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FX Monthly

Is the USD bear market resuming?

04/12

April 2021

Key highlights

- Following a strong March, the dollar has weakened so far in April, as too much optimism was in the price and US yields stabilised. We maintain a view of modest depreciation, although May has historically been a strong seasonal month for the greenback
- EURUSD has likely troughed; although there will be periods of short-term weakness (e.g. in May), we maintain a medium-term constructive view
- USDJPY has declined in April; we expect it to gravitate lower in the months ahead
- CHF has recovered after a steep depreciation since the beginning of the year. We continue to expect EURCHF to range trade between 1.10 and 1.12
- Sterling has come under a reality check, with positive cyclical factors in the price but structural headwinds only recently being priced in. A weak dollar should continue to lend support, but any rallies should be capped around the 1.40 level
- Despite a decline in EURUSD and a sharp rise in US 10Y yields in Q1, EMFX have held up quite well. We believe this reflects wider EM-US GDP differentials over H1. However, the spread should narrow from Q3, creating a more challenging backdrop for EMFX
- We reiterate our year-ahead theme of rotation to select EMFX (CNY, KRW, TWD, CZK, and ILS).

FX forecasts		Q221	Q421
G10	EURUSD	1.23	1.22
	USDJPY	106	105
	EURCHF	1.10	1.11
	GBPUSD	1.40	1.38
	EURGBP	0.88	0.88
EM	USDCNY	6.35	6.22
	USDINR	74.6	74.4
	USDIDR	14 451	14 523
	USDMXN	19.8	19.8
	USDBRL	5.68	6.03
	USDRUB	75.0	76.0
	USDZAR	14.5	15.1

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Important information: Please read important information at the end of the document.
Data as of 21 April 2021

At a glance

Introduction

Following a strong March, the trade-weighted (TW) dollar index has depreciated so far in April. The main reasons are the stabilisation of US nominal and real yields and negative USD seasonality in April. We maintain the view that the dollar is likely to depreciate further on a multi-month basis, based on the sharp global recovery (which is likely to become more synchronised as the vaccine roll-out in Europe progresses) and on the dollar's overvaluation, which has widened recently. We believe that the impact from the US fiscal stimulus is now largely in the price and, absent any big surprises, it is unlikely to influence the FX market further.

That said, 2021 has proven to be a year of differentiation and of reversal in trends. Furthermore, we would caution that May has historically been a very strong USD month, so it is also reasonable to expect a dollar rebound.

The main risk to our bearish USD view is clearly another abrupt yield increase without the Federal Reserve (Fed) pushing back against it. This would put pressure on risk appetite and underpin the dollar. While this is a non-negligible risk, we find it hard to believe that the Fed would remain idle in the face of a disorderly and persistent tightening of financial conditions, especially under its new framework of average inflation targeting.

Regarding EURUSD, we maintain our forecasts unchanged. A key metric to watch is the progress of the EU vaccination programme. We expect a substantial pick-up in the months ahead as vaccine supply increases, but any new bottlenecks would represent a headwind for the currency. EURCHF is likely to reflect better risk appetite, although eurozone-Swiss real rate spreads do not suggest extensive upside. We think the pair will trade in a range of 1.10-1.12.

Turning to sterling, we believe the depreciation since late-February is simply a reality check. Positive cyclical factors are now in the price, but structural headwinds (Brexit-related) are only just being priced in. We expect the weak dollar to lend support, but rallies will be capped around the 1.40 level, unless the Bank of England surprises with an earlier-than-anticipated rate hike.

On the USDJPY, following its break above 110, the pair has declined recently to below 109. We expect further gradual declines due to valuation, Japan's solid trade surplus, and ongoing equity outflows from Japanese investors.

In the Nordics, we reiterate our preference for the NOK and expect further NOKSEK upside. In the core commodity FX bloc, we think current AUD levels are attractive to position for upside; CAD should remain supported by global and domestic developments, whereas the NZD is likely to lag.

Over the first quarter, the GBIEM benchmark EMFX-USD index declined 3.9% compared to a 4.7% decline in EURUSD, suggesting EM currencies had held up quite well considering the very large 85-bps rise in US 10Y yields. We believe this partly reflects higher EM-US growth differentials of near five percentage points over H1, vs a decade average of two percentage points. That said, growth differentials are expected to compress in H2, suggesting that EMFX will face depreciation pressures going forward.

This view continues to favour our "rotation to select EMFX" theme, with CNY remaining our top pick. Strong balance-of-payments support, attractive yield, as well as likely USD selling flows by onshore market participants should allow the CNY to hold up well against the USD, EUR, and CHF.

Main risks to our views: The main upside risk to our forecasts comes from a stronger recovery in global trade, which would send the USD into an even steeper decline and support bigger and broader rallies in the G10 and emerging markets. On the downside, we see the following risks: **First**, further rapid increases in US yields. **Second**, the Fed turning less dovish and so triggering a market reaction like 2013's "taper tantrum". **Third**, further delays in the distribution of Covid-19 vaccines that would increase the risk of prolonged restrictions and economic disruption. **Fourth**, a premature withdrawal of fiscal support.

FX forecasts – G10 and gold

	Current spot	Q2 21	Q3 21	Q4 21	Q1 22	Estimates of long-term fair value
EURUSD	1.20	1.23	1.23	1.22	1.21	1.19
GBPUSD	1.40	1.40	1.40	1.38	1.37	1.42
EURGBP	0.86	0.88	0.88	0.88	0.88	0.85
EURCHF	1.10	1.10	1.10	1.11	1.11	1.03
USDCHF	0.92	0.89	0.89	0.91	0.92	0.87
USDJPY	108	106.00	104.00	105.00	106.00	92
EURJPY	130	130.38	127.92	128.10	128.26	109
EURSEK	10.13	10.00	9.97	9.97	10.00	9.69
USDSEK	8.41	8.13	8.11	8.17	8.26	8.16
EURNOK	9.99	9.90	9.80	9.80	9.80	9.93
USDNOK	8.30	8.05	7.97	8.03	8.10	8.37
AUDUSD	0.78	0.79	0.80	0.80	0.79	0.76
NZDUSD	0.72	0.73	0.73	0.73	0.73	0.66
USDCAD	1.25	1.24	1.23	1.24	1.24	1.25
Gold	1 769	1 750	1 600	1 600	1 600	
Oil (Brent)	67	68	68	64	60	

[2] The estimates of long-term (LT) fair values are calculated as the average value estimated using FEER and BEER models. The FEER (fundamental equilibrium exchange rate) model calculates the exchange rate required to bring macroeconomic balance, i.e. full-employment, low inflation and a sustainable current account balance. The BEER (behavioral equilibrium exchange rate) model uses econometric methods to estimate equilibrium FX rates based on a set of macroeconomic variables (our model uses terms of trade, investment as a share of GDP, and real rates within a panel data set across G10 FX).
Please refer to page 27 for a more detailed explanation.

Note: Past performance and forecasts are not a reliable indicator of future performance.

FX forecasts – EM

Asia

	Current spot	Q2 21	Q3 21	Q4 21	Q1 22
USDCNY	6.50	6.35	6.29	6.22	6.25
USDHKD	7.77	7.75	7.75	7.75	7.75
USDIDR	14 498	14 451	14 487	14 523	14 559
USDINR	74.8	74.6	74.5	74.4	74.4
USDKRW	1112	1105	1098	1091	1085
USDMYR	4.11	4.11	4.10	4.09	4.08
USDPHP	48.32	48.81	49.01	49.20	49.40
USDSGD	1.33	1.33	1.32	1.32	1.31
USDTWD	28.1	27.92	27.71	27.51	27.30
USDTHB	31.2	31.19	31.15	31.11	31.07

LatAm

	Current spot	Q2 21	Q3 21	Q4 21	Q1 22
USDMXN	19.8	19.8	19.8	19.8	19.7
USDBRL	5.55	5.68	5.85	6.03	6.20
USDCOP	3 602	3 638	3 674	3 710	3 746
USDCLP	702	698	695	691	688
USDPEN	3.67	3.67	3.66	3.66	3.66

CEEMEA

	Current spot	Q2 21	Q3 21	Q4 21	Q1 22
USDRUB	76.0	75.0	75.5	76.0	76.5
USDTRY	8.1	8.33	8.57	8.81	9.06
USDZAR	14.3	14.5	14.8	15.1	15.4
USDILS	3.25	3.27	3.24	3.21	3.18
EURPLN	4.55	4.55	4.55	4.54	4.54
EURCZK	25.9	25.8	25.7	25.7	25.6
EURHUF	361	362	364	365	366

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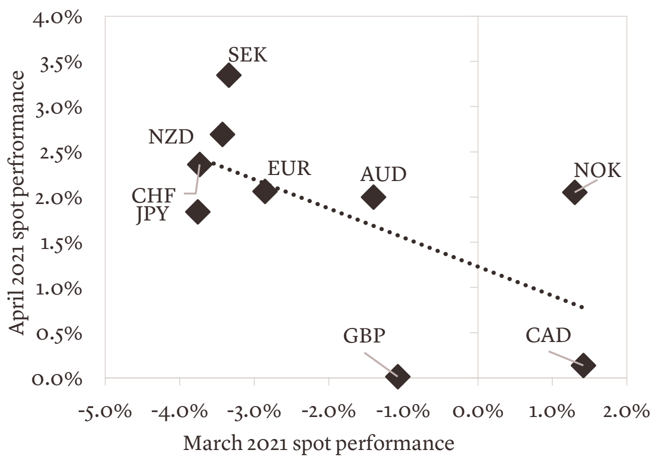
G10FX: Three key charts

We see a reversal of trends in April, with currencies that depreciated sharply in March benefiting the most this month

1. March losers are turning into April winners

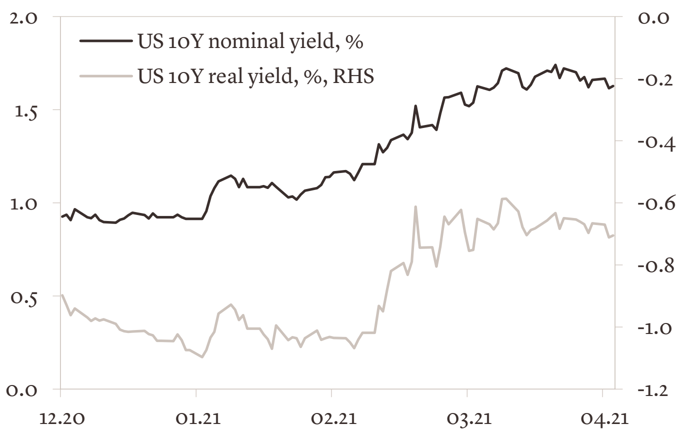
All vs the USD



Sources: Bloomberg, CFTC, Lombard Odier

This dollar weakness in April is based on negative seasonality as well as on the stabilisation in US nominal and real yields

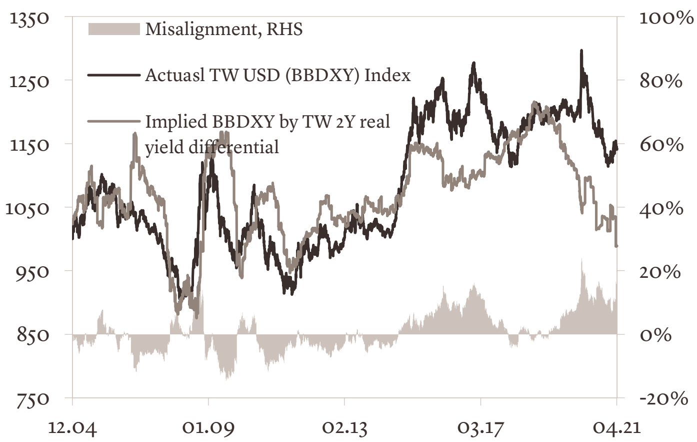
2. Since late March US nominal and real yields have stabilised



Sources: Bloomberg, Lombard Odier

At the shorter end of the US curve (which historically is more correlated with the dollar index), nominal yields remain anchored – but those adjusted for inflation have fallen. As a result, the trade-weighted (TW) 2Y real yield differential between the US and its seven most important trading partners has moved lower, generating a TW USD estimated overvaluation of 15%. This is significant and corroborates our medium-term view of some further dollar depreciation, despite short periods of strength

3. TW USD now even more overvalued



Sources: Bloomberg, Lombard Odier

Note: Past performance and forecasts are not a reliable indicator of future performance.

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FX majors

EUR (euro): EURUSD finds its footing

- EURUSD has rebounded in April for a multitude of reasons
- We maintain our medium-term constructive view...
- ... but will watch closely vaccination developments in the EU, which constitute the main downside risk to our call

EURUSD has rebounded so far in April, rising rising by nearly 3% on the month and now trading close to 1.21. In our view, six reasons are behind this bounce.

