

29 November 2020

Softer USD

The virus and incomplete recovery

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Core issues for outlook

- The path of the virus
- But also the market reaction to the virus
- The vaccine for next year, the virus for now

US Election

- Divided government?
- For FX and Rates: Fed policy
- Trade and China policy
- Muddled result

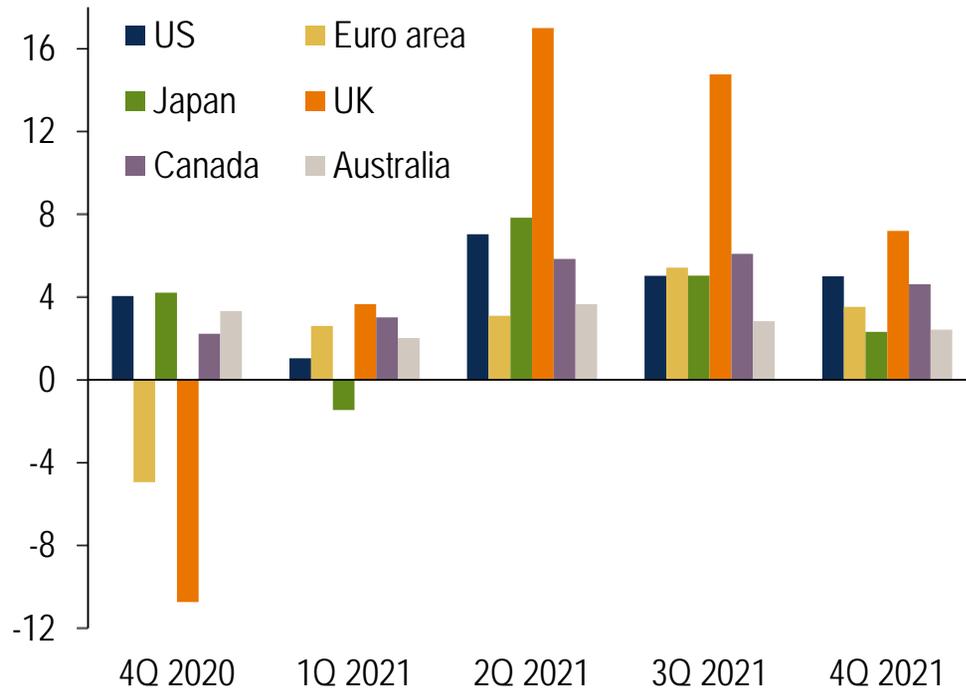
Core forecasts

- US GDP: 2020, -3.5%; 2021: 4.5% (Incomplete recovery)
- FX: EUR-USD end-2021, 1.25; USD-CNY end-2021, 6.30
- Rates: Fed on hold; US 10yr end-2021, 1.50%

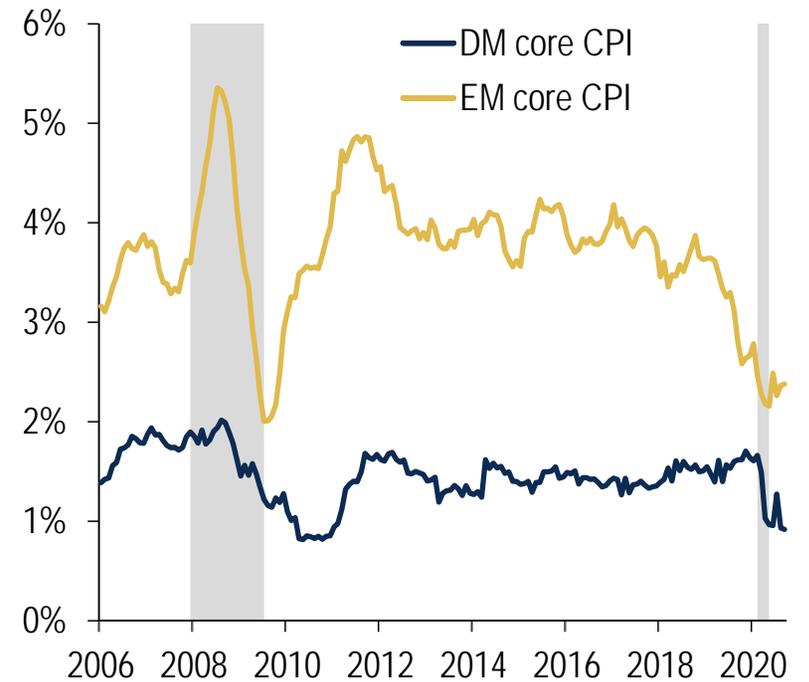
Global macro picture



G6 quarterly GDP growth forecasts
(%qoq saar)



The pandemic caused a large drop in inflation in DM and EM

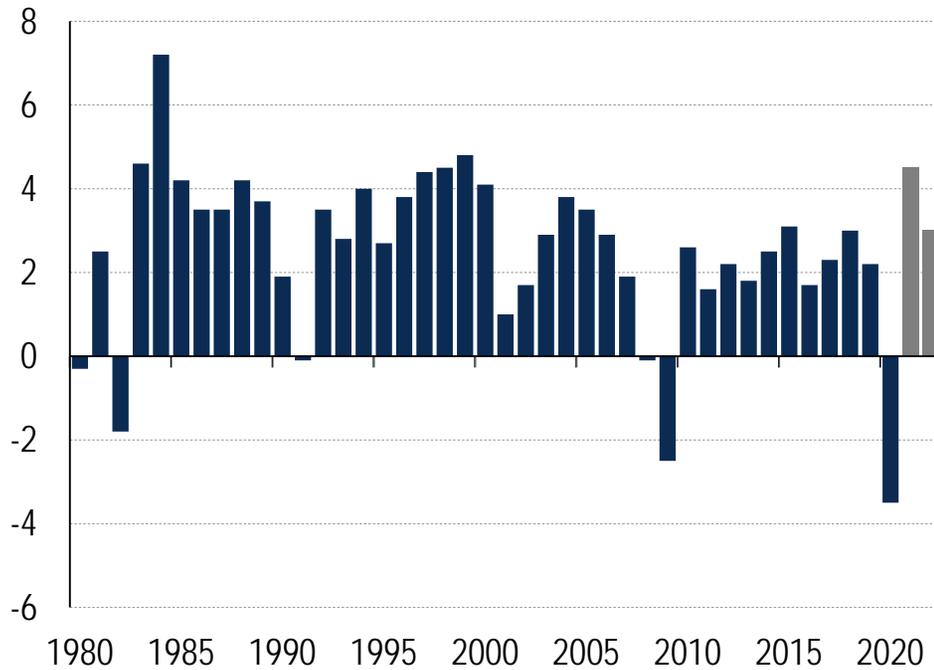


Source: Bloomberg, Haver Analytics, and BofA Global Research

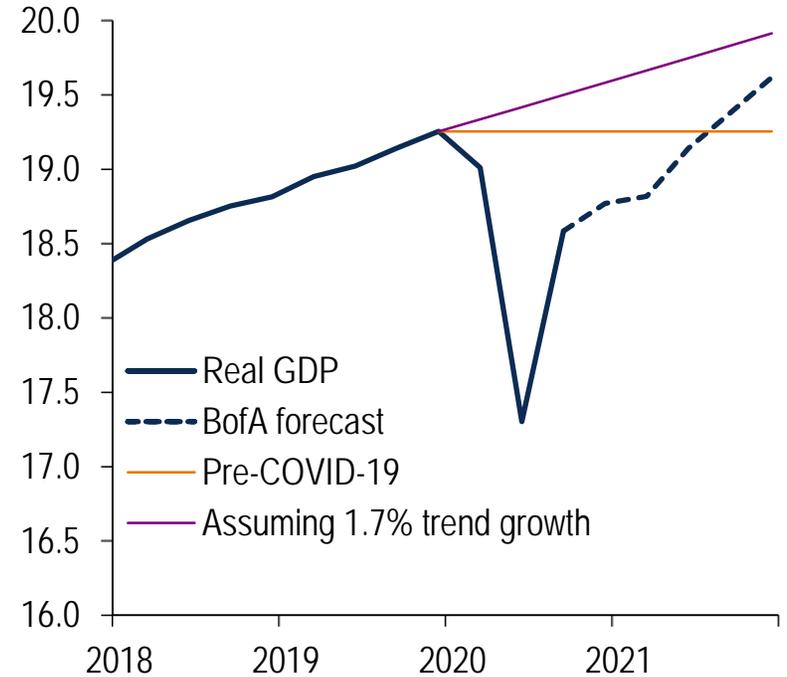
US Growth: slower recovery



Annual growth forecasts



Real GDP likely returns to pre-COVID-19 levels by 3Q 2021 (\$tr)



- US average growth since 2000: around 2%

Source: Bloomberg and BofA Global Research estimates

Fed outlook: on hold for foreseeable future



- Fed focus is flexible average inflation target (FAIT)
 - Market pricing first rate in '24, shorter period vs after financial crisis
 - Market tends to overestimate timing of Fed hikes when rates low

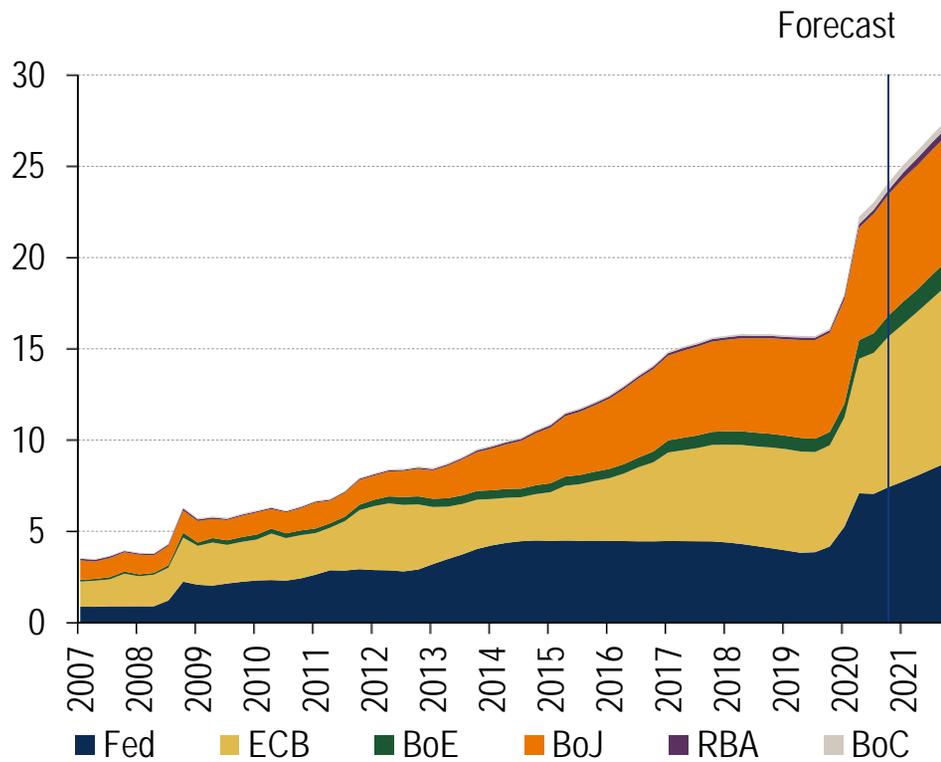


Source: BofA Global Research, Bloomberg

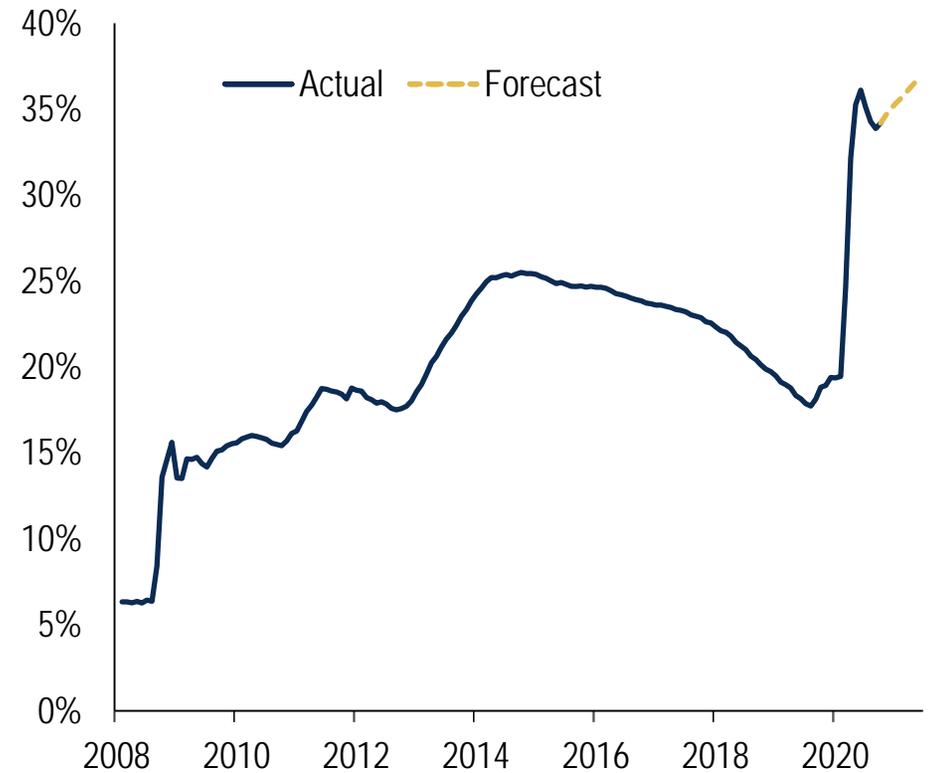


Monetary policy: US and around the world

G6 balance sheet (tr)



