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International Economics

WELLS FARGO SECURITIES

International Economic Outlook

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In this issue:

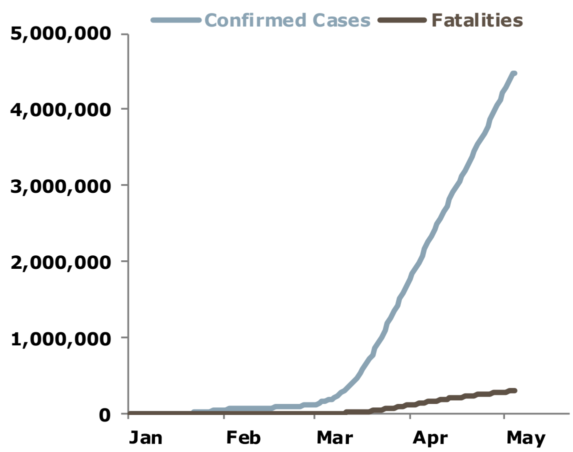
- **Forecast changes:** Activity and sentiment data remain underwhelming in both the developed and emerging world, and as a result, we have downgraded our GDP forecasts for the U.S. as well as most international economies. We now forecast global GDP to contract 3.8% in 2020, while we have also lowered our GDP forecasts for the Eurozone, U.K., Canada, India and Mexico. We have also made adjustments to the outlook for certain currencies, including becoming less positive on the prospects for the Japanese yen as well as becoming outright negative on the Brazilian real. **See our FX forecasts on page 4.**
- **Key themes:** Social distancing and lockdown measures have put stress on many economies, likely pushing most G10 and emerging economies into recession. While some lockdown measures have been lifted, uncertainties are likely to remain prevalent around the health and potential recovery of the global economy. As of now, we forecast a recovery to begin in Q3; however, uncertainty around the timing of the pickup is high and until the recovery takes shape we believe the U.S. dollar can strengthen over the short term. Once a global economic rebound gets under way and market sentiment improves, we believe the greenback is likely to weaken as Fed easing measures and improved sentiment weighs on the dollar and supports foreign currencies.

COVID-19 Monitor: Where Do We Stand?

For many months now, the COVID-19 pandemic has disrupted economic activity around the world. Confirmed cases and fatalities continue to rise, and as of mid-May, about 4.5M infections have been reported globally, while the virus has resulted in around 300,000 fatalities. Since our last monthly update, global infections have increased by about 2.4M cases, while the number of fatalities rose by almost 240,000. The United States continues to be the main hot spot for infections with around 1.4M confirmed cases, while Eurozone countries, the U.K. and Canada continue to see new infections as well. In addition, large emerging market countries have struggled to contain the spread of the virus, with Russia now the second most infected country, according to data compiled by Johns Hopkins University. Brazil and Mexico have also not been able to slow the number of infections amid lax lockdown measures.

Despite new confirmed cases, there is evidence that the pace of increase may be starting to slow in some of the world's largest economies. Countries that have been hit hard by the virus such as Italy, France and Germany have managed to flatten their respective virus curves, while the rate of new confirmed cases in the United States has also slowed. In each of these countries, governments have started to re-open less vulnerable parts of the economy and have laid out criteria to assess the spread of the virus as well as a timeline for potentially re-opening the remaining parts of the economy. While these developments are encouraging, this should not be interpreted as risks surrounding COVID-19 are dissipating. The risk of reinfection has yet to be fully determined, while the risk of re-opening economies too soon and sparking a second wave of infections is relatively high. To that point, in just the past week, a new wave of infections has occurred in Spain and South Korea, while new cases have also been confirmed in Wuhan, China—the epicenter of where COVID-19 originated.

Global COVID-19 Cases vs. Fatalities

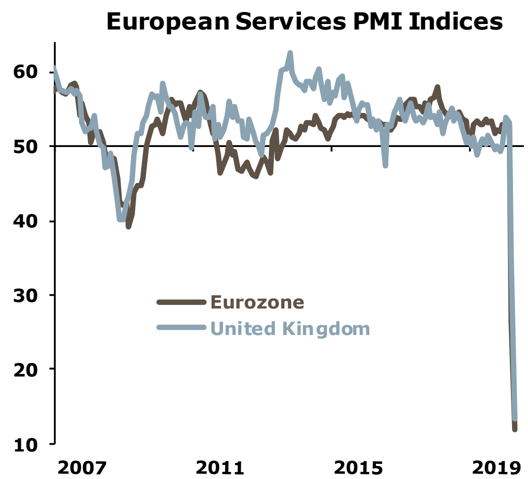


Sources: Bloomberg LP and Wells Fargo Securities

The Global Contraction to Get Worse

As we continue to get more clarity on the extent in which the virus has weighed on economic activity, our outlook for the global economy has worsened further. We have again downgraded our 2020 global GDP forecast as well as growth forecasts for many international economies. We now expect global GDP to contract 3.8% this year, while we also downgraded our GDP forecast for the Eurozone, U.K. and Canada. We expect the Eurozone economy to contract 8.0%, the U.K. to fall 8.1% and Canadian economy to decline 6.3%, in 2020. In addition, we have lowered our GDP forecasts for some emerging market economies and expect deeper recessions in both India and Mexico. An extended lockdown and underlying vulnerabilities led us to lower our 2020 GDP forecast to -1.7% in India, while a worse-than-expected Q1 GDP decline, along with an already fragile economy, has led us to revise our 2020 GDP forecast for Mexico lower, and we now anticipate an 8.3% contraction this year.

As for as G10 economies, economic data continue to be underwhelming, particularly in the Eurozone. Q1 GDP data were weaker than our forecast, with the broader European economy contracting 3.8% q/q. In addition, inflation slowed to 0.4% y/y in April on the back of lower energy prices and as consumer demand plummeted amid the lockdown measures implemented in many of the Eurozone's larger countries. Leading indicators suggest an even bleaker outlook for the Eurozone in the second quarter. The April manufacturing PMI fell to a record low 33.4, while the services PMI dropped to 12 in April, also the lowest on record. We think the uncertain nature of the Eurozone economy likely means the ECB will become more aggressive in providing stimulus to the economy—we expect **increased purchases under the Pandemic Emergency Purchase Program (PEPP) by another €500B to be announced in July**. For now, we believe the ECB will keep interest rates steady, but believe some possibility of additional rate cuts exists. Additional easing from the ECB as well as uncertainty around the spread of the virus and the recovery of the Eurozone should keep the euro restrained over the short term.



Sources: Bloomberg LP and Wells Fargo Securities

Similar economic dynamics exist within the U.K. We think the U.K. economy is likely to come under particular stress as lockdown measures were implemented later than other developed countries, and as a result, authorities have struggled to contain the spread of the virus. The contraction in Q1 was steep, with the British economy declining 2% q/q; however, we think the decline in Q2 will be more severe. The April PMIs were tepid with the manufacturing PMI dropping to 32.6 and the services PMI falling to 13.4. In addition, Brexit concerns could build again, which could also place additional downward pressure on the economy. We believe the Bank of England will ease monetary policy more aggressively to offset some of the slowdown caused by COVID-19. More specifically, **we think the BoE will expand its quantitative easing program and raise its asset purchase target by £100B to £745B in June.** The combination of easier BoE monetary policy, geopolitical uncertainty tied to Brexit and safe-haven flows into the U.S. dollar should keep the pound on the back foot.

The outlook has also darkened across most of the emerging markets spectrum. Countries with weaker fundamentals and limited policy space are likely to fall into deeper recessions relative to countries that were better positioned to manage an exogenous shock. While we do not explicitly forecast GDP for these countries, we believe economies such as Argentina, South Africa and Turkey may experience large economic contractions this year as each of these countries were fragile pre-pandemic with limited monetary and fiscal policy space to respond to the COVID-19 shock. In addition, we expect commodity-linked economies like Russia and Colombia to fall into recession; however, the underlying fundamentals in each country were solid before the virus and policy response options were adequate, which should lessen the economic impact and make for a steadier recovery.

As of now, we believe China is still on pace for its first annual contraction since the 1990s; though the risk to this forecast is tilted to the upside. Local businesses have reopened and data show a potentially more robust recovery than we currently forecast. Manufacturing and non-manufacturing PMIs remain at the breakeven 50 level as of April, while retail sales and industrial production data continue to improve. While data show signs of recovery, geopolitical relations with the U.S. may be heading in the opposite direction. As COVID-19 intensifies, the U.S. administration seems content with applying renewed economic pressure on China. This week, the Trump administration blocked a government pension fund from investing in Chinese equities, while President Trump also threatened to pull out of the Phase I trade deal if China does not fulfill its obligations. It's unclear if these actions are political jockeying ahead of the presidential election in November, but any escalation in tensions would likely be negative for China's economy and currency.

U.S. Dollar Still a Safe Bet…for Now

In the short term, we expect uncertainties around the evolution of COVID-19 to be a primary driver of currency markets. We think the risk of another wave of confirmed cases is a high possibility and should create uncertainty around the timing of the global recovery. In our view, these risks should keep market participants rather defensive in the short term and keep safe-haven currencies in demand for the time being. We think this cautious approach and aversion to risk will keep the U.S. dollar supported against most G10 and emerging currencies over at least the next three months. Longer term, we think the U.S. dollar could soften given significant monetary easing and dollar liquidity from the Fed to stimulate the U.S. economy. In addition, we believe the global economy will begin to recover in Q3 and risk sentiment will turn more positive, which should also alleviate investor concerns, lessen demand for safe-haven currencies and help foreign currencies strengthen.

Despite our view that safe-haven currencies should outperform in the short term, we have become less positive on the Japanese yen. The yen is typically a very reliable safe-haven currency; however, over the past few months has not reacted as strongly as usual to stressed financial markets. Limited access to dollar liquidity by Japanese institutions has restrained the yen; we believe that dynamic along with calmer markets could rein in the yen. In terms of other notable changes to our forecasts, we have turned negative on the Brazilian real and now forecast a weaker currency over the course of our forecast horizon. The administration's response to the virus has been underwhelming with the government pushing back on social distancing measures. As a result, the economy is likely to come under significant pressure, while elevated political risk surrounding proceedings into corruption and obstruction of justice against President Bolsonaro is likely to put depreciation pressure on the real over the longer term. We also expect Brazil's central bank to ease monetary policy through the end of the year and also suspect it will not adequately intervene in FX markets to defend the currency from further weakness.

