Currency Report Card – October 2020

07 October 2020

Global FX Strategy

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Forecasts

October 2020

Three month forecast returns

Most bullish	Most bearish
JPY	BRL
NOK	ZAR
SEK	AUD

Source: RBC Capital Markets

12 month forecast returns

Most bullish	Most bearish
MXN	TWD
BRL	GBP
CNY	AUD

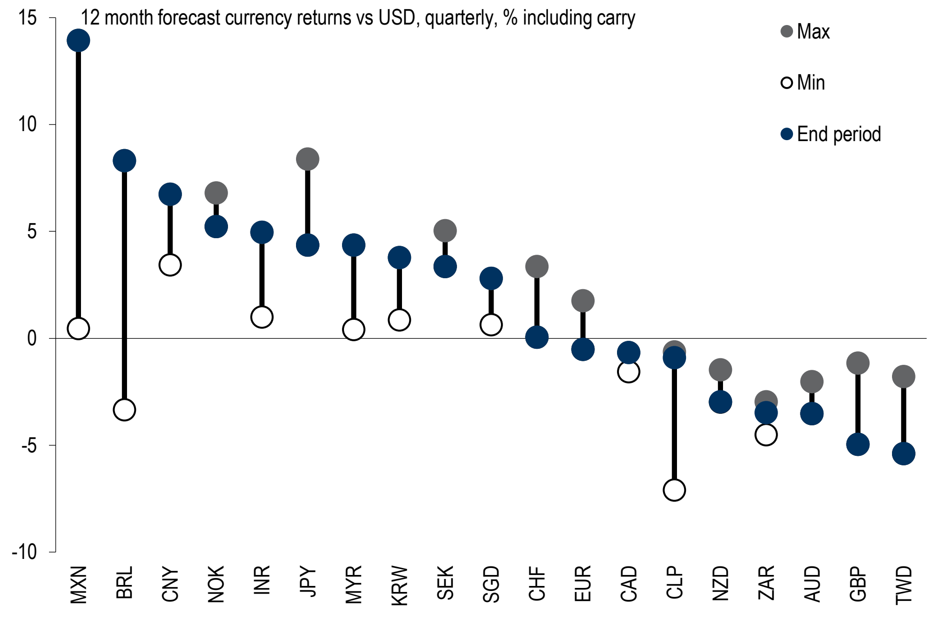
Source: RBC Capital Markets

Forecast revisions this month include:

USD/MXN: Profile revised lower. End-Q4 2020 now 21.60 (prior 22.17). End-2021 19.70 (21.67).

USD/CLP: Short-term profile revised lower. End-Q4 2020 now 800 (prior 820). Q1-Q3 2021 revised higher. End-Q4 2021 unchanged.

MXN, BRL, CNY outperformance; TWD, GBP, AUD underperformance



Source: RBC Capital Markets

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US Dollar

Adam Cole

1-3 Month Outlook – Election in focus

USD defied the very bearish consensus for a second month in September, gaining against all G10 currencies with the exception of JPY. USD appears to have regained its status as a haven currency in recent months and the sell-off in equities in September no doubt helped put a floor under it after the weakness in June and July. Broadly, our view on USD is more neutral than the consensus expectation, though arithmetically, DXY falls largely due to the significant JPY strength we expect. In the near-term, the presidential election is likely to be the main focus. As we noted elsewhere (*Total FX*, October 1), however, USD has shown remarkably little directional bias to shifts in the binary expectation of Trump vs Biden. Although USD weakness in June and July did coincide with a rise in Biden's prospects at the election (Figure 2), that the two moved together in this period was the exception rather than the rule over the last year. Notably, there was almost no reversal of USD's losses as Biden's lead fell to nothing through August. This insensitivity is in contrast to the run-up to the 2016 election, when DXY and individual pairs (most notably USD/MXN) closely tracked the probability of Trump winning. While markets appear relatively insensitive to whether the next President is Trump or Biden, one scenario which surely would cause an abrupt reaction is if the election left the presidency unresolved and the outcome with the courts. Such an outcome in 2000 resulted in comprehensively risk-off moves in bonds and equities, but had little impact in FX. At that time, however, FX traded entirely independently of general risk appetite, with all 45 G10 pairs uncorrelated to equity prices. In contrast, there are currently only 12 G10 pairs that are uncorrelated and cross asset correlations are historically very high. So a similar sell-off in risk would be expected to provoke a very different response in FX markets. Recent price action suggests USD would strengthen under this uncertainty, but we would watch the *relative* performance of US equities for signs it was turning USD-negative.

6-12 Month Outlook – Staying mixed

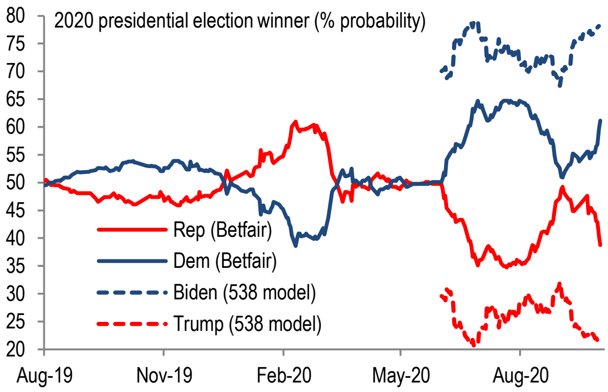
It is clear is that the hurdle for the Fed taking back rate cuts is very high and for both USD/JPY and EUR/USD, we think this will translate to FX hedges being put back onto holdings of USD assets and this flow is slow to play out (and positive for JPY and EUR). The US fiscal response to coronavirus is huge, but high private sector savings and foreign demand for USTs mean funding is assured for now and there are far worse examples of financial imbalance in G10 than the US.

Indicators

	Current (Previous)*
Official cash rate	**0.00-0.25% (1.00-1.25%)**
Trend interest rates (10yr average)	1.9%
Bias in interest rate market	Neutral
Core PCE Inflation %Y/Y Aug (Jul)	**1.6% (1.4%)**
Inflation target	Price stability
Budget balance % GDP FY17 (FY16)	**-3.4% (-3.1%)**
Budget balance target % GDP	-
GDP Growth % y/y Q2 (Q1)	-9.0% (0.3%)
Trend GDP %y/y	2.5%
Purchasing Power Parity Value	**-**
Spot	-
PPP Valuation	-
Current account balance % GDP Q2 (Q1)	**-2.6% (-2.2%)**
Trend current account balance % GDP	-2.6%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

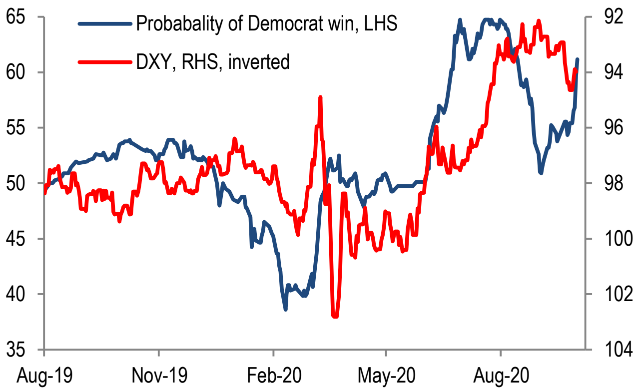
* Current is latest month, quarter or year

1. Biden moving further ahead in betting markets...



Source: RBC Capital Markets; Bloomberg

2. ...but USD seems indifferent to election outcome



Source: RBC Capital Markets; Betfair

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.10	1.12	1.17	1.20	1.20	1.20	1.18	1.16
USD/JPY	108	108	105	97	97	99	101	103
USD/CAD	1.41	1.36	1.33	1.34	1.35	1.35	1.34	1.33

Source: RBC Capital Markets estimates

Euro

Adam Cole

1-3 Month Outlook – Upside, but limited

EUR/USD peaked at 1.20 in late August and has trended moderately weaker since. While the steep gains in EUR/USD through the summer can partly be characterised as USD weakness, there was also an element of independent EUR strength associated with the agreement of the European Recovery Fund in the summer. Having fully digested the fiscal stimulus this implies, however, the impact on relative growth expectations is disappointing. Looked at cumulatively though 2020 and 2021, Eurozone consensus growth forecasts have not risen at all (Figure 1; black line). In contrast and despite the repeated failure to agree another stimulus package in the US, economists are consistently revising US growth expectations higher (blue line). Unless this changes, we see EUR getting little in the way of support from cyclical factors in the near-term.

Recent EUR gains were mentioned in the opening remarks of the September 10 ECB meeting press conference – something that has happened only rarely in the past. This was followed by numerous comments on the damaging effects of currency strength from various Governing Council members With EUR undervalued on almost all measures of competitive equilibrium, it was likely the pace of its appreciation that that was cause for concern, rather than the outright level. At the time, trade-weighted EUR had appreciated close to 5% in around three months, but the subsequent stabilisation and slight fall will have alleviated the ECB's concerns. We maintain a slight positive bias on EUR/USD, driven largely by hedging flow (see below) rather than policy or growth expectations, but expect gains to be capped by the recent high around 1.20.

6-12 Month Outlook – Domestic buyers drive gains

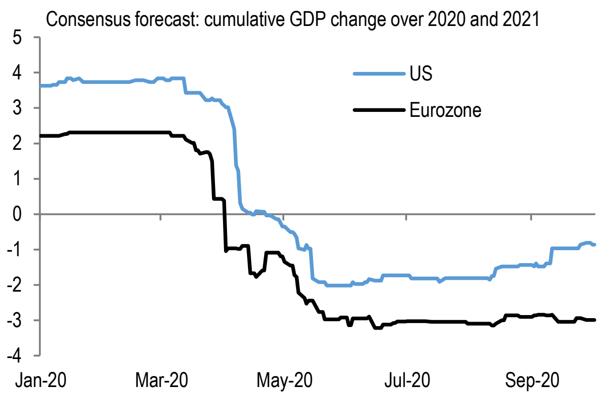
As implied yields in forwards markets settle, EUR-based investors will be faced with very different hedging arithmetic to that which has held for the last 2-3 years. Given the large stock of overseas, primarily USD-based assets, we expect hedging flow to support EUR/USD over the medium-term as European investors take advantage of reduced hedging costs and put hedges on investments that were probably made on a largely unhedged basis. This supports our moderately EUR-positive bias, though is less powerful than similar flow in the case of JPY. There are still risks to watch (mainly political). But with policy now more responsive to those risks and natural real money buyers of EUR emerging, we retain a slightly positive bias.