Fed balance sheet as % of GDP



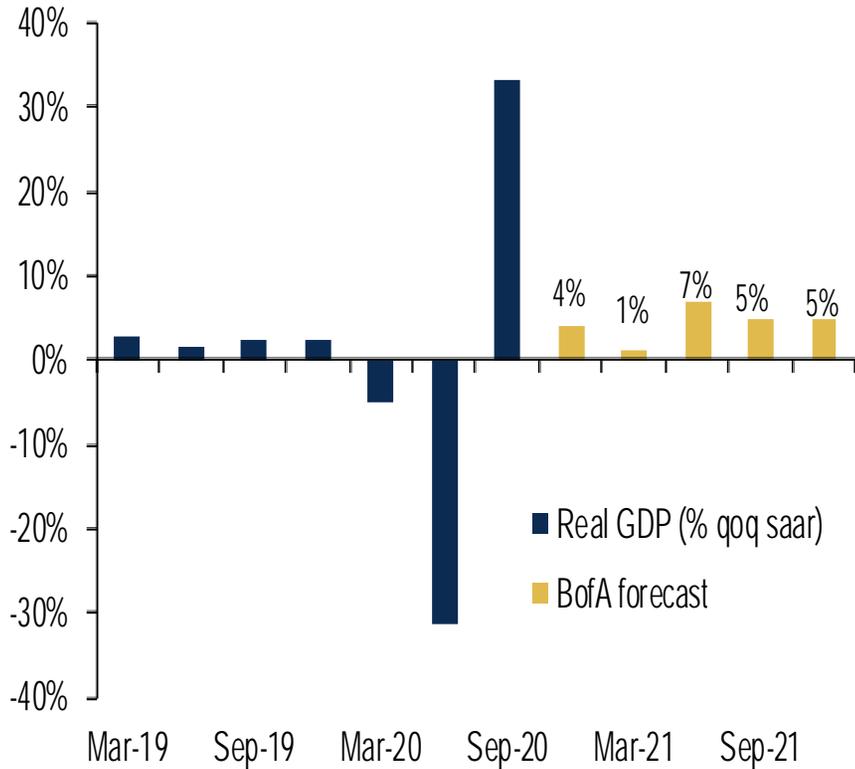
- US GDP is around ~\$19-20 tr

Source: Bloomberg and BofA Global Research estimates

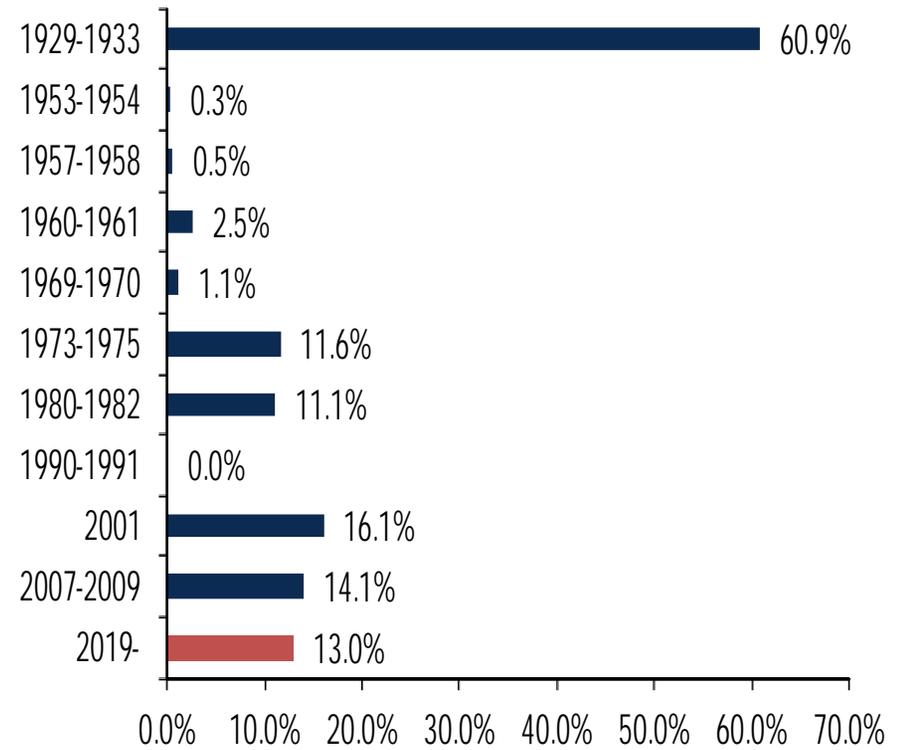


US near-term growth: bumpy

US quarterly GDP outlook



Previous US fiscal stimulus

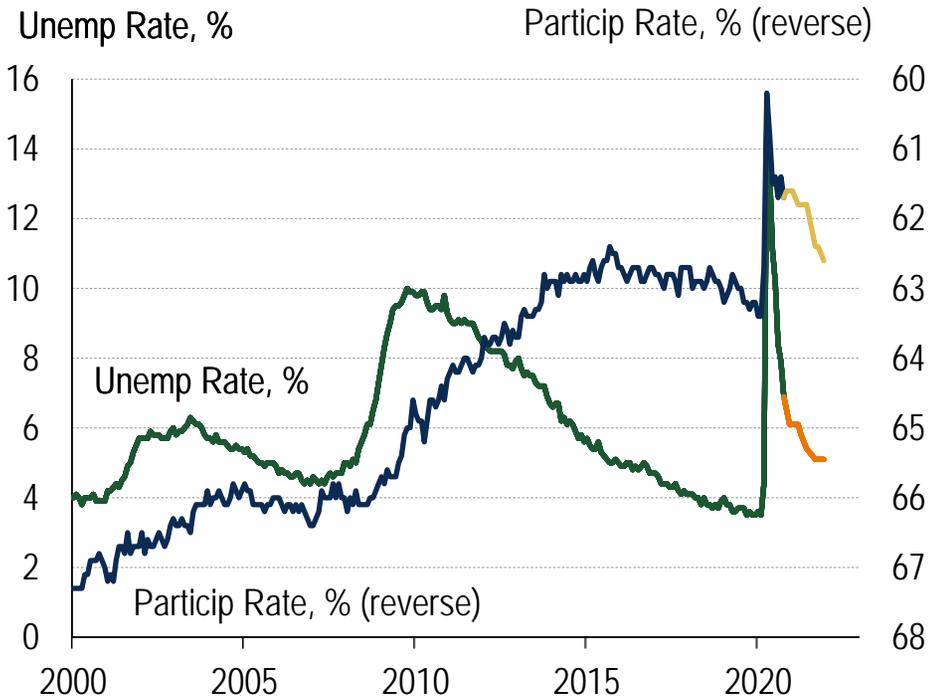


Source: Bloomberg, BofA Global Research, Federal Reserve Board of Governors; US Treasury, CBO, Joint Committee on Taxation, Templaski (2013), Fishback (2016)

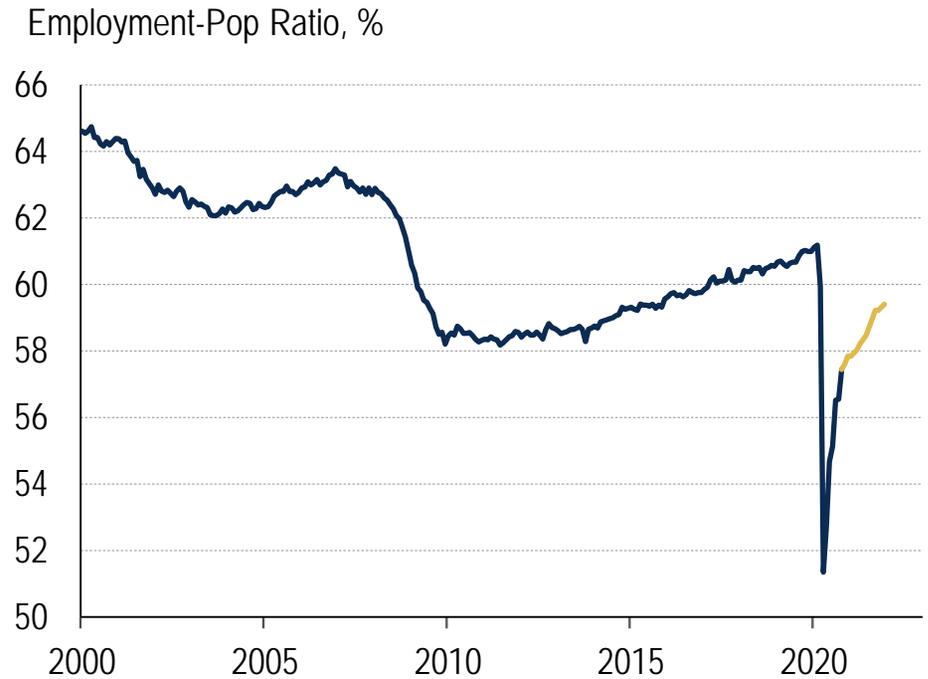
US labor market: long way to go



US unemployment and labor force participation rate



Employment-Population Ratio



- Unemployment Rate (UR) % of labor force (i.e. $1-UR$ is “employment rate”)
- Labor Force Participation (LFP) is % of adult population
- Employment-Population (EP) Ratio is simply $LFP \cdot (1-UR)$

