FX Themes and Trades
Monthly Outlook
August 28, 2020

Economics
FICC Strategy

Currencies Moving While Central Banks On Hold

Currency	What's Changed
USD	The trend is still for greenback weakening, but it's not a straight line from here.
CAD	The loonie looks rangebound near term; room to weaken in long-run when USD levels off globally.
EUR	A build-up of net euro longs might slow the pace of further euro gains in the months ahead.
GBP	Sterling to be challenged until a deal between the UK and EU is reached.
JPY	Narrower spreads continue to be a positive for the yen.
Commodity FX	There is some indication of a topping out in both AUD and NZD. NZD is underperforming AUD on the back of a dovish tilt from the RBNZ, with the bank preparing the market for negative rates.
FX Asia	The pace of Chinese activity appears to have softened slightly at the start of Q3. We anticipate some consolidation for USD/China in the near-term, but ultimately new lows in the months ahead.

Currency Outlook

End of Period:	Aug. 27/20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21	Q2 22	Q4 22
USD/CAD	1.31	1.30	1.32	1.33	1.34	1.36	1.40	1.39
EUR/USD	1.18	1.17	1.17	1.18	1.19	1.20	1.20	1.20
USD/JPY	107	103	101	100	100	99	99	99
GBP/USD	1.32	1.30	1.30	1.31	1.31	1.32	1.32	1.33
USD/CHF	0.91	0.92	0.92	0.92	0.91	0.91	0.90	0.89
USD/SEK	8.72	8.79	8.75	8.55	8.46	8.31	8.18	8.02
AUD/USD	0.73	0.71	0.72	0.74	0.74	0.75	0.76	0.77
NZD/USD	0.66	0.62	0.63	0.65	0.66	0.66	0.67	0.69
USD/NOK	8.90	9.05	8.97	8.80	8.68	8.43	8.22	7.97
USD/ZAR	17.03	17.00	16.75	16.50	16.25	16.15	15.90	15.50
USD/BRL	5.57	5.10	5.00	5.20	5.00	4.80	4.80	4.50
USD/MXN	22.1	22.0	21.0	20.5	20.5	20.0	19.5	19.0
USD/COP	3816	3800	3700	3600	3500	3500	3350	3200
USD/CLP	785	820	820	800	780	800	750	720
USD/CNY	6.89	6.88	6.83	6.80	6.75	6.70	6.50	6.30
USD/KRW	1185	1180	1180	1175	1170	1165	1145	1125
USD/INR	73.8	74.5	74.0	73.5	72.5	71.0	69.0	67.0
USD/SGD	1.37	1.37	1.37	1.36	1.36	1.35	1.35	1.33
USD/TWD	29.4	29.3	29.1	29.0	28.7	28.5	28.1	27.7
USD/MYR	4.17	4.15	4.10	4.05	3.95	3.85	3.65	3.45
USD/IDR	14660	14400	14250	14050	13950	13800	13600	13400

Other Crosses

End of Period:	Aug. 27/20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21	Q2 22	Q4 22
CADJPY	81.3	79.2	76.5	75.2	74.6	72.8	70.7	71.2
AUDCAD	0.95	0.92	0.95	0.98	0.99	1.02	1.06	1.07
GBPCAD	1.73	1.69	1.72	1.74	1.76	1.80	1.85	1.85
EURCAD	1.55	1.52	1.54	1.57	1.59	1.63	1.68	1.67
EURJPY	126	121	118	118	119	119	119	119
EURGBP	0.90	0.90	0.90	0.90	0.91	0.91	0.91	0.90
EURCHF	1.07	1.08	1.08	1.09	1.08	1.09	1.08	1.07
EURSEK	10.31	10.28	10.24	10.09	10.07	9.97	9.82	9.62
EURNOK	10.52	10.59	10.49	10.38	10.33	10.12	9.86	9.56