Indicators

	Current (Previous)*
Official cash rate	**0.00% (0.05%)**
Trend interest rates 10y average	1.9%
Bias in interest rate market	Flat
HICP core Inflation %Y/Y Seo (Aug)	**0.2% (0.4%)**
Inflation target	Close to but less than 2.0%
Budget balance % GDP FY18 (FY17)	**-0.5% (-0.9%)**
Budget balance target % GDP	3% of GDP-Unless special circumstances
GDP Growth %Y/Y Q2 (Q1)	**-14.7% (-3.2%)**
Trend GDP %y/y	1.5%
Purchasing Power Parity Value Aug	**1.2818**
Spot end-Sep	1.1721
PPP Valuation	EUR/USD is undervalued
Current account % GDP Q2 (Q1)	2.3% (2.4%)
Trend current account balance % GDP	0.3%
Moody's Foreign Currency Rating	**Aaa (Germany)**
Outlook	Stable

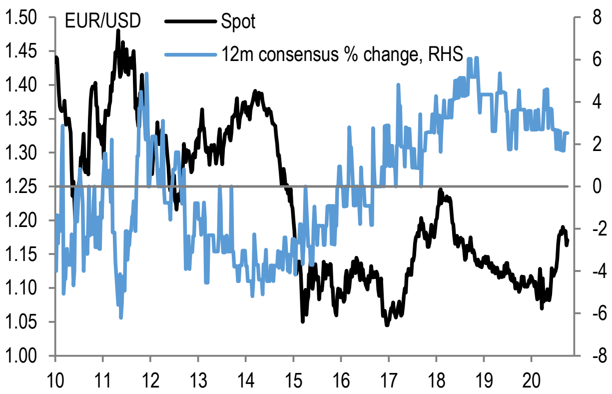
* Current is latest month, quarter or year

1. Growth dynamic still favours US



Source: RBC Capital Markets, Bloomberg

2. Analysts still bullish EUR



Source: RBC Capital Markets, Bloomberg

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.10	1.12	1.17	1.20	1.20	1.20	1.18	1.16
EUR/JPY	119	121	124	116	116	119	119	119
EUR/CAD	1.55	1.53	1.56	1.61	1.62	1.62	1.58	1.54

Source: RBC Capital Markets estimates

Japanese Yen

Adam Cole

1-3 Month Outlook – USD/JPY still trending down

USD/JPY continued to trend steadily lower through September and JPY was the best performing G10 currency in the month. Although markets were risk averse in September, this had little bearing on USD/JPY which has recently been entirely uncorrelated to general risk appetite as USD's status as a safe haven has risen to match that of JPY. Nor was USD/JPY's performance a function of broad USD direction as the month was dominated by broad USD gains against all other G10 currencies. Rather, we think JPY's outperformance has been driven by a steady drip feed of JPY buying from within Japan as investors gradually rehedge investments in USD assets, reflecting the dramatic fall in the cost of hedging earlier in the year. A 3m hedge on a USD asset currently costs a JPY-based investor just 0.5% (annualised) compared to 2.0% at the turn of the year and the fall in hedging costs is significant when seen against an estimate of around a 3% yield on Japan's foreign bond portfolio. In the coming weeks, the large life insurers will start to publish their investment plans for fiscal H2, and we expect these to confirm that a major shift from unhedged to hedged foreign bonds is underway. In terms of new investment, almost all major bond markets are now positive yielding in FX-hedged terms, though it is the adjustment of hedges on existing bond holding that generates the larger JPY flow.

Markets have taken the transition of LDP leadership from Abe to Suga in their stride and there are unlikely to be any major shifts in the mix of fiscal and monetary policy in the near-term, leaving USD/JPY largely driven by the lagged effect of previous Fed policy changes rather than policy in Japan. Our forecasts are unchanged this month and we expect USD/JPY to fall to 97 by year-end.

6-12 Month Outlook – Target 97 in USD/JPY

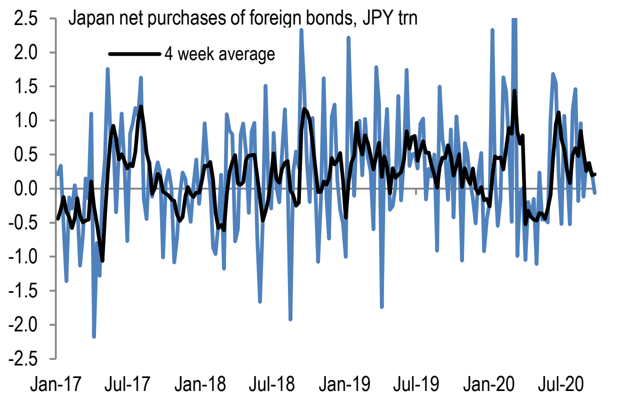
Large shifts in hedges take time to materialise, even when there are abrupt changes in the costs of hedging and, in aggregate the hedge ratio tends to trend for prolonged periods. We expect JPY strength to extend into 2021 H1 as Japanese investors remain opportunistic sellers of rallies in USD/JPY as they rehedge foreign investments. BoJ policy, as usual, plays a very limited role in driving JPY and the central bank's options remain very limited. Fiscal policy is at last playing a more significant role in supporting growth, recent Budget changes pushing net stimulus up to around 4% of GDP in 2020. The profile of a steady decline in USD/JPY is unchanged this month.

Indicators

	Current (Previous)*
Official cash rate	**-0.1% (-0.1%)**
Trend interest rates 10y average	0.15%
Bias in interest rate market	Flat
CPI Inflation %Y/Y Aug (Jul)	**-0.4% (0.0%)**
Inflation target	2.0%
Budget balance % GDP FY18 (FY19)	**-2.4% (-3.0%)**
Budget balance target % GDP	n/a
GDP Growth %Y/Y Q2 (Q1)	**-10.1% (-1.9%)**
Trend GDP %Y/Y	1.0%
Purchasing Power Parity Value Aug	**87.45**
Spot end-Sep	105.48
PPP Valuation	USD/JPY is overvalued
Current a/c balance % GDP Q2 (Q1)	2.6% (2.8%)
Trend current account balance % GDP	2.6%
Moody's Foreign Currency Rating	**A1**
Outlook	Stable

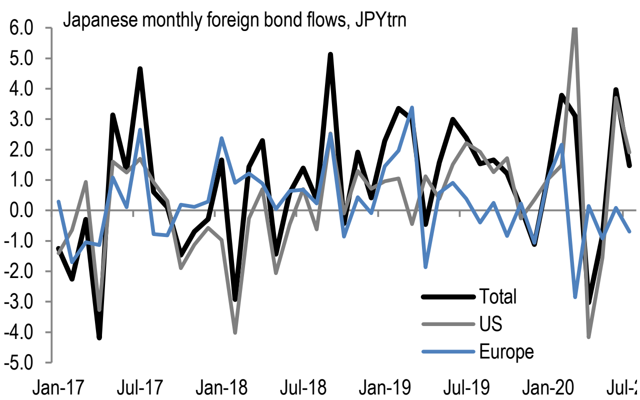
* Current is latest month, quarter or year

1. Capital steadily flowing out again…



Source: RBC Capital Markets, Bloomberg

2. …and most flow is into the US



Source: RBC Capital Markets, Bloomberg

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/JPY	108	108	105	97	97	99	101	103
EUR/JPY	119	121	124	116	116	119	119	119
CAD/JPY	76	80	79	72	72	73	75	77

Source: RBC Capital Markets estimates

Sterling

Adam Cole

1-3 Month Outlook – Crunch month for Brexit

GBP traded very badly in September as Brexit came screaming back onto the markets' agenda after a six month absence. Looked at through a 50/50 basket of EUR and USD, GBP dropped 4% in the space of a couple of sessions as the UK government's Internal Market Bill (IMB) started to pass through parliament and the EC countered by saying it will start legal proceedings against the UK. The course that the Brexit process will take as the transition period ends should therefore be clear within a month and there are two broad scenarios. In the positive scenario, the path to a trade deal is clear by the October 15/16 EU summit and the EU at that point hands the final negotiating remit to Barnier. The deal is finalised by end-October and the contentious clauses of the IMB are not needed. The alternative scenario is that the two sides are unable to reach a deal by October 16, the "real" deadline of early-November passes and the UK is on the road to no deal exit in December. While we would put the probability of these two scenarios as close to 50/50, we see the potential GBP reaction as asymmetric to the downside given the risk that the government is seen as agreeing to a poor deal from its weak negotiating position. Late October/early November is also likely to see very poor economic news as the government's furlough scheme ends. Although we will not have comprehensive labour market data covering November until January, there will be no shortage of anecdotal evidence pointing 100s of thousands of redundancies. Our spot forecasts are effectively an average of these two scenarios and are unchanged this month.

6-12 Month Outlook – Medium-term weakness

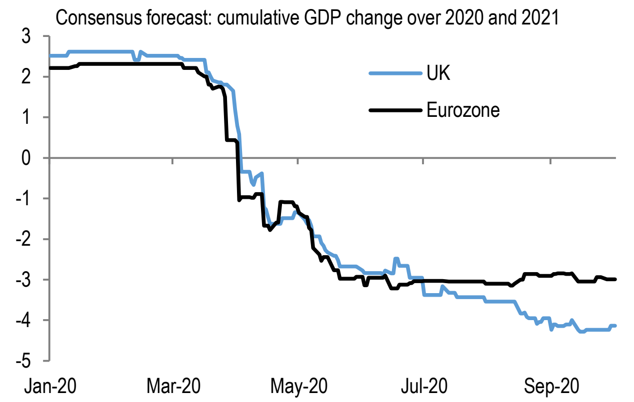
Going forward, there will be increasing focus on UK imbalances. The UK fiscal easing measures are amongst the largest in G10, The UK's automatic stabilisers are also powerful, so the cyclical deterioration in the budget position will be relatively large. Unlike the US and Australia, where policy is similarly active, however, the UK does not have a large private sector financial surplus to draw down in financing increased government borrowing. This means that the deterioration in the budget position is more likely to flow through to the current account, which is already in deficit by 4% of GDP. Our longer-term expectations for GBP have to include the risk that attracting the foreign inflows the UK will need "requires" a relative cheapening of UK assets via the currency. We therefore expect grinding GBP underperformance to continue into the medium-term.

Indicators

	Current (Previous)*
Official cash rate	**0.10% (0.25%)**
Trend interest rates 10y average	3.3%
Bias in interest rate market	Lower
CPI Inflation %Y/Y Aug (Jul)	**0.2% (1.0%)**
Inflation target (HICP)	2.0%
Budget balance % GDP FY18 (FY17)	**-2.3% (-2.4%)**
Budget balance target % GDP	Budget surplus as soon as possible
GDP Growth %Y/Y Q2 (Q1)	**-21.5% (-2.1%)**
Trend GDP %Y/Y	1.5%
Purchasing Power Parity Value Aug	**1.4507**
Spot end-Sep	1.2920
PPP Valuation	GBP/USD is undervalued
Current a/c balance % GDP Q2 (Q1)	-2.8% (-3.6%)
Trend current account balance % GDP	-3.9%
Moody's Foreign Currency Rating	**Aa1**
Outlook	Stable

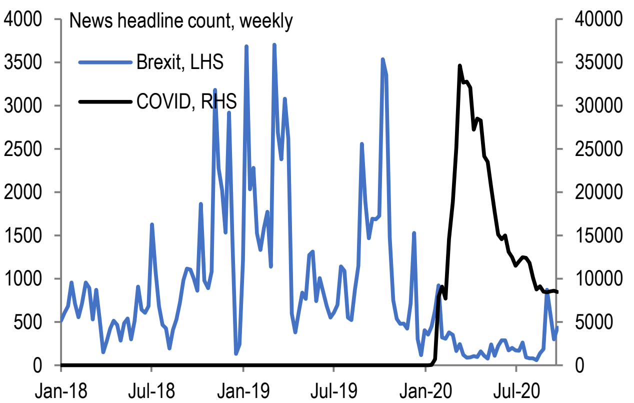
* Current is latest month, quarter or year

1. UK growth prospects still deteriorating



Source: RBC Capital Markets, Bloomberg

2. Brexit rising up the agenda



Source: RBC Capital Markets, Bloomberg

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
GBP/USD	1.24	1.24	1.29	1.28	1.26	1.25	1.23	1.21
EUR/GBP	0.89	0.91	0.91	0.94	0.95	0.96	0.96	0.96
GBP/JPY	134	134	136	124	123	124	124	124
GBP/CAD	1.75	1.68	1.72	1.71	1.71	1.69	1.65	1.61

Source: RBC Capital Markets estimates

Swiss Franc

Daria Parkhomenko

1-3 Month Outlook – Downside risk for EUR/CHF

For most of September, EUR/CHF traded sideways, with the pair continuing to broadly track moves in EUR/USD. Into year-end, we think EUR/CHF will be largely driven by the external backdrop & moves in EUR/USD, with our forecasts assuming EUR/CHF trades slightly lower towards 1.06. Although the 3m correlation based on daily returns between EUR/CHF and general risk sentiment (SPX as a risk proxy) declined in September (Figure 1), EUR/CHF's sensitivity to risk sentiment may increase on the back of US political uncertainty. This is especially if the results are contested and there is a sell-off in risky assets globally (i.e. the sell-off is not just situated in the US) – under such a scenario, we would expect CHF to strengthen, though potential SNB intervention may temper some of the appreciation (according to the SNB, the central bank spent CHF 90bn defending the currency from appreciation in H1 2020, the largest amount since 2012 (CHF 188bn)). Meanwhile, based on CFTC's IMM data, EUR/USD positioning remains long (albeit off the all-time highs). This along with options risk reversals for EUR/CHF suggesting that the market is on the more bullish end of the spectrum pose a downside risk to EUR/CHF (Figure 2). Another event to watch will be the US Treasury's semi-annual FX report – in January, the Treasury had put Switzerland on the "Monitoring List."