Global Economic Forecasts

	GDP				CPI			
	2018	2019	2020	2021	2018	2019	2020	2021
Global (PPP Weights)	3.6%	3.0%	-3.8%	3.3%	3.6%	3.4%	2.8%	3.0%
Advanced Economies[1]	2.2%	1.9%	-5.7%	1.9%	2.0%	1.6%	0.5%	1.5%
United States	2.9%	2.3%	-4.6%	1.2%	2.4%	1.8%	0.7%	1.5%
Eurozone	1.9%	1.2%	-8.0%	2.2%	1.8%	1.2%	0.3%	1.4%
United Kingdom	1.3%	1.4%	-8.1%	4.3%	2.5%	1.8%	0.7%	1.3%
Japan	0.3%	0.7%	-5.6%	0.1%	1.0%	0.5%	-0.1%	0.7%
Canada	2.0%	1.6%	-6.3%	3.5%	2.3%	1.9%	0.8%	1.7%
Developing Economies[1]	4.5%	3.8%	-2.4%	4.2%	4.8%	4.8%	4.4%	4.1%
China	6.7%	6.1%	-1.2%	7.5%	2.1%	2.9%	2.3%	1.5%
India	6.9%	5.3%	-1.7%	3.6%	3.9%	3.7%	4.2%	3.8%
Mexico	2.1%	-0.1%	-8.3%	-1.3%	4.9%	3.6%	2.7%	3.3%

Forecast as of: May 15, 2020. All figures represent year-over-year percent change

[1]Aggregated Using PPP Weights

Interest Rate Forecasts

Instrument	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
United States						
Fed Funds (Upper Bound)	0.25	0.25	0.25	0.25	0.25	0.25
2-Year	0.35	0.40	0.50	0.65	0.75	0.85
10-Year	1.00	1.15	1.25	1.30	1.35	1.45
Eurozone						
ECB Deposit Rate	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
2-Year	-0.70	-0.65	-0.60	-0.50	-0.40	-0.25
10-Year	-0.40	-0.30	-0.20	-0.10	0.00	0.10
United Kingdom						
Bank Rate	0.10	0.10	0.10	0.10	0.10	0.10
2-Year	0.10	0.20	0.30	0.40	0.50	0.60
10-Year	0.40	0.55	0.70	0.75	0.80	0.85
Japan						
Policy Rate Target	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
2-Year	-0.15	-0.15	-0.10	0.00	0.05	0.05
10-Year	0.00	0.05	0.10	0.15	0.15	0.20
Canada						
Overnight Rate Target	0.25	0.25	0.25	0.25	0.25	0.25
2-Year	0.50	0.55	0.60	0.75	0.90	1.00
10-Year	0.80	0.90	1.05	1.15	1.25	1.35

Source: Bloomberg LP and Wells Fargo Securities

Currency Forecasts

Currency Pair*	Current rate	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
G10							
EUR/USD	1.0847	1.0600	1.0700	1.0900	1.1100	1.1300	1.1400
USD/JPY	107.02	107.00	107.00	106.00	106.00	105.00	105.00
GBP/USD	1.2175	1.2000	1.2100	1.2300	1.2400	1.2500	1.2600
USD/CHF	0.9700	0.9900	0.9825	0.9675	0.9500	0.9375	0.9300
USD/CAD	1.4069	1.4300	1.4300	1.4200	1.4100	1.4000	1.4000
AUD/USD	0.6442	0.6200	0.6200	0.6300	0.6400	0.6600	0.6800
NZD/USD	0.5973	0.5800	0.5800	0.5900	0.6000	0.6200	0.6400
USD/NOK	10.2084	10.5650	10.7475	10.3675	10.0000	9.7350	9.5625
USD/SEK	9.8225	10.1900	10.1875	9.8175	9.4600	9.2025	9.0350
Asia							
USD/CNY	7.1023	7.0900	7.0700	7.0300	6.9900	6.9500	6.9100
USD/CNH	7.1293	7.1000	7.0700	7.0300	6.9900	6.9500	6.9100
USD/IDR	14860	14800	14600	14500	14400	14300	14200
USD/INR	75.58	76.50	77.50	78.50	78.00	77.50	77.00
USD/KRW	1231.04	1235.00	1225.00	1215.00	1205.00	1195.00	1185.00
USD/PHP	50.74	51.00	50.50	50.00	49.50	49.00	48.50
USD/SGD	1.4243	1.4400	1.4300	1.4200	1.4100	1.4000	1.3900
USD/TWD	29.92	30.25	30.00	30.00	29.75	29.75	29.50
USD/THB	32.07	32.25	32.00	31.75	31.50	31.25	31.00
Latin America							
USD/BRL	5.8042	6.0000	6.1000	6.2000	6.2500	6.3000	6.3500
USD/CLP	821.87	840.00	845.00	855.00	860.00	865.00	870.00
USD/MXN	23.8450	24.7500	25.2500	25.7500	26.2500	26.7500	27.0000
USD/COP	3925.73	4100.00	4000.00	3900.00	3800.00	3750.00	3700.00
USD/ARS	67.7250	68.2500	68.5000	68.5000	68.7500	69.0000	69.2500
USD/PEN	3.4506	3.4700	3.4600	3.4500	3.4400	3.4300	3.4200
Eastern Europe/Middle East/Africa							
USD/CZK	25.55	26.50	26.00	25.25	24.50	24.00	23.75
USD/HUF	326.75	335.75	334.50	331.25	327.00	322.00	319.25
USD/PLN	4.2078	4.3200	4.3000	4.2375	4.1800	4.1250	4.0875
USD/RUB	73.57	74.00	73.00	72.50	72.00	71.50	71.00
USD/ILS	3.5379	3.5600	3.5700	3.5800	3.5900	3.6000	3.6100
USD/ZAR	18.5405	19.0000	19.2500	19.5000	19.7500	20.0000	20.2500
USD/TRY	6.9176	7.2500	7.5000	7.5000	7.7500	7.7500	8.0000
Euro Crosses							
EUR/JPY	116.08	113.50	114.50	115.50	117.75	118.75	119.75
EUR/GBP	0.8909	0.8825	0.8850	0.8850	0.8950	0.9050	0.9050
EUR/CHF	1.0521	1.0500	1.0500	1.0550	1.0550	1.0600	1.0600
EUR/NOK	11.0730	11.2000	11.5000	11.3000	11.1000	11.0000	10.9000
EUR/SEK	10.6542	10.8000	10.9000	10.7000	10.5000	10.4000	10.3000
EUR/CZK	27.71	28.00	27.75	27.50	27.25	27.00	27.00
EUR/HUF	354.42	356.00	358.00	361.00	363.00	364.00	364.00
EUR/PLN	4.5641	4.5800	4.6000	4.6200	4.6400	4.6600	4.6600

Source: Bloomberg LP and Wells Fargo Securities

* Charts show forecast trajectory for the currency pair over the next 18 months

United States/USD

Outlook

We expect U.S. dollar strength in the near term and gradual weakness over the longer term. U.S. dollar funding strains have eased but not disappeared completely. That should support the greenback for now, as would any equity market volatility. With the outlook set to remain very weak and somewhat uncertain, Fed policy should remain aggressively easy for some time. Once the global economy stabilizes and markets improve, that should mean U.S. dollar softness and foreign currency strength.

Fundamental Focus: Economics, Policy & FX

Source: Datastream, Wells Fargo Securities

Bad Economic News Really Starts to Hit Home

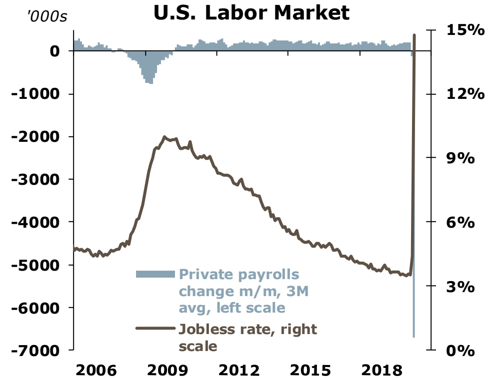
- The negative economic consequences of COVID-19 are starting to show through more clearly in the economic data. Q1 GDP shrank by 4.8% q/q annualized, while final private domestic demand contracted at an even faster 6.6% pace.
- As bad as the Q1 outcome was, the bigger concern is that Q2 GDP will be much worse as lockdown measures take effect. That has been borne out by the April data, including a staggering nonfarm payroll decline of 20,500,000 and a surge in the unemployment rate to 14.7%.
- Among the other indicators of economic damage were a 16.4% m/m drop in April retail sales, and an 11.2% m/m drop in April industrial output.
- Parts of the economy have begun to re-open, although that re-opening is much more gradual and cautious than what was essentially an overnight shutdown. Altogether we forecast a 24.7% q/q annualized decline in Q2 GDP, and only a partial recovery in the second half of the year. For full-year 2020, we expect GDP to contract 4.6%.

U.S. Dollar Steady for Now…but Softer Later?

- Despite the massive economic damage from COVID-19 and remarkably aggressive easing from the Fed, the U.S. dollar has remained resilient given that similar economic trends have played out internationally.
- The size of the Fed's balance sheet has surged 67% since late February, while the Fed has also provided ample dollar liquidity, both domestically and internationally.
- With Fed easing providing some support for equities, and injecting U.S. dollar liquidity, we still expect greenback weakness and foreign currency strength over the medium to longer term.

Economic & FX Risks

Downside Scenario



Source: Datastream, Wells Fargo Securities

- Our base case for a recovery in H2 2020 is predicated on a pickup in employment and consumer spending.
- Although our forecast already reflects a gradual re-opening, if businesses are reluctant to add workers given persistent uncertainty the employment rebound may be more modest than we currently expect.
- In addition even if employment and incomes gain, consumers may be cautious about spending, with health and economic concerns potentially restraining the willingness to spend. As the largest portion of the economy, a cautious consumer would clearly restrain overall GDP growth.
- State and local government spending could also be restrained, with budget positions severely challenged by lost revenue and extra spending from COVID-19.
- A slower-than-expected U.S. recovery would likely see a weaker dollar against many G10 currencies, but could see some U.S. dollar strength against emerging currencies—a currency group that could be weighed down by subdued global growth prospects.

