimmed, extending the output gap. Despite the SARB trimming 0.4% from their 2021 estimate, to now 3.5% and 0.2% in 2022, to 2.4%, they assume two 25bp rate hikes in H2 next year. However, the prospect of continued lockdowns suggests a more protracted period to retake lost output. This implies that SARB rate assumptions may be too ambitious.

Nevertheless, should the global recovery continue to be supported, this should underline relative ZAR outperformance. However, the pace of gains may partly depend on investors continuing to have confidence in the Ramaphosa regime, and for that the President needs to press on with his reformist agenda.

LATAM FX

MXN

Luis Hurtado

Refuelling the Carry Trade

Q1 2021: 20.0 | Q2 2021: 20.5 (USDMXN)

The volatility during the election led to a pullback from the momentum in the MXN leading into the first week of November. This situation, as we mentioned in our October 28th FX weekly publication, provided a window of opportunity to reload on short USD/MXN plays, in line with our 20.00 target into early 2021. The peso's high carry and the dissipation of electoral uncertainties should support a MXN recovery beyond this week. Remember, this is not 2016, and most of the political rhetoric from the US has moved away from Mexico, and the austere 2021 Budget announcement should kick downgrade concerns further down the road.

On the monetary front, Banxico left the overnight rate unchanged at 4.25%, in line with our forecast but against the market expectation for a 25 bps rate cut. As we thought, Banxico maintained a cautious approach to the recent spike in headline inflation. The peso's high carry and the dissipation of external uncertainties should support a MXN recovery beyond 2020. Moreover, speculative net long positions in the MXN remained relatively shallow in comparison to early 2020, providing some space for the continuation of this rally to 20.00.

BRL

Luis Hurtado

Looking Beyond Spending Cap Discussions

Q1 2021: 5.00 | Q2 2021: 5.20 (USDBRL)

The latest bout of volatility on the back of possible tweaks to the spending cap and creative ways to finance further fiscal spending caused USD/BRL to retest the 5.80 level in early November. We expect this risk to remain in place for the remainder of 2020. However, we regard the continuation of fiscal and administrative reform discussions as positive for the BRL, allowing the market to focus on the economic recovery, beyond the 2021 Budget discussion. Hence, we maintain our long BRL bias into Q1 2021 and suggest reflecting this position via 3m USD/BRL put spreads.

Supporting these ideas, we foresee the BCB intervening on recent spikes above 5.60 and limiting room for cuts beyond the current 2.0% Selic rate. The market has now accounted for over 300bps in rate hikes for the next year amid lingering fiscal risk concerns. Moreover, the BCB emphasized the fiscal trajectory (not the spending cap) when discussing forward guidance. This statement signals extreme caution and supports the idea of rate hikes in 2021.

CLP

Luis Hurtado

Cautious on the CLP

Q1 2021: 800 | Q2 2021: 800 (USDCLP)

USD/CLP appears to have found significant support around the 750 area. In our view, this level would prove difficult to break in the short term, as the CLP has already recovered most of the ground it lost late in 2019 and 2020. Moreover, we do not rule out the approval of populist measures in congress, and the resurgence of protests in a prolonged local election cycle.

On the new constitution process, 78% of Chileans opted for the drafting of a new constitution on October 25th. Voters also selected the option to elect a constitutional convention consisting of exclusively new members rather than one that included current lawmakers. Chileans will return to the polls during the first half of April in the first of many votes next year. Finally, we do not expect significant support for the CLP as the BCCh maintains its position of leaving the overnight rate at the current 0.5% throughout 2021.

COP

Luis Hurtado

Not Much Juice Left in the COP

Q1 2021: 3700 | Q2 2021: 3600 (USDCOP)

The central bank kept rates on hold on October 30th, leaving little space for further rate cuts over the remainder of 2020 and in 2021, a situation already priced in by the market. Although a break below the 3600 mark could open the path for a USD/COP to 3350, we do not see much space for a sustained appreciation of the COP beyond the recent rally of oil prices. Moreover, we expect USD/COP to remain within the 3600-3800 range into next year as fiscal uncertainties remain in place.

With regards to economic activity, Q3 GDP growth came in at -9% y/y (+8.7% q/q), in line with market expectations and recovering from the 15.8% y/y decline in Q2. We do not expect much support for the COP on the latest economic data as the market remains alert on the fiscal picture and vaccines prospects

Asia FX

CNY

Patrick Bennett

CNY CNH: Yuan to remain strong

Q1 2021: 6.40 | Q2 2021: 6.35 (USDCNY)

The Chinese yuan has lost its place as the best-performed major currency this year, but it continues to make gains against the USD and on trade-weighted measures. Confirmation of the US election result has provided further positive momentum.

With little comment that was prominent during the US election period regarding China trade and relations between the nations, it might be tempting to expect relations to improve under a new administration. We would treat that assumption with a large degree of caution.

As previously, our view is that hawkishness toward China will remain intact. Progress that has been made on US-China trade is open for debate, with China seen to be struggling to meet purchase quotas agreed in the phase one deal. Even so, the latest data and the trend of recent months is encouraging. But the overall stance of tensions is much wider than trade. Curbing of China's global ambitions – especially if the same are supported by perceived theft of intellectual property or forced transfer of technology, plus heightened distrust of some of China's technology companies, is not going away.

On the positive side, while there may be some twists and turns to come, that negotiations may be conducted in more diplomatic or pragmatic terms, is sufficient for some unwinding of risk premium. It is that premium unwind that the currency market is currently trading. Press reports that China will seek to renegotiate the phase one trade agreement with the US are circulating. If renegotiation does happen, and we don't presently see a strong case for the US to do so, that would be in favour of China, and its currency and assets.

On the yuan specifically, it has been strong Chinese economic data and ongoing demand for Chinese assets that have underpinned our positive outlook. Confirmation of both continue to be provided. The October trade report was positive – including the numbers on trade with the US. Chinese imports from the US expanded 33% y/y in October, following a 25% y/y expansion the previous month. Exports to the US expanded 18.5% and 18.3% y/y respectively the last two months.

Portfolio inflow has also remained strong. Equity buying via the Hong Kong-China stock recently hit records for the year. USD/CNH has broken below 6.6000, with the next major level of support seen at 6.5000 and then the way is clear through to 6.4300-6.4400. Our recommended strategy remains to be sellers of any retrace or strength in USD/CNH, and to also position through downside option strikes. We favour 6-months tenor with strikes at 6.3500.

As ever, the pace of any move will be a key factor which impacts the comfort of Chinese monetary authorities. We will track the daily USD/CNY fixings for indications on that front. So long as the spread between the daily fixings and spot markets remains contained, indications will be of official comfort with the currency appreciation.

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