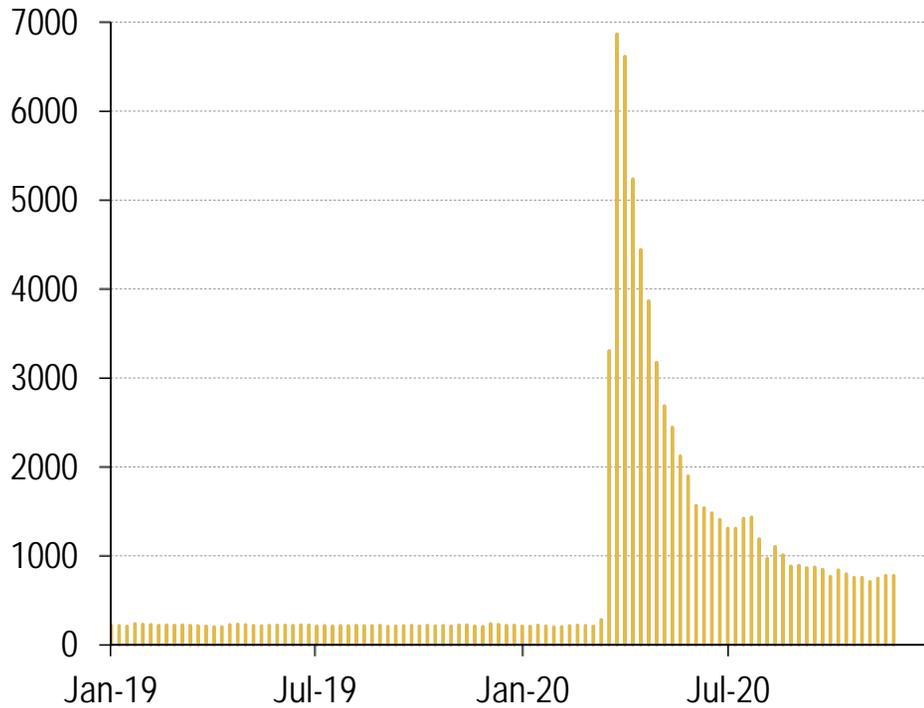
Note: Yellow and orange line represents BofA Global Research forecasts

Source: Bloomberg and BofA Global Research estimates

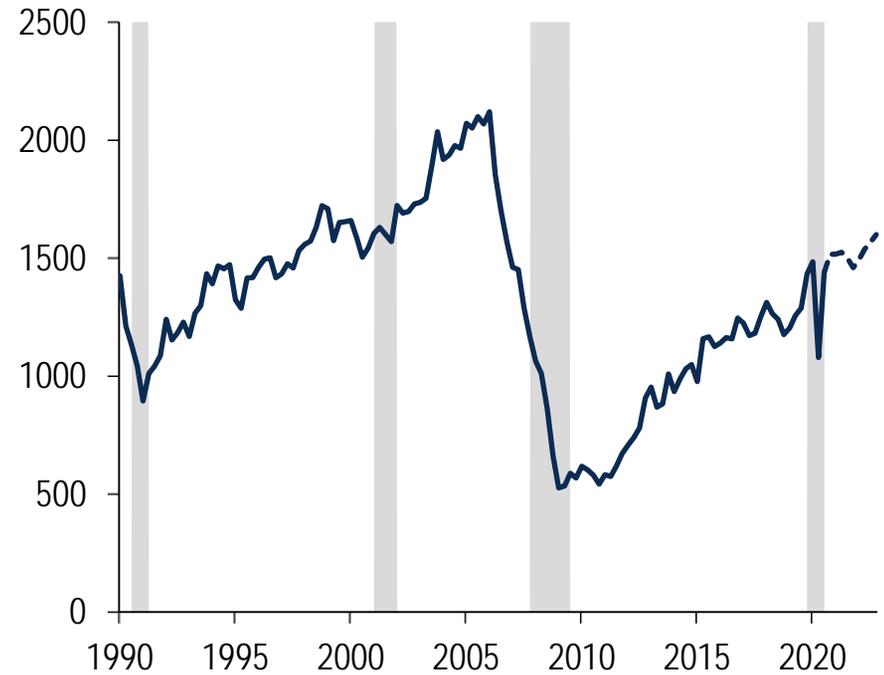
US: labor and housing



Initial jobless claims



Housing starts (000 saar, dotted line is BofA forecast)

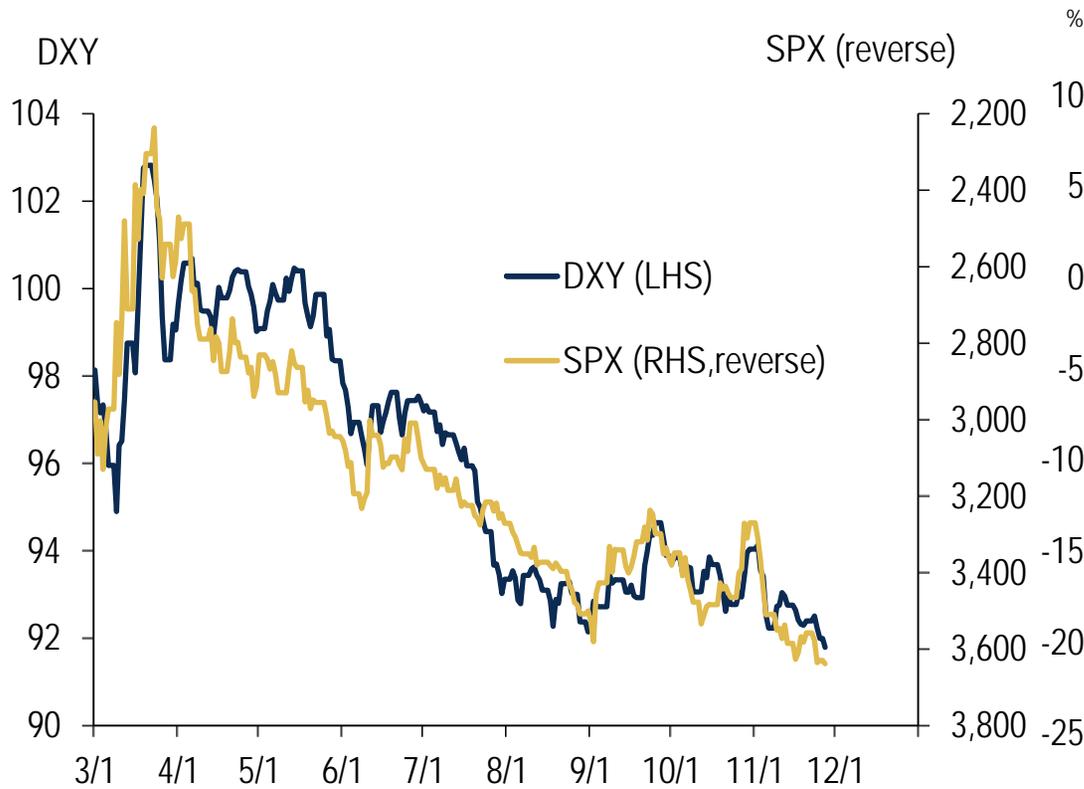


Source: Bloomberg and BofA Global Research estimates

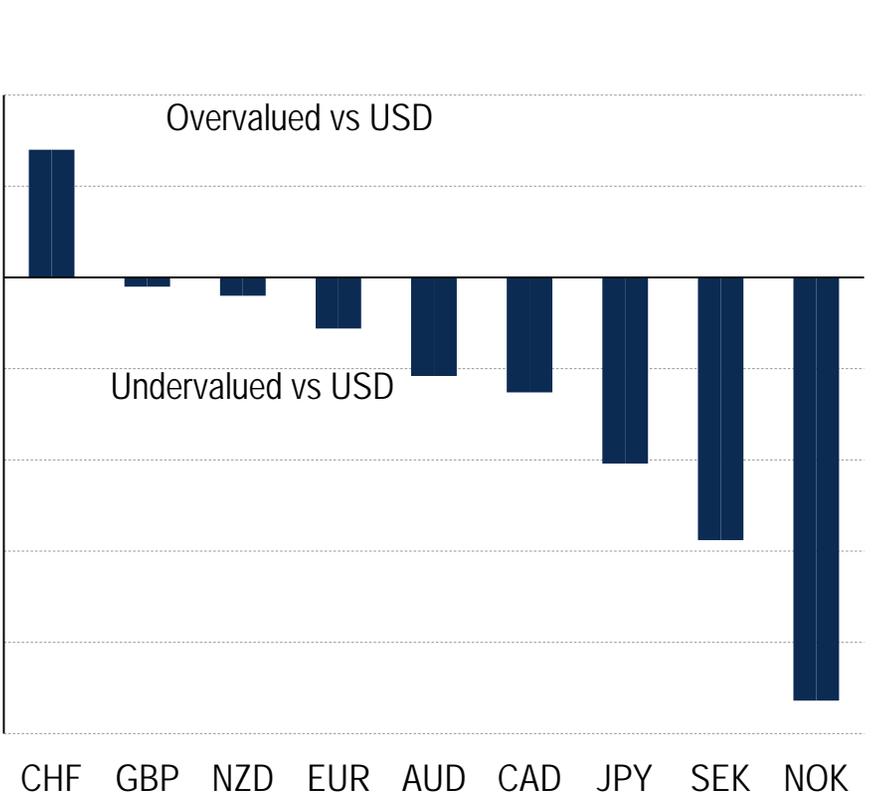
FX: USD on the weaker side



Risk sentiment: driving the market



FX valuation in G10:
undervalued against USD



Source: Bloomberg and BofA Global Research estimates

USD: longer-term perspectives

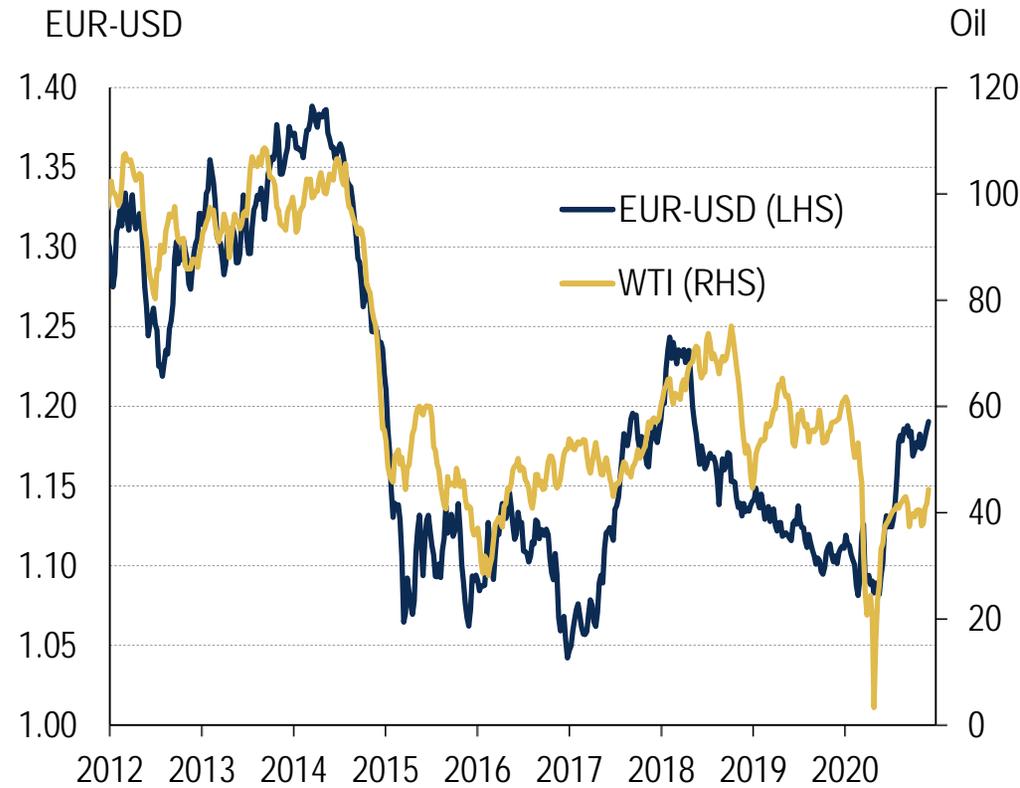


USD nominal trade-weighted dollar index against major currencies (mostly EUR, CAD, JPY)