Central Bank Outlook

Fed Funds Rate forecast			
Current: 0.13%	**3M**	**6M**	**12M**
Wells Fargo	0-0.25%	0-0.25%	0-0.25%
Market Implied	0.12%	0.11%	0.06%

Source: Bloomberg LP, Wells Fargo Securities

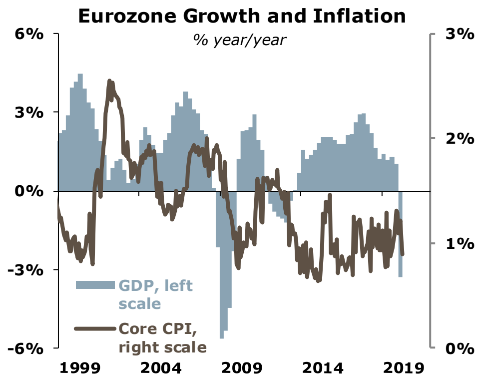
- The Fed has cut rates to zero and enacted a wide range of measures. Rather than further policy easing the focus for now appears to be on implementing announced measures including, for example, the Main Street Lending Program.

Eurozone/EUR

Outlook

The euro remains vulnerable to further downside in the near term, and will likely only gain gradually over the medium term. Q1 GDP fell sharply, while plunging confidence surveys suggest a much larger fall in Q2. With the extent of fiscal support so far less than ideal, we expect further ECB monetary easing, which is likely to weigh on the euro. Eventually the European economy and markets should stabilize, which should mean euro gains as long as U.S. dollar liquidity remains ample.

Fundamental Focus: Economics, Policy & FX



Source: Datastream, Wells Fargo Securities

Eurozone Recession Arrives

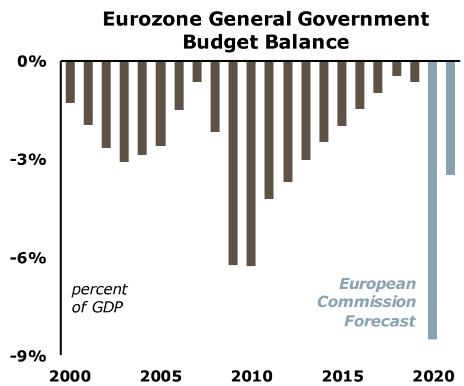
- Eurozone Q1 GDP declined 3.8% q/q, the largest fall on record, and by 3.2% y/y. German GDP fell 2.2% q/q, while France, Spain and Italy fell around 5% or more.
- Softening confidence surveys and weak activity data point to an even larger fall in Q2. The April services PMI fell to a record low 12.0 and the manufacturing PMI fell to 33.4.
- In addition, the sharp fall in March activity also points to a weak starting point for Q2. Retail sales slumped by 11.2% m/m, while industrial output fell 11.3% m/m. With lockdown measures extending through April, we expect activity declined even further last month.
- Given the large Q1 fall and continued weakness in confidence surveys, we have revised our 2020 GDP forecast lower and now see a fall of 8.0% this year.
- The April CPI slowed to 0.4% y/y and the core CPI eased to 0.9% y/y.

Further Policy Support Should Be Forthcoming

- The European Central Bank (ECB) kept its policy rates and asset purchase programs unchanged in April. However, the ECB eased terms and conditions on its targeted long-term lending program and introduced a new Pandemic emergency long-term refinancing operation (PELTRO). Given ongoing economic weakness, ***we expect the ECB to increase its (pandemic) asset purchases a further €500B in July.***
- Eurozone leaders have agreed on a €540B fiscal package; however, the prospects for further fiscal stimulus at a national or coordinated regional level remain uncertain.
- Soft growth and easy monetary policy should keep the euro under pressure for now, with euro gains likely only once the economy and global markets stabilize.

Economic & FX Risks

Downside Scenario



Source: European Commission, Wells Fargo Securities

- The risks to the Eurozone economic and currency outlook are tilted to the downside.
- Many Eurozone countries have started to re-open, although that is a cautious and gradual process. Moreover, there remains a risk of a renewed flare-up of COVID-19 cases as those economies re-open, which would further slow any rebound.
- Political differences between European countries, such as the more fiscally cautious Germany and the Netherlands, relative to France, Italy and Spain, could also frustrate prospects for an additional coordinated fiscal stimulus, and restrain the economy.
- In this scenario, the Eurozone economy could shrink perhaps 10% or more this year, while the ECB might have to increase is asset purchases even more than we forecast, as the onus continues to fall on monetary rather than fiscal policymakers.
- The EUR/USD exchange rate could fall close to the parity level, perhaps a range of $1.0000-$1.0200, a fall of around 6%-8% from current levels.

Central Bank Outlook

ECB Deposit Rate forecast			
Current: -0.50%	**3M**	**6M**	**12M**
Wells Fargo	-0.50%	-0.50%	-0.50%
Market Implied	-0.53%	-0.55%	-0.59%

Source: Bloomberg LP, Wells Fargo Securities

- We see the Deposit rate on hold for the next 12 months, although markets are currently pricing in modest interest rate cuts of around 9 bps over that period.

Japan/JPY

Outlook

We forecast only very gradual gains in the yen over time. Early 2020 market volatility has supported the yen, though the currency has not jumped as much on equity weakness as in the past. The correlation with yield spreads remains tight however, meaning any rise in global yields could restrain the yen. Given Japan's soft economic outlook and only limited safe-haven characteristics for the yen, we expect only very gradual Japanese currency gains as the global economy and markets stabilize.

Fundamental Focus: Economics, Policy & FX

Source: Datastream, Wells Fargo Securities

Japan's Economic Struggles Continue

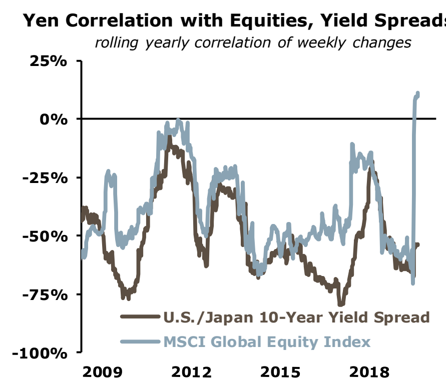
- Japan's economy was already struggling heading into 2020, and those difficulties have intensified as this year has progressed.
- A consumer sector already weighed down by the October 2019 consumption tax hike has been further affected by COVID-19 and the associated lockdown measures. In March, for example, retail sales fell 4.5% m/m and real household spending fell 4% m/m. We expect consumer spending, and overall GDP, to fall for a second straight quarter in Q1. The manufacturing sector is also showing weakness, as March industrial output fell 3.7% m/m.
- Confidence surveys suggest that subdued economic activity will persist through Q2 and likely beyond. Consumer confidence fell to a new low of 21.6 in April, while the economy watchers survey fell to a new low of 7.9. We expect an extended recession with Japan's GDP forecast to fall for five quarters in a row and expect GDP to shrink by 5.6% for full-year 2020.

Limited Impact from Modest Central Bank Tweaks

- The Bank of Japan (BoJ) made some modest adjustments at its latest monetary policy meeting, although we view those changes as more "style" than "substance."
- The BoJ kept its policy rate steady and said it was prepared to buy government bonds in unlimited amounts. However, net purchases are already running well below the previous ¥80T/year target, suggesting that move was largely symbolic. The BoJ did however raise its purchase target for corporate bonds and commercial paper to ¥20T.
- We expect only gradual yen strength over time, initially as markets remain somewhat unsettled, and eventually as Fed easing weighs on the greenback.

Economic & FX Risks

Downside Scenario



Source: Bloomberg LP, Wells Fargo Securities

- Although our base case is for moderate yen gains versus the U.S. dollar, the risk is for either smaller yen gains, or possibly outright yen declines over the longer term.
- The yen has generally been the "safest haven" in FX markets, though its inverse correlation has disappeared in recent weeks. That suggests the yen may not get that much support even if market jitters return in the weeks ahead.
- In contrast the correlation between USD/JPY and the U.S./Japan 10-year yield spread has remained quite tight. With that spread perhaps unlikely to narrow much further, it could also restrain any yen gains.
- While our base case for USD/JPY to move to JPY105.00 over time, if the global economy and markets improve more than expected, and global bond yields rise, it is possible the yen could soften over time, perhaps to a USD/JPY exchange rate of JPY110.00.

Central Bank Outlook

BoJ Policy Rate forecast			
Current: -0.10%	**3M**	**6M**	**12M**
Wells Fargo	-0.10%	-0.10%	-0.10%
Market Implied	-0.06%	-0.08%	-0.06%

Source: Bloomberg LP, Wells Fargo Securities

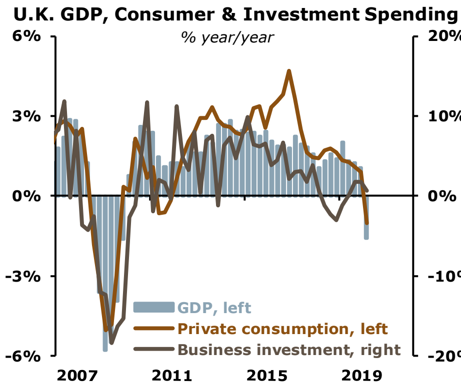
- Despite modest changes in some asset purchase targets, we think a change in the policy rate or significant changes in government bond purchases are unlikely for some time.

United Kingdom/GBP

Outlook

We expect near-term weakness in the pound, and only a modest recovery over the medium term. The economy fell sharply in Q1 and, with lockdown measures persisting through much of Q2, we expect a much larger decline in economic activity in Q2. The should prompt the Bank of England to ease monetary policy further, while Brexit concerns could also weigh on the pound for some time. Sterling gains are possible longer term as the economy stabilizes, BoE easing ends and Brexit concerns lessen.

Fundamental Focus: Economics, Policy & FX



Source: Datastream, Wells Fargo Securities

Domestic Economy Knocked Down

- Q1 GDP fell by a large 2% q/q and 1.6% y/y, while the release also showed weakness across many areas of the economy. Consumer spending fell 1.7% q/q, while exports were down 10.8% q/q.
- Weak activity in March, and slumping confidence surveys since, essentially guarantee a much larger economic contraction in Q2. GDP fell 5.8% m/m in the month of March alone, pointing to a weak starting point for Q2 activity, while lockdown measures became more stringent in April and May.
- In early Q2 data, the April manufacturing PMI fell sharply to 32.6 and the services PMI plunged to a record low 13.4. We expect Q2 GDP to fall 13% q/q, and for the economy to decline 8.1% for full-year 2020.