Technically, EUR/CHF continues to trade within a rectangle pattern. Initial support stands at 1.0768 (trendline off the May 18 & July 10 lows), followed by 1.0730 (Aug 3 low, lower bound of the rectangle) & the 200-dma at 1.0682. Resistance stands at 1.0838 (upper bound of the rectangle).

6-12 Month Outlook – External backdrop

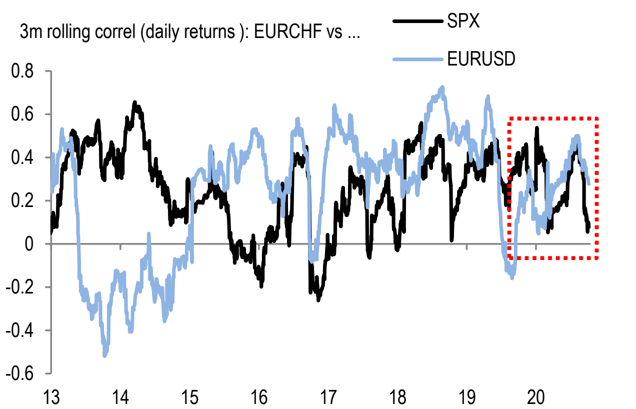
In the long-term, the external environment will remain the main driver of CHF. If the risk backdrop deteriorates and EUR/CHF trades towards the perceived floor at ~1.05, we would expect the SNB to intervene. However, as noted in prior reports, it will be an uphill battle for the SNB to prevent CHF's appreciation in a *severely* risk-off environment with CHF a default safe haven and nominal rates already low, and thus, it is not a given that the SNB will endlessly commit to intervention in order to prevent CHF from appreciating. Domestically, the SNB revised its inflation forecasts slightly higher for 2020 & 2021 in September, but inflation is still expected to remain well below the SNB's inflation target over the forecast horizon through Q2 2023. This means that rates will remain low for quite some time.

Indicators

	Current (Previous)*
Official cash rate	**-0.25 to -1.25% (0.25 to -0.75%)**
Trend interest rates average	-0.7%
Bias in interest rate market	Flat
CPI Inflation %Y/Y Sep (Aug)	**-0.8% (-0.9%)**
Inflation target	less than 2.0%
Budget balance % GDP FY19 (FY18)	**1.2% (1.6%)**
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Y/Y Q2 (Q1)	**-9.3% (-0.7%)**
Trend GDP %Y/Y	1.80%
EUR Purchasing Power Parity Value Aug	**1.1773**
EUR/CHF spot end-Sep	1.0794
EUR/CHF PPP Valuation	EUR/CHF is undervalued
Current a/c balance % GDP Q2 (Q1)	8.9% (10.2%)
Trend current account balance % GDP	10%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

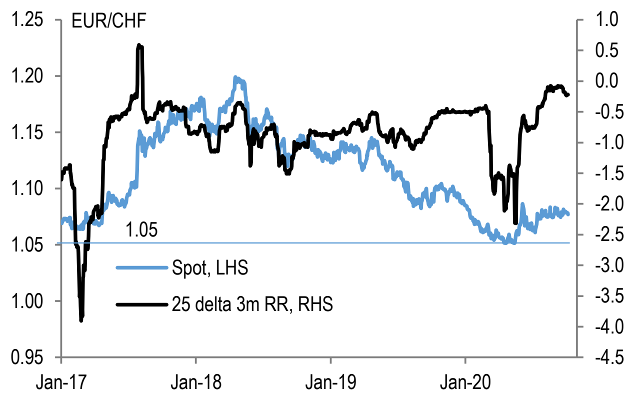
* Current is latest month, quarter or year

1. 3m correlations: EUR/CHF vs. S&P 500 and EUR/USD



Source: RBC Capital Markets; Bloomberg; Latest reading is October 6, 2020

2. RRs remain close to the highest levels since August 2017



Source: RBC Capital Markets; Bloomberg, SNB; Latest reading as of October 6, 2020

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CHF	0.96	0.95	0.92	0.88	0.88	0.88	0.91	0.93
EUR/CHF	1.06	1.06	1.08	1.06	1.06	1.06	1.07	1.08
CHF/JPY	112	114	115	110	110	112	111	111
CAD/CHF	0.68	0.70	0.69	0.66	0.65	0.65	0.68	0.70

Source: RBC Capital Markets estimates

Swedish Krona & Norwegian Krone

Adam Cole

Swedish Krona – Moderate outperformance

SEK was second worst performing G10 currency in September after NOK. The rally in EUR/SEK through the month, however, had little to do with domestic news and reflected the weakness in global equities as SEK continues to trade as proxy for general risk appetite. Domestic news has been neutral to slightly positive. At its September 22 meeting, the Riksbank left all of its policy settings unchanged and its forward guidance remained at zero for the entire forecast period (to 2023). Although the central bank continues to say it has the option of cutting rates below zero again, the hurdle for doing that appears to be high, given the mixed evidence on its previous impact. Markets price in a small risk of negative rates (Figure 1), though the forward curve is slowly converging toward the Riksbank's guidance, the longer rates are sustained at zero. Going forward, high levels of cross-asset correlation will leave SEK's prospects beholden to swings in global risk appetite and events outside Sweden – the US election, evolution of COVID-19 infections, etc. On an assumption that these factors are neutral in the longer-term, the balance of risks is that SEK reverts to moderate outperformance as markets price out residual expectations of further rate cuts.

Norwegian Krone – Gains constrained by CB

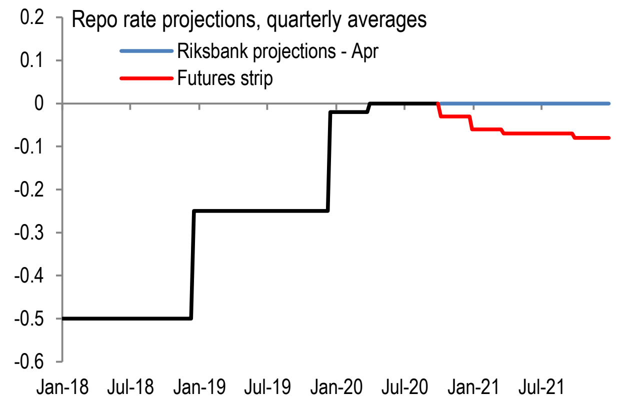
EUR/NOK rallied from 10.40 to a high above 11.00 in September and NOK was the worst performing G10 currency by a large margin. In a similar way to SEK, however, this largely reflected global rather than local factors. Our World of One Trade framework consistently shows NOK as one of the riskiest currencies in G10. NOK's September weakness as markets turned risk-negative was compounded by moderate losses in crude prices, to which NOK is also highly correlated currently. Unlike SEK, NOK does not really have a near-term policy dynamic – the central bank shows no inclination to go negative and QE has never really been an option due to the scarcity of domestic bonds to buy. In the longer-term, however, Norges Bank is the only DM central bank to formally incorporate the start of policy normalisation in its forecasts, with rates rising gently in late-2022 and more significantly in 2023. While this is a positive background, the high sensitivity of these forecasts to exchange rate movements suggests the hurdle would be low for lowering them if NOK appreciated significantly.

Indicators - Sweden

	Current (Previous)*
Official cash rate	**0.0% (-0.25%)**
Trend interest rates 10y average	3.0%
Bias in interest rate market	Lower
CPIF Inflation %Y/Y Aug (Jul)	**0.7% (0.5%)**
Inflation target (UND1X)	2.0%
Budget balance % GDP FY18 (FY17)	**1.25% (1.55%)**
Budget balance target % GDP	Cyclical average surplus of 1%
GDP Growth %Y/Y Q2 (Q1)	**-7.7% (0.7%)**
Trend GDP %Y/Y	2.0%
EUR Purchasing Power Parity Value Aug	**9.1143**
Spot end-Sep	10.4986
PPP Valuation	EUR/SEK is overvalued
Current a/c balance % GDP Q2 (Q1)	4.5% (4.1%)
Trend current account balance % GDP	4.5%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

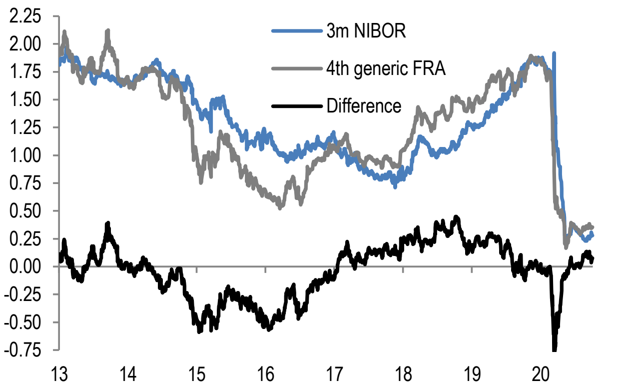
* Current is latest month, quarter or year

1. Market still skewed to negative Riksbank rates



Source: RBC Capital Markets, Bloomberg, Riksbank

2. NOK rate expectations flat



Source: RBC Capital Markets; Bloomberg

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/SEK	9.91	9.32	8.96	8.50	8.46	8.42	8.56	8.62
EUR/SEK	10.93	10.47	10.50	10.20	10.15	10.10	10.10	10.00
NOK/SEK	0.95	0.97	0.96	0.98	0.97	0.97	0.97	0.96
CAD/SEK	7.04	6.87	6.73	6.34	6.27	6.23	6.39	6.48

Source: RBC Capital Markets estimates

Canadian Dollar

George Davis

1-3 Month Outlook – Uncertainty to linger

USD/CAD underwent a correction through the month of September, trading from a 7-month low of 1.2994 to end the month near 1.3400. Given that CAD has a very strong correlation with equity markets, it was not surprising that a 10.5% correction in the S&P 500 Index led to CAD weakness as the risk backdrop deteriorated. Market uncertainty is expected to increase and linger through Q4 on a number of fronts. First and foremost, the number of new COVID cases has started to increase drastically, causing some provinces to tighten restrictions on activity again (Figure 1). This is particularly notable in Ontario and Quebec - the two largest contributors to GDP - with the new restrictions likely to dampen growth in Q4. RBC Economics is currently monitoring a sharp rebound of 45.0% annualized for Q3 GDP after Q2's record 38.7% decline, but with Q4 GDP expected to tail off to the low single digits. COVID-related shutdowns would present downside risks for Q4 numbers that were already expected to show much more moderate growth (Figure 2). This would also be consistent with the BoC's base case view of a "bumpy" recuperative phase beyond the initial "v-shaped" recovery and is a second factor contributing to uncertainty. Third, while the latest betting odds show an increasing probability of a Biden victory in the November US election, recent comments from Trump suggest that he may contest the election results. The resulting incremental uncertainty would carry bearish implications for equities. Lastly, the cost of new measures introduced in September's Throne Speech will have to be detailed in the fall fiscal update. This is likely to be in late November/early December and projections for future fiscal years will be important as many programs extend beyond the current fiscal year. The Parliamentary Budget Office (PBO) has pegged the current year fiscal deficit at CAD328.5bn and the degree to which deficits are seen as "structural" or "discretionary" will be a focus of ratings agencies (Fitch downgraded the federal government to AA+ in June, others remain at AAA). All of these uncertainties leave the door open for some CAD weakness in Q4.