Key Indicators- Latest Data Point

	Quarterly Real GDP (y/y %)	CPI (y/y %)	Current Acct (% of GDP)	Central Bank Rate (%)
US	-9.5	1.0	-1.9	0.125
Canada	-0.9	0.2	-1.9	0.250
Eurozone	-15.0	0.4	2.3	0.000
Japan	-9.9	0.3	3.1	-0.100
UK	-21.7	1.0	-3.3	0.100
Switzerland	-1.5	-0.9	11.2	-0.750
Sweden	0.4	0.5	3.9	0.000
Australia	1.4	-0.3	1.1	0.250
New Zealand	-0.2	1.5	-3.1	0.250
Norway	1.1	1.3	4.1	0.000
South Africa	-0.1	2.2	1.3	3.500
Brazil	-0.3	2.1	-2.7	2.250
Mexico	-1.4	3.3	-0.3	5.000
Colombia	1.1	2.2	-4.2	2.500
Chile	0.4	2.6	-3.9	0.500
China	3.2	2.5	0.6	3.850
South Korea	1.3	-0.3	3.8	0.500
India	3.1	6.7	-0.9	3.754
Singapore	-13.2	-0.5	16.6	n/a
Taiwan	1.6	-1.2	10.7	1.125
Malaysia	0.7	-2.9	2.8	1.750
Indonesia	3.0	2.2	-2.5	4.000

CAD

Katherine Judge | Avery Shenfeld

Loonie Rangebound at Stronger Levels

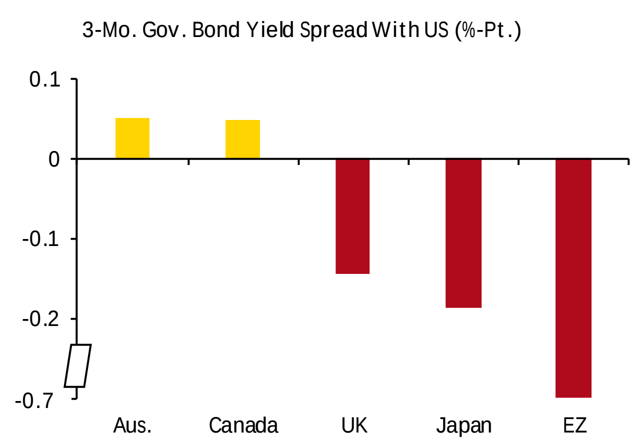
Q4 2020: 1.30 | Q1 2021: 1.32 (USDCAD)

The loonie has been carried stronger than we expected in the past month by general USD weakness, alongside a positive spread in short rates. Oil prices, a traditional loonie driver, have moderated in recent weeks upon a resurgence of the virus in many countries, putting the demand outlook in jeopardy. It appears that the negatives for CAD, including a wide current account deficit and soft oil prices relative to prior to 2015, will largely be overlooked until the trend to a weaker USD has run its course. The current account deficit will get a temporary benefit from a narrowing in the travel deficit due to frozen cross-border tourism.

With central bank target rates globally largely expected to stay at current levels through next year, currencies could become more sensitive to small moves in short rates. On this front, the BoC is increasingly focused on purchasing longer-duration assets as shorter-term ones mature, amplifying the already modest positive short-rate spread for CAD (Chart 1).

The weakness in Canada's trade fundamentals should only come to the forefront in the latter part of 2021, when the run against the USD might have run its course. The Bank of Canada could end up slightly lagging the Fed on rate hikes with an eye of undoing some loonie strength and allowing exports to take a larger share of growth, thereby reducing the dependence on debt-driven housing or consumption. We see USDCAD ending 2021 at 1.36 as a result.

Chart 1: CAD Benefitting From Modest Short-Rate Spread



Source: Bloomberg, CIBC

USD

Avery Shenfeld | Katherine Judge

Only a Pause

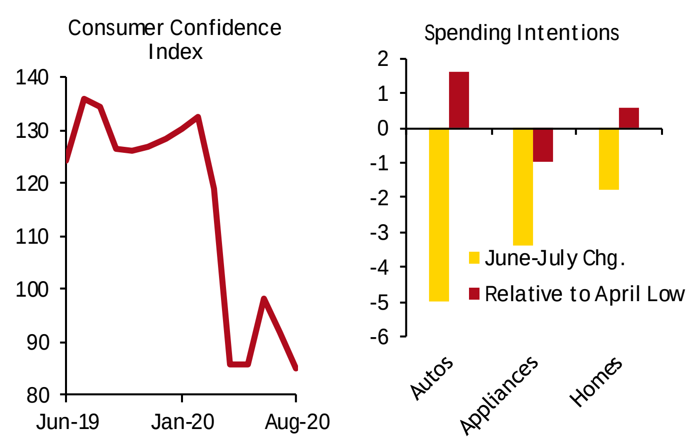
Q4 2020: 93.28 | Q1 2021: 93.14 (DXY)

We've been bearish on the USD against overseas majors, and while a lot of the available ground is now behind us, there's still room for a further adjustment in the quarters ahead. Concerns over a restoking of the virus haven't been enough to trigger a flight-to-safety run that favours the greenback over other majors, just as equity markets haven't wavered in looking beyond the current situation towards a further recovery ahead.