Index: Jan 2006 = 100



EUR and oil since 2012

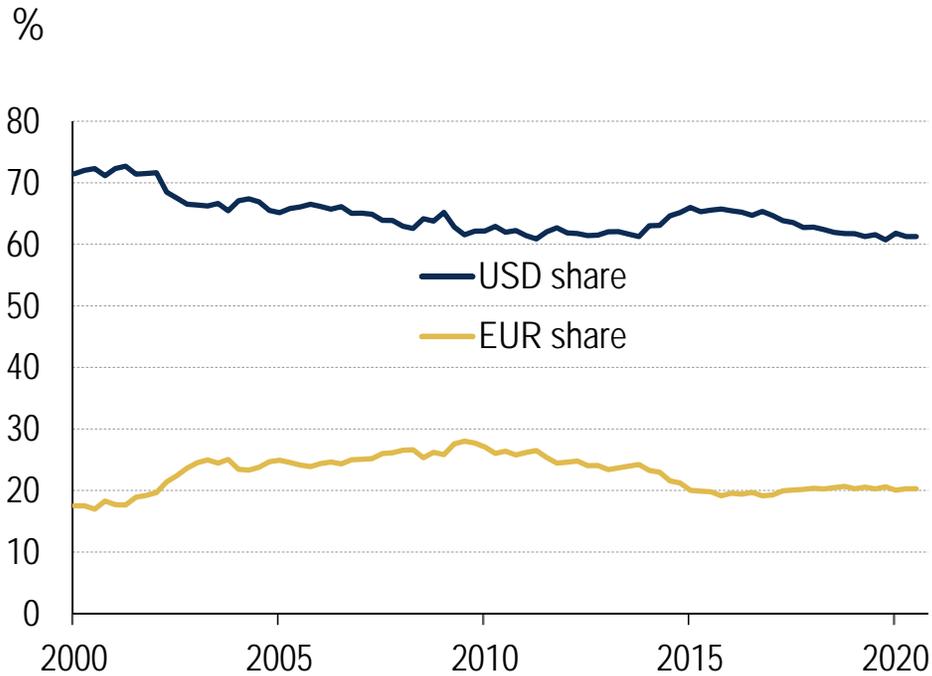


Source: Board of Governors of the Federal Reserve System, Bloomberg and BofA Global Research

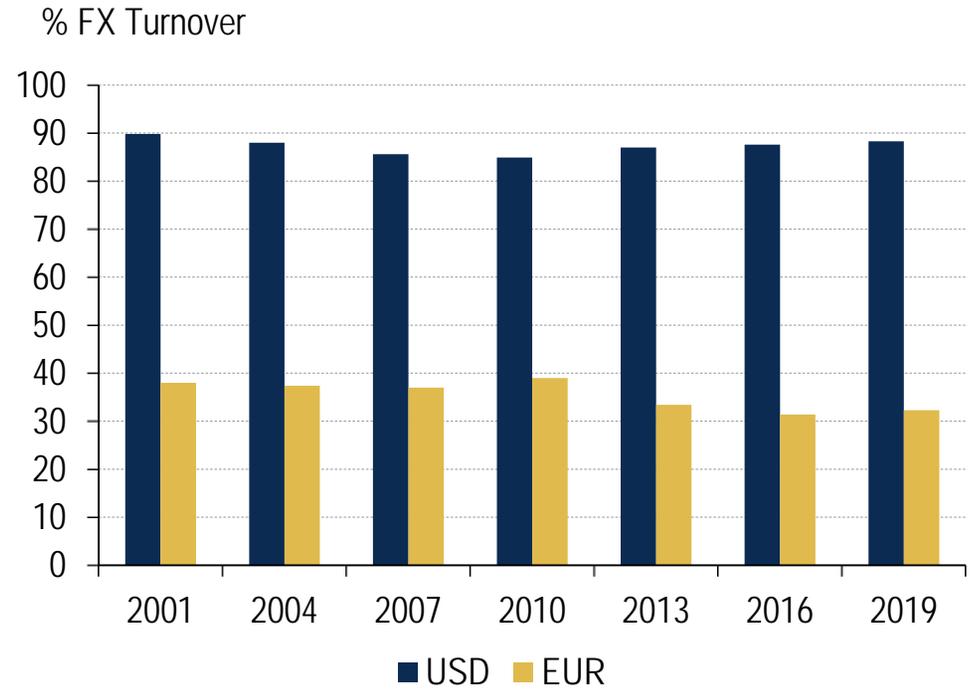


USD: still far too soon for debasement talk

Currency share of FX reserves



USD and EUR usage in FX turnover (% add up to 200)

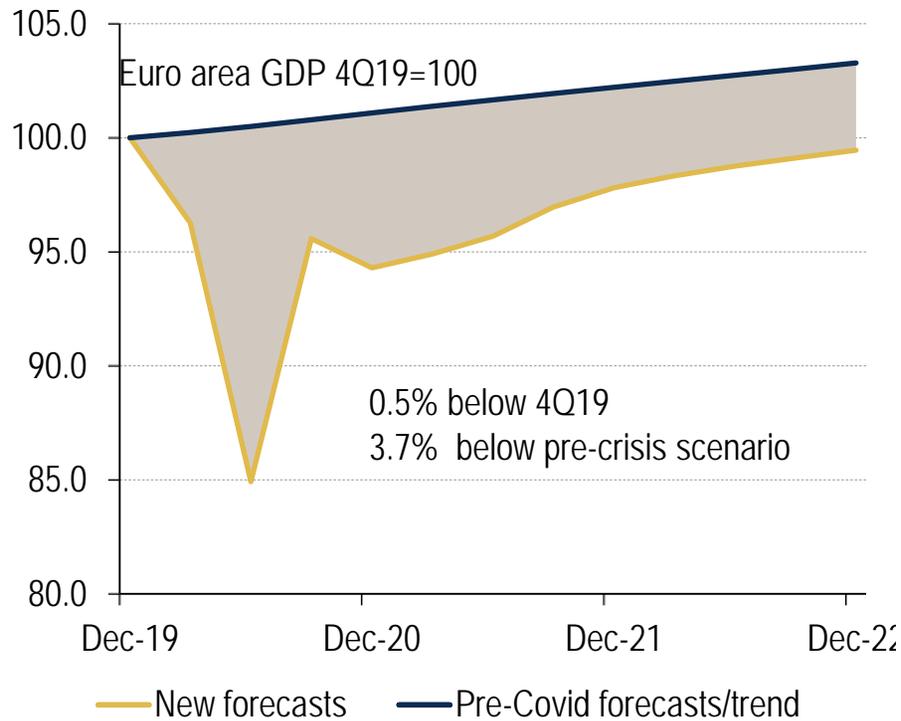


Source: Bank of International Settlements, International Monetary Fund, Bloomberg and BofA Global Research