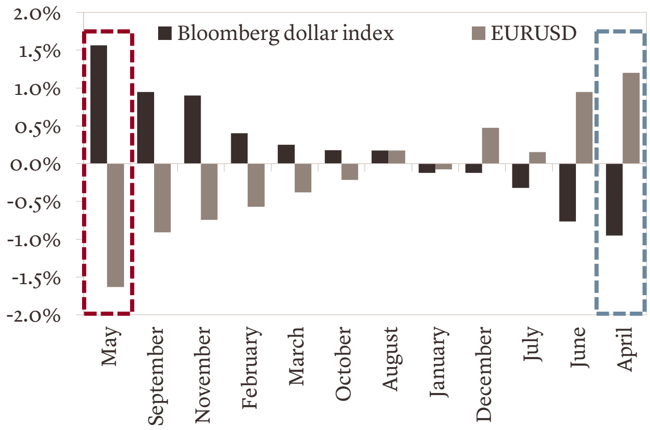
First, April contains a clear element of negative seasonality for the dollar – and hence, positive for EURUSD (see chart 4). **Second**, US yields appear to have stabilised as of late; US 10Y real yields have stayed below -0.60% while Fed rate hike expectations have normalised somewhat lower. **Third**, currencies that depreciated during March have tended so far to pare back some of these losses (see chart 1 on previous page); in other words, there is an element of mean reversion at play. **Fourth**, confirmed EU Covid-19 cases seem to have peaked at the end of March and have declined during the first couple weeks of April. **Fifth**, soft indicators in the euro area (PMIs) surprised on the upside. Finally, positioning in EURUSD is no longer extreme; in fact, it is very close to neutral.

Going forward, we still expect EURUSD to appreciate modestly towards 1.23, fuelled by the strong upswing in global growth and trade. These periods are typically characterised by EURUSD overshooting its fair value (currently around 1.20) due to the eurozone's exposure to trade links, especially with China (see chart 5). In addition, we believe that the US fiscal stimulus and vaccination trends (between the US and the EU) are largely in the price. However, further bottlenecks in the vaccine rollout in European countries currently represent the main risk to our constructive EUR view.

Finally, we would highlight that next month (May) the dollar seasonality has historically been quite strong, so we would not be surprised to see a (temporary) weakening of the euro during this period (see chart 4).

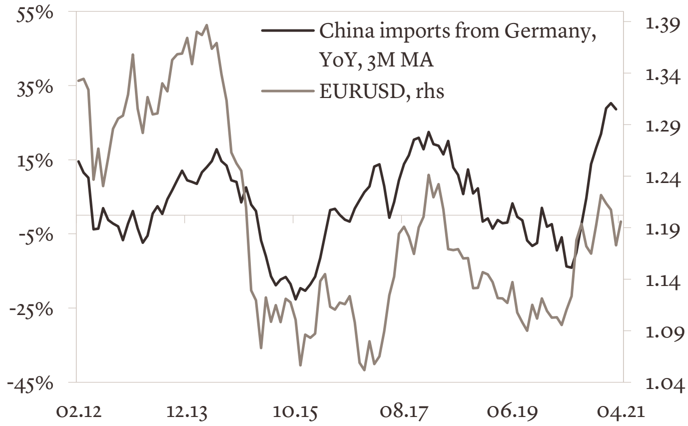
Risks to our views: Downside risks: Further bottlenecks in vaccine distribution in the EU; a resumption of abrupt rises in US yields; the Fed turning less dovish. **Upside risks**: An even stronger economic and trade recovery as well as a more efficient EU rollout of the Covid-19 vaccines.

4. April and May seasonality
Average monthly spot performance over the last 10 years



Sources: Bloomberg, Lombard Odier

5. Chinese imports from Germany should be an added EUR tailwind



Sources: Bloomberg, Lombard Odier

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FX majors

CHF (Swiss franc): Swiss franc pares back some of its losses

- **The Swiss franc strengthens in April as previous levels seemed quite overstretched**
- **We still expect EURCHF to fluctuate between 1.10 and 1.12 for the remainder of 2021**

Following significant weakness since the start of the year, the Swiss franc has managed to rise this month against both the USD (+3%) and the EUR (+0.30%). This occurred despite risk assets holding up very well during the same period, with the S&P 500 having gained nearly 5% MtD.

As we discussed in our previous FX Monthly, CHF crosses were becoming very stretched and the currency seemed due for some consolidation/rebound. That said, we do not think its recent strength heralds significant upside, especially against the EUR. Better global growth prospects are likely to keep pressuring the franc. At the same time, we do not envisage significant weakness. On balance, we continue to expect EURCHF to fluctuate between the 1.10 and 1.12 levels because – in sharp contrast to 2017 – rate differentials between the eurozone and Switzerland do not suggest a clear trigger for further sustained upside (see chart 6).

Main risks to our view:

Upside risks to EURCHF: acceleration of Swiss outflows, especially if the vaccination rollout in Europe gathers pace substantially; a much stronger trade and growth recovery, underpinning carry trades and weighing on the franc.

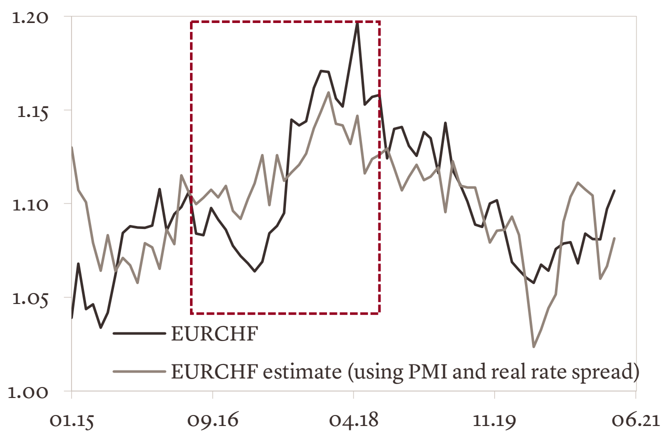
Downside risks to EURCHF: currently we see them as largely concentrated in eurozone developments, especially ongoing bottlenecks in vaccine distribution accompanied by more prolonged lockdowns and a deeper impact on regional economic activity.

GBP (pound sterling): Sterling subjected to a reality check

- Despite the softer dollar in April, GBP has kept underperforming
- We think that positive cyclical factors are in the price, but structural headwinds may not be
- GBPUSD is likely to be supported given the lower dollar, but rallies may be capped

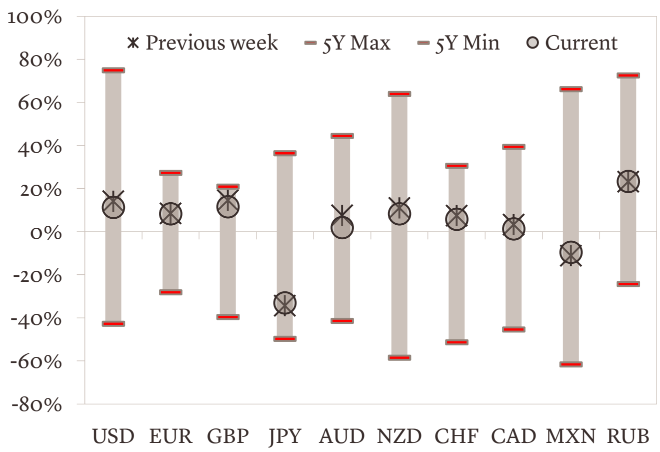
Following sterling's sharp outperformance up to late February, the currency has come under depreciating pressure. GBPUSD is now around 1.39, down from this year's peak at 1.41. EURGBP is just short of 0.87, up from 0.85 at the beginning of April.

6. Eurozone-Swiss real rate spread does not suggest significant EURCHF upside



Sources: Bloomberg, Lombard Odier

7. CFTC data shows much extended speculative GBP longs
Numbers of contracts as a percentage of open interest



Sources: Bloomberg, Lombard Odier

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FX majors

In our view, this move in sterling has emerged because by now plenty of the positive cyclical elements (the big success of the domestic vaccination rollout and the anticipation of a swift UK economic recovery) are in the price, while the structural headwinds (Brexit) that were neglected initially are now being priced in gradually. Additionally, speculative positioning is now close to its five-year maximum level (see chart 7), implying that we may be seeing the start of some long GBP unwinding.

Looking farther out, we believe that GBP will remain underpinned by a weaker dollar and receive support from the rise in UK yields reflecting the reflation theme. That said, rallies should be capped around the 1.40 level (see chart 8). **First**, the area above 1.40 has proven to be a very strong resistance level; second, our short-term model (which uses rate differential as its main driver) suggests a fair value just below 1.38. For that to extend sustainably above 1.40, the rate spread between the US and the UK would have to narrow considerably, something unlikely for the near future – unless the Bank of England (BoE) surprises and hikes rates earlier. We would also expect some further upside in EURGBP close to 0.90.

Main risks to our view: We see **three upside risks** to our forecasts: UK economic activity surprising significantly on the upside in the second half of the year; BoE tightening expectations rising; and a faster dollar depreciation than we currently envisage.

Downside risks relate to a shallower-than-expected UK rebound; and the Fed turning less dovish.

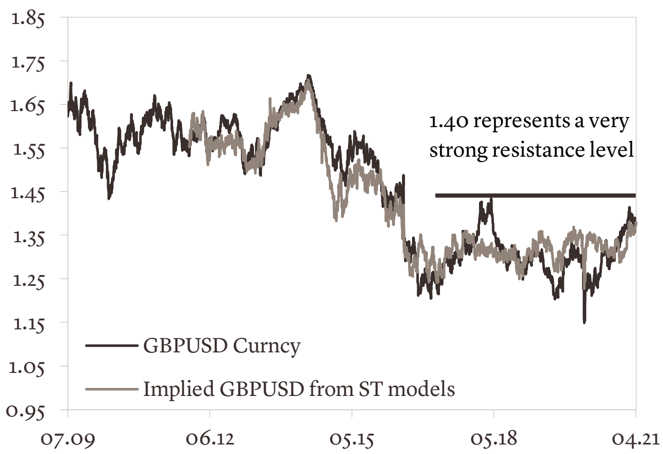
JPY (Japanese yen): USDJPY at an inflection point?

- **USDJPY appreciation reverses in April**
- **We still expect USDJPY to gravitate lower...**
- **.... although our degree of conviction is no longer as high**

Following its rise above the 110 level last month (which triggered a stop-loss in our short USDJPY position across our portfolios), USDJPY has declined so far in April, now trading below 109. Aside from the stabilisation in US nominal and real yields and the ensuing USD weakness, positioning is also likely to have played a role. Asset managers and leveraged funds had turned very abruptly long USDJPY, so a “pause for thought” was likely due (see chart 9).

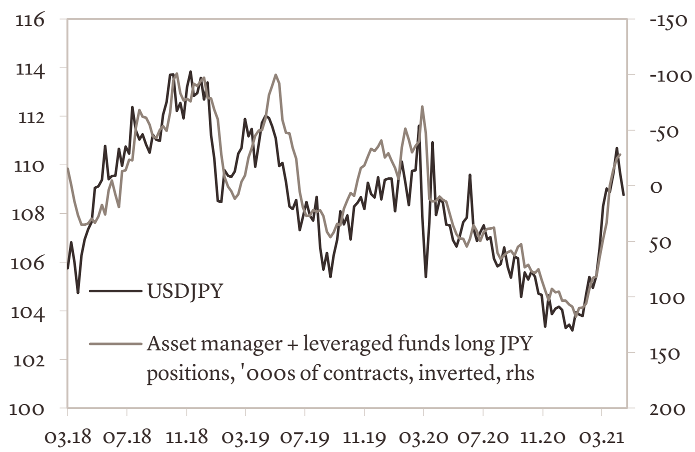
From a near-term perspective, USDJPY is still somewhat expensive when seen through the lens of rate differential and equity markets (see chart 10). Long term, USDJPY is overvalued by more than 18%. We expect yen undervaluation, alongside some small upside in Japanese yields due to the

8. GBPUSD in line with yield differential



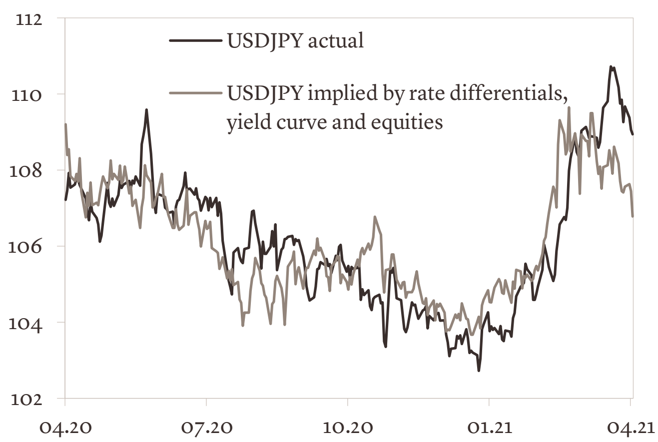
Sources: Bloomberg, Lombard Odier

9. Closing of JPY longs was very fast and abrupt



Sources: Bloomberg, Lombard Odier

10. USDJPY too high relative to yield differential



Sources: Bloomberg, Lombard Odier

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FX majors

[Bank of Japan widening the target range for 10Y yields](), as well as USD weakness to allow JPY to appreciate. Japan's trade surplus and ongoing equity outflows from Japanese residents are also likely to help in this direction. However, USDJPY downside pressures may be less intense than we had thought initially, due to further rises in US yields.