US data has been mixed, with some concerning signals from consumer confidence (Chart 2) and loss of momentum towards lower jobless claims, but pleasant surprises on housing and durable orders. Somewhat weaker monthly growth in the near term could help the dollar hold ground in the very near term if it increases risk aversion temporarily, particularly against European majors where heavy existing euro longs and Brexit uncertainties might weigh.

But more broadly, we still see room to extend some USD weakness in 2021. This is, after all, a correction for a currency that was overvalued on trade fundamentals vs. Europe and Asia, and which no longer has the support it once had from a divergent central bank policy.

Chart 2: Consumers Remain Cautious (L), But Spending Intentions Mixed Relative to Height of Lockdowns (R)



Source: Conference Board, Bloomberg, CIBC

EUR

Bipan Rai

EUR Poised for Medium-Term Momentum

Q4 2020: 1.17 | Q1 2021: 1.17 (EURUSD)

After a few years of consolidation and decline, the EUR has emerged as an outperformer over the past few months. Of course, this hasn't exactly been due to an impressive fundamental backdrop, as EU economies continue to grapple with the effects of COVID-19. Rather, the EUR has outperformed because of actions taken at the policy level to address concerns such as the risk of fragmentation.

The agreement between EU leaders on the upcoming seven-year budget and recovery fund has provided lots of goodwill to the EUR. This has helped to offset years of disagreements and resistance to the notion of fiscal transfers, sending a strong signal to markets that the Union will work together to fight a common shock. The added benefit of a more involved fiscal process, is that it relieves a large part of the burden of stimulating the European economy from the ECB. Indeed, there is now chatter, albeit premature, that the Bank may not need to fully utilize the entire envelope of its Pandemic Emergency Purchase Programme (PEPP).

Going forward, we expect the EUR to perform as fragmentation risk is mitigated and weakness in the USD continues. However, we're going to have to wait until a period of correction/consolidation is over first, given that markets are too far skewed towards net EUR longs.

JPY

Bipan Rai

Yen Benefitting From Narrower Spreads, Weaker USD

Q4 2020: 103 | Q1 2021: 101 (USDJPY)

The yen continues to perform even in the midst of a market recovery. Indeed, a good chunk of the JPY's move higher can be attributed to narrowing short-and-long rate spreads against UST. This is supported by weekly MoF data indicating that the pace of outward foreign investment flows is still much less than it was before the crisis hit earlier this year.

For the real economy, the hope right now is that the Chinese economy will continue to recover, helping Japanese exports and easing pressure to do more on the fiscal front. Authorities have highlighted that government finances are in a tough spot and that it's unlikely that the sales tax will be cut. The BoJ remains on autopilot, but are ready to act if yields drift higher. The JPY should continue to take its cue from a weaker USD plus narrowing spreads for now.

GBP

Bipan Rai

Sterling Challenges Compounded by Brexit and Pandemic

Q4 2020: 1.30 | Q1 2021: 1.30 (GBPUSD)

UK data has outperformed and has driven the economic surprise index higher since July. Of course, this is the result of low market expectations rather than real outperformance, as the UK has lagged most G10 counterparts during the pandemic. In fact, Q2 GDP shrank 20.4%, the largest economic contraction in major European economies (the next was Spain, at 18.5%). We believe that expectations will remain low moving forward, as the UK economy will face headwinds beyond those expected from Brexit uncertainty.

The most recent jobs report shows that employment has dropped to levels not seen since the financial crisis. Survey data suggests that expectations of job cuts are discouraging discretionary spending, which in turn is impacting business decisions. With the government furlough scheme ending in October, we expect a slowdown in growth as we head into Q4, unless an extension is announced.