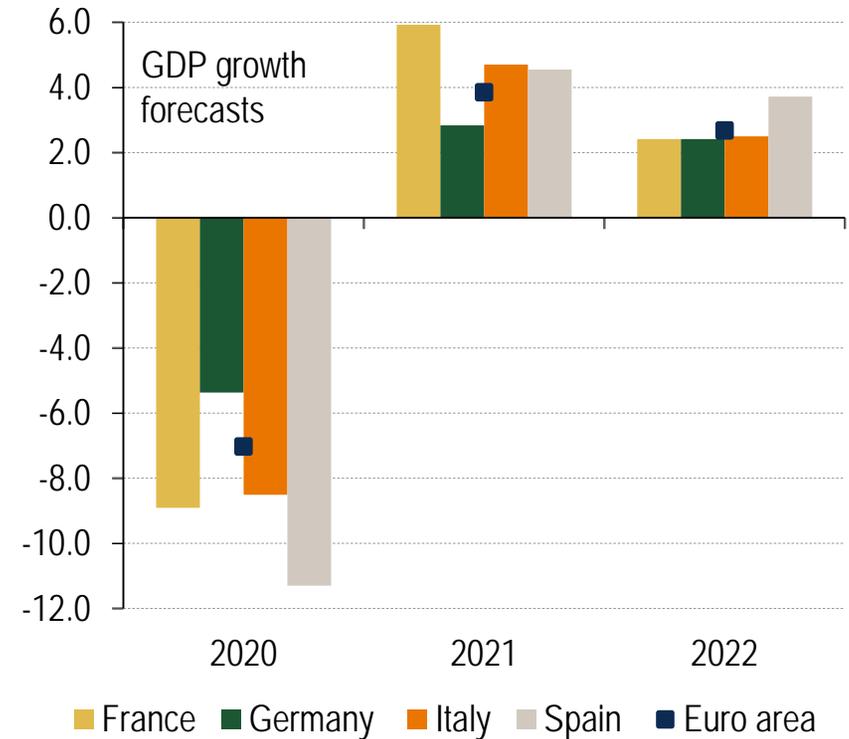
Europe: more incomplete recovery



GDP forecasts



Narrowing growth differentials

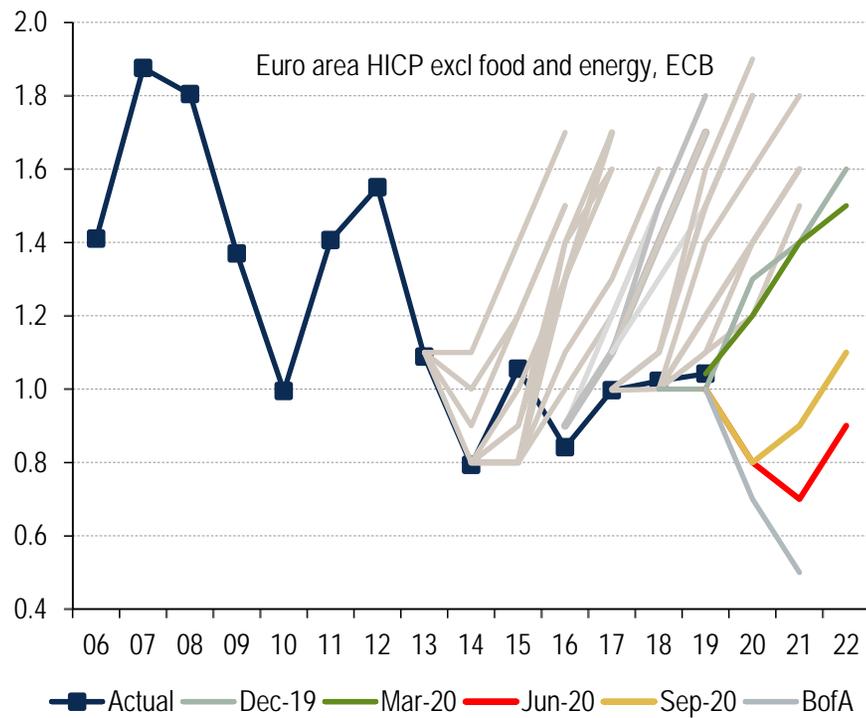


Source: Bloomberg and BofA Global Research estimates

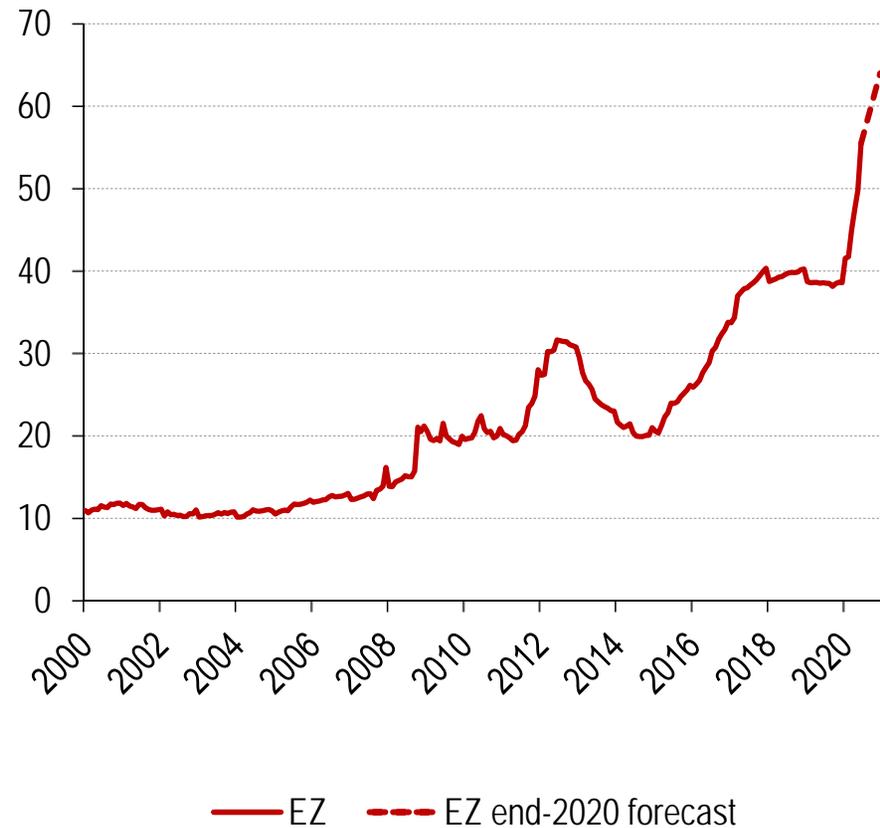
Europe: disinflation



ECB inflation forecasts message: this is not an inflationary shock



ECB balance sheet as share of GDP

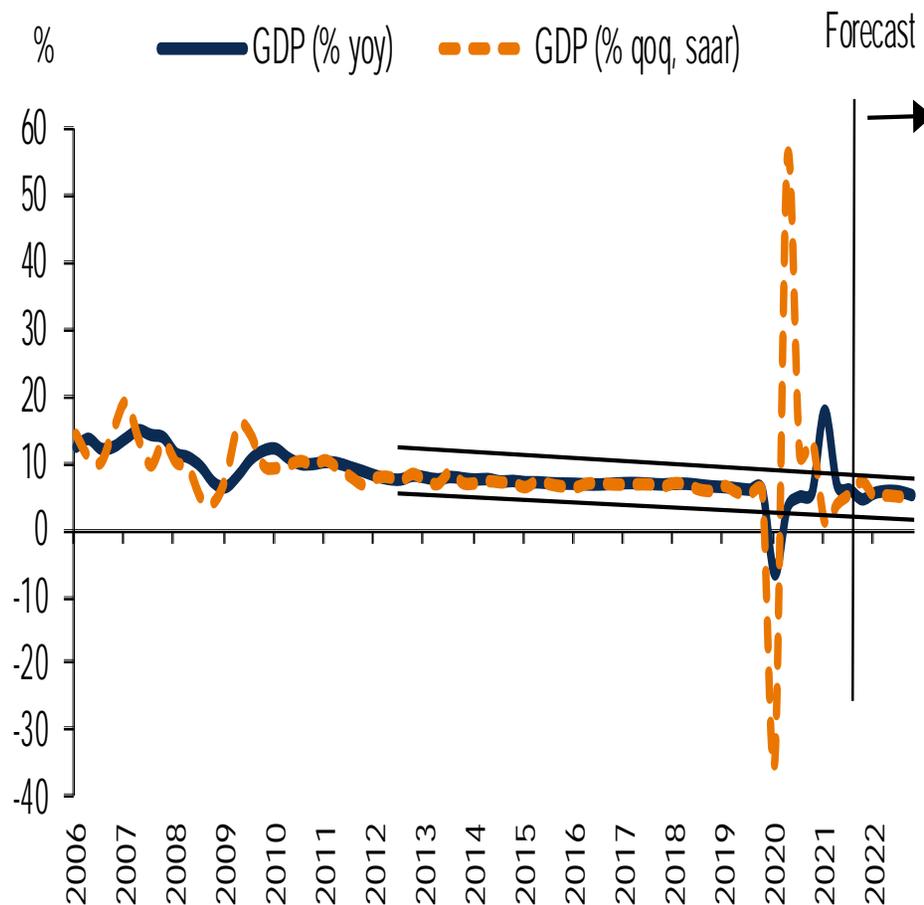


Source: Bloomberg and BofA Global Research estimates

China: growth and currency



2021E will feature a strong 1H
and weak 2H in yoy terms



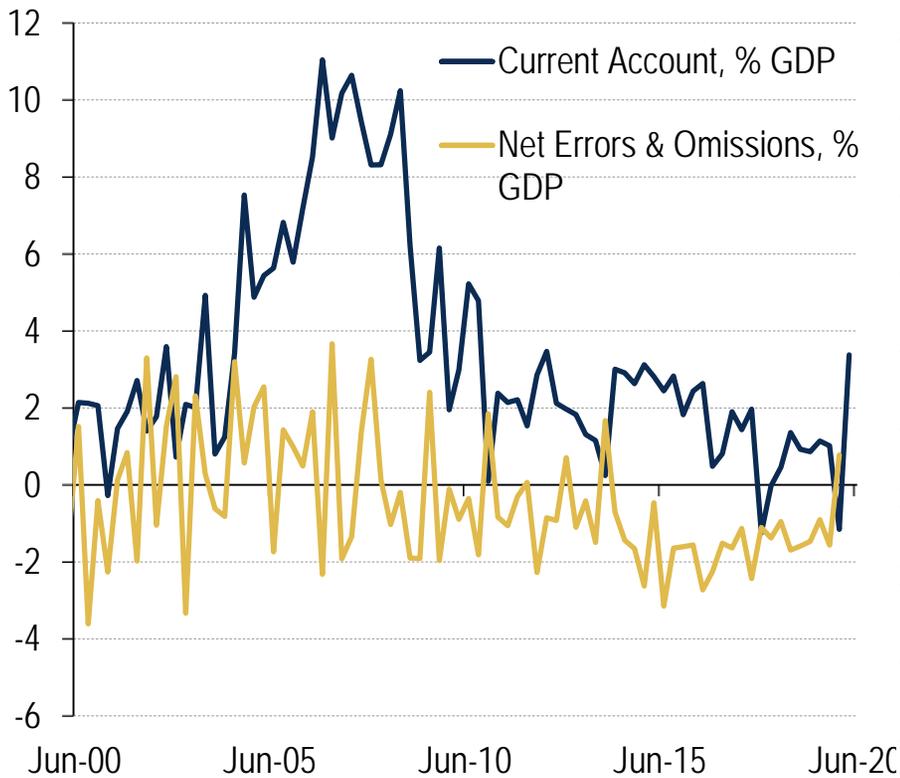
CNY



China: external balances



China current account and Net Errors & Omissions rebound



China FX reserves recover smartly from Q1 drawdown



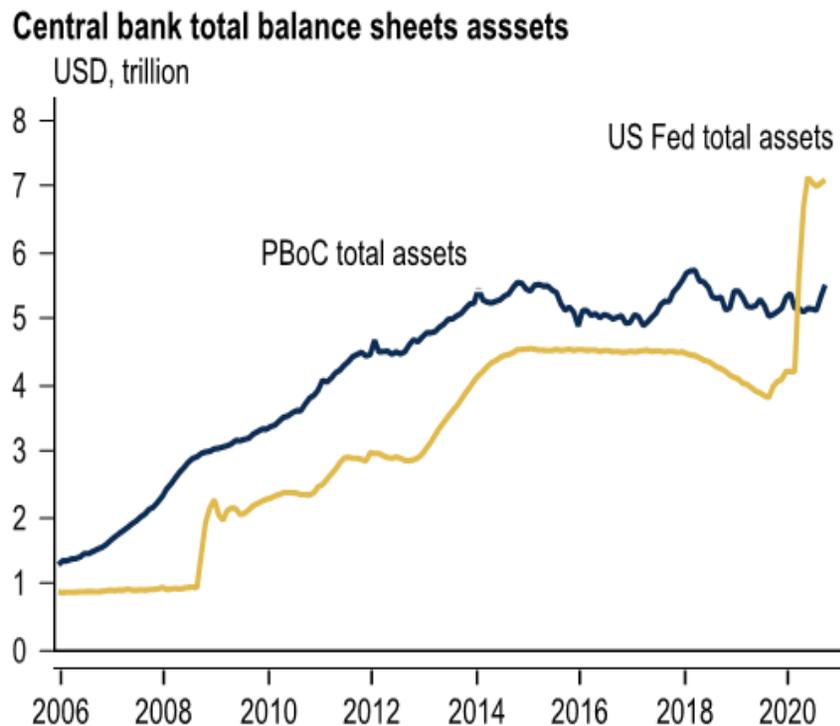
Source: Bloomberg and BofA Global Research estimates