Main risks to our views:

1. Downside risk to USDJPY: US yields stabilising and the dollar depreciating more than we currently expect.

2. Upside risks to USDJPY: further rapid rises in US yields and expectations of tighter US monetary policy without the Fed pushing back.

Nordic currencies: NOK remains one of our favourite picks

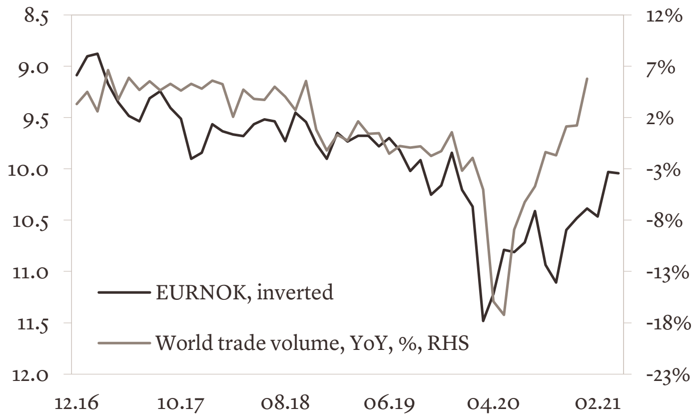
- **NOK remains one of our preferred picks in G10 FX**
- **SEK has rebounded in April, but we expect only modest further gains**
- **We still see upside in NOKSEK**

NOK (Norwegian krone): NOK remains our favoured currency, against both the USD and the EUR. The currency will remain supported by a strong economy, the ongoing recovery in global growth and trade (see chart 11), as well as a hawkish Norges Bank. High oil prices alongside NOK's high correlation with risk assets should provide additional tailwinds. We also expect NOK's outperformance vis-à-vis the SEK to extend further.

SEK (Swedish krona): SEK has gained some ground in April, largely as a result of its earlier depreciation. While we expect some further modest gains against the USD and the EUR, we believe that the currency will underperform. The economy is still recovering from the pandemic hit, but the Riksbank has maintained its dovish tone while the basic rate will remain at zero for a long period. Rate differentials with Norway continue to suggest further NOKSEK upside (see chart 12).

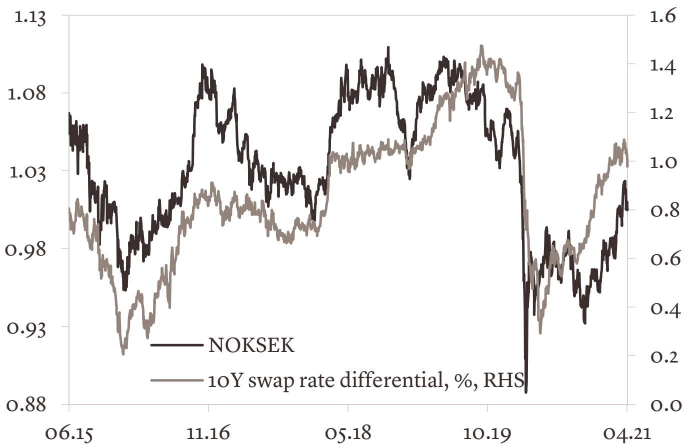
Main risks to our view: In the case of NOK, there are two main risks: euro-area recovery faltering, and/or renewed oil price declines. In the case of the SEK, the main risk relates to external factors that could disrupt the global recovery and risk appetite.

11. The improvement in global trade points to more NOK gains



Sources: Bloomberg, Lombard Odier

12. Still upside for NOKSEK



Sources: Bloomberg, Lombard Odier

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FX majors

Commodity currencies: global dynamics still supportive

- **AUD currently attractive to position for upside**
- **Several factors point to ongoing support for the CAD**
- **NZD likely to lag**

AUD (Australian dollar): AUDUSD has weakened since March, in line with the rise in US yields and the dollar appreciation. We believe current levels (around 0.77) are attractive to position for a resumption of AUD upside. While the RBA will remain on hold for the near future, several factors should continue to underpin the currency. **First**, the global upswing in trade and Chinese imports will remain supportive. **Second**, risk appetite remains strong and should underpin the AUD further. **Third**, the AUD has one of the highest betas/positive correlations to base metal prices, which are rising on the back of strong global demand (see chart 13). As things currently stand, we see AUDUSD peaking at around 0.80 in Q2/Q3 2021 – though May could prove challenging given negative seasonality.

CAD (Canadian dollar): USDCAD seems to have stabilised since mid-March, but it remains in a medium-term downward trend. While it is true that the market has already priced hikes by the Bank of Canada (BoC), high oil prices, the global trade recovery, and a very strong rebound in the domestic labour market (see chart 14), which is likely to quicken the closure of the output gap, should maintain support for the currency.

NZD (New Zealand dollar): NZD should follow the AUD, but underperform. Valuation is the least attractive amongst G10 currencies (we estimate NZDUSD to be around 9% overvalued), while tight Covid-19-related travel restrictions are still likely to weigh on tourism, New Zealand's biggest export industry.

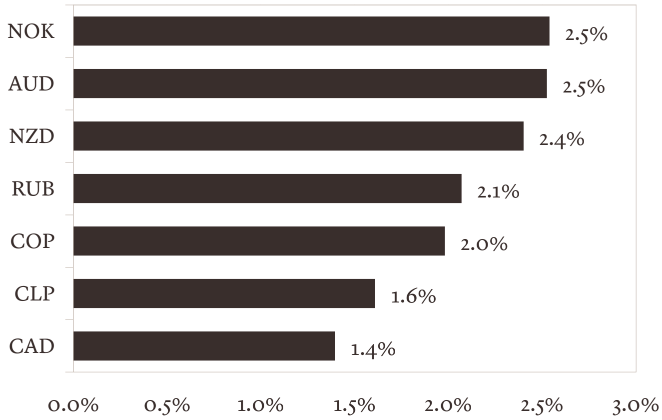
Main risks to our view:

Upside risks to our forecasts could materialise if the growth recovery is sharper and the dollar depreciation deeper than we currently envisage.

Downside surprises could manifest in case of delays or other bottlenecks in the distribution of the Covid-19 vaccine that could dampen growth expectations and weigh on risk-sensitive assets.

13. Estimated betas to base metals over the last year

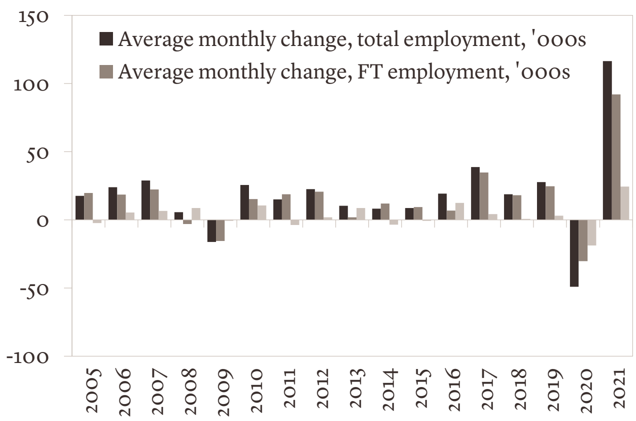
Estimates assume a hypothetical increase of 10% to the Bloomberg base metals index



Sources: Bloomberg, Lombard Odier

14. A super-charged Canadian labour market

Monthly average employment gains by year, in thousands



Sources: Bloomberg, Lombard Odier.

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Commodity corner

Gold consolidates as global bond market sell-off pauses

- **Gold has been in a USD 1,700-1,750/oz trading range since March**
- **The upcoming prints of inflation data, in sharp uptrend, will certainly support the yellow metal in the near future**
- **Medium term, a combination of bear factors, such as risk-on sentiment and a recovering global economy – both aided by the Covid-19 vaccine rollout – and a further gradual rise in bond yields will continue to weigh on prices**

On a year-to-date basis, gold is down more than 8%, in line with liquidation witnessed on the yellow metal as higher US yields dampened the appeal of the non-interest-bearing asset. The sell-off paused last month, once again reflecting the US rates, trading sideways. We believe that at this stage of the economic recovery, real rates will remain the key driver for gold prices, as the shifting Fed outlook will remain a key area of market focus in the months ahead.

True, inflation is on the rise thanks to a combination of statistical base effects and the impact of reopening. Furthermore, taking advantage of the recent slide, some central banks have opportunistically increased their purchases, while demand for gold jewellery has also rebounded in India and China. In a context of stabilising real rates, these new sources of demand might offset exchange traded fund (ETF) outflows in the near future (chart 15).

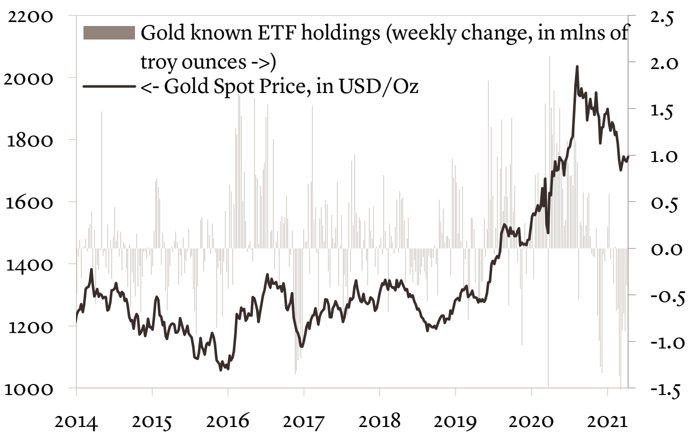
But still, later this year investors' focus will return to asset purchase tapering, while in the longer term, the Fed's 'dot' expectations point to a rate of 2.5%. If, as we expect, macro data remains solid, the policymakers' guidance is likely to evolve over time. Since the Fed reintroduced quantitative easing policies in 2008, major sell-offs have typically been triggered by a change in expectations regarding the Fed's bond purchases and the subsequent effect on longer-duration yields. The best example is the taper tantrum of 2013. Even if we believe Fed officials should be able to avoid such a volatile episode, the direction of travel for real rates is higher, thus lower for gold prices. **In this context, we expect our USD 1,600/oz target to be reached in Q3 (chart 16)**. Combined with strengthening risk appetite, this validates our cautious stance on gold. The risk/reward of holding the precious metal continues to deteriorate as risks on our forecast remain on the downside.

Strategically, gold should be considered in investors' portfolio allocation as one of the best alternatives to government bonds in periods of zero rates. But its inherent volatility (which is close to equity volatility) begs tactical management and discipline, especially in periods of recovery. In such a context, **we are currently underexposed to gold**, with an allocation ranging from 1% to 2.5% depending on the risk profile and currency of the portfolio.

Main risks to our view: inflation expectations running out of control while the Fed caps nominal rates; Covid-19 vaccines struggling against variants of the disease.

15. Financial demand in a clear downtrend

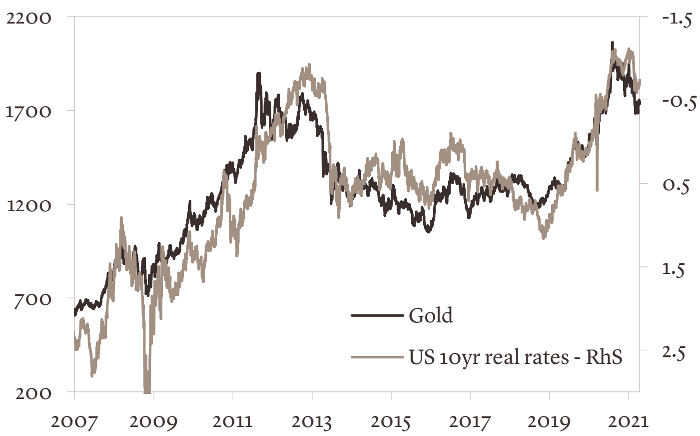
Almost relentless outflows from Gold ETFs since November



Sources: Bloomberg, Lombard Odier

16. Further normalisation of US real rates will continue to weigh on gold prices later this year

Shifting Fed outlook will remain a key area of market focus



Sources: Bloomberg, Lombard Odier.