Further Bank of England Easing Not Far Away

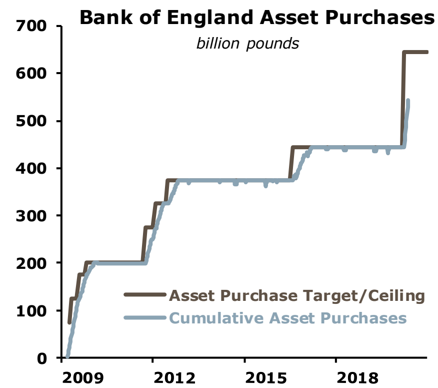
- The Bank of England (BoE) kept its policy rate at 0.10% and held its asset purchase target at £645B in May. However, Governor Bailey said the central bank will act as needed to deliver monetary and financial stability, as well as signaled the possibility of further quantitative easing in June. Meanwhile, two policymakers voted for an immediate £100B increase in the asset purchase target.
- We now expect the ***BoE to raise its asset purchase target further by £100B to £745B in June***, while we also see the risks as tilted towards a larger and/or further asset purchase increases.

Near-term Sterling Weakness

- We expect further downside for GBP/USD to $1.2000. A weak economy, central bank easing and potential Brexit uncertainty ahead of a July 1 deadline to request an extension, are all factors that could weigh on the pound.

Economic & FX Risks

Downside Scenario



Source: Datastream, Wells Fargo Securities

- The U.K. economy has been significantly affected by COVID-19. While some continental European economies have begun to re-open, the U.K. has so far made only "first careful steps" toward re-opening, perhaps suggesting that a U.K. recovery could lag behind that of the Eurozone.
- While a large fall in U.K. Q2 GDP is widely expected, the range of forecasts is extremely wide. Among the more negative views, the BoE's May Inflation report offered an illustrative scenario that saw a Q2 decline of 25% q/q.
- Should the U.K. economic decline match these more negative scenarios and/or extend into the second half of the year, the central bank would likely increase its asset purchase target by more than the £100B we forecast. It is also possible, though less likely, the BoE could cut its policy interest rate to zero, or even into negative territory.
- As of early May net speculative short sterling positions were moderate, at 23,200 contracts, indicating plenty of scope for renewed selling. If the economy is weaker—or the Bank of England eases further—than we expect, GBP/USD could fall near its 2020 low of $1.1412.

Central Bank Outlook

Bank Rate forecast			
Current: 0.10%	**3M**	**6M**	**12M**
Wells Fargo	0.10%	0.10%	0.10%
Market Implied	0.10%	0.07%	0.03%

Source: Bloomberg LP, Wells Fargo Securities

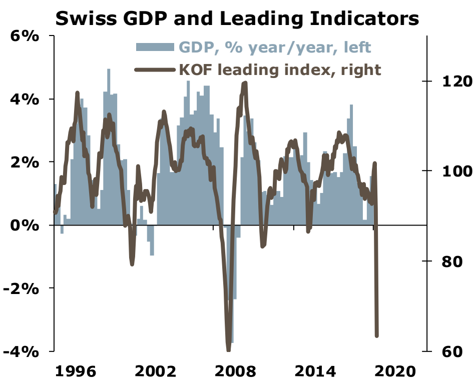
- We do not expect the central bank to cut rates further, but we do expect an increase in the asset purchase target to £745B in June, and also view an increase beyond that target as quite likely.

Switzerland/CHF

Outlook

We expect the franc to be steady-to-stronger against the euro and greenback for now, but potentially weaker (especially versus the euro) over time. The franc appears to be enjoying safe-haven support, prompting the central bank to rapidly ramp up its FX intervention activity. However, rate cuts are still a possibility and leading indicators are soft, suggesting some Swiss franc weakness once the global economy and markets stabilize.

Fundamental Focus: Economics, Policy & FX



Source: Datastream, Wells Fargo Securities

Swiss Economy Getting Weaker…

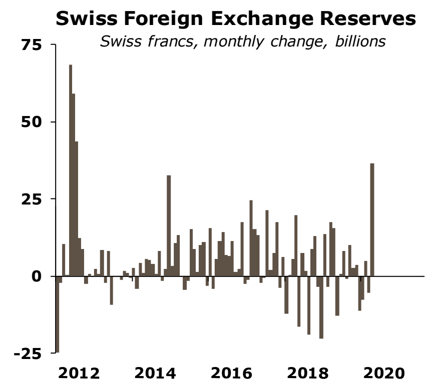
- Similar to its European neighbors, evidence of an intensifying economic downturn in Switzerland is mounting.
- Activity data are already showing softness, with March real retail sales fell 5.6% y/y. On the trade front, March real exports fell 4% m/m and imports fell an even larger 6.7% m/m. The rise in the April jobless rate to 3.3% was also notable.
- Even more significant, however, are slumping confidence surveys, which portend an even larger downturn as 2020 progresses. The April KOF leading indicator fell to 63.5, the lowest level since 2009, while the manufacturing PMI declined to 40.7. Given signs of widespread weakness we have revised our Swiss GDP forecast lower, and now expect the economy to contract 5% in 2020.
- Inflation remains absent as the April CPI fell 1.1% y/y. The lack of inflation offers scope for the Swiss National Bank to cut rates further, though whether the central bank will deliver lower rates is unclear.

…While Swiss Franc Stays Strong

- Despite economic weakness, the Swiss franc has remained strong, especially against the euro. In part that likely reflects the weakness of Switzerland's neighbors, though "safe haven" flows may also be providing support at times.
- Indeed, the central bank has become more wary of franc strength, and has stepped up its FX intervention activity in recent weeks. April FX reserves rose 36B francs to 800B francs, the largest monthly gain since 2012.
- The franc should remain strong near current levels as the central bank restrains the currency, but soften modestly over time as the global economy and markets stabilize.

Economic & FX Risks

Downside Scenario



Source: Datastream, Wells Fargo Securities

- While our base case is for gradual Swiss franc weakness (versus the euro) over the medium term, we believe the risks lean toward an even faster decline.
- For now a significant increase in central bank FX intervention should limit any meaningful franc gains.
- While we do not forecast further rate cuts, the chance of such cuts are rising. Domestically, a sharp recession and intensifying deflationary pressures could push the Swiss National Bank to act.
- Globally, a stabilization of the global economy and markets would likely see support for the franc wane and the currency soften, as investors seek higher returns elsewhere.
- Although less likely, an unexpected pick up in the Eurozone economy would also see the franc soften versus the euro.
- Overall, if the Swiss National Bank were to lower rates further and the global economy and markets stabilize, it is plausible the EUR/CHF exchange rate could rise as high as CHF1.1000 over time.

Central Bank Outlook

SNB Policy Rate forecast			
Current: -0.75%	**3M**	**6M**	**12M**
Wells Fargo	-0.75%	-0.75%	-0.75%
Market Implied	-0.98%	-0.88%	-0.94%

Source: Bloomberg LP, Wells Fargo Securities

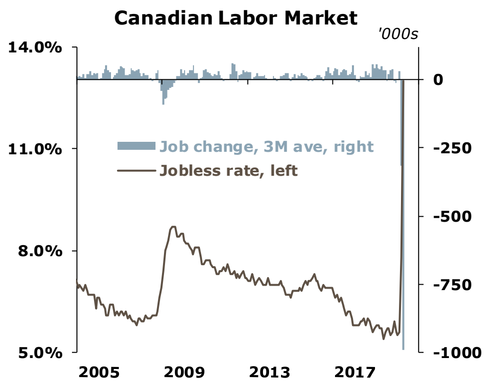
- The central bank has consistently highlighted that lower interest rates are still possible, though our base case is for rates to remain steady over the next 12 months.

Canada/CAD

Outlook

We believe the Canadian dollar is vulnerable to further weakness in the near term, and see only a moderate recovery over time. An extremely weak Canadian economy, very easy monetary policy, and subdued global oil prices are all factors that could weigh on the currency. The prospects for the currency largely hinge on a global economic rebound and further rise in oil prices. Still with most economies only slowly re-opening and excess oil supply prevalent, any Canadian dollar recovery should be gradual.

Fundamental Focus: Economics, Policy & FX



Source: Datastream, Wells Fargo Securities

Bracing for a Bumpy Economic Ride

- The labor market continues to provide the best window into the current soft state of the Canadian economy.
- The April employment report, while not as bad as expected, was another shocker. Overall employment fell by 1,994,000, essentially twice as large as the March decline.
- In addition some important sectors of the economy showed sizeable falls, with full-time jobs down 1,472,000, private sector jobs down 1,874,000 and service sector jobs down 1,373,000. Finally, the jobless rate jumped to 13.0%.
- Meanwhile, total hours worked dropped 14.9% m/m after a 15.1% m/m fall in March. As a result, we forecast Canada's GDP to contract a very sharp 34% q/q annualized in Q2, and fall 6.3% for full-year 2020.

Low Oil Prices Another Headwind for the Economy

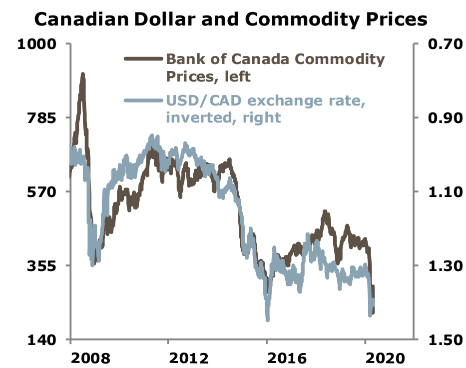
- The combination of a Saudi Arabia/Russia oil price war in early 2020, followed subsequently by the demand destruction from COVID-19, has seen oil prices drop precipitously this year. Even with some recent recovery, WTI crude prices have still only returned to the mid $20/barrel range.
- Canadian oil production held up well through February, though an extended period of low prices should see a drop in oil production and associated activities in the months ahead.

Bank of Canada Eases Policy Further

- The Bank of Canada kept policy rates steady in April, but did announce two new asset purchase programs—a provincial bond purchase program of C$50B and corporate bond purchase program of C$10B. The Bank of Canada also said it could act further if needed.

Economic & FX Risks

Upside Scenario



Source: Datastream, Wells Fargo Securities

- Our base case for near-term weakness in the Canadian dollar reflects a soft economy and low global oil prices.
- However, global oil prices have staged a recovery back close to US$30/barrel. While unlikely given still significant excess global oil supply, if oil prices rise further it could limit Canadian currency downside.
- Signs of recovery in China's economy, and especially its manufacturing sector, could be significant and help Canadian dollar sentiment, as China is a substantial resource and commodity user.
- The government has provided significant fiscal stimulus, and the IMF estimates the general government budget deficit will widen to 10.4% of GDP in 2020. That might not help the economy and currency for now, but it could lead to a faster recovery once lockdown measures are eased.
- Clearly U.S. trends will be important, in particular whether the U.S. economy can re-open without a significant resurgence in COVID-19 cases. Should that and the other factors above occur, the Canadian dollar could avoid much further softness, a recover to a USD/CAD exchange rate of CAD1.3500 over time.