6-12 Month Outlook – A more level growth path

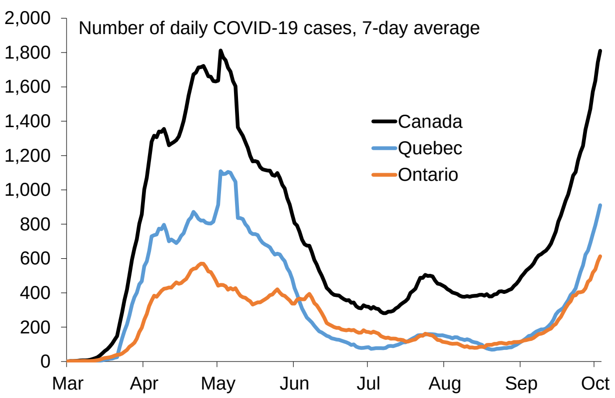
A more level growth path is expected in 2021 assuming that there are no major reopening setbacks. With low policy rates helping to underpin growth, a recovery in the global economy and increased demand for commodities should set the stage for some mild CAD appreciation.

Indicators

	Current (Previous)*
Official cash rate	**0.25% (0.75%)**
Trend interest rates 10y average	0.97%
Bias in interest rate market	Neutral
Core CPI Inflation (Trim) %Y/Y Aug (July)	**1.7% (1.7%)**
CPI inflation target range %Y/Y	1-3%
Budget balance % GDP FY19 (FY18)	**-0.6% (-0.9%)**
Budget balance target % GDP	Declining over the business cycle
GDP growth %Q/Q saar Q2 (Q1)	**-38.7% (-8.2%)**
Trend GDP %Q/Q	0.83%
Purchasing Power Parity value Aug	**1.2373**
Spot end-Sep	1.3319
PPP valuation	USD/CAD is overvalued
Current account balance % GDP Q2 (Q1)	**-1.9% (-1.9%)**
Trend current account balance % GDP	-2.93%
Moody's foreign currency rating	**Aaa**
Outlook	Stable

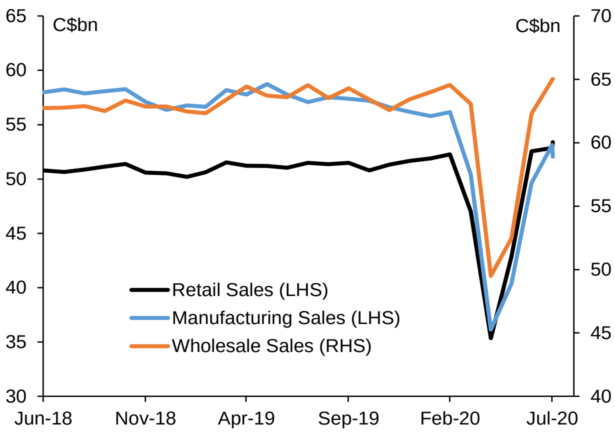
* Current is latest month, quarter or year

1. A second wave of COVID infections has arrived



Source: CBC, RBC Economics

2. Various sales metrics are starting to level off



Source: Statistics Canada, Haver, RBC Capital Markets

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CAD	1.41	1.36	1.33	1.34	1.35	1.35	1.34	1.33
EUR/CAD	1.55	1.53	1.56	1.61	1.62	1.62	1.58	1.54
CAD/JPY	76.5	79.5	79.2	72.4	71.9	73.3	75.4	77.4

Source: RBC Capital Markets estimates

Australian Dollar & New Zealand Dollar

Adam Cole

Australian Dollar – Weaker bias

AUD/USD fell around 200pts to a low of 0.70 in September. There was very little in way of domestic direction, however. As Figure 1 shows, general USD gains and a risk-negative global environment fully explain AUD/USD's move in the month. Domestically, the RBA left policy unchanged at the early February meeting, disappointing the high profile minority that had been expecting a final rate cut. The central bank kept its options open on further easing in the future, but we think the highly expansionary stance of fiscal policy, further enhanced by this month's Budget, will keep monetary policy on hold for the remainder of the year. Forward rates price in only a slight risk of lower rates and imply negligible risk of negative rates, in contrast to NZD (Figure 2). Going forward, without a clear domestic rates story as a conduit for economic news, USD direction and risk appetite are likely to be the main AUD drivers. Our USD view is more neutral than the bearish consensus, but we maintain a mildly negative bias on AUD as long positioning still appears extended and the risk of a more material correction in equity prices still overhangs. A key risk to the outlook in the near-term is the uncertainty around the US election and in particular, the potential for markets to turn very risk averse if the election outcome is contested.

New Zealand Dollar – Underperforming AUD

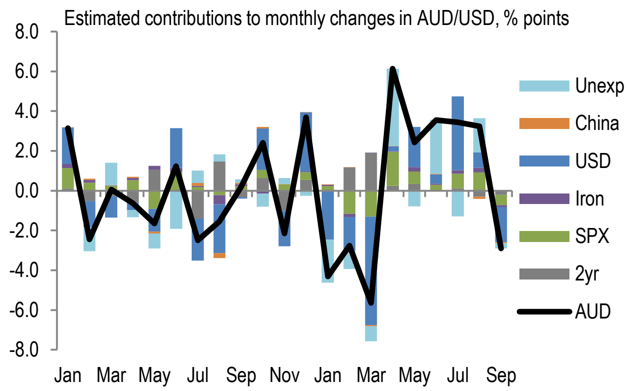
NZD/USD also weakened in September, though NZD slightly outperformed AUD. Also like AUD, NZD weakness largely reflected general USD strength and the sell-off in global equities. Although RBNZ continues to talk up the prospect of negative rates, there is little to suggest a move is imminent and market expectations remain anchored to rates falling though zero in the first half of next year (Figure 2). There is some scope for NZD underperforming AUD going forward if markets move to more fully price negative rates, though as with AUD, the main drivers are likely to be USD and risk appetite. This month's general election (delayed to October 17) adds an additional layer of uncertainty for NZD, though a reelected Labour government seems like a near-certainty (implied probability of 95% on prediction markets) and markets should be priced for this already. Like AUD, NZD is vulnerable to an unwind of very extended long positions and would also be hit hard in the event of a prolonged period of uncertainty if November's US election produces a contested result.

Indicators – Australian Dollar

	Current (Previous)*
Official cash rate	**0.25% (0.25%)**
Trend interest rates 10y average	2.9%
Bias in interest rate market	Slightly lower
CPI Inflation %Y/Y Q2 (Q1)	**-0.3% (2.2%)**
CPI Inflation target range %Y/Y	2.0-3.0%
Budget balance % GDP FY18/17	**-0.01%/-0.8%**
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Y/Y Q2 (Q1)	**-6.3% (1.6%)**
Trend GDP %Y/Y	2.8%
Purchasing Power Parity Value Q2	**0.6688**
Spot end-Sep	0.7143
PPP Valuation	AUD/USD is overvalued
Current account balance % GDP Q2 (Q1)	**1.8% (1.2%)**
Trend current account balance % GDP	-3.4%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

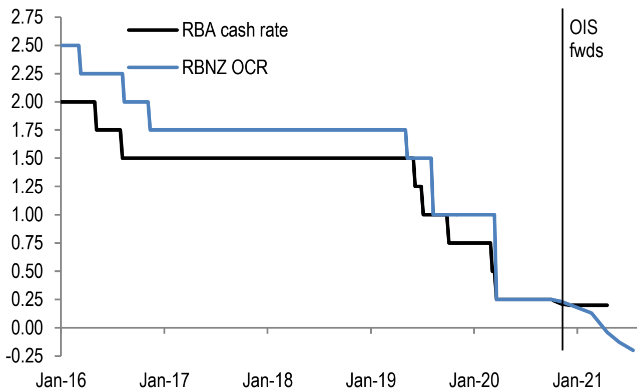
* Current is latest month, quarter or year

1. USD direction dominated September



Source: RBC Capital Markets, Bloomberg

2. RBNZ negative rate priced for early 2021



Source: RBC Capital Markets, Bloomberg

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
AUD/USD	0.61	0.69	0.72	0.70	0.69	0.69	0.69	0.69
EUR/AUD	1.80	1.63	1.64	1.71	1.74	1.74	1.71	1.68
AUD/NZD	1.03	1.07	1.08	1.08	1.08	1.08	1.08	1.08
AUD/CAD	0.86	0.94	0.95	0.94	0.93	0.93	0.92	0.92

Source: RBC Capital Markets estimates

Chinese Yuan

Alvin T. Tan

1-3 Month Outlook – Broadening recovery

China's economic recovery is strengthening. The demand-side of the economy has joined the growth upswing, though still lagging the production-side. Beijing has also become more focused on supporting domestic growth drivers. Upside risks to the growth outlook are accumulating, so long as the pandemic stays subdued in the country.

The PBOC is pursuing a "steady" monetary policy that has allowed interest rates to rise gradually as the growth recovery strengthens. There is at the same time a strong positive domestic credit impulse supporting the recovery. Aggregate social financing has seen a notable increase this year, and is expected to persist through year-end. Bank loans have been joined by increased government bond issuance.

CNY has been buoyed by the combination of implicit monetary tightening and strong credit growth, contributed in part by loose fiscal policy. The yuan was the top performing Asian currency in Q3, and further gains are expected in coming months as growth strengthens. Notwithstanding the decline in USD/CNY in recent months, the CNY CFETS Index remains below the year's highs.

Both China and the US remain committed to the Phase 1 trade deal, notwithstanding the general deterioration of the relationship. Chinese entities have continued to buy sizeable amounts of US goods recent months, and various US officials have voiced their satisfaction with the pace of Chinese purchases. The impact of the US election has been evident in the volatility market, and not so much in spot currency rates.

6-12 Month Outlook – Fundamental tailwinds

The yuan's upward march is supported by the intensifying growth upturn. The implicit monetary tightening amid loose fiscal policy is a key fundamental driver of the yuan's rise. The growing weight of China in various global financial indices is another fundamental long-term tailwind.

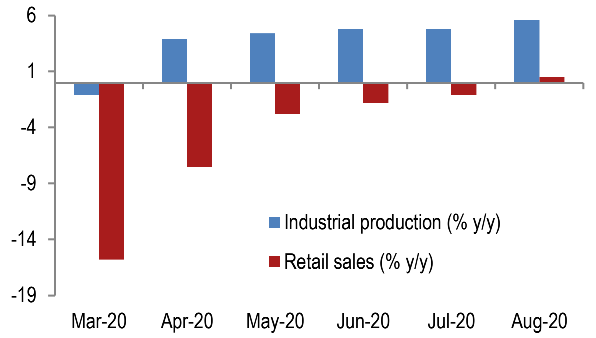
Moreover, China's continental economy and the need to encourage more domestic consumption-driven growth suggests diminishing incentives to weaken the currency. Beijing will however still want to control the pace of appreciation. The wild card in this is how the US-China relationship evolves after the US election.