Note: Past performance and forecasts are not a reliable indicator of future performance.

Commodity corner

Oil market rebalancing accelerates; the future path of prices is in OPEC's hands.

- **A more volatile month for oil markets, but Brent still trading within the USD 60-70/bbl range.**
- **Forecasts for oil demand in 2021 have been revised up by both the IEA and OPEC, acknowledging a brighter economic outlook**
- **Meanwhile, OPEC+ has made the decision to restart productio**n in May to meet these increased demand needs

Since OPEC+ members agreed on 3 December 2020 to manage their exit strategy together, raising their production in an orderly manner, prices have already risen by almost 35% (chart 17). While the initial guidance was for a gradual +0.5mb/d rise in production (adjusted if needed), the Organisation decided in its three subsequent meetings to maintain production unchanged despite improved outlook on the demand front in March. This announcement has supported prices to levels not seen since end-2019. One year after the record 9.7 mn b/d cut, OPEC+ agreed earlier this month to increase production from May. Producers will collectively add over 2 mn b/d in the coming three months, which includes the unwinding of additional voluntary curbs by Saudi Arabia.

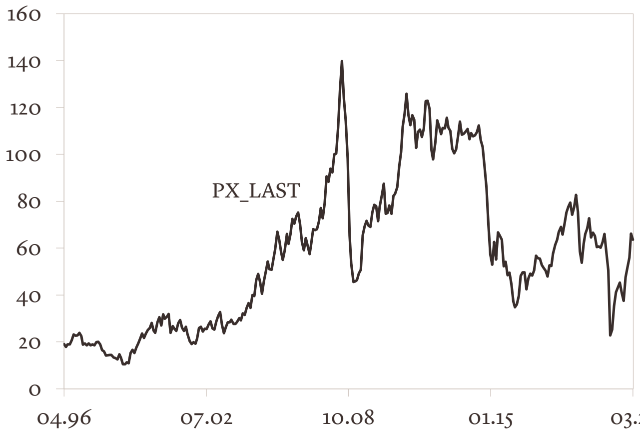
The OPEC+ policy has clearly helped accelerate the oil market rebalancing (chart 18). The recent decisions also suggest that the members are comfortable with the current higher oil price environment and do not fear a return of US shale production in the near future. We share this view, and now expect the US shale industry to maintain capital discipline, favouring return to shareholders when prices rise.

Going forward, the OPEC+ adjustments to demand recovery will be the main driver for oil prices. Forecasts for oil demand in 2021 have been revised up by both the IEA and OPEC, acknowledging a brighter economic outlook. As the OPEC+ seems to react to rather than act in anticipation of changes in demand, some short-term overshooting around USD 70/bbl cannot be excluded when economies' reopening allows for more mobility and strengthens demand for oil.

We keep our 12-month forecast unchanged at USD 60/bbl, as spare capacities within OPEC+ remain large and will cap potential upside. Some US shale producers will also have the capacity to increase production once their balance sheets are repaired. From an investment standpoint, the inevitable upcoming rises in OPEC+ production will cap the upside, while the erratic and unpredictable OPEC+ guidance makes the risk/reward of a long exposure less appealing. However, we believe that other oil-link assets in the credit or equity universe, not to mention specific currencies, should perform well with prices trading above USD 60/bbl in the foreseeable future.

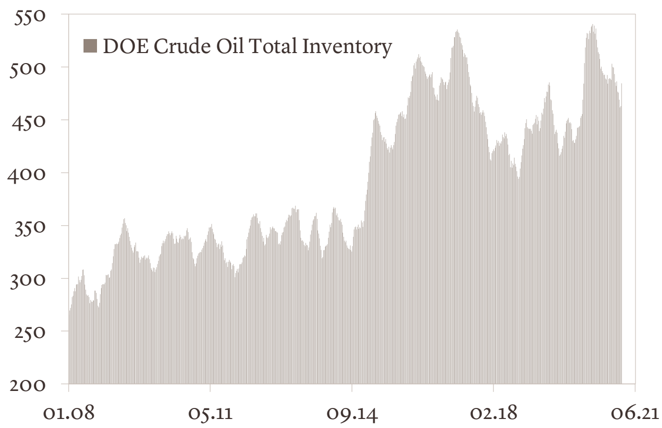
Main risk to our view: diverging interests leading to a very dysfunctional OPEC+ when the market is back at equilibrium and the return of Iranian production requires some adjustments by other members.

17. Oil prices stabilise in our USD 60-70/bl range



Sources: Bloomberg, Lombard Odier

18. Market rebalancing is underway thanks to OPEC+ policy
US inventories on a downtrend since their May record



Sources: Bloomberg, Lombard Odier.

Note: Past performance and forecasts are not a reliable indicator of future performance.

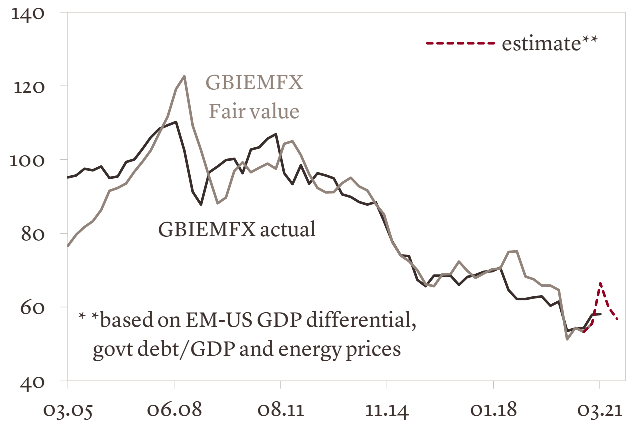
EMFX: Three key charts

GBI EMFX – what the model suggests:

Our GBI EMFX model has flagged decent gains over H1 (chart 19). The gains are driven notably by the consensus forecast for a sharp recovery in EM growth over Q1, with the growth differential rising to five percentage points over the first half, from a prior-decade average of two percentage points.

However, in H2, high debt loads, a narrowing of EM-US growth differentials, and higher US yields will mark a more challenging backdrop for GBI EMFX.

19. GBI EMFX – Expect a more challenging period after Q2



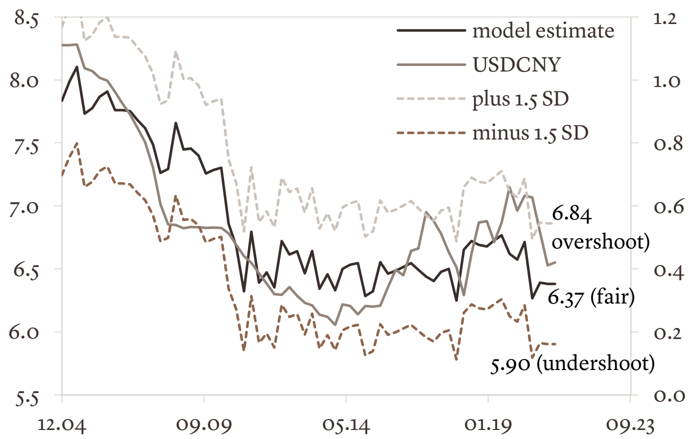
Sources: Bloomberg, Lombard Odier

Key differences with 2013 taper tantrum for GBIEMFX:

USDCNY still overvalued: We have formulated a model of the USDCNY based on relative CPI, Chinese share in global trade, the nominal rate differential vs US, and a dummy to account for the Chinese FX regime (as the country shifted from fixed to a managed float after 2005). The model suggests that current fair value stands at 6.37, and that the recent USDCNY decline is in the process of correcting an overvaluation suffered throughout 2019 (chart 20).

The overvaluation came about because of the imposition of tariffs by the former US President Trump's administration. In our view, even if US-China tensions remain high in "non-trade"-related areas, as long as they improve on the trade front and result in some tariff reduction eventually, USDCNY will face further downside risks.

20. USDCNY still overvalued and could undershoot if trade tensions ease

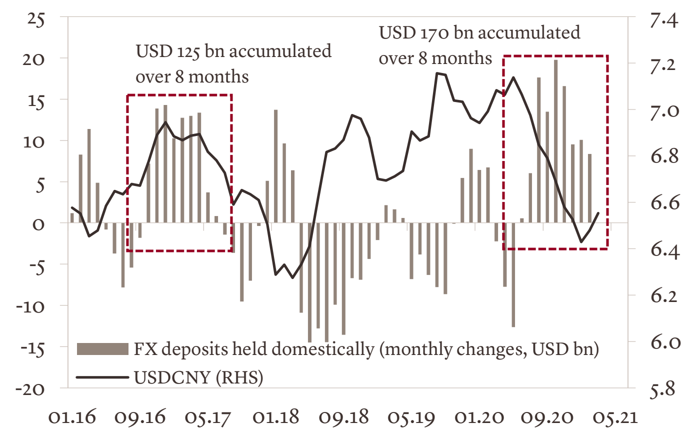


Sources: Bloomberg, Lombard Odier

FX flows supportive of a further USDCNY decline

Despite a strong increase in portfolio flows to China from non-resident investors, resident participants have accumulated a large USD 170 bn sum over the past eight months. A similarly large accumulation seen over 2016-17 suggests scope for further USDCNY declines as residents offload their accumulated USD holdings. Hence, data suggests that there is plenty of scope for domestic investors to sell USDCNY, keeping spot heavy in the months ahead (chart 21)

21. Pent-up demand for selling USD onshore suggest USDCNY decline still has legs



Sources: Bloomberg, Lombard Odier

Note: Past performance and forecasts are not a reliable indicator of future performance.

Asia FX

- **We adjust our expectations modestly for South Asian currencies such as INR and THB to reflect the impact of the recent COVID19 waves.**
- **We see CNY, KRW, TWD, and SGD as the best currencies for global reflationary rebound in spring. We are neutral on IDR and MYR. We remain slightly bearish on PHP.**
- **Vaccine roll-out, the US-China strategic competition, and intermittent scares about premature monetary policy tightening will be key risks for the currencies.**

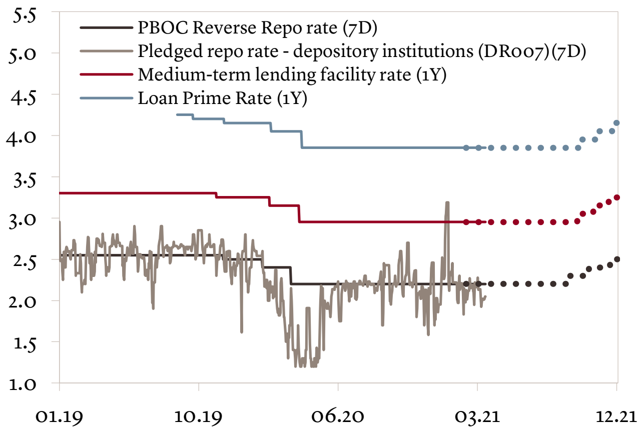
CNY: Macro and policy scenarios still favourable

We maintain our constructive forecasts for the Chinese yuan (CNY or RMB), as macro and policy scenarios point to the currency's further appreciation in 2021. **First**, the recent hawkish shift in Beijing's policy stance will be a key anchor for the CNY. Given Beijing's continued focus on medium-term financial stability, we expect the central bank (PBOC) to raise its benchmark rates by 30 basis points later this year and in early 2022 to maintain discipline in the onshore credit market (see chart 22). Alongside other newly introduced macro prudential measures that will likely boost demand for liquidity in the onshore market, we expect this potential tightening to shield the yuan from any intermittent currency market volatility arising from US growth outperformance. **Second**, we believe that trade-related scenarios remain asymmetrically favourable to the yuan. Strong global growth should be positive for the currency due to China's competitive export sectors. More importantly, our macro team sees the yuan's strength as the most expedient pathway for a bilateral compromise on trade between China and the US, as it would accelerate economic transitions that both Beijing and Washington D.C. desire in the medium term. For this reason, we still designate 50% probability to the yuan breaking out of its five-year range at some point over the next 12 months – despite recent noises about other geopolitical issues between the two countries (see chart 23). **Third**, additional support will come from the apparent revival of corporate USD deposit conversions back to CNY, likely driven by the positive view on the country's macroeconomic fundamentals and thus those of its currency. Inflows to the country's bond market will remain solid due to global benchmark index inclusions and low correlation to other bond markets. We see the recent turmoil surrounding large bad debt companies as mostly limited to the relevant offshore hard currency bonds with keep-well structures.