Central Bank Outlook

Overnight Rate forecast			
Current: 0.25%	**3M**	**6M**	**12M**
Wells Fargo	0.25%	0.25%	0.25%
Market Implied	0.27%	0.24%	0.23%

Source: Bloomberg LP, Wells Fargo Securities

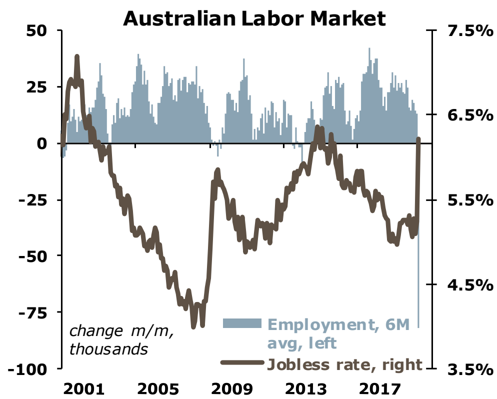
- The current policy rate of 0.25% looks unlikely to move in either direction for some time, with new Bank of Canada governor Tiff Macklem saying he is quite comfortable with the effective lower bound.

Australia/AUD

Outlook

Our outlook for the Australian dollar is little changed as we still expect modest weakness in the currency in the near term given the challenges of the coronavirus and weaker commodity prices. Meanwhile, the return of U.S.-China trade tensions is likely to create an additional headwind as it is could weigh on sentiment towards the Australian dollar. In addition, the Australian economic outlook is bleak, as recent data reveals that the economy may contract more sharply this year than previously forecast.

Fundamental Focus: Economics, Policy & FX



Source: Datastream, Wells Fargo Securities

RBA Holds Fire at May Policy Meeting

- At its most recent policy meeting in May, the Reserve Bank of Australia (RBA) held its Cash Rate and the yield target on three-year Australian government bonds at 0.25% as expected. Policymakers indicated that it will maintain a steady Cash Rate until progress is made toward full employment and it is confident that inflation will be within its 2-3% target band.
- Given that three-year bond yields have been steady near the 0.25% target, the RBA has scaled back the size and frequency of its bond purchases. Nevertheless, the RBA indicated that it is prepared to scale-up its bond purchases again, if necessary to ensure bond markets remain functional.

Outlook Weakening amid Virus Outbreak

- Australian retail sales volumes rose steadily in Q1, while March retail sales surged 8.5% m/m as overall sales got a boost from supermarket, liquor and pharmaceutical sales in pre-COVID-19 spending. The coronavirus, however, presents a downside risk to sales in the coming months.
- Subsequent data have been softer, with April business conditions falling to -34, while business confidence rose, but still remains very weak. Furthermore, the April jobs report showed employment collapsed by 549,300 for the month, the largest decline on record, with over one-third of the losses in full-time employment. The unemployment rate rose just 1.0 percentage points to 6.2%, with the increase limited by a fall in labor market participation.
- We look for real GDP in Australia to contract more than previously forecast, falling 4.4% in 2020, marking the first recession since the early 1990s.

Economic & FX Risks

Upside Scenario

- Stronger Chinese growth prospects should support Australian economic activity and be helpful for the broader global economy.
- For Australia specifically, a stronger economic recovery is possible if there is substantial progress in containing the spread of the coronavirus in the near term and there is a quicker return to normal economic activity.
- If growth is more stable than expected, that would lessen the risk of disinflation and the chances of further easing. We note, for example, that the RBA has already scaled back its bond purchases.
- In a scenario of stable domestic and global growth as well as limited further monetary policy easing, we see scope for the Australian dollar to strengthen as high as A$0.7300.

Downside Scenario

- A re-escalation of the U.S.-China trade war as well as other uncertainties could increase volatility and weigh on domestic and global growth. That could potentially lead to equity weakness, putting pressure on the risk-sensitive Australian dollar.
- The effects of the coronavirus could persist for longer than we currently anticipate. Moreover, to the extent the consumer is hesitant to spend, or businesses are unwilling to invest and hire, the post-COVID-19 recovery could be weaker than expected and the central bank could ease policy further.
- In this environment of subdued growth and easy monetary policy, the Australian dollar could be vulnerable in the near term, and perhaps reach a level of only around A$0.6300 over the medium term.

Central Bank Outlook

Cash Rate forecast			
Current: 0.25%	**3M**	**6M**	**12M**
Wells Fargo	0.25%	0.25%	0.25%
Market Implied	0.30%	0.28%	0.24%

Source: Bloomberg LP, Wells Fargo Securities

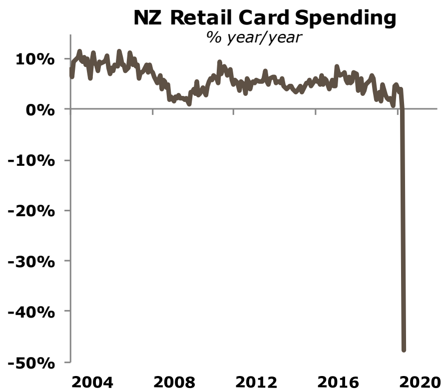
- We expect the RBA to keep its policy rate at its current level for an extended period of time, as indicated at its most recent policy meeting.

New Zealand/NZD

Outlook

We maintain our expectation for modest New Zealand dollar weakness in the near term, before an eventual stabilization in the currency over the longer term. The outlook for the New Zealand economy remains challenging and we view the risks over the next few months as tilted toward the downside given the current risk environment. We have downgraded our 2020 GDP growth forecast, and now look for the economy to fall 4% this year.

Fundamental Focus: Economics, Policy & FX



Source: Datastream, Wells Fargo Securities

RBNZ Unleashes Large Stimulus Measures

- The RBNZ substantially expanded its Large Scale Asset Purchase (LSAP) program to NZ$60B (~19% of GDP). The central bank's rhetoric was dovish in tone, leaving the door open for further policy easing. The central bank also projected inflation will approach zero by early next year. If any additional easing were to occur, we believe it would likely be via the expansion of its LSAP program.
- The NZ government budget outlined a NZ$50B COVID-19 response (16% of GDP), of which NZ$30B has already been allocated. The new package comes on top of an initial rescue package of NZ$12B announced in March.

Strict Lockdowns Likely to Weigh on Growth

- The Q1 jobs report provided a mixed picture for the labor market, but worse is likely to come. Q1 employment rate rose 0.7% q/q. However, despite the solid job growth, the unemployment rate climbed to 4.2% and private sector labor costs rose a meager 0.3% q/q. In addition, the number of individuals seeking unemployment benefit support at the end of March and start of April soared, hinting that the unemployment rate may rise in the current quarter.
- Preliminary business confidence data for May rose, but still remains extremely weak. Headline business confidence rose to -45.6, while businesses' own activity outlook figure rose to -42.0. Meanwhile, NZ card spending plummeted in April with retail card spending falling 46.8% m/m, the largest decline on record.
- Although the NZ economy was solid heading into the pandemic, given the massive disruptions to the New Zealand economy we now look for GDP growth to contract 4.0% for full-year 2020.

Economic & FX Risks

Upside Scenario

- The government has made significant progress in containing the spread of the coronavirus outbreak domestically, allowing New Zealand to re-open its economy and lift restrictions much quicker than most of its international peers. Its plan to relax restrictions provides potential for a rebound in activity to more "normal" levels in a relatively timely manner.
- Earlier this year, fiscal and monetary policy were eased aggressively, which should provide a significant impetus to an economic rebound once the economy begins to open.
- As risk appetite across markets increases, investor demand could increase for the risk-sensitive NZ dollar.
- New Zealand's key tourism sector should eventually be supported as domestic mobility improves and once international travel restrictions are lifted.
- In this scenario, the NZ dollar could strengthen to NZ$0.6900.

Downside Scenario

- Further deterioration in the labor market is possible and the central bank has not ruled out cutting interest rates into negative territory.
- As the RBNZ further increases the size of its Large Scale Asset Purchase program and maintains an easy policy for an extended period, ample NZ dollar liquidity could weigh on the currency.
- Disinflationary pressures could intensify, although deflation is not our base case.
- The outlook for commodity prices remains uncertain, specifically dairy prices, which could create an additional headwind for growth
- In this more cautious scenario the NZ dollar could fall more than expected in the near term, and only rise close to NZ$0.6000 over time.

Central Bank Outlook

Official Cash Rate forecast			
Current: 0.25%	**3M**	**6M**	**12M**
Wells Fargo	0.25%	0.25%	0.25%
Market Implied	0.21%	0.14%	-0.03%

Source: Bloomberg LP, Wells Fargo Securities

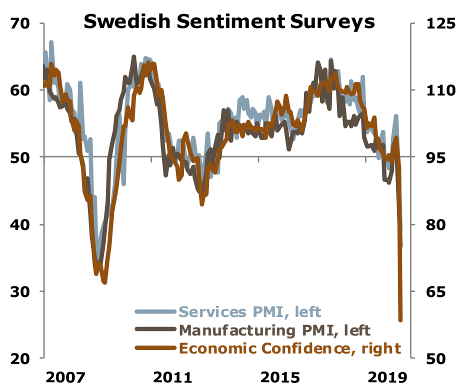
- Given recent commentary from policymakers and recent measures taken by the central bank, we believe the RBNZ will maintain a steady policy over the foreseeable future.

Sweden/SEK

Outlook

We continue to expect the Swedish krona to remain on the defensive for the near term as Sweden's open economy is largely exposed to global and local disruptions from the coronavirus outbreak. In addition, we think the growth outlook is bleak as recent data suggest a sharp slowdown in months ahead, despite efforts from policymakers aimed at supporting its economy.

Fundamental Focus: Economics, Policy & FX



Source: Bloomberg, Wells Fargo Securities

Risks Tilted Toward Expansion of Bond Purchases

- At its latest policy meeting on April 28 the Riksbank kept its repo rate steady at zero. While the central bank did not rule out further rate cuts, it signaled some hesitation to return to negative interest rates. The accompanying statement and the policy minutes highlighted policymakers' willingness to continue to evaluate its combination of policy measures, and suggested that further balance sheet measures would be the preferred method of providing policy support amid the current crisis. We now look for the Riksbank to hold its repo rate at zero for the foreseeable future, and if any easing were to occur, we believe it would be via balance sheet measures, perhaps some time during Q3.
- Sweden experienced deflation in April as lower energy prices and the effects COVID-19 weighed on demand. CPIF fell 0.4% y/y, while headline prices fell 0.4% y/y.