Indicators

	Current (Previous)*
PBOC 7-day reverse repo rate	**2.20 %**
Trend interest rates (10yr average)	2.73%
Bias in interest rate market	Higher
CPI Inflation %Y/Y last (prev)	**2.4% (2.7%)**
Inflation target	3.0%
Budget balance % GDP last (prev)	**-4.9% (-4.1%)**
Budget balance trend % GDP	-2.7%
GDP Growth % y/y last (prev)	3.2% (-6.8%)
Trend GDP %y/y	7.0%
Purchasing Power Parity Value Jul	**7.9161**
Spot end-Sep	6.7910
PPP valuation	USD/CNY is undervalued
Current acct balance % GDP last (prev)	**1.1% (0.6%)**
Trend current account balance % GDP	2.0%
Moody's Foreign Currency Rating	**A1**
Outlook	Stable

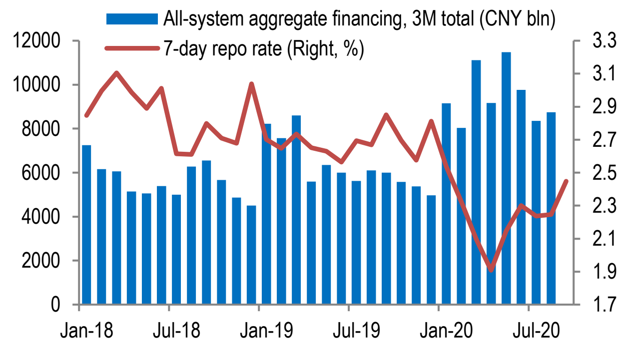
* Current is latest month, quarter or year

1. Broadening economic recovery



Source: RBC Capital Markets; Bloomberg

2. Rising interest rates amid strong credit impulse



Source: RBC Capital Markets; Bloomberg

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CNY	7.08	7.07	6.79	6.60	6.60	6.50	6.50	6.40
EUR/CNY	7.81	7.94	7.96	7.92	7.92	7.80	7.67	7.42
CNY/JPY	15.2	15.3	15.5	14.7	14.7	15.2	15.5	16.1
CAD/CNY	5.04	5.20	5.10	4.93	4.89	4.81	4.85	4.81

Source: RBC Capital Markets estimates

Indian Rupee

Alvin T. Tan

1-3 Month Outlook – More easing measures

New Delhi surprised the market by declining to increase its borrowing targets last week. But this was likely a mere postponement, as the fiscal stress mounts. The federal deficit has already hit the fiscal year's target with another half-year to go. State-level borrowing is also expected to swell.

India has become the second worst pandemic-hit country in the world. The consumption-driven economy remains hampered by a sluggish consumption recovery with the pandemic still largely untamed. The services PMI has risen steadily from the April nadir but still sub-50, and high frequency Google Mobility data are showing weaker Indian retail activity revival relative to other Asian countries.

India entered the pandemic with a weak starting fiscal position, and the burden of policy support has fallen heavily on the RBI. However, conventional monetary policy has been hamstrung by elevated inflation holding above the upper band of the RBI's target range. The RBI has pursued various unconventional easing measures, but yet refrained from launching an outright QE program.

New appointments to the RBI policy panel suggest a more dovish tilt is imminent. The general thrust of monetary easing throws up a headwind against sustained rupee appreciation. Moreover, the RBI may be expected to continue to lean against rupee strength. The INR is consequently expected to be a laggard in the Asian FX complex.

6-12 Month Outlook – Fiscal dominance risk

India's economic recovery has been and will continue to be restrained by the tepid fiscal response and fragile financial sector. The poor real yields offered by Indian bonds is another fundamental hurdle for the rupee, though there is persistent foreign interest in the local equity market and technology ventures.

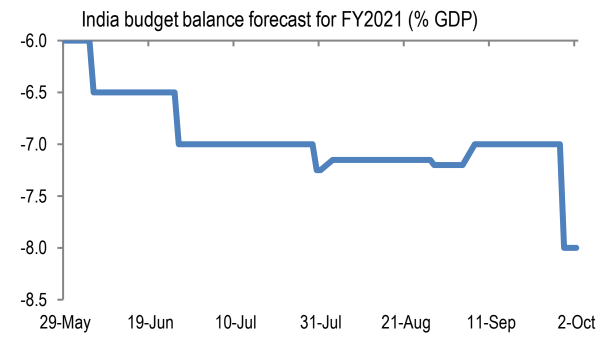
Finally, the acute fiscal stress thrown up by the pandemic creates a growing longer-term risk of fiscal dominance over Indian monetary policymaking. The RBI has been reluctant to commit to a QE program, much less Indonesian-style debt monetisation, but this circumspection is unlikely to last given the escalating pressures to both prevent yields from rising and support the economy.

Indicators

	Current (Previous)*
RBI policy repo rate	**4.00%**
Trend interest rates (10yr average)	6.942%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	**6.7% (6.9%)**
Inflation target	4% +/- 2%
Budget balance % GDP last (prev)	**-6.1% (-4.6%)**
Budget balance trend % GDP	-4.9%
GDP Growth % y/y last (prev)	-23.9% (3.1%)
Trend GDP %y/y	6.6%
Purchasing Power Parity Value Jun	**80.62**
Spot end-Sep	73.77
PPP valuation	USD/INR is undervalued
Current acct balance % GDP last (prev)	**0.4% (-0.8%)**
Trend current account balance % GDP	-2.3%
Moody's Foreign Currency Rating	**Baa3**
Outlook	Negative

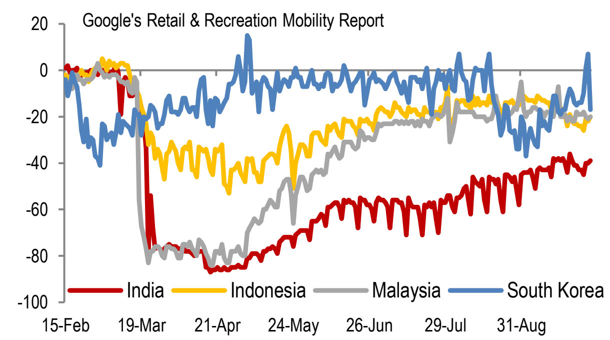
* Current is latest month, quarter or year

1. Deteriorating fiscal outlook



Source: RBC Capital Markets, Bloomberg

2. Sluggish consumption recovery



Source: RBC Capital Markets; Google

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/INR	75.3	75.6	73.8	73.3	73.0	73.0	72.5	72.0
EUR/INR	83.1	84.9	86.5	88.0	87.6	87.6	85.6	83.5
INR/JPY	1.43	1.43	1.43	1.32	1.33	1.36	1.39	1.43
CAD/INR	54	56	55	55	54	54	54	54

Source: RBC Capital Markets estimates

South Korean Won

Alvin T. Tan

1-3 Month Outlook – Some beta is returning

The Korean won has historically been seen as a “high beta” Asian currency. It was uncharacteristically subdued in Q2 in the face of the global risk rally, but seems to have rediscovered some of its mojo in Q3. A more positive macro risk environment amid the strengthening Northeast Asian economic recovery should help drive the won higher.

South Korea’s tech-heavy economy continues to be supported by the worldwide shift to online telecommunication and remote working. Exports are recovering, though at a sluggish pace. US export restrictions to Chinese tech companies are both an opportunity and a threat. Korea’s fiscal position will also remain in relatively good shape despite expansive fiscal measures, with the public debt expected to stay under 50% of GDP next year.

The room for conventional monetary policy is limited with the policy rate at 0.50%. The Bank of Korea has announced a small bond purchase program through year-end that is likely to grow, given the need to support the government’s sizeable bond issuance in coming quarters.

Moreover, the near-zero yields coupled with a still relatively elevated implied vol has placed KRW among the least attractive Asian currencies from a carry perspective. The ongoing shift towards unconventional policy and the poor yield-to-vol ratio have likely been some of the factors that have robbed the won of its traditional high beta status.

6-12 Month Outlook – Poor yield-to-vol and a difficult external environment will restrain gains

KRW gains should persist over the medium-term as the regional and global economic recoveries extend. South Korea’s fiscal balance will remain among the better ones in the EM space. The won’s poor yield-to-vol ratio however is expected to temper the upside gains.

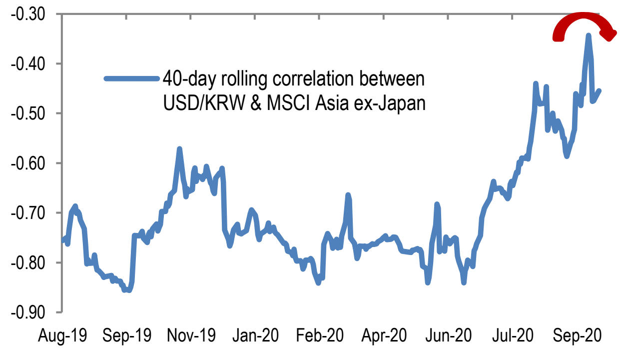
China’s recent announced aim to develop an advanced semiconductor industry strikes at the heart of the Korean economy. South Korea cannot help but be caught in the crossfire of US-China tensions. These add to the medium-term uncertainties.

Indicators

	Current (Previous)*
BOK base rate	**0.5%**
Trend interest rates (10yr average)	2.08%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	**1.0% (0.7%)**
Inflation target	2.0%
Budget balance % GDP last (prev)	**0.9% (3.0%)**
Budget balance trend % GDP	1.3%
GDP Growth % y/y last (prev)	-2.7% (1.4%)
Trend GDP %y/y	3.1%
Purchasing Power Parity Value Aug	**1100.6**
Spot end-Aug	1170.2
PPP valuation	USD/KRW is overvalued
Current acct balance % GDP last (prev)	**3.6% (3.8%)**
Trend current acct. balance % GDP	4.5%
Moody's Foreign Currency Rating	**Aa2**
Outlook	Stable

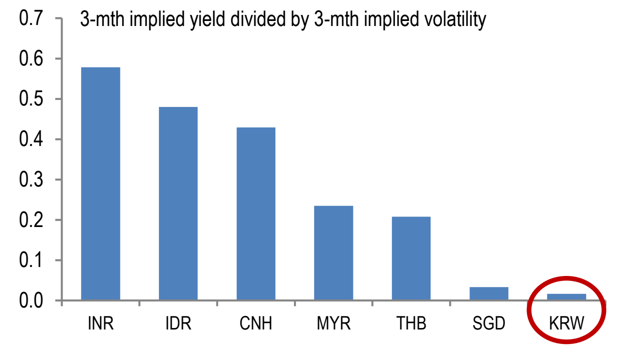
* Current is latest month, quarter or year

1. The won’s evolving beta to macro risk



Source: RBC Capital Markets; Bloomberg

2. Unattractive yield-to-vol ratio



Source: RBC Capital Markets; Bloomberg

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/KRW	1219	1199	1165	1150	1130	1120	1120	1100
EUR/KRW	1345	1347	1365	1380	1356	1344	1322	1276
JPY/KRW	11.3	11.1	11.0	11.9	11.6	11.3	11.1	10.7
CAD/KRW	867	883	875	858	837	830	836	827

Source: RBC Capital Markets estimates

Taiwanese Dollar & Singapore Dollar

Alvin T. Tan

Taiwan Dollar – Gradual gains ahead

The Taiwan dollar enjoys important fundamental supports, such as a sizeable persistent current account surplus and the economy's large tech sector, which has gained from increased pandemic-driven demand. Moreover, Taiwan is benefitting from the increased desire by global companies to diversify their supply chains, plus the reshoring of Taiwanese investments.

The CBC finally allowed USD/TWD to trade under the 29 level, but it has not given free rein to the currency. The central bank is reluctant to cut its policy rate below 1%, and may be expected to restrain TWD from rising too quickly, especially against its regional peers. There is poor risk-reward to chase TWD's recent gains, given the appreciation baked into the NDF points for the next few months.

On the flipside is the rising geopolitical rivalry between US and China, which spills over easily onto Taiwan given its contested status and economic linkages to the mainland. The strained state of cross-straits relations is also another related longer-term risk for TWD.

Singapore Dollar – MAS to lean against strength

Singapore's slow and steady growth recovery remains fragile. The electronics industry is driving the upturn, but conditions remain weak outside of manufacturing. Global growth risks and the continued curtailment of international travel continue to weigh on the economic outlook.

The pandemic, along with the US-China rivalry, has thrown into question Singapore's longstanding economic model as a regional trade, finance and travel hub. Singapore assets nonetheless are highly attractive for those seeking quality, with Singapore government bonds among the highest-yielding of the AAA club. The fiscal position is very strong thanks to years of budget surpluses.