Weakness in domestic fundamentals will be made worse by Brexit risks, especially as we approach the end of the transition period. The EU and the UK have concluded the seventh round of negotiations this month with little progress on the usual sticking points: fishing, competition, and enforcement. The next round of talks will begin on September 7, though unless concessions can be made, progress will be limited. We do not expect to see GBP strength until a deal is agreed upon, as our base case is still for some form of skinny trade agreement in Q4.

CHF

Bipan Rai

CHF Resilient Given a Floundering USD

Q4 2020: 1.08 | Q1 2021: 1.08 (EURCHF)

Realized volatility in the Swiss Franc has been much higher than many may have originally envisaged. As such, the currency has moved towards our forecasted calls much quicker than expected. The reason for this move is not surprising– it's the pass through from a weak trade-weighted USD.

What is surprising, however, is that the CHF's beta to market moves is as high as it's been. Traditionally, the CHF is seen as a safe haven currency. For the SNB, it's the EUR/CHF cross that matters and we've seen evidence that intervention is picking up of late. That remains the bank's first option in terms of tools, with the risk of another rate cut still left if that fails. Against the USD, we're modifying the profile to reflect a slightly firmer CHF given that we're expecting some more downside to the trade-weighted USD over time.

SEK

Bipan Rai

SEK Steady As She Goes Through Year-End
Q4 2020: 10.28 | Q1 2021: 10.24 (EURSEK)

EUR/SEK has stabilized in the 10.20-10.37 range since mid-July, after falling around 8% since March. We believe that EUR/SEK can trade within the current range over the coming months as macroeconomic shocks have normalized over the summer, and ample monetary stimulus will dampen volatility on highly correlated pairs such as EUR/USD and SEK/USD moving forward.

Although Sweden did not impose major lockdown restrictions like most developed markets, the economy was impacted by contagion effects. Q2 GDP is forecasted to fall -8.6% vs. -12.1% in the Eurozone. We suspect that this was caused by reduced household consumption for certain services such as travel, and weaker export demand. To mitigate the impact of the virus, the Riksbank expanded its QE to SEK500bln, and will start to purchase corporate bonds in September. This should not impact the move in EUR/SEK, given that monetary policy has converged around the world.

Commodity FX

NOK

Bipan Rai

NOK Driven By Oil Price Moves
Q4 2020: 10.59 | Q1 2021: 10.49 (EURNOK)

USD/NOK has fallen over 20% since March highs, and roughly 8% since the start of July. NOK strength was driven by many factors: weakness on the USD leg, EUR optimism, and firmer oil prices. During its August meeting, the Norges Bank affirmed that activity has picked up over the summer, even though it is still a long way from pre-Covid levels. Rising oil revenues will support the domestic economy moving forward. While rates will remain low for an extended period of time, the Norges Bank remains the only G7 bank hinting at any kind of monetary normalization. A gradual rise in the policy rate is scheduled to start in Q4 2022.

We remain optimistic on the NOK both relative to the USD and the EUR for the rest of the year, but we prefer to sell USD/NOK and EUR/NOK at better levels. Should we see oil prices rise faster than expected, we will upgrade our targets for the NOK.

AUD

Patrick Bennett

AUD: Pace of Gains Slowing
Q4 2020: 0.71 | Q1 2021: 0.72 (AUDUSD)

AUD has gained around 1% against the USD over the last month, the only poorer performed G10 currency in the period has been the NZD (-1.6%). Gains ytd are a moderate 2.5%, and have been driven by a combination of upbeat messaging from the RBA, ongoing demand for Australian bonds by Japanese investors, broad global risk appetite underpinned by policy support, and a related weaker USD environment.

A shift in preference for geographical denomination of foreign bonds purchased by Japanese investors has been noticeable over recent months, with strong buying of Australian holdings featuring. The yield achievable for Japanese investors in Australian bonds has topped that available elsewhere, helping to underpin the market in both bonds and the currency.

This shift was associated with a strong rebound in the AUD against the JPY, but that trend now looks to be topping out. The highs around 76.50-77.00 recorded in early-June and again in late-July are anticipated to mark the top of the near-term range. We forecast AUD/JPY shifting toward 74.00 by end-4Q and recommend shorts with stops above 77.00.