Main risks to our view: unexpected serious geopolitical flare-ups between China and the US (e.g. Taiwan, South China Sea, other maritime borders) or a re-escalation of tit-for-tat

22. PBOC is likely on its way to monetary policy adjustment

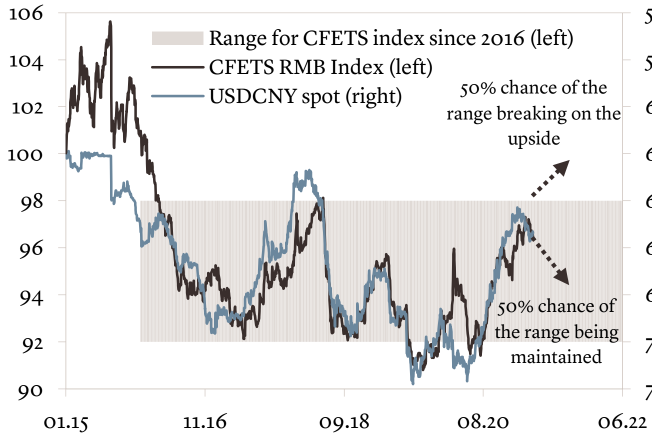
Benchmark onshore rates in China, %



Sources: CEIC, Bloomberg, Lombard Odier

23. Will CFETS RMB index break out of its 5-year range in 2021?

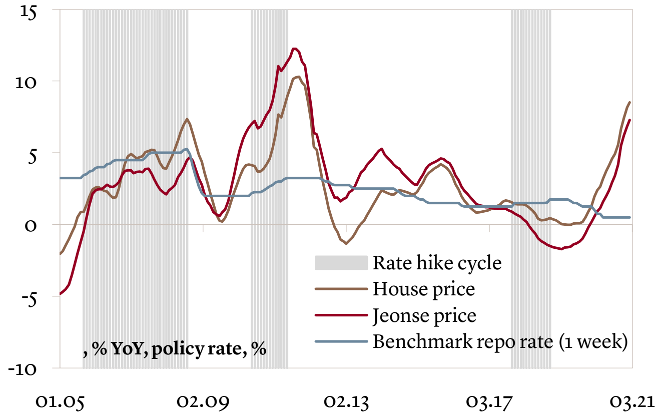
CFETS RMB index estimate, 31 Dec. 2014 = 100 (LHS), USDCNY spot (rhs)



Sources: Bloomberg, CEIC, Lombard Odier

24. Housing price appreciation tends to trigger BOK rate hikes

Housing and rental price appreciation (KPB data)



Sources: Bloomberg, CEIC, Lombard Odier

Note: Past performance and forecasts are not a reliable indicator of future performance.

Asia FX

tariffs would be key risks for the yuan. We do not believe that the pandemic or rising global yields pose significant risks to the currency for the time being. Beijing's action on the possible debt restructuring of large asset management companies (AMCs) should be monitored for any spillover effects.

KRW: Upside risk from municipal by-elections

The Korean won (KRW) has performed poorly vs USD year to date, but we expect the currency to regain its momentum in the remainder of the year. **First**, the policy elite are now primed to favour the use of monetary policy to counter the rally in real estate prices and strong growth in household debt after the ruling party's crushing defeat in the April municipal by-elections. The elections were widely seen as the public verdict on the government's housing policy, and the Bank of Korea will be under pressure to respond to this political shift ahead of its leadership change in April 2022 (see chart 24). Pressure from the Biden administration to refrain from FX market intervention could also nudge the Bank of Korea (BOK) in this hawkish direction. **Second**, the country will benefit strongly from the global recovery in 2021 thanks to its relatively diversified export sector (high tech and cyclical industries). We note that KRW shows the highest positive correlation among its Asian peers to global trade volume growth. **Third**, KRW has been suffering from its correlation to JPY, Asia's worst-performing currency this year, but we expect JPY to rebound in the coming weeks and ease this pressure for KRW.

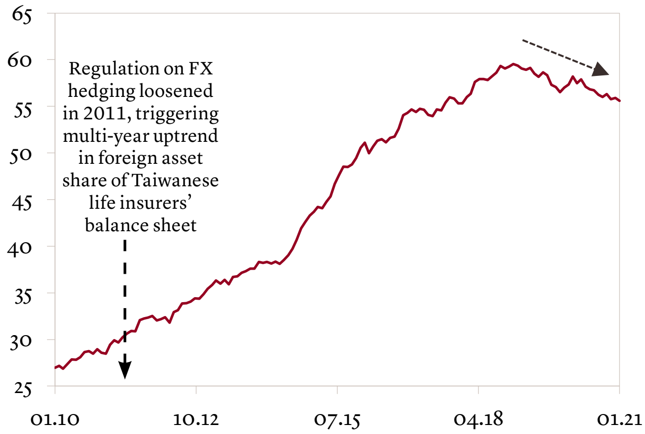
Main risks to our view: Geopolitical risks surrounding China and North Korea will remain a key risk for the Korean won. The Biden administration's stance towards Asian currencies will be another risk to watch, as the country has been closely monitored by the US treasury for its semi-annual reports on FX manipulation. JPY's direction also bears monitoring due to KRW correlation.

TWD: Still in the earning innings of structural appreciation

The New Taiwan dollar (TWD) remains one of the most under-valued emerging market currencies, and we see the currency's steady appreciation in the medium-term. **First**, the CBC faces a delicate task of managing TWD's strength when Taiwan itself is at the risk of being labelled as a currency manipulator by the Biden administration. While Taiwan avoided this designation in April, the threat could motivate the CBC's tolerance of TWD strength in the future. **Second**, macro fundamentals for Taiwan are exceptionally robust thanks to the country's world-beating virus containment efforts and sovereign solvency metrics.

25. Taiwanese lifers slowly turning away from foreign assets

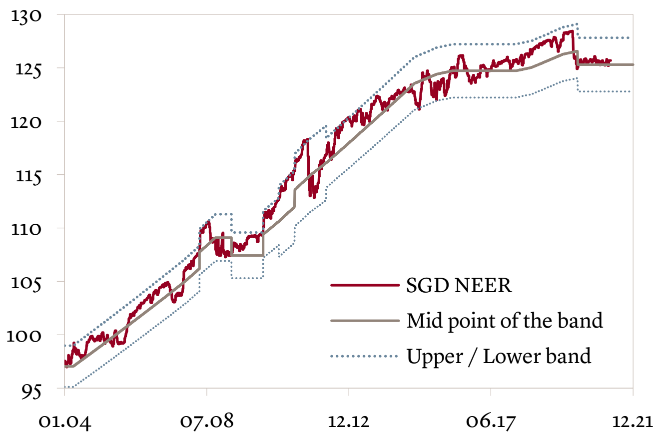
Foreign assets as % of total



Sources: CEIC, Lombard Odier

26. Chart 26: MAS's upper bound for SGD NEER to be tested later in 2021

SGD NEER curve and estimated MAS policy bands



Sources: Bloomberg, Lombard Odier

Note: Past performance and forecasts are not a reliable indicator of future performance.

Asia FX

Furthermore, booming high tech exports (especially in the semiconductor sector) will lift domestic capex cycle and make this year the best growth year since 2014. Such sustained growth outperformance alone should be a compelling reason for TWD to appreciate. **Third**, Taiwan's life insurance companies, key players in the FX market, are beginning to refrain from adding more foreign assets to their balance sheets after a period of TWD strength (see chart 25). The turn in life insurance companies' investment behaviour removes an important unofficial channel for Taiwan's policymakers to lean against TWD appreciation, as their large unhedged foreign bond portfolios have been a key conduit for capital outflows.

Main risks to our view: Main risks are potential direct confrontation with China, further escalation of tension between the US and China, and a shift in the US stance on Taiwan's currency policy.

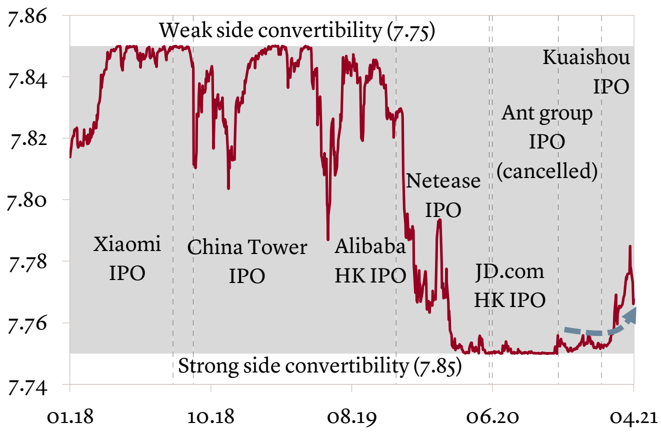
SGD: Eventual testing of the upper bound

The Singapore dollar (SGD) experienced a modest depreciation this year due to the recent strength of the USD vs other G10 currencies, but we expect the currency to appreciate solidly in the next 12 months. **First**, the Monetary Authority of Singapore (MAS) has confirmed our expectation of a gradual shift towards policy normalisation in its April policy meeting. While no changes emerged from the meeting, the MAS introduced a temporary dimension to its current "accommodative stance", hence signalling a potential change in its forward guidance in the October policy meeting later this year. This supports our view that the SGD **nominal effective exchange rate (NEER)** curve will test the upper bound of the current target range (see chart 26). If it does so, such testing of the upper band would create 1.5-2.0percentage points of additional downside for the USDSGD spot rate. **Second**, growth recovery will add to markets' confidence that the MAS will return to its policy of long-term nominal appreciation for the SGD. We note that Singapore's macroeconomic and public health performance have been rather strong in the past few months thanks to the successful containment of the virus and relatively efficient vaccine rollout. **Third**, we expect many of the major currencies that are tracked implicitly via the SGD NEER curve to appreciate versus the USD in the remainder of the year, and this will boost SGD's nominal value in tandem.

Main risks to our view: the performances of major currencies in the SGD NEER basket; US stance on Singapore's unique FX policy framework; and public health and macroeconomic conditions in the surrounding South-Asian economies.

27. Post-IPO reversion in progress for HKD

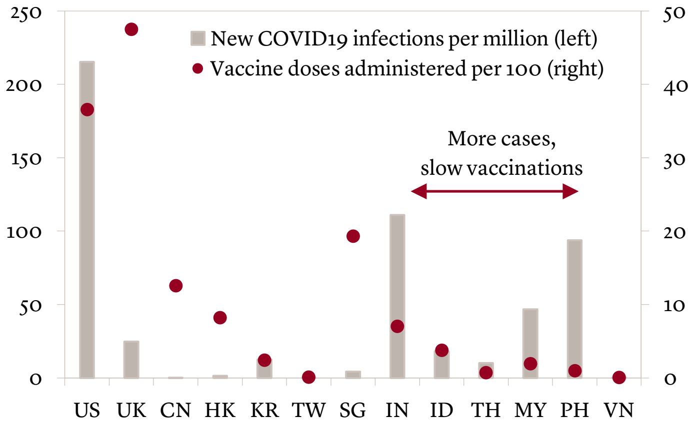
USDHKD spot, HKMA's convertibility zone, key IPOs



Sources: Bloomberg, Lombard Odier

28. India's Covid-19 infections now much higher than UK's

New cases per million, 7-day moving average (lhs), doses per 100 (rhs)



Sources: CEIC, Bloomberg, Lombard Odier

Note: Past performance and forecasts are not a reliable indicator of future performance.

Asia FX

HKD: Gradual reversion to the middle of the convertibility zone

We expect the Hong Kong dollar (HKD) peg to the US dollar to remain in place for the foreseeable future, but we believe that USDHKD will gradually move to the middle of the Hong Kong Monetary Authority (HKMA)'s convertibility zone, i.e. 7.80. **First**, the temporary scarcity of liquidity related to various IPOs will eventually ease towards year-end, when the bulk of expected marquee listings are complete (see chart 27). It is possible, however, that additional listings of large tech companies could introduce intermittent episodes of temporary strength in the currency. **Second**, the city's economic and political news flows remain uneven, and medium-term concerns could motivate steady shifts in the FX allocation of the city's residents. **Third**, HKD tends to soften slightly vs USD in times of strong global trade growth, as discussed earlier.