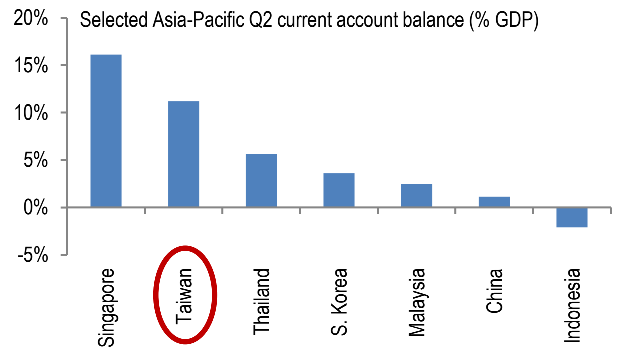
The largest fiscal stimulus in Asia relative to GDP has supported the economy, but the heavy trade-dependence means that external trends remain crucial. MAS will help ensure this by leaning against a sustained SGD rise through its current "zero appreciation" setting on the currency policy band. Thus, SGD will continue to follow the broader Asian FX complex, and not be a leader.

Indicators

	Current (Previous)*
CBC discount rate	**1.125%**
Trend interest rates (10yr average)	1.6%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	**-0.3% (-0.5%)**
Inflation target	None
Budget balance % GDP last (prev)	**0.5% (0.1%)**
Budget balance trend % GDP	-1.1%
GDP Growth % y/y last (prev)	-0.6% (2.2%)
Trend GDP %y/y	3.5%
Purchasing Power Parity Value Aug	**27.44**
Spot end-Aug	29.02
PPP valuation	USD/TWD is overvalued
Current acct balance % GDP last (prev)	**11.2% (10.6%)**
Trend current account balance % GDP	10.9%
Moody's Foreign Currency Rating	**Aa3**
Outlook	Stable

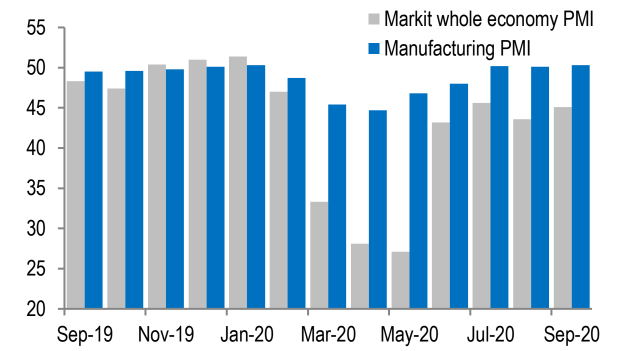
* Current is latest month, quarter or year

1. Huge external surpluses in Taiwan & Singapore



Source: RBC Capital Markets; Bloomberg

2. Singapore's manufacturing-led rebound



Source: RBC Capital Markets; Bloomberg

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/TWD	30.26	29.56	29.02	28.80	28.60	28.50	28.40	27.90
EUR/TWD	33.37	33.21	34.01	34.56	34.32	34.20	33.51	32.36
TWD/JPY	3.6	3.7	3.6	3.4	3.4	3.5	3.6	3.7
CAD/TWD	21.52	21.78	21.79	21.49	21.19	21.11	21.19	37.11

Source: RBC Capital Markets estimates

Malaysia Ringgit

Alvin T. Tan

1-3 Month Outlook – Flagging economic recovery

The Malaysian ringgit has lagged over the past month. The country's political uncertainties caused by the government's razor-thin parliamentary majority are one factor. Other factors are a worsening Covid-19 flare-up, the tepid pace of economic recovery, and a less benign global risk environment.

The Malaysian government has not fallen notwithstanding the opposition leader's claim, but it reminded the market of the government's tenuous hold on power. The possibility of a change of political leadership is never far in the background. Moreover, Malaysia's August manufacturing PMI slipped for the third consecutive month, falling further under the 50 level. This was before the pandemic's recent upsurge, which threatens to further undermine the recovery.

The chief attraction of the ringgit is the comparatively high real yield it offers, with a central bank still firmly in conventional policymaking mode. This feature becomes less enticing when domestic and external risks rear their heads. The ringgit is thus expected to struggle for direction, with a possibly more benign risk environment counteracted by the local pandemic flare-up.

However, the ringgit will find support thanks to its attractive carry, so look to buy it on dips. It should offer compelling medium-term total returns in a global economic recovery scenario. But monitor the evolving pandemic situation in the country closely.

6-12 Month Outlook – Cheap valuation and compelling real yields

Another positive factor for the ringgit is that it is arguably cheap on a number of long-term valuation metrics, on top of its attractive real yields. Malaysia could also be a major beneficiary from post-pandemic supply chain diversification trends.

That said, a catalyst for sustained MYR outperformance would require greater political stability and policy certainty. While that is difficult to foresee at this point, the ringgit should at least be able to keep pace with the broader Asian currency complex.

Indicators

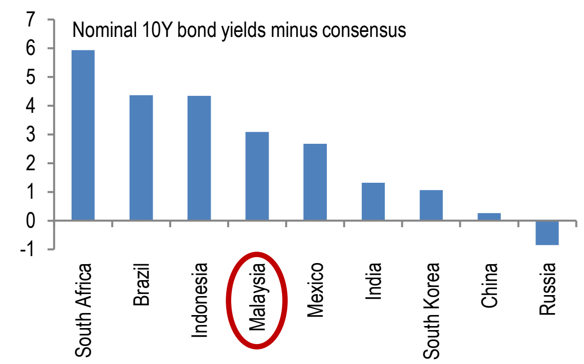
	Current (Previous)*
BNM official overnight night	**1.75%**
Trend interest rates (10yr average)	3.00%
Bias in interest rate market	Lower
CPI Inflation %Y/Y last (prev)	**-1.4% (-1.3%)**
Inflation target	None
Budget balance % GDP last (prev)	**-5.6% (-4.8%)**
Budget balance trend % GDP	-3.8%
GDP Growth % y/y last (prev)	-17.1% (0.7%)
Trend GDP %y/y	5.4%
Purchasing Power Parity Value Aug	**3.6126**
Spot end-Sep	4.1565
PPP valuation	USD/MYR is overvalued
Current acct bal % GDP last (prev)	**2.5% (2.8%)**
Trend current acct balance % GDP	5.1%
Moody's Foreign Currency Rating	**A3**
Outlook	Stable

* Current is latest month, quarter or year

1. Flagging recovery momentum

Source: RBC Capital Markets; Bloomberg

2. Highly attractive real yields



Source: RBC Capital Markets; Bloomberg

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/MYR	4.32	4.28	4.16	4.15	4.10	4.07	4.02	4.00
EUR/MYR	4.76	4.81	4.87	4.98	4.92	4.88	4.74	4.64
MYR/JPY	24.9	25.2	25.4	23.4	23.7	24.3	25.1	25.8
CAD/MYR	3.07	3.16	3.12	3.10	3.04	3.01	3.00	3.01

Source: RBC Capital Markets estimates

Turkish Lira

Daria Parkhomenko

1-3 Month Outlook – Positive steps, but not enough

In September, TRY was the worst performing currency in EM (down ~4.8% vs. USD), as the CBRT's rate hike failed to stem the currency's decline and the Armenia-Azerbaijan conflict added an additional geopolitical risk. There are a few market friendly steps that Turkey has taken over the past month, however, the steps are not sufficient to change our bearish view on TRY and we continue to think that the risk is tilted to the upside for our USD/TRY forecast profile.

First, although it was a positive step that the CBRT surprised the market by hiking rates by 200bps, the amount of tightening so far has been insufficient. Since hiking rates on September 24, the CBRT's weighted average cost of funding has increased from 10.69% to just 11.45% (as of Oct 6), leaving the ex-post real rate slightly negative and the ex-ante real rate slightly positive. In our view, more hikes will be needed in order to prop up the currency, though for now, with the upper bound of the CBRT's interest rate corridor at 13.25%, the CBRT has some breathing space to rely on backdoor measures to further tighten policy before outright hiking rates again. Second, the banking regulator eased local banks' restrictions on derivative transactions with the offshore market, which has raised the risk of speculation against TRY by the offshore market (TRY-negative). Simultaneously, a relaxation of the restrictions is a step towards a more market-friendly environment. If the regulator continues to ease these regulations (even if it raises the risk of speculation against TRY) *and* the CBRT continues to hike rates, these measures may potentially attract foreigners back to Turkey. However, it will be an uphill battle to convince the market that these changes are not temporary, and thus, we remain bearish on TRY. Other steps that Turkey has taken towards a more market-friendly environment are easing the Asset Ratio rule for banks & lowering the BMSV tax.

The US elections' results may impact US foreign policy towards Turkey (e.g. a Biden win/Dem sweep may result in a more negative shift for TRY), especially with Bloomberg news reporting that Turkey is planning to test the S-400s the week of October 12.

6-12 Month Outlook – Bearish on TRY

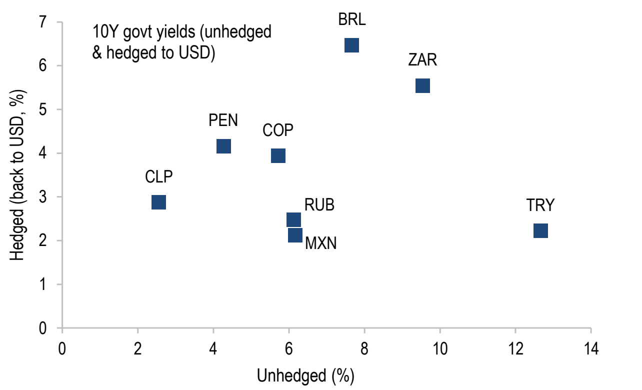
In the medium-term, we remain bearish on TRY. Although the government's policies may have pushed out foreigners, the locals still need FX as evident by the current account deficit (the C/A deficit has widened despite a contraction in the net energy deficit; Figure 2) and the external debt repayments. Meanwhile, the CBRT's FX & gold reserves remain low vs FX liabilities, including the outstanding FX swaps.

Indicators

	Current (Previous)*
One-week repo rate (%)	**10.25% (8.25%)**
Trend interest rates (historical average)	9.3
Bias in interest rate market	-
CPI Inflation %Y/Y Sep (Aug)	**11.75 (11.77)**
Inflation target	5.00%
Budget balance % GDP 2019 (2018)	**-2.9 (-2.0)**
Budget balance trend % GDP	-2.0
GDP Growth % y/y Q2 (Q1)	-9.1 (4.4)
Trend GDP %y/y	5.9
Purchasing Power Parity Value Aug	**4.3415**
Spot end-Sep	7.7157
PPP Valuation	USD/TRY is overvalued
Current a/c (12m. rolling) %GDP Q2 (Q1)	**-1.5 (0.2)**
Trend current account balance % GDP	-4.4
Moody's Foreign Currency Rating	**B2**
Outlook	Negative

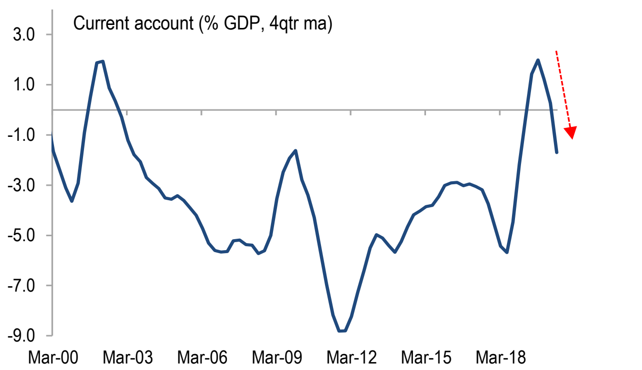
* Current is latest month, quarter or year

1. TU's 10Y yield (hedged) is at the low end of the spectrum



Source: RBC Capital Markets, Bloomberg; Latest reading as of October 6, 2020

2. The C/A turned back to a deficit during the pandemic



Source: Haver, RBC Capital Markets; Latest reading as of Q2 2020

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/TRY	6.62	6.85	7.72	8.00	8.10	8.10	8.10	8.10
EUR/TRY	7.30	7.70	9.04	9.60	9.72	9.72	9.56	9.40
TRY/JPY	16.3	15.7	13.7	12.1	12.0	12.2	12.5	12.7

Source: RBC Capital Markets estimates

South African Rand

Daria Parkhomenko

1-3 Month Outlook – Domestic & external risks

In September, USD/ZAR was volatile, though on a net basis, ZAR was the third best performing currency in EM vs USD, due to (1) an easing of lockdown restrictions, (2) the SARB keeping the policy rate unchanged, and (3) ZAR's low idiosyncratic risk relative to some other EM FX. These factors helped propel USD/ZAR below a double bottom at 16.3385 that has capped selloffs since June, however, a stronger USD due to US political uncertainty pushed the pair higher later in the month.