Sweden Still Vulnerable to Economic Weakness

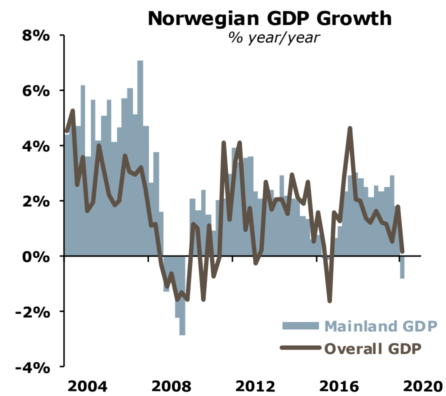
- Overall economic confidence plunged to 58.6 in April, the lowest level on record. Meanwhile, consumer and manufacturing confidence also declined in April, falling to 73.9 and 70.5, respectively. Leading indicators have also slowed as the April manufacturing PMI slid to 36.7 and the services PMI slumped to 39.0 as the new orders sub-index plunged to 27, indicating a rapidly worsening situation for the services sector.
- Sweden's indicator for GDP showed only a modest contraction in Q1, but given that this is only a flash estimate, the fuller quarterly figure released later this month should provide a more complete picture.

Norway/NOK

Outlook

We remain negative on the Norwegian krone, anticipating renewed softness in the near term as it faces the dual shock of the coronavirus pandemic and lower oil prices. The krone should perform better in 2021, but likely to remain a laggard against other major currencies. Given the Norwegian's economy's reliance on trade and oil, we now expect GDP growth to contract 5.1% for full year 2020.

Fundamental Focus: Economics, Policy & FX



Source: Datastream, Wells Fargo Securities

Norges Bank Catches Markets Off Guard with Cut

- The Norges Bank opted to cut its policy rate 25 bps to zero as activity in the economy has fallen amid the coronavirus pandemic and a sharp fall in oil prices. That said, we still see a rate move into negative territory as unlikely. In the accompanying statement, the committee indicated that the downturn could have a prolonged impact on the Norwegian economy, and the unemployment rate could remain elevated for quite some time. To improve liquidity, the Norges Bank will continue to provide its extraordinary short-term loans to banks through the end of August.
- Headline CPI inflation unexpectedly rose in April to 0.8% y/y, but energy costs declined 4.3%, restraining prices. Meanwhile, underlying inflation jumped to 2.8% y/y.

Dual Shock Hits Activity in Norway

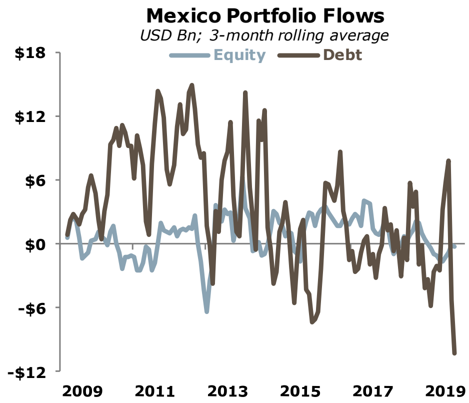
- Economic activity appears to have been hit hard. Since March 9, the Norwegian Labor and Welfare Administration received over 442,000 applications for unemployment benefits, while Norway's unemployment rate still remains exceptionally high at 9.6% in April.
- Q1 mainland GDP contracted more than expected, shrinking 2.1% q/q, and plunged 6.9% m/m in March, the largest fall since monthly data began in 2016, as accommodation and food service activities as well as arts, entertainment and other service activities were hit particularly hard.
- Norwegian manufacturing output saw a significant decline of 3% m/m in March as measures to contain the spread of the virus weighed on activity, particularly within petroleum-related manufacturing.

Mexico/MXN

Outlook

Our outlook for the Mexican peso is little changed, and we still forecast a weaker currency over the forecast horizon. As of now, we expect sentiment to remain negative toward emerging currencies, which should place downward pressure on the peso. In addition, a lackluster fiscal response to COVID-19 and lower oil prices should result in a sharper and prolonged recession in Mexico, which we believe the central bank will need to aggressively ease monetary policy to offset.

Fundamental Focus: Economics, Policy & FX



Source: IIF, Wells Fargo Securities

Economic Uncertainty to Weigh on the Peso

- COVID-19 has placed broad depreciation pressure on emerging currencies, and with the timing of the recovery uncertain, we expect sentiment to remain negative towards emerging currencies. We believe, this negative sentiment should weigh on the peso in the short-term.

Mexican Economy Is in Trouble

- Mexican GDP fell more than we forecast in Q1, declining 1.6% q/q. The effects of COVID-19 clearly contributed to the contraction; however, Mexico's economy was already in a fragile state pre-virus having contracted on annual basis in 2019.
- The sharper-than-expected decline in Q1, coupled with a lax fiscal response policy from the AMLO administration, led us to believe the Mexican economy could experience a significant contraction this year. In this context, we have downgraded our annual GDP forecast and believe the Mexican economy will decline 8.3% in 2020.
- In an effort to offset the impact from the virus, we believe the Central Bank of Mexico will need to lower interest rates aggressively. Easier monetary policy will eventually erode the high real interest rate associated with the peso, which would weigh on the peso over time.

Capital Outflows Intensify

- Negative sentiment toward emerging markets has resulted in large capital outflows from Mexico, particularly as it relates to Mexican debt. We expect credit rating downgrades to continue, which will likely result in additional debt outflows in the future. Should the Mexican government lose investment grade ratings, capital outflows could intensify which may also place additional downward pressure on the currency.

Economic & FX Risks

Upside Scenario

- In order for the peso to outperform, the spread of COVID-19 would have to be contained relatively quickly and risk sentiment would need to notably improve.
- Should sentiment improve, emerging currencies could rally and the Mexican peso would likely be a large beneficiary. In addition, the containment of the virus should result in renewed demand and higher prices for oil, which would be supportive of the economy and currency.
- Containment of the virus would lift lockdown measures and could result in a more pronounced rebound in U.S. economic activity. Given the strong trade linkages between the U.S. and Mexico, the Mexican economy would not contract as much as we forecast.
- A more V-shaped recovery would likely mean less monetary easing from the central bank, which would keep Mexico's high real interest rate in place which is supportive of the peso.

Downside Scenario

- We believe the balance of risk is tilted toward more peso weakness than we currently forecast, and this scenario is defined by a second wave of virus infections that turns sentiment negative for much longer.
- Failure to contain the virus would likely result in longer lockdown protocols and sharper contractions in global growth, as well as a much deeper and prolonged recession in Mexico.
- The AMLO government continues to push back on implementing fiscal stimulus, which likely results in the central bank cutting rates more aggressively than we currently forecast.
- The combination of these events would place significant pressure on the peso and we would downgrade our USD/MXN forecast.

Central Bank Outlook

Overnight Rate forecast			
Current: 5.50%	**3M**	**6M**	**12M**
Wells Fargo	4.50%	4.25%	4.00%
Market Implied	4.79	4.47%	4.23%

Source: Bloomberg LP, Wells Fargo Securities

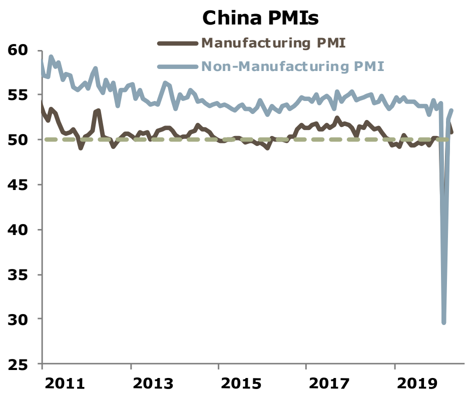
- Mexico's central bank is expected to ease further, as reflected in our outlook for a further 100 bps of cuts over the next three months, even more than priced into markets.

China/CNY & CNH

Outlook

We maintain a cautiously optimistic outlook on the renminbi, despite indications the Chinese economy is recovering, risks to the currency have increased slightly. Renewed trade tensions between the U.S. and China seem to be building, while reports indicate new confirmed virus cases in Wuhan. As of now, we believe most bad news is already priced into the renminbi; however, if another wave of infections occurs and trade tensions escalate, our outlook on the currency would likely change.

Fundamental Focus: Economics, Policy & FX



Source: Bloomberg LP, Wells Fargo Securities

Indicators Suggest a Strong Q2 Rebound

- As expected, Chinese GDP contracted sharply in Q1, although the economy could be on track for a pronounced recovery in Q2. Manufacturing and non-manufacturing PMIs have rebounded back above the breakeven 50 level in April, a positive indicator for the trajectory of China's economy.
- Timely indicators of activity also suggest the rebound is underway as retail sales declined 7.5% y/y in April, a notable improvement from March, while industrial production rose 3.9% y/y.

An Economic Recovery Leads to a Currency Recovery

- With activity and sentiment data rebounding and local businesses fully operational, the likelihood that China avoids an annual contraction this year is increasing. As of now, we maintain our GDP forecast for China to contract 1.2% this year; however, we acknowledge that an upgrade to this forecast is likely if data continue to suggest a robust rebound.
- As the Chinese economy recovers, we believe the renminbi will recover as well. More constructive activity and sentiment data should fuel positive sentiment towards China as well as the currency, and we believe there is scope the currency to strengthen over the short and long term.

A Second Wave? Trade Tensions Renewal?

- While we have not integrated these risks into our base case forecasts, renewed trade tensions with the United States seem to be building which could affect sentiment. In addition, reports indicate new confirmed COVID-19 cases have been discovered in Wuhan. If either of these risks escalate or intensify, we would incorporate them into our base case forecasts.