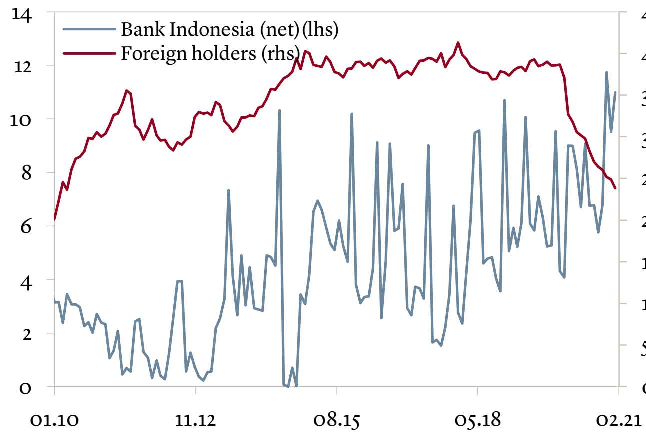
Main risks to our view: Main risks are the magnitude of the IPO boom including the new attempt to list Ant Group, and domestic political developments related to the Legislative Council elections. We do not believe there is a high risk of another unexpected tax hike like the stamp duty on trading.

INR: Lowering our expectations amidst a major infection wave

We are adjusting our outlook on the Indian rupee (INR) due to the unexpected rapid deterioration in public health conditions since March. We now see the currency registering only a limited recovery vs the USD in the remainder of the year. **First**, the ongoing wave of Covid-19 infections will likely require substantial tightening of social distancing restrictions as India lacks the infrastructure to ramp up vaccinations materially from the current pace (see chart 28). Even if the Modi cabinet shies away from a punitive national lockdown, a combination of individual precaution and localised stringency measures will likely lower the headline growth rate by 2.0-3.0%. While the markets have probably priced in this setback already, the country's vulnerability to an unexpectedly prolonged wave means that outright material appreciation of INR might be difficult. **Second**, the central bank (RBI) will find itself in a more difficult spot as the new wave increases the necessity for domestic liquidity support and weakens capital inflows at the same time. Admittedly, portfolio inflows have been somewhat resilient to the new wave thus far, thanks in part to recovering inflows in the debt market. Should the public health condition deteriorate further, however, equity outflows could begin and put more pressure on INR unless the RBI is willing to defend a particular level for the FX rate. **Third**, another positive catalyst is unlikely in fiscal policy

29. Dramatic change in the bond market ownership in Indonesia

Outstanding tradeable IDR bonds by ownership, % of total



Sources: Bloomberg, CEIC, Lombard Odier

Note: Past performance and forecasts are not a reliable indicator of future performance.

Asia FX

after the passage of the new budget at the end of January and the Modi cabinet's likely reluctance to test the patience of credit rating agencies that continue to rate India as a borderline investment grade country.

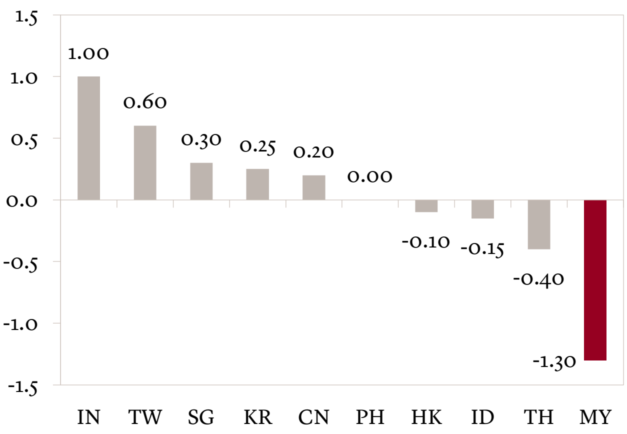
Main risks to our view: We do not believe that there will be additional downgrades in India's investment-grade rating, but it will be important to monitor the rating agencies' assessment of the country's medium-term fiscal risks in light of the new infection wave. Industrial commodity prices, geopolitical tensions with China, and global government bond yields will be other key risks.

IDR: Cyclical upside capped by excess domestic liquidity

We expect only modest appreciation for the Indonesian rupiah (IDR) in 2021 vs USD. In line with our expectations, IDR's rally since the passage of the Omnibus Bill began to peter out in December. We see three reasons for the currency's limited gain. **First**, the latest government bond auction revealed that Bank Indonesia (BI) continues to be the essential buyer in the primary market by filling the gap left by more hesitant foreign investors (see chart 29). While foreign investors' fears over the burden-sharing agreement between BI and the government have quieted somewhat, the wall of new bond issuances will require significant excess domestic liquidity from the BI. **Second**, Indonesia is unlikely to achieve a quick escape from the Covid-19 epidemic even if the overall infection rate is somewhat better than those in the US, Europe, and other emerging market peers. The logistical challenges of pre-vaccine containment efforts and vaccine rollout are substantial, and the country will not be able to return to its GDP trend until 2022. **Third**, the currency's downside is also limited due to a relatively higher real rate trajectory in 2021 and to its sensitivity to a global cyclical upturn. Indonesia's real interest rate in particular will likely be higher than its regional peers', even though it will decline somewhat from 2020 levels due to the BI's recent dovish signal.

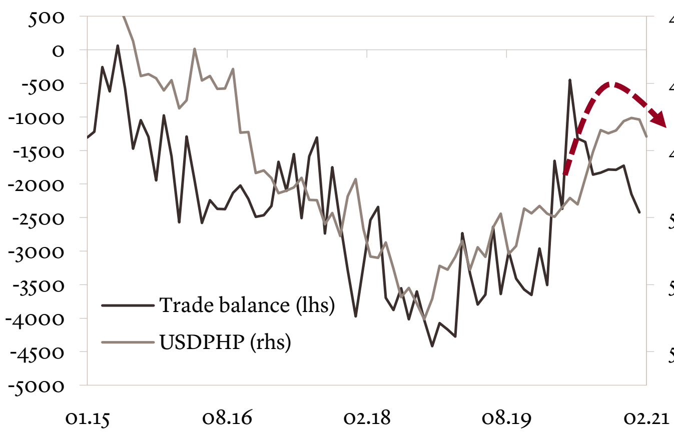
Main risks to our view: The country's lax approach to Covid-19 containment will be a key risk given its fragile healthcare system. Somewhat disappointing and unclear efficacy data for Chinese vaccines will be an issue since Indonesia's vaccine strategy depends heavily on them. The local bond market's sensitivity to global yields will also be a key risk.

30. Malaysia has seen the worst growth forecast revision for 2021
Change in consensus outlook for 2021 real GDP growth, ppts



Sources: Bloomberg, Lombard Odier

31. Widening deficit would increase PHP depreciation pressure
Trade balance, USD mn (lhs), USDPHP, inverted (rhs)



Sources: Bloomberg, Lombard Odier

Note: Past performance and forecasts are not a reliable indicator of future performance.

Asia FX

THB: Vaccine news more impactful than political uncertainties

We lower our forecast for the Thai baht (THB) even though the currency is still likely to appreciate slightly vs USD in the remainder of the year. **First**, Thailand's macro outlook will be extremely sensitive to vaccine developments due to its tourism sector, but relatively slow vaccination rollout in major emerging markets will likely push back the timing of full a recovery in tourism until 2022. We note no emerging market comes close to Thailand in terms of dependence on tourism for USD earnings. **Second**, the ongoing local infection wave, while rather limited in magnitude in comparison to those outside the country, will likely cap Thailand's 2021 growth as authorities will keep social distancing restrictions over a longer period of time. **Third**, the Bank of Thailand (BOT) is unlikely to cut its rates further but is keen to keep THB as competitive as possible to help the country maximise the ongoing recovery's benefits. Domestic investors have reacted to the BOT's relaxation of FX regulation by snapping up foreign equities, creating a significant portfolio outflow.

Main risks to our view: the government's response to the new infection wave; political stability after the street protests; and retail-driven portfolio outflows.

MYR: Trade boost undermined by uncertain politics and Covid-19 wave

We expect the Malaysia ringgit (MYR) to post only a modest gain against USD in 2021. **First**, the fragility of the new governing coalition points to the high likelihood of a snap election in 2021. Although the declaration of emergency gives the ruling party some time to fend off no-confidence votes and snap elections, we believe that political intrigue will dominate policy outlook and weigh on MYR. That said, the impact of these developments has not been visible on the currency so far. **Second**, the ongoing boom in the global goods and industrial commodity trades will boost the country's exports, but Malaysia has suffered a major negative revision of its growth outlook due to Asia's worst Covid-19 wave in Q1 (see chart 30). While the infection wave has flattened amidst the invocation of a health emergency, it will take time for the country's domestic demand to rebound. **Third**, Bank Negara Malaysia has begun to signal the end of its easing cycle, and we expect the central bank to remain on hold for the next 12 months in the absence of a new external shock. All told, the currency will neither gain nor lose significantly as positive and negative factors offset each other.

Main risks to our view: unexpected failure to pass the new budget in November; the trajectory of local confirmed cases of Covid-19; oil price trends and their impact on the government's fiscal balance; and global demand for the country's industrial commodities and mid-end manufactures..

PHP: Countercyclical outperformance likely to reverse

We believe that the end of the period of outperformance for the Philippine peso is near, even though we do not see significant depreciation in the next 12 months. **First**, the stabilisation of the Covid-19 epidemic curve in the country has led to the re-opening of the economy and an exceptional rebound in its activities in Q3, but the Philippines will face significant logistical challenges in the nationwide deployment of Covid-19 vaccines and thus rapid virus containment. **Second**, the country's external balance will begin to deteriorate with the resumption of economic activity and with government spending that will push the deficit to 7-8% of GDP (see chart 31). **Third**, the Bangko Sentral ng Pilipinas (BSP) may not cut rates further, but it will continue to support growth via liquidity operations and adjustments in reserve requirements for the banking sector. We note that the BSP's holding of government bonds has risen significantly since the start of 2020. Stabilising remittance flows and better access to USD liquidity, however, will limit the downside for the currency.

Main risks to our view: the trajectory of local confirmed Covid-19 cases and investor pricing for the likely period of political uncertainty ahead of the 2022 elections

Note: Past performance and forecasts are not a reliable indicator of future performance.

LatAm FX

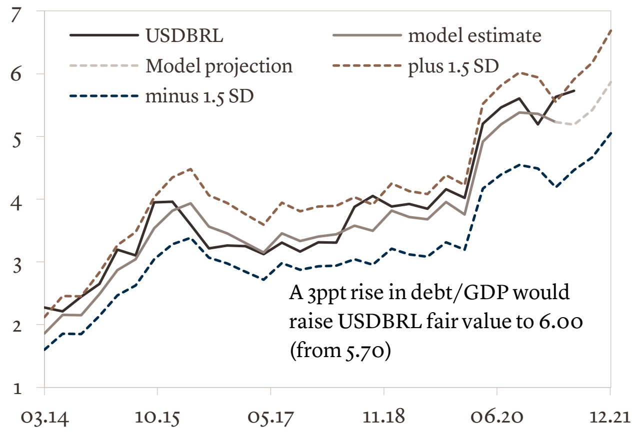
- **We maintain our cautious view on the BRL and COP, preferring the MXN and CLP**
- **While we like the MXN, heading into the June election, we hold off from outright short USDMXN positions and prefer to be short BRLMXN instead**
- **With CLP having performed strongly in line with our views, some further gains could occur in the months ahead given growth upgrades to Chile**
- **Political risks will need to be monitored for Mexico, Chile, and Peru.**

BRL (Brazilian real): Still the LatAm FX laggard

We have had an extremely cautious view on the BRL, which is in our "EMFX underperformer" category. The key reason for this is the deteriorating fiscal path that will continue to weigh on valuations. Fundamentally, the debt trajectory plays a key view in our thinking for the Brazilian real. Assuming a 3-percentage point higher government debt/GDP ratio, USDBRL fair value would rise from 5.70 all the way to 6.00 (chart 32). Simultaneously, BRL in the past has cheapened relative to broad emerging market currencies in election cycles (chart 33). Accordingly, we believe the USDBRL will chalk out a higher range of 5.50-6.50 in the next 12 months. On fiscal policy, there is uncertainty over whether any further emergency aid issued will come alongside reforms that stabilise the debt ratio. With Covid case numbers rising and former President Lula likely entering the race for the 2022 presidency, fiscal policy direction could pivot towards more populist and/or fiscal easing. This should see markets continue to price in worsening fiscal risks over the next 12 months. We have already seen increasing state interventionism in the private sector by the government (and incumbent President Bolsonaro in particular) in a bid to improve popularity among voters. Going forward, the interaction between monetary and fiscal policy will be key. While the central bank (BCB) has started the rate hike cycle by raising by a higher-than-expected 75 bps (and flagging further hikes), let us not forget that the real policy rate still stands at minus 250 bps (vs +200 bps pre-pandemic). We think much higher policy rates (and hence FX carry) would be required to help the BRL amid heightened fiscal risks.