Heading into year-end, domestic and external risks are likely to keep ZAR volatile and trading with a cautious tone. Domestically, Finance Minister Mboweni will present the Medium-term Budget Policy Statement later this month, President Ramaphosa is expected to announce an economic recovery plan with infrastructure investment at the forefront, and there is an ongoing wage dispute with the unions. All of these will serve as "tests" of the government's progress on pro-growth reforms and fiscal consolidation. Although the government is taking steps forward, the progress has been arguably too slow and we remain on the more skeptical end of the spectrum about the government's ability to fully deliver, given the government's poor track record, union opposition about cutting wages, and policy disagreements in the ANC. On infrastructure, the government unveiled a ZAR2.3 trillion infrastructure program for the next decade in June, with 62 projects (worth R340bn) announced as part of the first phase in July. The government is planning to leverage the private sector's help in funding the program which is a positive step for growth in the long-term, though there have been limited details on the timelines/projects and implementation will be key for its success. On wages, the government did not raise public workers' salaries in April as set out in the 2018 wage agreement, and the dispute is currently with the Labour Court. If the ruling is against the government, it may hinder Mboweni's plans to cut the wage bill.

Externally, risk sentiment/moves in USD pose a risk to our forecast profile, especially if sentiment turns risk-on.

6-12 Month Outlook – Reforms & fiscal consolidation

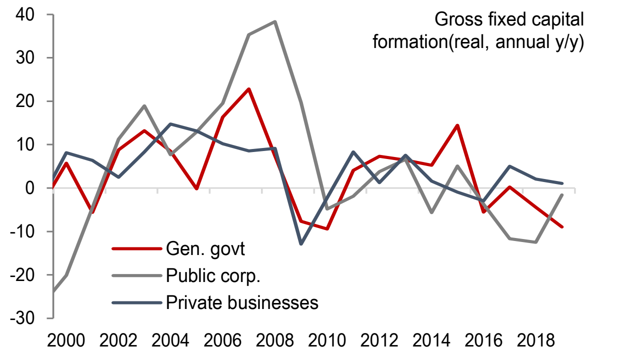
In the medium-term, the domestic outlook will be determined by the government's progress on pro-growth reforms & fiscal consolidation, with the 2021 Budget & the next public wage agreement serving as the next "tests." Our forecast profile assumes USD/ZAR trends higher, albeit at a gradual pace as we appreciate our skeptical view on the government's progress is not out of consensus.

Indicators

	Current (Previous)*
Official cash rate (repo rate)	**3.50 (3.75)**
Trend interest rates (10yr average)	5.9
Bias in interest rate market	Close to neutral
CPI Inflation %Y/Y Aug (Jul)	**3.1 (3.2)**
Inflation target	3.0 to 6.0%
Budget balance % GDP 2019/20 P (2018/19)	**-6.3 (-4.0)**
Budget balance trend % GDP	-3.8
GDP Growth % q/q saar Q2 (Q1)	-51.0 (-1.8)
Trend GDP %	2.1
Purchasing Power Parity Value Aug	**12.30**
Spot end-Sep	16.7484
PPP Valuation	USD/ZAR is overvalued
Current account % GDP Q2 (Q1)	**-2.4 (1.2)**
Trend current account balance % GDP	-3.7
Moody's Foreign Currency Rating	**Ba1**
Outlook	Negative

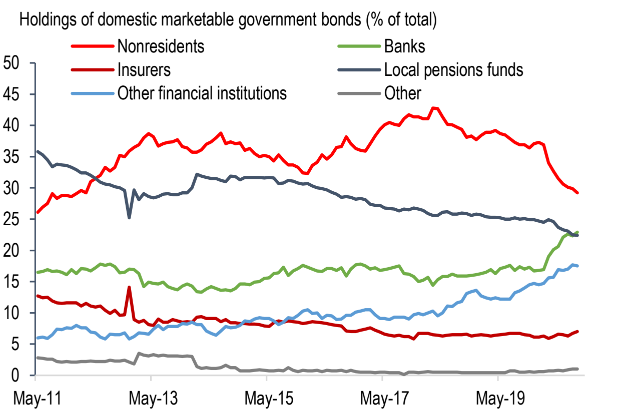
* Current is latest month, quarter or year

1. Slowdown in investment, especially by the public sector



Source: RBC Capital Markets, Haver; Latest reading is 2019

2. Foreign holdings at the lowest level since early 2012



Source: RBC Capital Markets, Haver; Latest reading is September 2020

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/ZAR	17.84	17.35	16.75	17.30	17.50	17.90	17.90	17.90
EUR/ZAR	19.68	19.49	19.63	20.76	21.00	21.48	21.12	20.76
ZAR/JPY	6.03	6.22	6.30	5.61	5.54	5.53	5.64	5.75

Source: RBC Capital Markets estimates

Brazilian Real

Daniel Rico

1-3 Month Outlook – Spending cap….

Recent volatility in BRL was mainly driven by a weak external backdrop, in addition to endless political discussions locally about the extension of the emergency relief program that has created further short term weakness to the currency. The discussions have remained very fluid over the last few weeks between congress and minister Guedes but ultimately the ideological differences will be put aside to work on structural reforms. The IMF has highlighted that the fiscal situation that Brazil is facing is "exceptionally high and multifaceted" and that preserving the constitutional spending cap as a fiscal anchor is essential to maintaining risk premiums. As highlighted by the IMF, the adjustment is likely to be a long process. Meanwhile, expectations remain unhinged and risk premia high in local assets. Although volatility remains high, the CB has done a great job maintaining the currency expectations at a steady rate.

Local exchange positioning continues to indicate some local optimism, but as we mentioned previously, USD/BRL price action will not only be determined by the external backdrop but also in part by the government's ability to deliver a clear path for tax reform. The overall trend of BRL remains complex and is difficult to forecast despite what seems to be a swift plan to approve the much needed reform agenda. Overall positioning in BRL in the local exchange remains fairly balanced with offshore short BRL and long local investors. In the short term we expect USD/BRL to trade in the low end of the [5.3-5.6] range.

6-12 Month Outlook – Tax Reform…

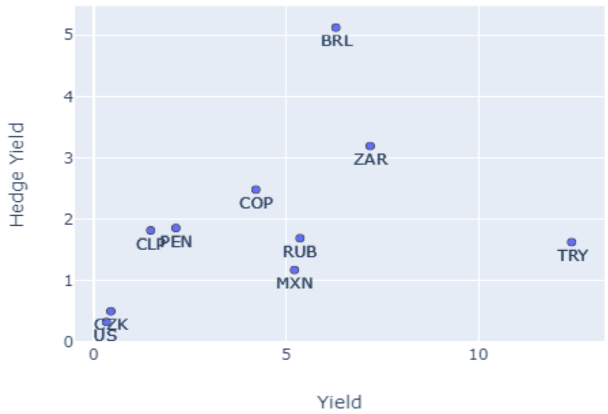
Our 6-12 month outlook remains highly dependent on the continuity of the reform agenda in order to anchor fiscal expectations and debt metrics. The nominal level of the currency, however, will remain under pressure in order to fight reflationary forces and larger government spending. We expect USD/BRL to trade in a wide range [5.5-6.0] with a high risk to break the 6 handle before finding some relief in 2H of 2021 ahead of the 2022 presidential elections.

Indicators

	Current (Previous)*
Official cash rate	**2.00**
Trend interest rates (10yr average)	7.98
Bias in interest rate market	Higher
Core PCE Inflation %Y/Y	**2.44**
Inflation target	4%
Budget balance % GDP	**-5.91**
Budget balance target % GDP	-1.4
GDP Growth % y/y	-11.4
Trend GDP %y/y	Lower
Purchasing Power Parity Value-Aug	**3.4061**
Spot end-Sep	**5.6102**
PPP Valuation	USD/BRL is overvalued
Current account balance % GDP	**-2.76%**
Trend current acct balance % GDP	-2.72
Moody's Foreign Currency Rating	**Ba2**
Outlook	STABLE

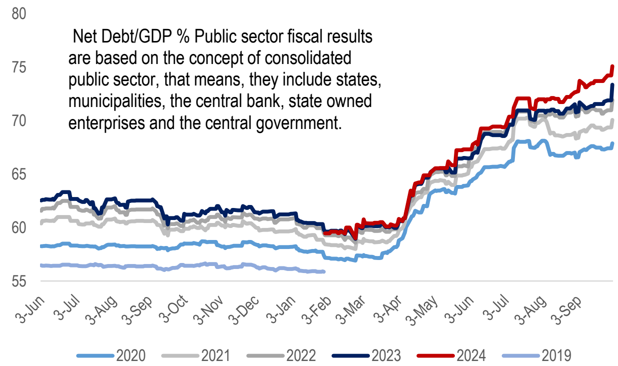
* Current is latest month, quarter or year

1. Brazil high premium: 5y yields vs 3m NDF



Source: RBC Capital Markets; Bloomberg

2. Unhinged Fiscal Expectations: Net Debt/GDP



Source: RBC Capital Markets, Central Bank of Brazil

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/BRL	5.21	5.47	5.61	5.80	5.50	5.20	5.20	5.20
EUR/BRL	5.74	6.14	6.58	6.96	6.60	6.24	6.14	6.03
BRL/JPY	20.7	19.7	18.8	16.7	17.6	19.0	19.4	19.8
CAD/BRL	3.70	4.03	4.21	4.33	4.07	3.85	3.88	3.91

Source: RBC Capital Markets estimates

Mexican Peso

Daniel Rico

1-3 Month Outlook – US elections and year end…

"*Never ignore the elephant in the room*" – Donna Lynn Hope

The credit rating reviews of Pemex and Mexico remain a primary focus. The low growth expectation, weakening of Capex and the risk represented by Pemex's contingent liabilities are a threat for the sovereign rating. The 2021 budget presented by the government is very conservative and optimistic but in line with the austerity pledge of AMLO. However, economic effects of the pandemic will require more decisive actions by the government to stimulate the economy; unsurprisingly AMLO maintained and even increased the funding of the projects perceived by the market as 'white elephant' like the Dos Bocas refinery.

Regardless, this week the government finally released details about the new infrastructure program and public-private-partnerships which currently represents 1% of GDP and is expected to account for 22% of GDP by 2021. The announcement came after the Frente Nacional Anti-AMLO marched against the president with some new outlets reporting over 100k people asking the president to resign. The new infrastructure plan was presented during the president's morning meeting and in our view is the single most important plan presented by this president under a clear, fiscally disciplined, pro-growth agenda.

Despite this positive news, MXN will continue to be driven in the short term by the global risk sentiment and the US elections. But we expect MXN to outperform its peers and to trade now in the low/mid 21s with a skewed break to higher 20s.