Economic & FX Risks

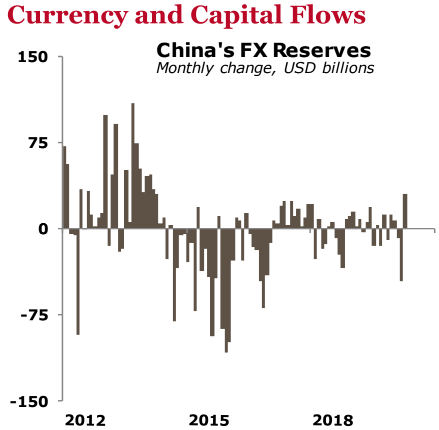
Upside Scenario

- As of now, we think risks around our GDP and currency forecasts slightly tilted toward the upside; however, we acknowledge downside risks are also emerging.
- Local Chinese businesses and manufacturing plants continue to re-open and economic activity data is consistent with a more robust recovery in GDP.
- Global containment of the virus sparks risk-on sentiment across global markets, with investors becoming less risk averse to emerging market currencies. Capital flows into China and other emerging markets pick-up in response.
- Tensions between the United States and China do not escalate any further as China meets all obligations under the Phase I trade deal and the Trump administration does not seek any concessions or seek to punish China for COVID-19 originating in China.

Downside Scenario

- A second wave of infections in Wuhan and other cities in China results in manufacturing plants shutting down again. Lockdown measures go back in place, and economic activity grinds to another sudden halt.
- Q3 GDP sinks similar to Q1 and the annual contraction is much deeper than we currently forecast, while sentiment towards China and other emerging market countries sours even further.
- Another wave of infections sparks retaliation measures from the U.S. administration, including additional tariffs or further limitations on investment into China.

Currency and Capital Flows



Source: Bloomberg LP, Wells Fargo Securities

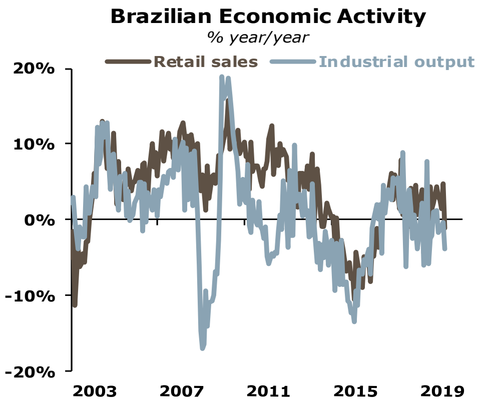
- China's April FX reserves rose by US$31B to US$3091B, hinting at likely currency inflows.

Brazil/BRL

Outlook

We have become outright negative on the prospects for the real as global and local developments continue to put pressure on the Brazilian currency. In particular, we are worried about elevated political risk as President Bolsonaro has removed multiple members of his cabinet and authorities currently investigate him for obstruction of justice and corruption. In our view, its likely proceedings against Bolsonaro move forward, while formal impeachment is a real possibility.

Fundamental Focus: Economics, Policy & FX



Source: Bloomberg LP, Wells Fargo Securities

Politics Takes Center Stage

- A lot has happened in just a month's time. President Bolsonaro fired Brazil's health minister on opposing views related to COVID-19 as well as the head of Brazil's federal police. In addition, Sergio Moro, a top federal judge resigned as he interpreted the firing of the head of federal police as Bolsonaro attempting to obstruct justice against ongoing investigations into him and his family.
- The reaction to Bolsonaro's actions has been swift as Brazil's Supreme Court Judge authorized federal prosecutors to investigate allegations that Bolsonaro is attempting to interfere with federal police investigations. In addition, Moro claims to have video evidence of Bolsonaro obstructing justice, which we believe should expedite the investigation and potentially lead to formal charges against Bolsonaro.
- Political developments have been at the core of Brazil's economic downturn over the last few years and one of the key catalysts for the country's recession in 2014 as well as 2016. At this time, we believe Bolsonaro will be charged with federal crimes and the impeachment process will formally begin. It is too early to tell whether Bolsonaro will be removed from office, but progress toward impeachment should place downward pressure on the currency.
- Aside from impeachment proceedings, Bolsonaro's rejection of social distancing has made Brazil one of the most COVID-infected countries in the world. The high infection rate and lack of confidence in Brazil's institutions and policymakers at this time, is likely to result in further capital outflows and more aggressive easing from the central bank, all which should contribute to a weaker currency over the short and long term.

Economic & FX Risks

Upside Scenario

- An upside scenario for Brazilian real would include a global containment of the virus and V-shaped recovery, which as of now, seems less likely. In addition, Bolsonaro would have to implement strict lockdown measures to contain the spread of the virus, which at this time, also seems unlikely.
- A robust recovery could lead the central bank to refrain from easing policy too aggressively, while political risk would also have to dissipate and allegations against Bolsonaro be dismissed.
- We place a relatively low probability on these events materializing and believe the real will struggle to gather any significant momentum in the current environment.

Downside Scenario

- Despite our bearish outlook on the currency, we believe risks are still tilted toward the even further weakness. Political developments have the potential to result in a very sharp movement in the currency, and given the investigation comes amid a broad risk-off in emerging currencies, the real could sell-off significantly more than we forecast.
- Other key cabinet members resigning their posts (i.e., economy minister Paulo Guedes) would also contribute to the Brazilian real selling-off considerably. Additional protests against social distancing led by Bolsonaro himself, could also incite prolonged disruptions to the economy and weigh on the currency.
- Should political developments spiral and the economy worsens, it is likely the Brazilian Central Bank cuts its Selic rate aggressively, pushing real rates back into negative territory.

Central Bank Outlook

Selic Rate forecast			
Current: 3.00%	**3M**	**6M**	**12M**
Wells Fargo	2.50%	2.00%	2.50%
Market Implied	2.53%	2.46%	3.83%

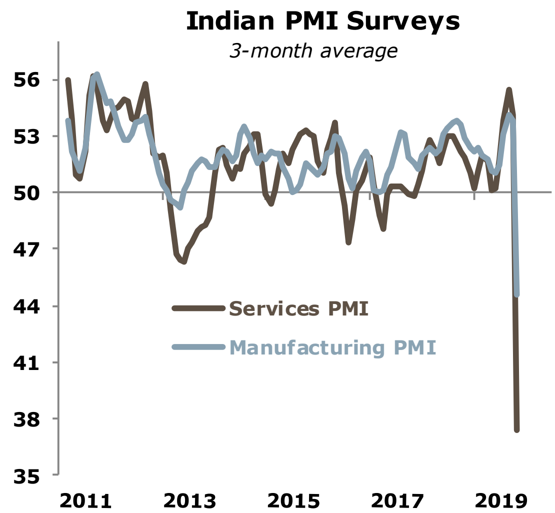
Source: Bloomberg LP, Wells Fargo Securities

- We expect Brazil's central bank will cut interest rates by more than the market currently anticipates, while we also expect policy interest rates to remain at relatively low levels for an extended period of time relative to market expectations.

Asia

Indian Rupee (INR)

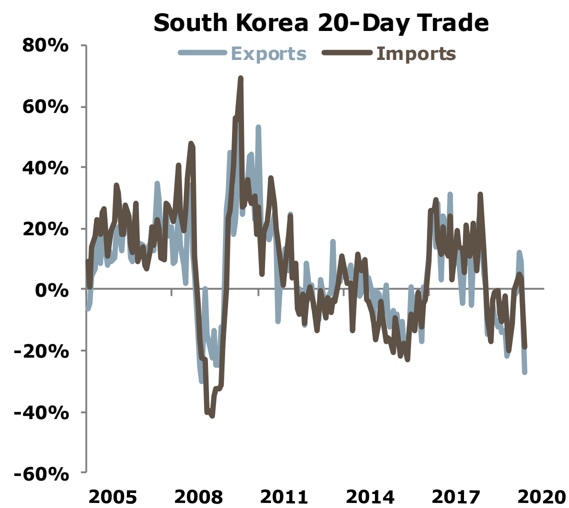
Outlook: Given our outlook for elevated uncertainty surrounding the evolution of the virus, we believe the short- to medium-term outlook for the rupee remains challenging. Prime Minister Modi implemented nationwide lockdown measures in late March, eventually extending lockdown protocol through early May. Some distancing measures have been lifted; however, the suppression of mobility across the country has had a significant impact on India's economy. In April, the manufacturing PMI hit a record low, while the services PMI representing the largest part of India's economy, fell to 5.4. In addition, industrial output contracted 16.7% y/y in March, further highlighting how COVID-19 is disrupting India's economy. There are also underlying vulnerabilities within the Indian economy that were of concern pre-virus. These include a fragile banking sector, particularly state-owned banks, lower consumption rates and elevated political risk. As a result, we have lowered our GDP forecast for India's economy and now expect a 2020 contraction of 1.7%. Authorities announced a stimulus package worth around 10% of GDP, which could offset some of the economic impact; however, we believe it will not be enough to keep the economy from experiencing an annual contraction.



Source: Bloomberg LP, Wells Fargo Securities

Korean Won (KRW)

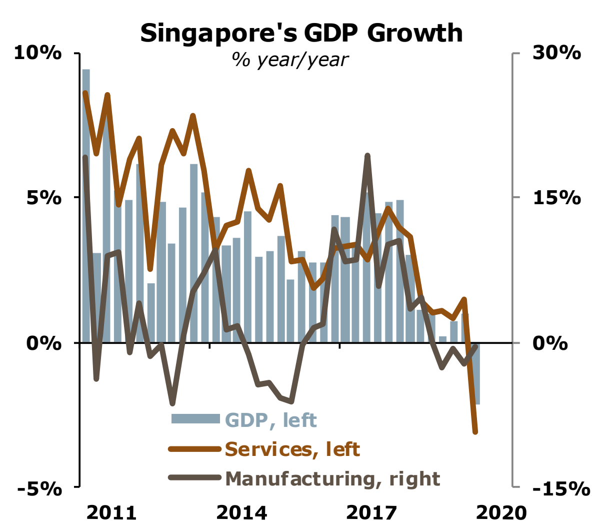
Outlook: Until recently, South Korea has been able to contain the spread of COVID-19. Social distancing measures were lifted as infection rates slowed; however, over the past week, reports indicate that new confirmed cases are beginning to increase, raising concerns not only domestically but globally that lockdown measures may need to stay in place. While it is too soon to tell if another significant wave of infections will occur across the country, these reports could weigh on sentiment towards the Korean currency and potentially emerging markets more broadly. In this context, we maintain our view that the Korean won is likely to weaken over the short-term as uncertainties around the spread of the virus, and health and recovery of the global economy are likely to persist. The Korean economy contracted 1.4% q/q in Q1, and as of now, we assume the global recovery will begin in Q3. Given how integrated South Korea is in the global economy and how export oriented the economy is, the South Korean economy and currency should start to recover as the virus dissipates. We will be particularly focused on assessing whether another wave of infections will occur in South Korea and how the global economy recovers, with any setbacks likely to result in downgrades to our USD/KRW forecast.