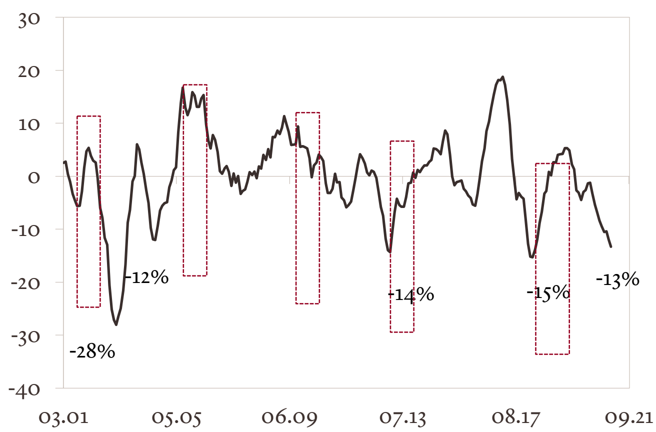
Main risks to our views: A downside USDBRL risk would be if former President Lula fails to run for the 2022 presidential election and Covid numbers improve, which would reduce fiscal risks somewhat. An upside risk would be a more significant worsening of the debt trajectory (without offsetting reforms), as well as the BCB failing in returning real rates to positive territory.

32. We expect USDBRL to rise to 5.50-6.50 given the likelihood of higher debt than previously assumed



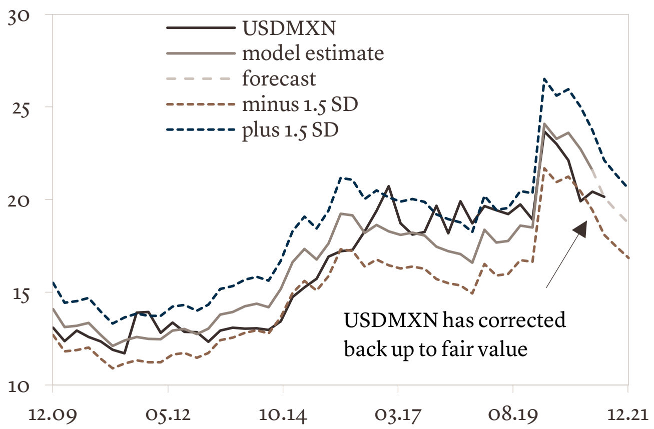
Sources: Bloomberg, Lombard Odier

33. BRL cheapened versus EMFX in some past election cycles



Sources: Bloomberg, Lombard Odier

34. USDMXN has corrected. Fair value seen grinding lower for the rest of the year



Sources: Bloomberg, Lombard Odier

Note: Past performance and forecasts are not a reliable indicator of future performance.

LatAm FX

MXN (Mexican peso): Decent fundamentals, but prefer short BRLMXN to short USDMXN in Q2

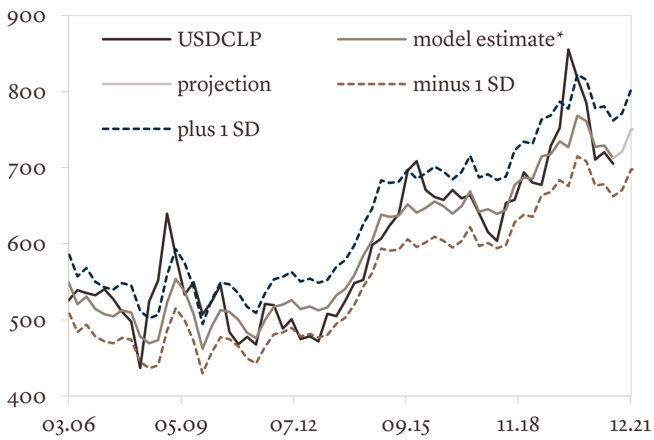
Having been bullish on MXN for H2 2020, we downgraded the currency to “cautious” in the January edition of the Monthly. What concerned us was both valuation and positioning for the peso, which seemed overdone. However, a modest correction has materialised on both these fronts. On valuation, we are now trading in line with our fair value estimate compared to being undervalued at the start of the year (chart 34). On positioning, sum of asset managers and leveraged investors CFTC exposures has corrected to the 60th percentile of its history (vs 80th percentile at the start of the year). At the same time, the central bank has provided less dovish signals of late given inflationary pressures. This could maintain the MXN`s yield advantage in LATAM for a while longer. However, for now, we hold off from upgrading the currency given the close proximity to the event risk of the June election. However, we like to run long MXN exposure against the BRL. One factor that could support the MXN compared to other EMFX is its linkage with the US economy (80% of exports go to the US). Going forward, the fiscal-monetary policy backdrop would need to be monitored closely: so far, despite weaker growth, the fiscal deficit figures have been stronger than expected, helped by securing extra sources of revenues from the stabilisation funds. This has helped postpone rating downgrade risks to 2022. However, at some point, these sources of stabilisation could run out and could turn the focus to a potentially worsening fiscal trajectory in 2022.

Main risks to our views: The main upside risks to USDMXN relate to US 10Y yields and politics (either from uncertainty related to June elections, or if President AMLO’s energy agenda clashes with US President Biden’s clean energy agenda).

CLP (Chilean peso): Still the most resilient LatAm FX

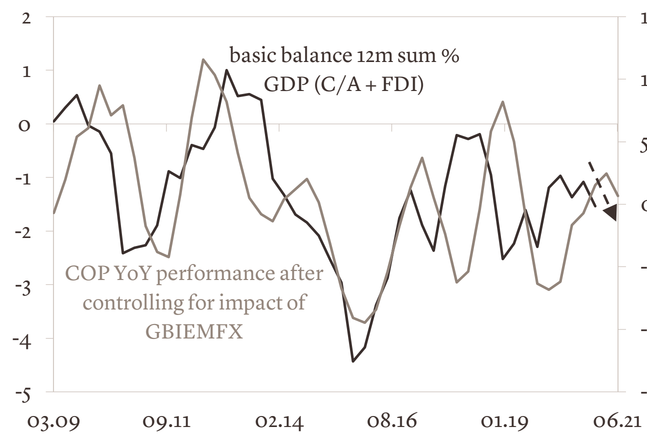
The CLP has long been our top pick in LatAm FX – over 2020 as well as the past quarter, and currently stands in our “modest performer” category. Our model, based on variables like copper prices, government debt, relative growth (vs the US), and real interest rates, signals USDCLP trades near to fair value. Under the most optimistic scenario where we see further upgrades to Chile’s growth rates (given its successful vaccination campaign), we believe USDCLP could mark a low point near 670 up until Q3. However, a compression of growth differentials (versus the US) should see USDCLP drift higher towards the end of the year (chart 35). All told, despite the strong CLP rally already seen, CLP could still perform over the coming three months. Politics will be in focus in H2.

35. USDCLP screens as fairly valued after recent sharp declines



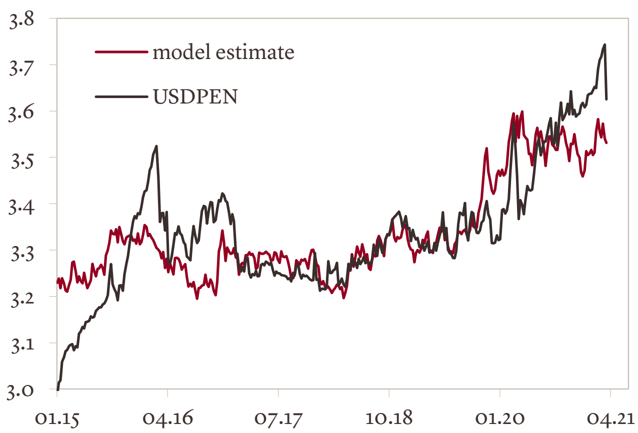
Sources: Bloomberg, Lombard Odier.

36 Widening basic balance deficit should drive COP under-performance



Sources: Bloomberg, Lombard Odier

37. Reduction in political risk premium could see USDPEN decline to a lower 3.55-3.65 range



Sources: Bloomberg, Lombard Odier.

Note: Past performance and forecasts are not a reliable indicator of future performance.

LatAm FX

A new 155-member constitutional convention body is set to be formed in mid-May (postponed from April). Markets will scrutinise the make-up of the assembly. This will set the stage for the general election (November) and potentially a second-round presidential election (December). These events could create headline risks in H2. At the same time, one of the tailwinds for the CLP over 2020 – i.e. large USD sales in the spot market linked to conversion from sovereign funds and fiscal spending (from issuance of FX bonds) – will be likely decline in intensity over 2021.

Main risks to our views: Negative risks come from politics. A more populist make-up of the constitutional convention (to be formed in mid-May) could begin to impact CLP assets in H2 2021. Still, relatively low government debt should imply limited fallout for the CLP. A sharp decline in copper prices is another risk.

COP (Colombian peso): Twin deficit vulnerabilities

Along with the BRL, the COP is the other LatAm currency in our group of EMFX underperformers. Price action has supported our classification, with USDCOP over 7% higher in Q1, the second-worst EMFX performer behind the BRL. This may seem surprising considering that energy prices are still 24% higher compared to the end of 2020. However, in our view, two factors can explain this fragility in COP. **First**, on our long-term model, USDCOP screened as the most undervalued USDEM pair in LatAm at the start of the year, with our model signalling equilibrium of between 3,800 and 4,000. **Second**, The COP is a clear twin-deficit currency in EM – an outlier. External balances should remain weak: the current account deficit will likely remain wide at near 3.8% of GDP, with the trade deficit still intact and widening (despite weaker growth last year). Foreign direct investment (FDI) flows could also slow, weakening in Q4 compared to a 5Y average of 3.2% GDP). This should keep the COP an underperformer within EMFX based on historical trends (chart 36). With Colombia (along with Peru), having been a clear vaccine laggard in LatAm, downside risks to growth would put fiscal accounts under pressure. Foreign debt holdings, which held up quite well in 2020, could be susceptible to negative news on the fiscal front. Finally, and somewhat similar to the case with the CLP, COP will benefit less in 2021 from USD sales.

Main risks to our views: Markets expect a reform bill to be sent to Congress to implement a fiscal adjustment in 2022. The degree to which this is watered down (or not) will impact COP.

PEN (Peruvian sol): Volatility to remain with us

The PEN falls into our category of “cautious” EMFX. Having traded above 3.75 in late-March, USDPEN saw a very large sell-off down to 3.62 (a four-sigma event by historical standards) in the first week of April after initial polls indicated the possibility of a less divisive second round election. That said, results still suggest the likelihood of continued uncertainty. Far left candidate Castillo, who won the first round with a stronger than expected lead, will be running against far right candidate Fujimori. Markets fear a Castillo win resulting in large changes (he ran his campaign on altering the constitution and economic model). The markets focus will shift to the formation of political alliances by these two candidates ahead of the June second round election. For the PEN to regain composure, the burden will be on far right candidate Fujimori to unite parties on the political-right. We expect a 3.65 – 3.75 range (and above our short-term fair value estimate – chart 37) to hold in the weeks and months ahead, with risks skewed higher if a Castillo win becomes the market`s base case assumption. That said, either way, both candidates will likely face a divided Congress which could limit the scope for large changes to policy.

Main risks to our views: USDPEN downside risks would come from locals unwinding sizeable long USD positions should political uncertainty decline (FX deposits rose 20% after September 2021). USDPEN upside risks would come from ongoing FX hedging by foreign investors (who own 50% of the local bond market).

Note: Past performance and forecasts are not a reliable indicator of future performance.

CEEMEA FX

- **USDRUB has corrected to the top of the 72-76 range as markets build in geopolitical risk premium. We like scaling into long RUB at these levels**
- **We remain bearish on the TRY but expect a more controlled depreciation in ZAR. We like short TRYZAR**
- **CEE has seen some position shakeout recently. HUF remains our preferred short in CEEMEA, while we continue to like ILS and CZK**

RUB (Russian rouble): Look to scale into long RUB following recent correction

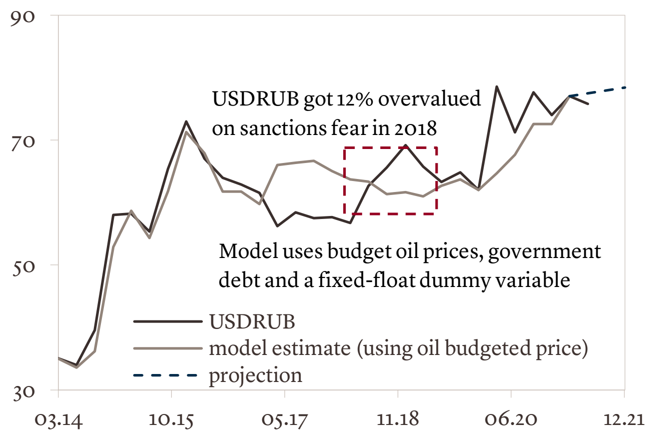
The RUB has been in our group of "cautious EMFX" for some time. The main rationale was twofold: the likelihood of a more challenging US-Russia relationship under Biden, as well as our reasoning that USDRUB fair value is near 75, above most consensus estimates (chart 38). Recently, the US has introduced a number of sanctions via Executive Order, the most notable being the prohibition of US financial institutions from participating in the primary market for RUB denominated government bonds (OFZ). While this opens up a new front in US-Russia tensions as it suggests nuclear options (like sanctioning secondary market in OFZ) are possible, at current levels, we believe that currently a fair amount of risk is priced into the market. While recognising that risks remain two-way, we would favour scaling into long RUB exposure cautiously. On the still negative side, the sanctions will likely see a structurally lower demand for OFZ bonds from foreign investors. Investors would likely need a higher risk premium to hold debt. On the more positive side, the US's suggestion to invite Russia to a Summit to discuss these issues in the months ahead point to some potential thawing of tensions. At the same time, despite the recent escalations in tensions between Russia and Ukraine, so far, the Russian response has, so far, been measured.