6-12 Month Outlook – Infrastructuire plan full effect

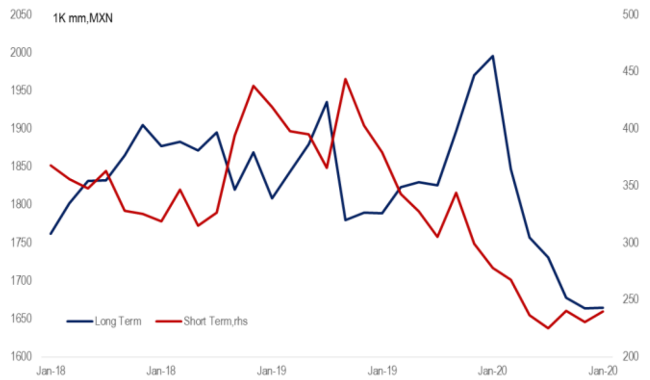
The hurdle for the Fed to normalize rates is now higher than ever and the overall USD weakness trade will continue to get tested vs EM as the dollar devalues further vs EUR and gold. However, the pain tolerance level for EM, especially for oil exporters, is much lower as the energy outlook remains challenging. We have mentioned before that Mexico's diverse economic activity could provide additional tail winds to MXN. Moving forward with a swift implementation of the infrastructure plan under a clear-business-friendly regulatory framework could provide an additional push to MXN as the infra-project proves to reactivate the economy. However, we expect MXN to trade in the [19.5 – 21] range and to outperform other EMs but the 12 month outlook remains highly uncertain.

Indicators

	Current (Previous)*
Official cash rate	**4.25**
Trend interest rates (10yr average)	**5.94**
Bias in interest rate market	Higher
Core PCE Inflation %Y/Y	**4.05**
Inflation target	3%
Budget balance % GDP	**-1.64**
Budget balance target % GDP	1
GDP Growth % y/y	-18.7
Trend GDP %y/y	lower
Purchasing Power Parity Value-Aug	**16.18**
Spot end-Sep	**21.115**
PPP Valuation	**USD/MXN is overvalued**
Current account balance % GDP	**-0.36**
Trend current acct balance % GDP	**-1.62**
Moody's Foreign Currency Rating	**Baa1**
Outlook	NEG

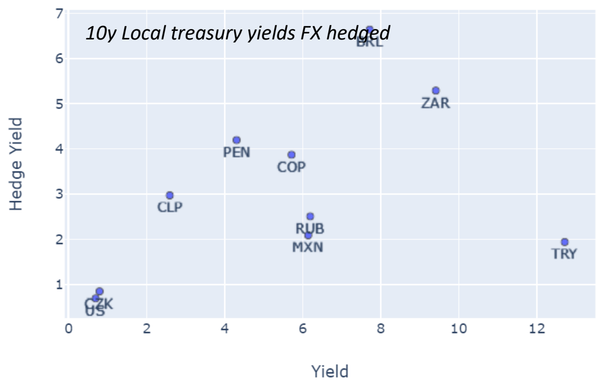
* Current is latest month, quarter or year

1. Foreign ownership of local debt by maturity profile



Source: RBC Capital Markets; Banxico

2. Mbonos not attractive risk reward



Source: RBC Capital Markets

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/MXN	23.67	22.99	22.11	21.60	20.00	19.50	19.36	19.70
EUR/MXN	26.11	25.83	25.92	25.92	24.00	23.40	22.84	22.86
MXN/JPY	4.54	4.69	4.77	4.49	4.85	5.08	5.22	5.23
CAD/MXN	16.83	16.94	16.60	16.12	14.81	14.44	14.44	14.81

Source: RBC Capital Markets estimates

Chilean Peso

Daniel Rico

1-3 Month Outlook – Referendum...

Just under two months have passed since the pension fund bill was approved, allowing pensioners to withdraw 10% of their retirement funds. As a result, over 15bn USD was drawn from the system. The government and central bank did a tremendous amount of work to contain the impact on the market by limiting the government dollar selling operation in July and providing corporate bonds repo operations. Similarly, in less than two months, local adviser FYF changed their multi-fund recommendation three times shifting from all-in local assets E to 70/30 A/E external vs local assets. Further, a combination of 1/ the weak external environment, 2/ PF portfolio reallocation and 3/ constitutional referendum uncertainty again pushed CLP close to the 800 level.

Our view remains quite bearish CLP in the long term and we believe that CLP will continue to trade in a volatile fashion. In the next 3 months, we continue to expect that CLP will trade around [775-800] with a higher risk of breaking the upper end of the range if the referendum creates additional social distress.

6-12 Month Outlook – Uncharted territory

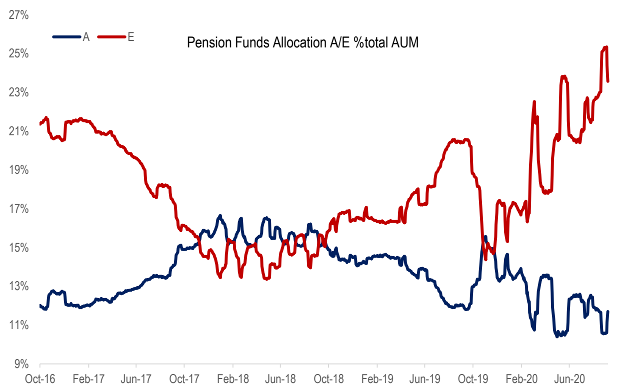
The outlook a year from now remains highly uncertain as we will be approaching a new presidential election with a very different balance of power in the midst of an economic recovery and fiscal tightening in 2021. This does not even account for a drafting of a new constitution and potentially a pension system reform. We continue to believe that the Central Bank must keep providing ample liquidity in order to maintain the orderly formation of prices, however the tolerance level to act will likely be much lower. Thus, given the balance of risk we expect the economic recovery to be highly dependent on the external backdrop and we expect CLP to trade in a [815-850] range and the CB will likely be forced to continue expanding the monetary base further.

Indicators

	Current (Previous)*
Official cash rate	**0.5**
Trend interest rates (10yr average)	**2.33**
Bias in interest rate market	stable
Core PCE Inflation %Y/Y	**2.4**
Inflation target	3%
Budget balance % GDP	**-2.83**
Budget balance target % GDP	
GDP Growth % y/y	-14.1
Trend GDP %y/y (10y average)	2 .0
Purchasing Power Parity Value-Aug	643.3
Spot end-Sep	**784.31**
PPP Valuation	**USD/CLP is overvalued**
Current account balance % GDP	**-3.86**
Trend current acct balance % GDP	**-2.3**
Moody's Foreign Currency Rating	**A1**
Outlook	NEG

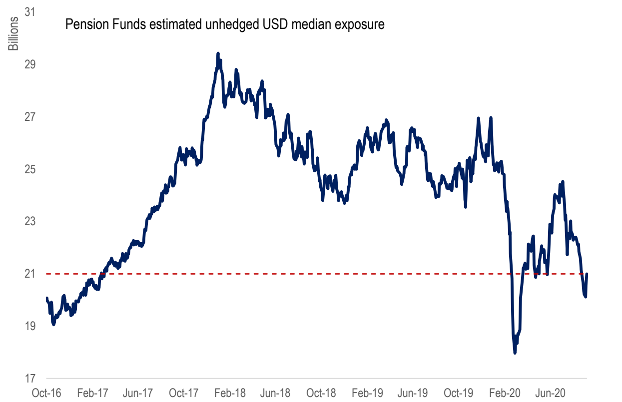
* Current is latest month, quarter or year

1. Pension Funds Long Local Treasuries



Source: RBC Capital Markets

2. Low dollar exposure by Pension Funds



Source: RBC Capital Markets

Forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CLP	856	823	786	800	820	850	800	775
EUR/CLP	944	924	921	960	984	1020	944	899
JPY/CLP	8.0	7.6	7.4	8.2	17.6	19.0	19.4	19.8
CAD/CLP	609	606	590	597	607	630	597	583

Source: RBC Capital Markets estimates

Forecasts

Spot forecasts

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.10	1.12	1.17	1.20	1.20	1.20	1.18	1.16
USD/JPY	108	108	105	97	97	99	101	103
GBP/USD	1.24	1.24	1.29	1.28	1.26	1.25	1.23	1.21
USD/CHF	0.96	0.95	0.92	0.88	0.88	0.88	0.91	0.93
USD/SEK	9.91	9.32	8.96	8.50	8.46	8.42	8.56	8.62
USD/NOK	10.40	9.63	9.33	8.67	8.71	8.67	8.81	8.97
USD/CAD	1.41	1.36	1.33	1.34	1.35	1.35	1.34	1.33
AUD/USD	0.61	0.69	0.72	0.70	0.69	0.69	0.69	0.69
NZD/USD	0.60	0.65	0.66	0.65	0.64	0.64	0.64	0.64
USD/CNY	7.08	7.07	6.79	6.60	6.60	6.50	6.50	6.40
USD/KRW	1219	1199	1165	1150	1130	1120	1120	1100
USD/INR	75.34	75.56	73.80	73.30	73.00	73.00	72.50	72.00
USD/TWD	30.26	29.56	29.02	28.80	28.60	28.50	28.40	27.90
USD/SGD	1.42	1.39	1.37	1.35	1.34	1.34	1.32	1.32
USD/MYR	4.32	4.28	4.16	4.15	4.10	4.07	4.02	4.00
USD/HKD	7.75	7.75	7.75	7.75	7.75	7.76	7.76	7.77
USD/TRY	6.62	6.85	7.72	8.00	8.10	8.10	8.10	8.10
USD/ZAR	17.84	17.35	16.75	17.30	17.50	17.90	17.90	17.90
USD/MXN	23.67	22.99	22.11	21.60	20.00	19.50	19.36	19.70
USD/BRL	5.21	5.47	5.61	5.80	5.50	5.20	5.20	5.20
USD/CLP	856	823	786	800	820	850	800	775

Source: RBC Capital Markets estimates

EUR Crosses

	2020				2021			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.10	1.12	1.17	1.20	1.20	1.20	1.18	1.16
EUR/JPY	119	121	124	116	116	119	119	119
EUR/GBP	0.89	0.91	0.91	0.94	0.95	0.96	0.96	0.96
EUR/CHF	1.06	1.06	1.08	1.06	1.06	1.06	1.07	1.08
EUR/SEK	10.93	10.47	10.50	10.20	10.15	10.10	10.10	10.00
EUR/NOK	11.48	10.81	10.94	10.40	10.45	10.40	10.40	10.40
EUR/CAD	1.55	1.53	1.56	1.61	1.62	1.62	1.58	1.54
EUR/AUD	1.80	1.63	1.64	1.71	1.74	1.74	1.71	1.68
EUR/NZD	1.85	1.74	1.77	1.85	1.88	1.88	1.84	1.81
EUR/CNY	7.81	7.94	7.96	7.92	7.92	7.80	7.67	7.42
EUR/KRW	1345	1347	1365	1380	1356	1344	1322	1276
EUR/INR	83.10	84.89	86.50	87.96	87.60	87.60	85.55	83.52
EUR/TWD	33.37	33.21	34.01	34.56	34.32	34.20	33.51	32.36
EUR/SGD	1.57	1.57	1.60	1.62	1.61	1.61	1.56	1.53
EUR/MYR	4.76	4.81	4.87	4.98	4.92	4.88	4.74	4.64
EUR/HKD	8.55	8.71	9.08	9.30	9.30	9.31	9.16	9.01
EUR/TRY	7.30	7.70	9.04	9.60	9.72	9.72	9.56	9.40
EUR/ZAR	19.68	19.49	19.63	20.76	21.00	21.48	21.12	20.76
EUR/MXN	26.11	25.83	25.92	25.92	24.00	23.40	22.84	22.86
EUR/BRL	5.74	6.14	6.58	6.96	6.60	6.24	6.14	6.03
EUR/CLP	944	924	921	960	984	1020	944	899

Source: RBC Capital Markets estimates

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