US and China central bank balance sheets



Fed's balance sheet surpasses
China in absolute USD terms

Relative to GDP, US Fed balance sheet is
also bigger than China

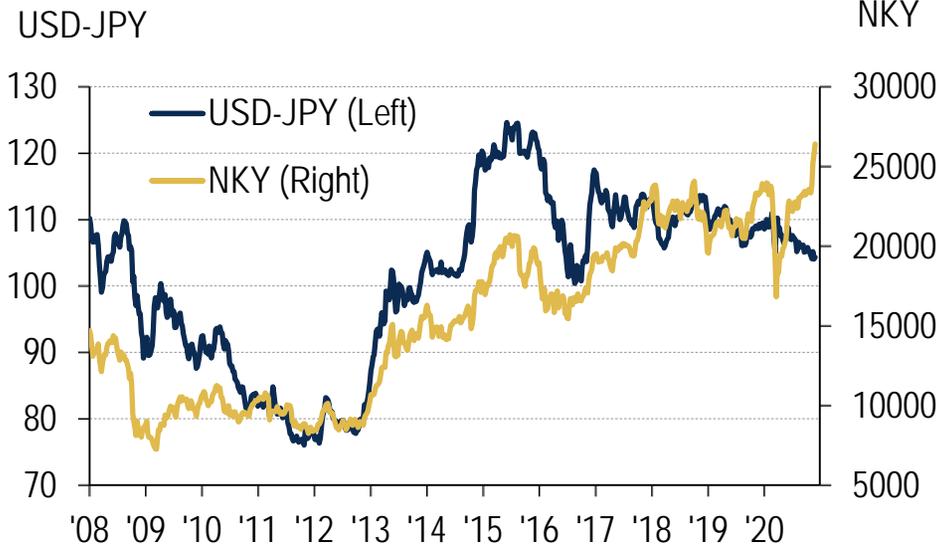


Source: Bloomberg, Macrobond and BofA Global Research estimates

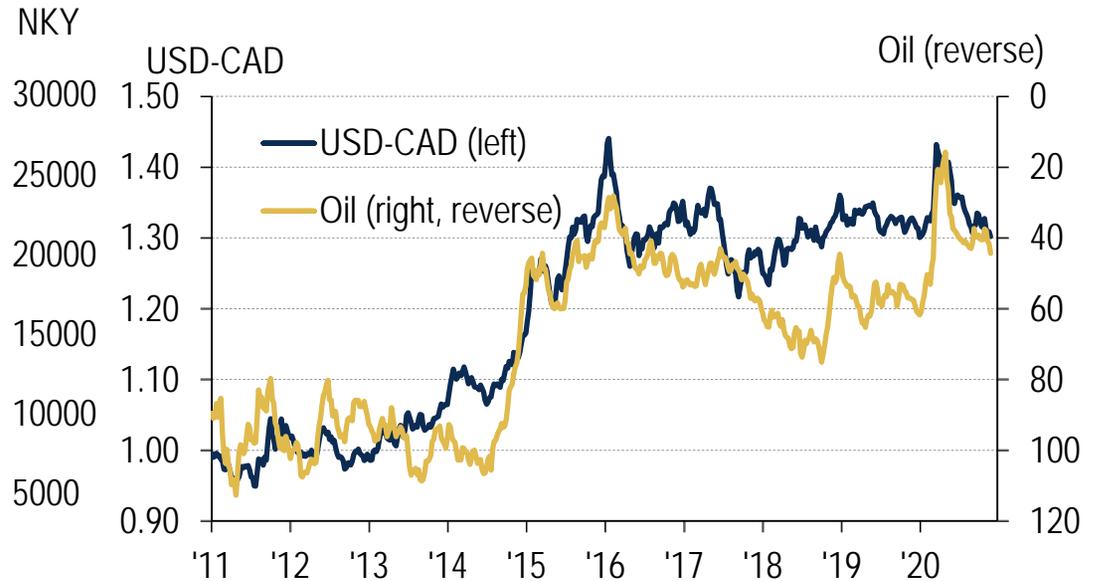
USD: G5



JPY and JP equities



CAD and oil

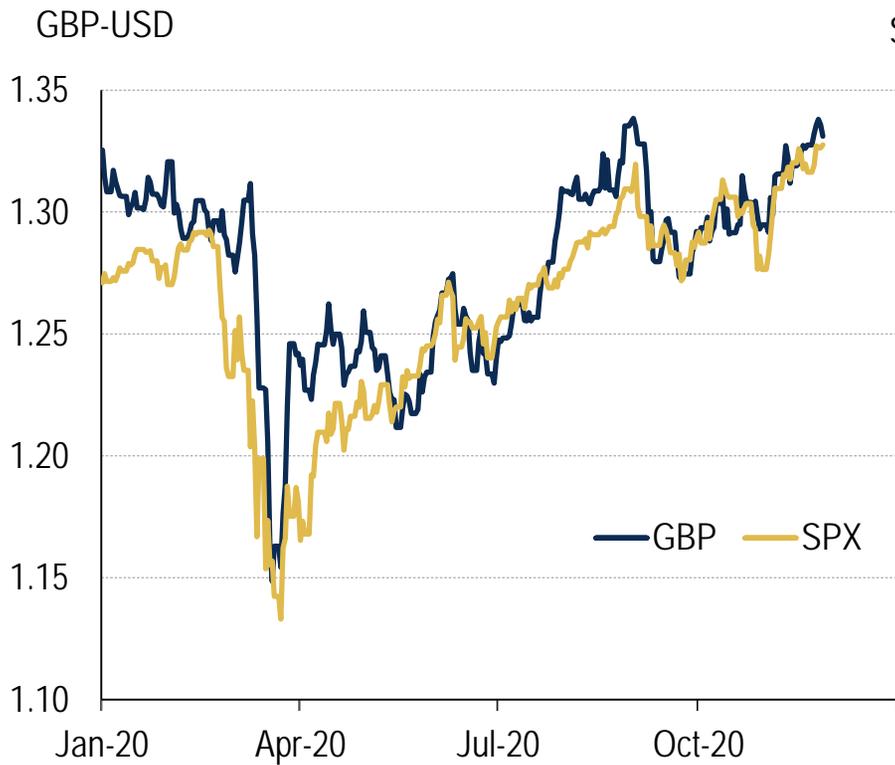


- Expect USD-JPY modestly lower: external balances, weaker USD
- Expect USD-CAD linked with: oil, risk

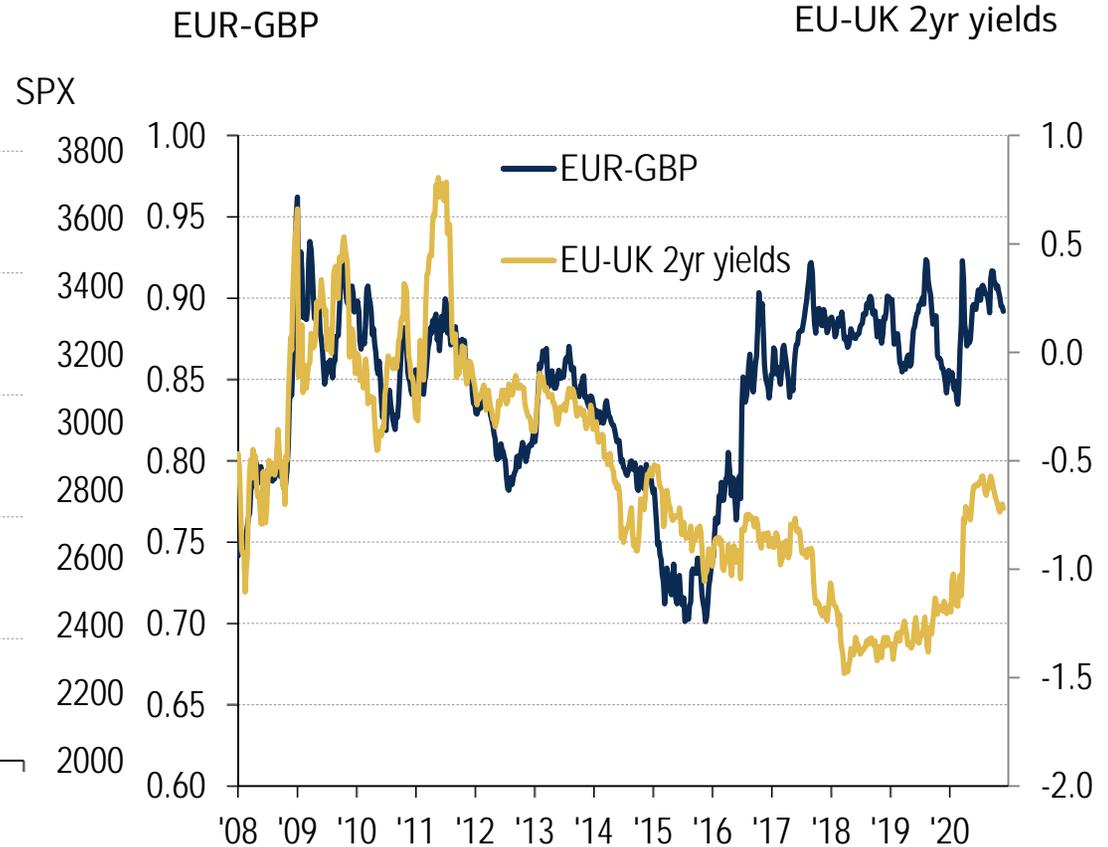


GBP: Risk and Rates

GBPUSD and risk (short-term)



EURGBP and rate spreads (medium-term)



Source: Bloomberg and BofA Global Research



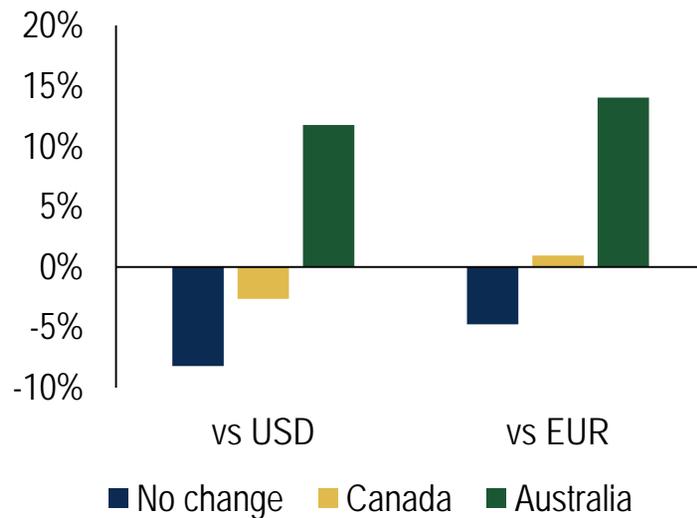
GBP: Equilibrium under Brexit

Equilibrium Estimate and Misalignment				
	Equilibrium Estimate		Misalignment	
	GBP/USD	EUR/GBP	vs USD	vs EUR
No change	1.4	0.87	-8%	-5%
Canada	1.32	0.92	-3%	1%
Australia	1.15	1.06	12%	14%

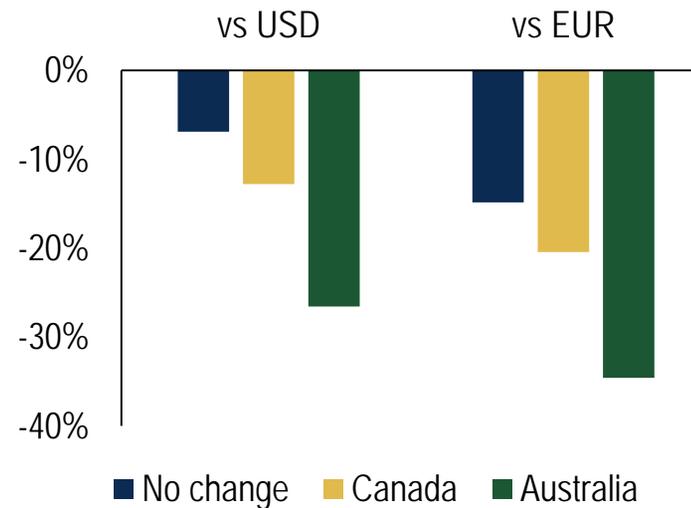
NOTE: EUR/GBP assumes EUR/USD equilibrium at 1.22

Source: BofA Global Research, Bloomberg

Misalignment under different Brexit Scenarios



Equilibrium Level adjustment from pre-Brexit estimates



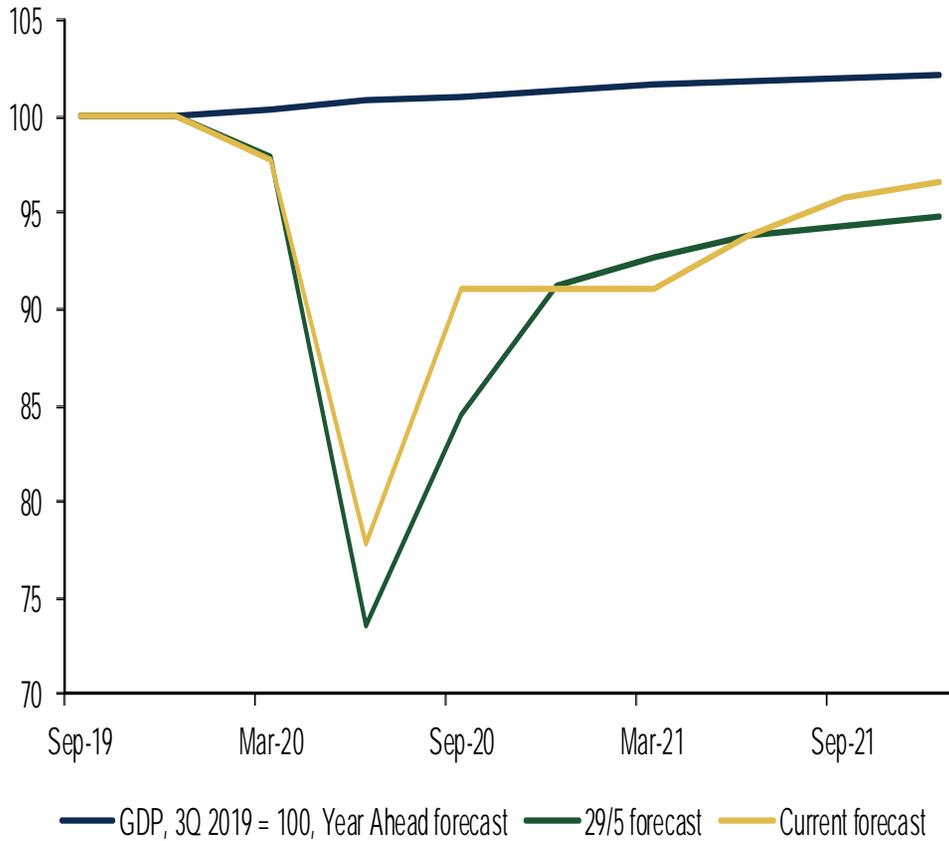
Note: Canada – the baseline scenario of skinny deal, and Australia – no-deal. We assume a move towards 2% inflation, a modest drop in terms of trade back towards average levels, trend growth in fiscal spending, rates at 40bp and 0bp respectively (Canada vs Australia) and the current account deficit at -4% (-6%). We shock the productivity input to be down 5% in the Canada scenario and down 7.5% in the Australia scenario.