Source: Bloomberg LP, Wells Fargo Securities

Singapore Dollar (SGD)

Outlook: Despite the pressure applied to emerging currencies, the Singapore dollar has only come under modest stress. As of mid-May, the currency weakened around 5.5% against the U.S. dollar, one of the more stable emerging currencies year to date. We expect this stability to continue and only forecast moderate downside in the Singapore dollar over the short term as uncertainties surrounding the evolution of the virus persist. The deterioration in the health of the global economy should have knock-on effects for Singapore's economy as the country is a major exporter of goods of services. In fact, Singapore's economy contracted 2.2% y/y and declined over 10% q/q annualized in Q1, with lower demand for services leading the contraction. Lower global demand as a result of COVID-19 should weigh on Singapore's economy in Q2 as well, and we expect another sizable GDP decline. Despite our expectations for the economy, we do not expect a major short-term impact on the currency. Longer term, as the global economy begins to recover, we expect Singapore's economy to recover and for the currency to gradually strengthen starting in the second half of this year.



Source: Datastream, Wells Fargo Securities

Emerging Europe, Middle East & Africa

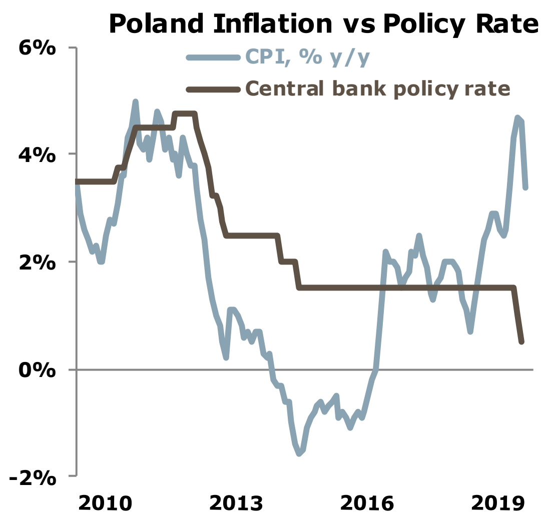
Czech Koruna (CZK)

Outlook: We think the koruna is likely to weaken over the short term as sentiment broadly remains negative and market participants continue to exercise risk aversion to emerging market currencies. Negative real interest rates could also contribute to additional downside in the koruna, as the central bank has continued to reverse course on monetary policy and cut interest rates 75 bps to 0.25% in early May. The Czech economy was already weak heading into the virus shock, and is likely to be particularly exposed going forward. In that context, GDP contracted 3.6% q/q in Q1, while we also expect a significant decline in Q2. According to the IMF, the Czech economy could contract 6.5% this year, which would be one of the more significant GDP declines within the emerging markets. Over the medium to long term, a global economic recovery in the second half of this year should help the koruna strengthen modestly against the euro, while we believe more pronounced strength against the U.S. dollar is likely given our view for long-term euro strength and dollar weakness. Improved sentiment should be supportive of the koruna, while a stabilized Eurozone economy should help the euro, and the liquidity measures put in place by the Fed should eventually result in a weaker greenback.

Source: Bloomberg LP, Wells Fargo Securities

Polish Zloty (PLN)

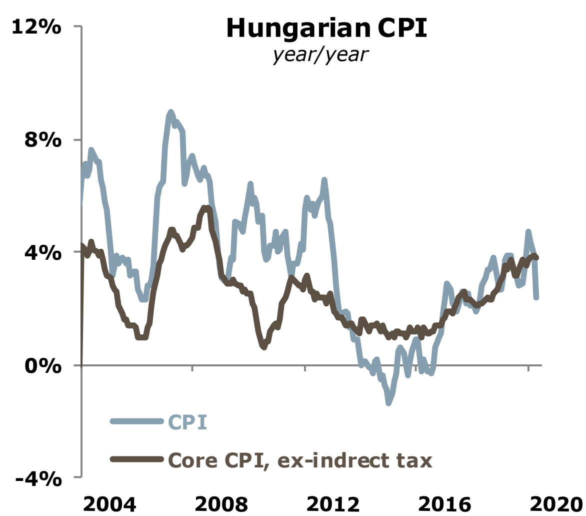
Outlook: Amid the outbreak of COVID-19, the Polish zloty has come under modest pressure selling-off around 7% year to date against the euro and 10% against the U.S. dollar. Going forward, we expect the zloty to continue to weaken against the euro over the forecast horizon as sentiment toward emerging currencies remains negative, real interest rates remain in negative territory and political risk is a bit more elevated. In April, CPI slowed to 3.4% y/y reversing the trend of rising prices as oil prices collapsed and consumer demand plummeted. In addition, the central bank lowered its main policy rate 100 bps to 0.50%, maintaining a deeply negative real interest rate, which should keep the zloty vulnerable over time. We also believe political risk has increased as the COVID-19 pandemic has impacted Poland's presidential elections. Elections were set to take place on May 10; however, given lockdown measures and the risk of further infections, authorities have decided to delay the election until June or possibly July. Before the delay, the ruling and opposition parties held differing views on when the election should be held. Calls to boycott the election ensued, and if the election does not happen this summer, we would expect protests to continue which could also weigh on the zloty.



Source: Bloomberg LP, Wells Fargo Securities

Hungarian Forint (HUF)

Outlook: Given our theme of COVID-19 driven uncertainty dominating markets over the short term, we expect additional weakness in the forint against the euro over the next few months. We believe the forint is a particularly vulnerable currency in this type of risk-off environment as a result of negative interest rates and relatively weak economic fundamentals. The central bank opted to switch to a bias of tighter monetary policy earlier this year; however, given the shock of COVID-19 it is highly unlikely the central bank moves forward with raising interest rates. We believe the central bank will eventually ease monetary policy, although official deposit rates and interest rates have been unchanged as the virus has intensified. Ultimately, we believe more unorthodox measures of easing policy are likely as the overnight deposit rate is already in negative territory. In the past, policymakers have utilized measures such as deposit caps, and could resort to those measures again, which we believe should be less currency-negative than outright rate cuts. Over the long term, and as the effects of COVID-19 dissipate and sentiment improves, we believe there is scope for the forint to strengthen against the dollar. However, we forecast further weakness against the euro given our view for long-term euro strength.

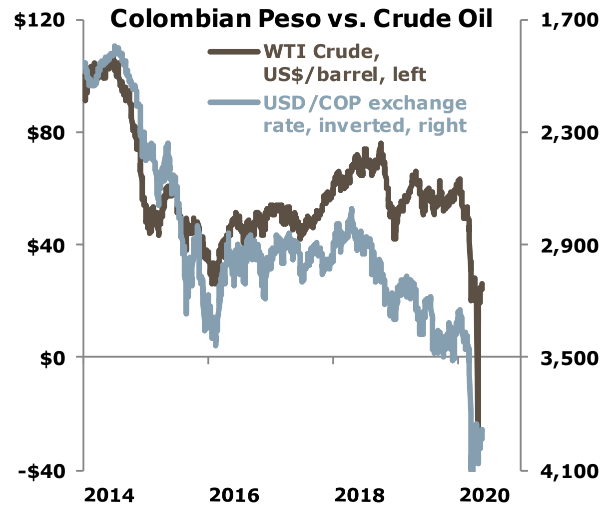


Source: Bloomberg LP, Wells Fargo Securities

Latin America

Colombian Peso (COP)

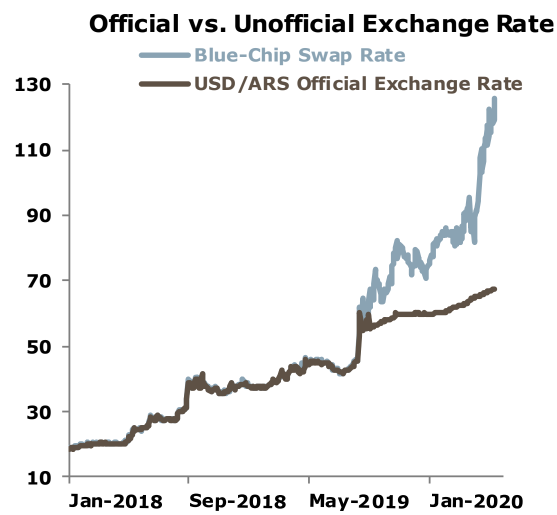
Outlook: In the short term, we believe uncertainty around the evolution of the virus will continue to result in negative sentiment towards emerging currencies, which is likely to keep the Colombian peso under pressure. As uncertainty remains prevalent oil prices should also remain subdued, and with the Colombian economy highly dependent on the oil sector, should contribute to a weaker peso over the next few months. Given our assumption for a rebound in global economic activity in Q3, that should eventually push global oil prices higher, which would help the currency recover over the medium to longer term. In addition, the Colombian economy was relatively strong pre-COVID-19, while the central bank and fiscal authorities also have adequate monetary and fiscal policy space to support the economy as well as soften the impact from the virus. On that note, the Central Bank of Colombia has kept policy rates somewhat elevated, which should also help the currency recover and strengthen over the longer term. Finally, starting in the second half of this year we expect sentiment toward emerging currencies to turn more positive and for the U.S. dollar to broadly depreciate. These dynamics should also help the peso strengthen longer term and return closer to pre-COVID-19 levels.



Source: Bloomberg LP, Wells Fargo Securities

Argentine Peso (ARS)

Outlook: The Argentine government remains on the brink of default as investors have continued to reject the government's offer to restructure $65 billion worth of international debt. Most recently, the government extended the deadline to May 22 for investors to either propose a deal or accept the government's original proposal. In an official statement, Argentine policymakers suggested they would consider any good faith proposal that puts the government's debt on a sustainable trajectory. The new deadline matches a due date for a US$500 million interest payment that the government has already missed, while a failure to make that payment, regardless of a debt restructure deal or not, would officially result in Argentina defaulting on its sovereign obligations yet again. Despite the negative sentiment toward emerging currencies, the Argentine peso has been somewhat stable relative to the currency's historical performance. As of mid-May, the peso has weakened around 11% against the U.S. dollar and has outperformed Latin American peer currencies. Capital controls remain effective in stabilizing the peso and means we forecast limited and gradual peso weakness going forward. We would only downgrade our forecast if the government lifted capital controls, which would likely result in significant peso depreciation.



Source: Bloomberg LP, Wells Fargo Securities