Main risks to our views: Risks remain two way dependent on politics. In terms of events, we would monitor the health of jailed Russian opposition leader (and staunch Putin critic) Navalny, potential second round of sanctions under the Biological Weapons Control and Warfare Elimination Act (CWB) in late May/June, and comments around a potential US-Russia Summit.

ZAR (South African rand): A slower grind higher for USDZAR – favour short TRYZAR

In March, we upgraded ZAR by moving it to our group of "cautious" EMFX (from "underperformer" previously). Our end-2021 forecast now stands at 15.70 (vs 16.20 previously). The eventual direction of USDZAR remains higher: our model suggests that weakening productivity growth and higher debt

38. Our model suggests USDRUB fair value is near 75-76

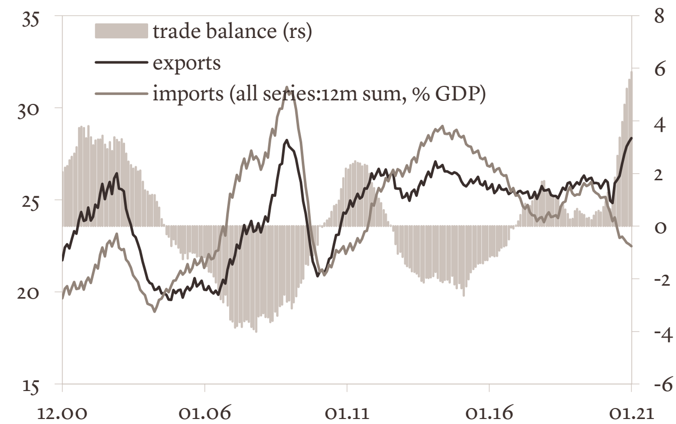


Sources: Bloomberg, Lombard Odier

39. Non-resident holdings of Russian local currency bonds are lower much lower compared to the last sanctions scare in 2018

Sources: Bloomberg, Lombard Odier

40. ZAR trade balance improvement will slow the rise in USDZAR we expect



Sources: Bloomberg, IMF, Lombard Odier

Note: Past performance and forecasts are not a reliable indicator of future performance.

CEEMEA FX

levels would be offset only modestly by improved terms of trade, triggering a move in the region of 18.00 in the years ahead. That said, the speed of the move would likely be much slower for two reasons. **First**, the strong improvement in the current account balance is being driven by both exports and imports, which could last somewhat longer (chart 40). A stronger basic balance has seen ZAR well supported against the GBIEMFX index historically). **Second**, given the very steep local bond curve, FX hedge ratios likely run high on non-resident bond holdings. Both these factors could continue to keep USDZAR less volatile compared to history.

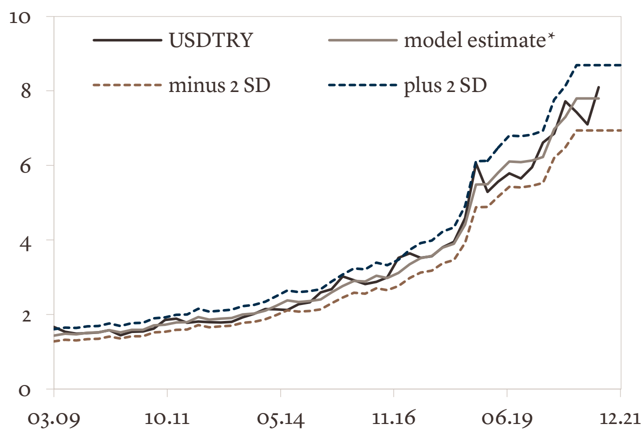
Main risks to our views: On the positive side, a longer-than-expected spell of external rebalancing could keep ZAR somewhat supported. On the negative side, negative news from the fiscal front (given rising Covid numbers) and/or contagion from Turkey remain risks.

TRY (Turkish lira): Staying cautious

The Turkish lira is on our list of EMFX underperformers. Our longer-term model continues to suggest that USDTRY will move higher. We find that longer-term macroeconomic fundamentals such as relative core-CPI trends, relative productivity, FDI, government debt, and external debt can explain the trajectory of USDTRY. A model that uses these variables suggests that USDTRY fair value stands at 7.80 (see chart 41), with a likely trading range of 6.90-8.70 (defined by two standard deviations). There remains considerable uncertainty as to the direction of macroeconomic policy following the recent changes, including the unexpected dismissal of orthodox central bank (CBRT) Governor Aqbal. However, if we assume that the CBRT will now reverse some of the tightening of the past six months, we would expect USDTRY to first move towards the November all-time spot closing high of 8.50. However, even in the event that the central bank stays hawkish, our view is that the damage may have already been done last year and may be difficult to repair. Indicators suggest that local citizens may have already lost faith in the local currency: there was a sharp rise in gold imports over 2020 and limited evidence of locals reducing FX deposits following the Q4 2020 rally in TRY. This suggests that a cautious approach will still be required for the TRY, even considering very low non-resident positioning in Turkish assets.

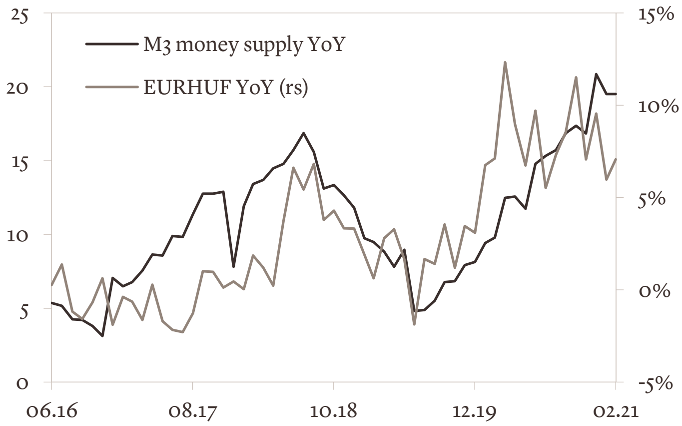
Main risks to our views: Political ties between the EU and US will need ongoing monitoring given that markets assume some thawing in tensions

41. USDTRY fair value stands at 7.80 on our model



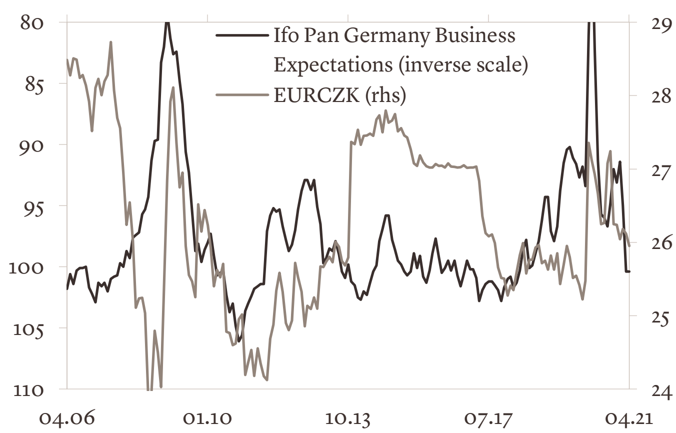
Sources: Bloomberg, Lombard Odier

42. Expansionary monetary policy to keep EURHUF well supported



Sources: Bloomberg, Lombard Odier

43. EURCZK vs German IFO expectations



Sources: Bloomberg, Lombard Odier

Note: Past performance and forecasts are not a reliable indicator of future performance.

CEEMEA FX

Central Eastern Europe & ILS: HUF our preferred short, with ILS and CZK our favoured currencies

Over Q1, the Polish zloty (PLN) and Hungarian forint (HUF) faced downside pressure following the decline in EURUSD and country-specific events. We have recently seen a position-unwind and rebound in both, with EURPLN and EURHUF declining 3% in the latter part of March. From here, we would remain cautious on the PLN, but would favour long Czech koruna (CZK), long Israeli shekel (ILS), and short HUF exposure.

The Hungarian forint has long been our preferred short in CEE. The central bank has been expanding its balance sheet at a fast pace in recent years. The acceleration in money supply growth should keep EURHUF elevated (see chart 42), similar to the situation after 2016. Another important driver here is the trend of external balances. Hungary has seen its broad basic balance erode in trend terms over the past three years, in contrast to peers'.

By contrast, **both the Czech koruna and Israeli shekel remain our preferred longs**

We like the CZK given its historical response to stronger German growth sentiment, which tends to herald CZK gains (chart 43) and a relatively healthy debt trajectory.

In recent years, strong FX flows linked to Israel's emergence as a tech hub, rising gas exports, low US real yields, and good performance of the tech sector have added to strong ILS appreciation pressure. While the beginning of the year has seen a correction of these themes (US real yields higher and tech shares underperforming), what is striking is that the USDILS rise has been limited (despite substantial FX intervention from the Bank of Israel). If US yields show some near-term stability, we believe that USDILS should move back down towards the bottom of its current 3.20-3.30 range.

Elsewhere, **we are more neutral on the PLN**, as stronger external balances are being offset by low real yields and an increasingly interventionist central bank. Recently, the PLN has weakened as markets built in a risk premium around the conversion of legacy CHF mortgage loans, which in turn, could spark sales of PLN (and purchases of foreign currency). However, the amounts involved are still unclear based on the final scenario, and whether resultant PLN sales (and CHF purchases) would occur in the open market or if the central bank would provide the liquidity. The deliberations are still fluid, and more clarity would be needed before gaining exposure, in our view.

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Our Lombard Odier long-term FX fair valuation framework

BEER **Behavioural equilibrium exchange rate model**	**FEER** **Fundamental equilibrium exchange rate model**
Definition Econometric model, which estimates FX fair values by "mapping" the exchange rate to a set of fundamental economic variables	**Definition** Framework tries to identify the level of the exchange rate that would bring the economy into macroeconomic equilibrium (Current account balance sustainably financed by flows)
Inputs · Terms of trade · Investment as % of GDP · Rate differentials · Inflation differentials	**Inputs** · Price elasticity of trade · Output gap · Current account · Capital flows
Output Fair value estimates for major forex crosses Updated 2 to 3 times annually Weight: 50%	**Output** Fair value estimates for major FX crosses Updated 2 times annually Weight: 50%

COMBINED OUTPUT – LO FX long-term fair value estimates

Usage	**Usage**
Anchor for long-term forecast	Degree of misalignment can be a sell or side signal

Note: Past performance and forecasts are not a reliable indicator of future performance.

Glossary

ASEAN
Association of South East Asian nations

BEER
Behavioural Equilibrium Exchange Rate – one method for evaluating the fair value of a currency.

BIS
Bank for International Settlements

BRL
Brazilian Real

CEEMEA
Central eastern Europe, middle east and Africa

C/A
Current account

CFETS
China Foreign Exchange Trade System.

CFTC
Commodity Futures Trading Commission

CLP
Chilean Peso

CNY
Chinese Yuan

COP
Colombian Peso

CZK
Czech Koruna

DXY index
US Dollar Index (DXY)

EM
Emerging market(s)

EMFX
Emerging market currencies

FEER
Fundamental-equilibrium exchange rate – rate consistent with a steady economy at full employment and a sustainable current-account balance.

GBIEMFX
JP Morgan Emerging Market Currency Index

HUF
Hungarian Forint

IDR
Indonesian Rupiah

ILS
Israeli Shekel

INR
Indian Rupee

KRW
South Korean Won

LATAM
Latin America

MXN
Mexican Peso

MYR
Malaysian Ringgit

PEN
Peruvian Sol

PHP
Philippine Peso

PLN
Polish Zloty

RT
Real time

RUB
Russian Ruble

SGD
Singapore Dollar

THB
Thai Baht

TRY
Turkish Lira

TW
Trade-weighted (dollar, etc.)

TWD
Taiwan dollar

ZAR
South African Rand

1W
1-week

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