Source: Bloomberg and BofA Global Research

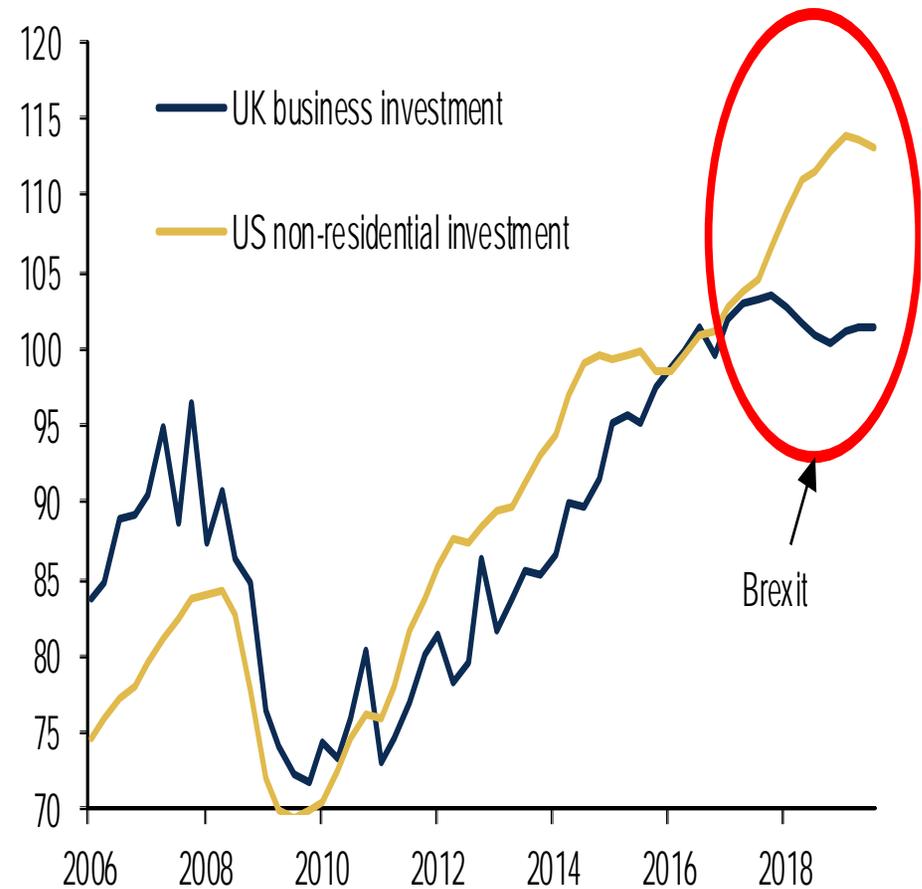


GBP: UK macro

UK Growth outlook



UK Business Investment

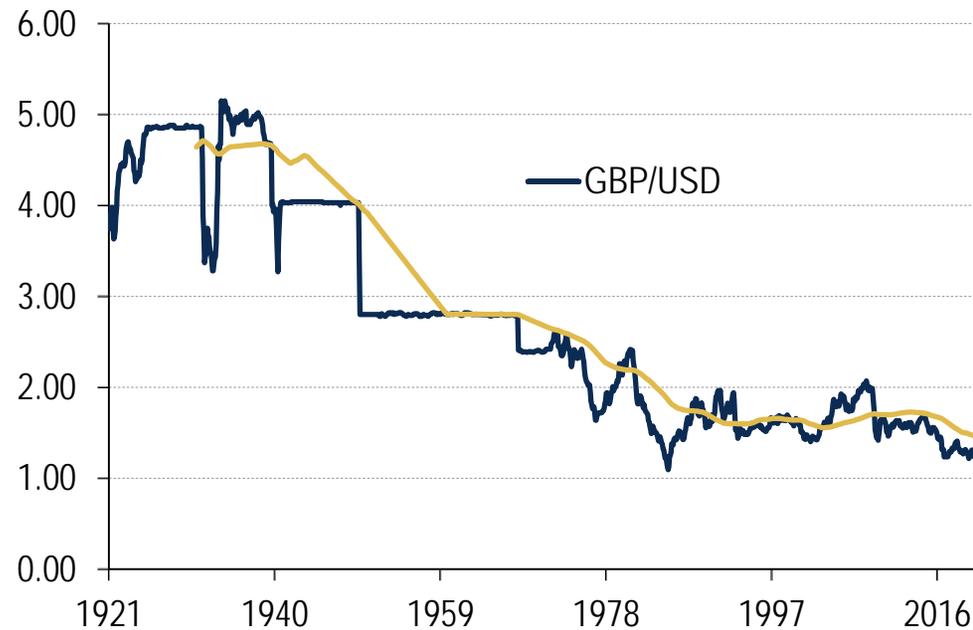




GBP: Brexit choices and the long-term

Scenario	Description	Possible impact				Long term		
		GDP (20/21)	CPI Inflation (20/21)	RPI Inflation (20/21)	Bank Rate (20/21)	Potential growth	Neutral rate	Loss in GDP vs no Brexit
1. Deal	FTA	-10.6 / 6.3	0.7 / 1.9	1.1 / 2.2	0 / 0	<1%	<1%	5%-7.5%
2. No deal	WTO initially/FTA eventually	-10.7 / 5.0	0.7 / 2.3	1.1 / 2.1	0 / -0.5	<0.5%	~0%	5-10%

GBP since 1921

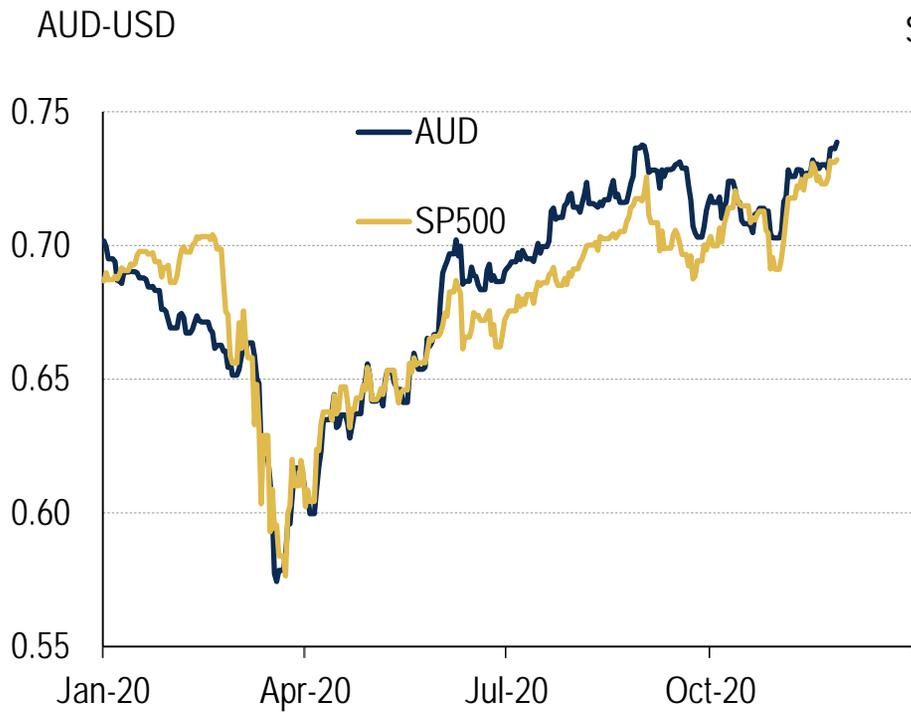


Source: Bloomberg and BofA Global Research

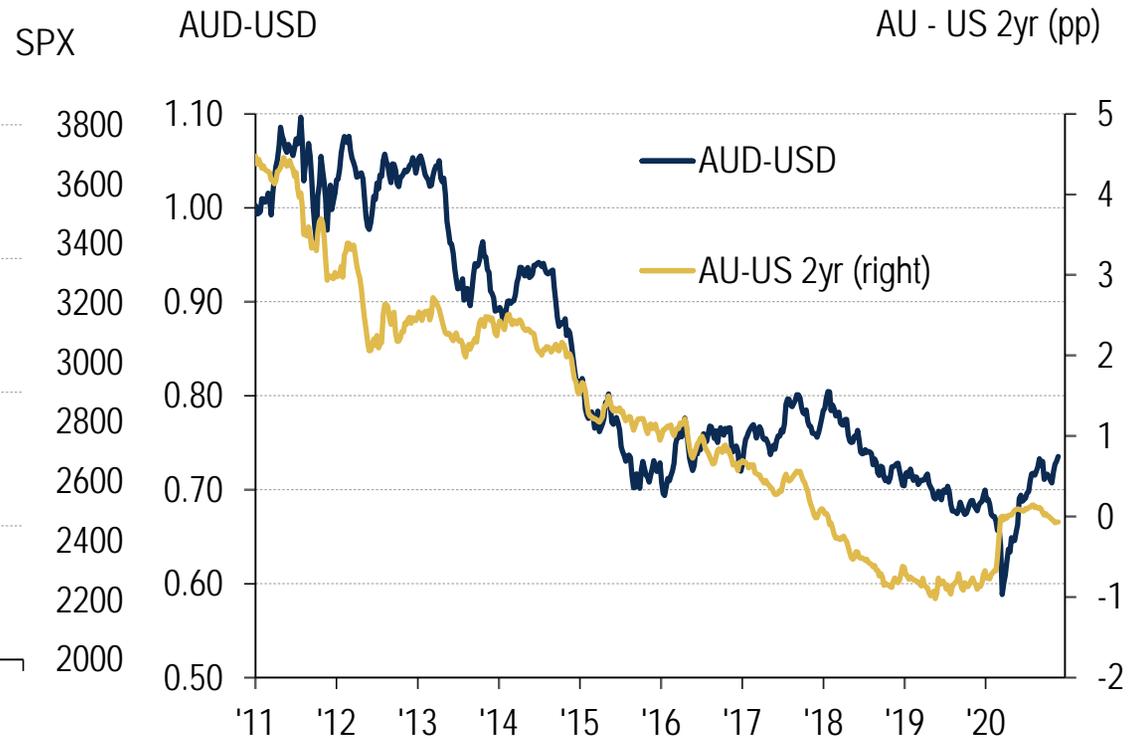


AUD: Risk and rates

AUD and equities (this year)



AUD and rates (since 2011)