The flare up in Covid-19 cases in the state of Victoria appears to be being brought under control, though the impact is still not fully felt. Tensions between China and Australia are again feeding into a cautionary undertone for the economy and the currency. A complaint over dumping of wine in the Chinese market is the latest flash point.

NZD

Patrick Bennett

NZD Softens on Dovish RBNZ
Q4 2020: 0.62 | Q1 2021: 0.63 (NZDUSD)

The NZD shows as the weakest G10 currency over the last month, losing 1.6% against the USD. The weakness has been a direct response to overtly dovish signalling from the RBNZ.

Not for the first time, the New Zealand central bank (RBNZ) has shown a willingness to pursue an aggressive and at times innovative mix of policy in order to meet its goals. The bank upped the ante on easing at its latest meeting, indicating that 'negative rates remain in active preparation and that purchases of foreign assets remain an option'. Purchasing foreign assets would be akin to intervention.

Following the policy meeting the bank also announced an expansion of the Large Scale Asset Purchase (LSAP) program to $100bln from $60bln. To-date purchases have been around $25bln, thus the increase is substantial. The overarching theme from the bank was encompassed by comment from Governor Orr who said the bank wants to 'actively get bond yields lower'.

NZD/USD caught the updraft from USD selling and general positive risk appetite founded on global policy stimulus from March through June, though has now eased as the currency responds to the RBNZ message. We are forecasting a sideways to lower NZD against a still softer USD and look for downside in NZD/JPY, initially targeting 68.10, and also anticipate further gains in AUD/NZD, targeting 1.1400. Against AUD, moves have been driven very clearly by a shift in yields and expectations thereof. As the RBNZ prepares the market for negative cash rates in 2021, we expect bond yields and swaps tracking toward and eventually below zero.

Asia FX

CNY

Patrick Bennett

CNY CNH: Consolidation, then gains

Q4 2020: 6.88 | Q1 2021: 6.83 (USDCNY)

The yuan has posted gains against the USD and also edged off lows on trade-weighted measures over recent weeks. We credit the moves to a combination of a faster recovery in the domestic economy than in other major peers, investor demand for Chinese assets, and the influence of an overall weaker USD.

China's economic recovery out of the Covid-19 shutdowns has been relatively swift, though data readings on July activity do give some reason to reassess. Industrial production was the pick of the results, expanding 4.8% y/y in the month, retail sales were soft at -1.1% y/y, and new loans for the month fell well-short of expectations. The challenge for China, as in other economies, appears to be that production is being sustained in small or large part by official support, while consumer activity is lagging. The overall data picture is certainly cause for caution, though not sufficient to reverse USD/China downside unless the spread between China's economic performance and other major economies results narrows significantly.

Increased foreign participation in Chinese domestic markets is notable and introduces two-way market risks, but also adds depth. China yields are tracking well-above those in the US and provide a buffer or risk premium. Equity valuations can also encourage foreign portfolio inflow. The Shanghai Composite P/E is cheaper than other major indices at around 17 vs 26 for the S&P, 23 for the ASX and 37 for the Nikkei. Unless those relationships change dramatically, we expect negative impacts on the currency to be quelled.

In regard of the tensions between the US and China, they have been building for some time and will surely remain prominent in the run into, and likely beyond, the US elections in November.

The initial front-line was over trade, though trade tariffs were merely the front-end to deep-set efforts to rein in China's failure to act fairly over issues including theft of intellectual property and technology transfer. Tariffs imposed remain in place and China is increasing purchases of US agricultural products – even if running short of interpolated targets.

Wider and more concerning tensions – which are more difficult to quantify, include the targeting of Chinese businesses by the US under the guise of national security and the response from the US and others to China's administration of Hong Kong.

The US administration has heightened pressure and placed outright sanctions and restrictions on Chinese technology companies. Targeting those companies meshes with an ongoing response to China's ambitions set-out in the 'Made in China 2025' vision that was announced in 2015. The agenda has been a clear touch point for the current US leadership and administration. China 2025 included targets to achieve 70% self-sufficiency in high-tech industries by the same year, and by 2049 (the 100 year anniversary of the People's Republic of China) achieve a dominant position in global markets. Not much has been heard of China 2025 of late, though we doubt it has been scrapped. Watch this space.

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