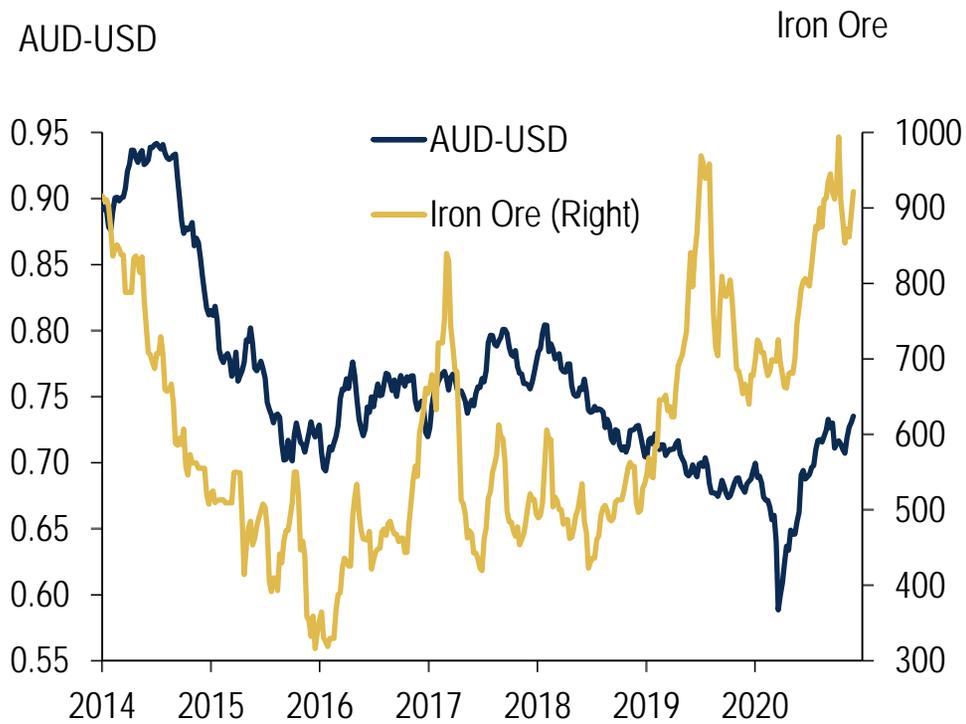


Source: Bloomberg and BofA Global Research

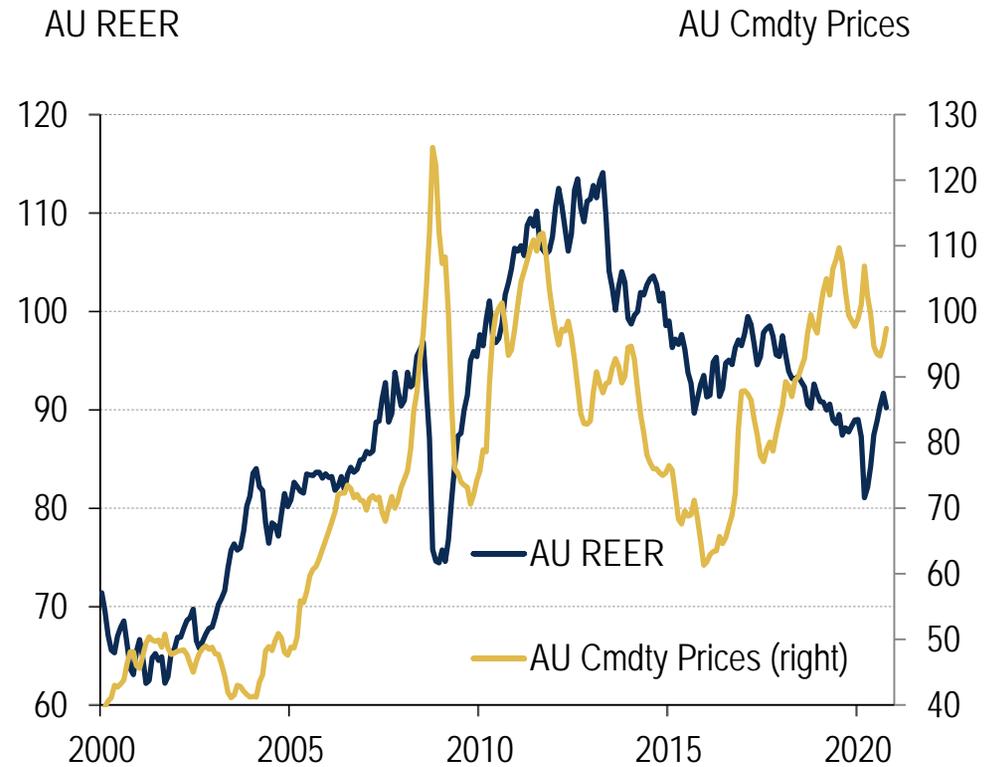


AUD: Commodities

AUD and metals



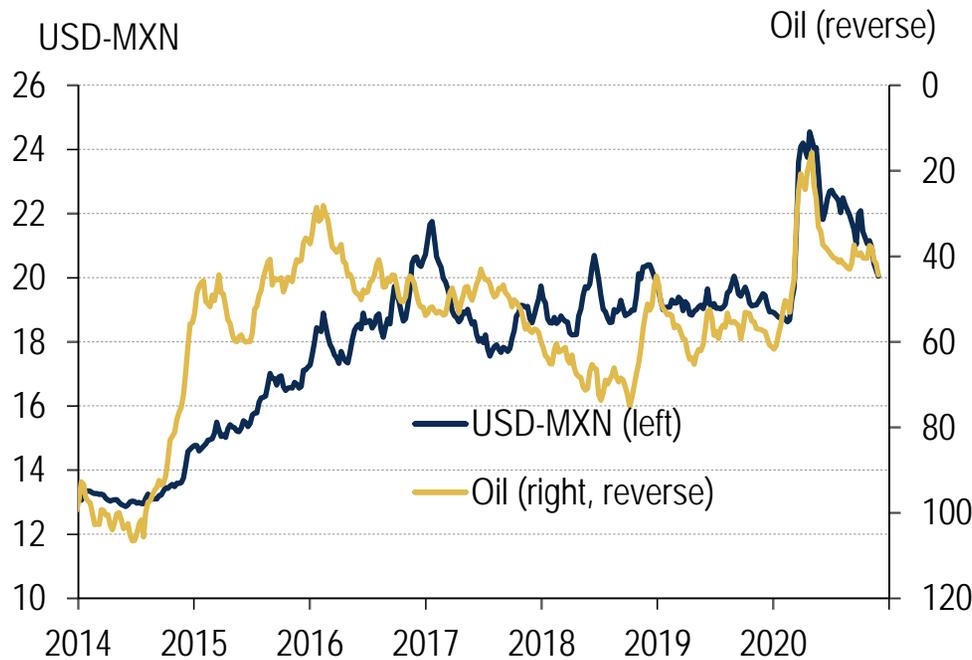
AUD and commodity prices



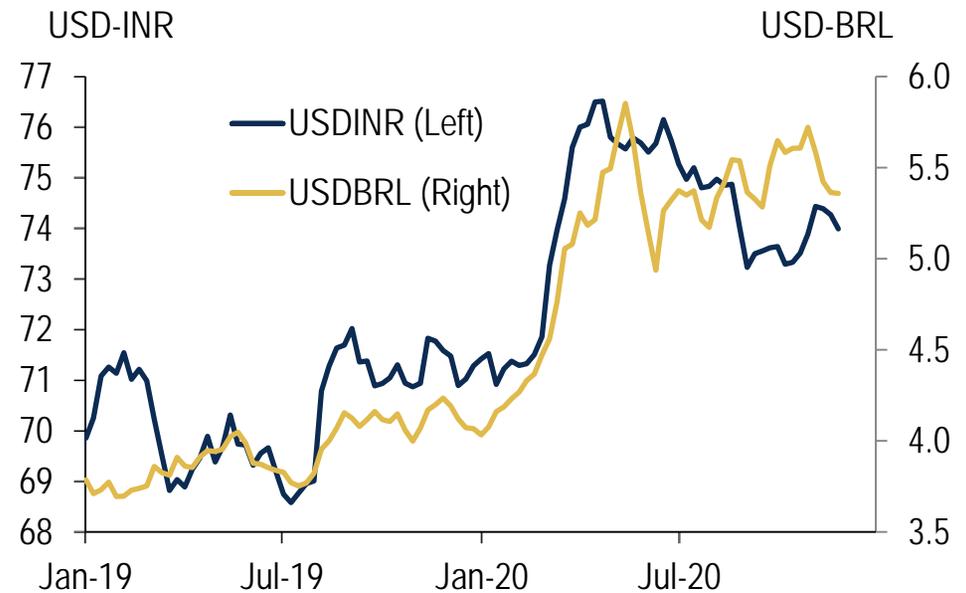


USD: risk and EM currencies

USD-MXN



INR and BRL



- “Higher beta” cuts in both directions
- Oil prices crucial for many currencies around the world
- Risk sentiment at recent odds with EM and COVID

G10 FX forecasts



G10 FX Forecasts

	Spot	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
G3										
EUR-USD	1.20	1.18	1.20	1.22	1.24	1.25	1.25	1.25	1.25	1.25
USD-JPY	104	103	103	102	101	100	101	102	104	105
EUR-JPY	124	122	124	124	125	125	126	128	130	131
Dollar Bloc										
USD-CAD	1.30	1.31	1.34	1.32	1.29	1.30	1.30	1.30	1.30	1.30
AUD-USD	0.74	0.72	0.71	0.73	0.74	0.75	0.75	0.76	0.76	0.76
NZD-USD	0.70	0.68	0.68	0.69	0.70	0.71	0.72	0.72	0.72	0.72
Europe										
EUR-GBP	0.90	0.92	0.92	0.93	0.94	0.94	0.93	0.92	0.92	0.91
GBP-USD	1.33	1.28	1.30	1.31	1.32	1.33	1.34	1.36	1.36	1.37
EUR-CHF	1.08	1.08	1.08	1.09	1.09	1.10	1.10	1.09	1.09	1.08
USD-CHF	0.91	0.92	0.90	0.89	0.88	0.88	0.88	0.87	0.87	0.86
EUR-SEK	10.17	10.30	10.10	10.00	9.80	9.70	9.70	9.70	9.70	9.70
USD-SEK	8.50	8.73	8.42	8.20	7.90	7.76	7.76	7.76	7.76	7.76
EUR-NOK	10.57	10.80	10.60	10.40	10.10	9.90	9.70	9.60	9.50	9.50
USD-NOK	8.84	9.15	8.83	8.52	8.15	7.92	7.76	7.68	7.60	7.60

S Forecast as of Nov-27-2020. Spot exchange rate as of Nov-27-2020. The left of the currency pair is the denominator of the exchange rate. Source: BofA Global Research

EM FX forecasts



EM FX Forecasts

	Spot	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Latin America										
USD-BRL	5.34	5.30	5.10	5.10	5.10	5.10	5.10	5.10	5.10	5.00
USD-MXN	20.04	20.50	21.10	21.70	21.90	22.00	22.20	22.50	22.70	23.00
USD-CLP	767	760	760	770	780	770	750	750	760	760
USD-COP	3,606	3,600	3,500	3,500	3,500	3,500	3,600	3,600	3,500	3,400
USD-ARS	81.06	84.30	93.40	102.50	112.50	129.90	140.30	151.50	163.60	176.70
USD-PEN	3.60	3.75	3.82	3.70	3.70	3.54	3.54	3.55	3.56	3.57
Emerging Europe										
EUR-PLN	4.49	4.45	4.40	4.40	4.30	4.30	4.30	4.30	4.30	4.30
EUR-HUF	361	355	357	359	361	363	365	366	367	369
EUR-CZK	26.19	26.25	26.00	25.75	25.50	25.00	25.00	25.00	25.00	25.00
USD-UAH	28.53	27.50	27.00	27.00	27.00	27.00	27.00	27.00	27.00	27.00
USD-RUB	76.00	72.00	71.00	70.00	69.00	68.00	68.00	68.00	68.00	68.00
USD-ZAR	15.24	15.60	15.20	15.00	14.80	14.70	14.70	14.70	14.70	14.70
USD-TRY	7.84	7.70	7.05	7.20	7.30	7.50	7.70	7.90	8.10	8.30
EUR-RON	4.87	4.87	4.89	4.91	4.93	4.95	4.97	4.99	5.01	5.01
USD-EGP	15.64	15.50	15.50	15.50	15.50	15.50	15.50	15.50	15.50	15.50
USD-ILS	3.31	3.37	3.34	3.30	3.30	3.30	3.30	3.30	3.30	3.30
USD-AED	3.67	3.68	3.68	3.68	3.68	3.68	3.68	3.68	3.68	3.68
USD-KWD	0.31	0.28	0.28	0.28	0.28	0.28	0.28	0.28	0.28	0.28
USD-SAR	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
USD-QAR	3.69	3.64	3.64	3.64	3.64	3.64	3.64	3.64	3.64	3.64
Asian Bloc										
USD-KRW	1,103	1,115	1,090	1,065	1,055	1,045	1,035	1,025	1,035	1,045
USD-TWD	28.53	28.70	28.50	28.30	28.20	28.10	28.00	27.90	28.00	28.10
USD-SGD	1.34	1.35	1.32	1.31	1.30	1.30	1.29	1.28	1.28	1.29
USD-THB	30.29	30.20	30.00	30.00	30.00	29.50	29.00	28.50	29.00	29.50
USD-HKD	7.75	7.75	7.75	7.75	7.76	7.77	7.77	7.78	7.79	7.80
USD-CNY	6.58	6.60	6.50	6.40	6.35	6.30	6.25	6.20	6.25	6.30
USD-IDR	14090	14,200	14,100	14,100	14,000	14,000	13,900	13,800	13,900	14,000
USD-PHP	48.08	48.50	48.00	47.50	47.00	47.00	46.50	46.50	47.00	47.00
USD-MYR	4.07	4.14	4.10	4.05	4.00	3.95	3.90	3.85	3.85	3.80
USD-INR	74.05	74.00	73.00	72.00	71.50	71.00	71.00	70.50	70.50	70.00

Forecast as of Nov-27-2020. Spot exchange rate as of Nov-27-2020. The left of the currency pair is the denominator of the exchange rate. Source: BofA Global Research

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