

International Commentary — December 17, 2021

International Economics 2022 Outlook

Summary

Forecast Changes

- We have turned more optimistic on the prospects for the U.S. dollar and adjusted our forecasts to now reflect dollar strength throughout 2022 and into 2023. A hawkish Federal Reserve should provide support to the dollar going forward, while we believe financial markets may still be priced for too much monetary tightening from several foreign central banks.
- In our view, renewed and persistent U.S. dollar strength should keep most G10 currencies weaker through early 2023. We have revised our forecasts for most G10 currencies lower, including the Canadian dollar, British pound and the euro.
- 2022 is likely to be a challenging year for emerging market currencies. Tighter Fed monetary policy should keep downward pressure on most emerging currencies, while political risks should also be a source of depreciation pressure. In particular, political risk should weigh on the Brazilian real, and Chilean and Colombian pesos, while an unorthodox policy framework should result in a significantly weaker Turkish lira for the foreseeable future.

Key Themes

- As we head into 2022, we believe the evolution of COVID could continue to have an important influence over the path of the global economy as well as currency markets. The Omicron variant has yet to reveal its full economic impact and introduces new downside risks to global economic activity. Research on Omicron is still limited; however, should Omicron become the new Delta, the global economic recovery could be disrupted by COVID developments next year. Persistent inflation pressures should also be a significant influence in 2022, posing some downside risk to growth as it weighs on consumer purchasing power and prompts central banks to tighten monetary policy.
- China's economy came under pressure for most of 2021 amid the government's commitment to COVID-related policies as well as protecting the economy from perceived systemic risks. While risks to China's economy are likely to persist in 2022, we expect the economy to be supported by a shift to more accommodative policy settings. As China's economy stabilizes, the global economy as well as China-dependent economies should find a pillar of support.
- The political calendar in 2022 is quite heavy, as the United States will host midterm elections. We expect China policy to play a major role in U.S. midterms and for U.S.-China tensions to escalate over the course of next year. Local political developments in China could also be a source of stress, as China's 20th National Congress is likely to result in President Xi breaking tradition and staying in power. Brazil and Colombia will also head to the polls, where we expect developments to weigh on each respective currency, while a contentious constitutional rewrite process should keep depreciation pressure on the Chilean peso going forward.

Economist(s)

Nick Bennenbroek

International Economist | Wells Fargo Securities, LLC
Nicholas.Bennenbroek@wellsfargo.com | 212-214-5636

Brendan McKenna

International Economist | Wells Fargo Securities, LLC
Brendan.Mckenna@wellsfargo.com | 212-214-5637

Jessica Guo

Economic Analyst | Wells Fargo Securities, LLC
Chuyue.Guo@wellsfargo.com | 704-410-4405

2021: A Year in Review

Heading into this year, economists and market participants alike had a sense of optimism. There was optimism the worst of the pandemic was behind us as vaccines were introduced and other forms of therapeutics looked promising. Countries around the world began to reopen, and while we have been thrown into a “new normal”, a sense of normality was beginning to set in. The first three months of the year were defined by receding infections and a reduced case burden around the world. However, by the middle of the year, COVID reared its ugly head again as the virus mutated into Delta and reminded the world that COVID is an enemy unwilling to relent. Delta proved to be more transmissible and more infectious than prior strains of the virus, and eventually disrupted the global economic recovery. The optimism felt at the beginning of the year has slowly faded as governments re-imposed restrictions and consumers around the world altered spending patterns out of an abundance of caution. As a result, our outlook on global growth became less sanguine, and over the second half of the year, we made multiple downward revisions to our global GDP forecast.

Even countries with intense COVID protocols were unable to escape the economic wrath of the virus. China, known over the course of the pandemic for its “COVID zero” policy, reported surging case numbers as Delta spread nationwide. In response, Chinese authorities locked down many provinces and issued stay-at-home mandates to large portions of the population. Re-imposed restrictions certainly took a toll on the Chinese economy over the course of the year. In fairness, virus-related developments were not the only driving force behind China's slowdown. President Xi's commitment to “common prosperity” resulted in sharp downturns across multiple sectors of the Chinese economy and placed downward pressure on local financial markets. China's real estate industry was arguably impacted the most as Chinese authorities prioritized protecting the economy against asset bubbles and over-speculation in the property market. Regulatory crackdowns weighed on home prices and residential real estate sales, while the implementation of China's “three red lines” policies limited borrowing capabilities of most local property developers. As these policy adjustments took shape, many of China's largest property developers defaulted on their obligations. With real estate and related activities accounting for around a third of China's economy, market participants began to wonder if a collapse in China's real estate market was the country's “Lehman Brothers moment” and if another global financial crisis was imminent. While the global economic effects of China's failing property market are yet to be fully realized, China's growth prospects deteriorated as a result and contributed to slower global GDP growth in 2021.

COVID developments have come to define the last two years. The health and human services impact has been difficult to internalize, and one way or another, all of us have likely been affected. While we are in no way seeking to minimize the health effects of the last two years, the ramifications of COVID have reverberated on households in other ways as well. This year, households around the world were also pressured by a sharp rise in inflation. Global purchasing power has been reduced as supply chain disruptions persist, and demand for goods and services rose amid the reopening process. Just in the United States, November CPI inflation reached the highest rate in almost 40 years, while price growth in many developed and emerging market countries has risen above central bank inflation targets. Once deemed transitory, policymakers, particularly in the United States, have become more concerned regarding price formation trends. FOMC members began tapering asset purchases this year, while Fed Chair Powell announced to the U.S. Congress the word “transitory” to describe inflation has been officially retired. Fed policymaker commentary as well as the latest “Dot Plot” suggest interest rate hikes should start as early as next year. Internationally, central bank policymakers also began removing accommodative monetary policy due to elevated inflation. G10 central banks have turned more active and have signaled rate hikes are likely in 2022, while central banks across the emerging markets tightened monetary policy aggressively in an effort to push back against incessant inflation.

As we head into 2022, we expect the evolution of COVID to still have a major influence over the path of the global economy as well as global financial markets. To date, Delta is still the dominant strain; however, the recently identified Omicron variant could present new challenges for global economic activity. Research tied to Omicron is still limited, but should Omicron be as transmissible and severe as Delta, the global economic recovery could be disrupted once again. The issues surrounding China's economy are unlikely to dissipate anytime soon; however, we expect Chinese policymakers to support the economy through monetary and fiscal stimulus over the course of next year. With stimulus likely forthcoming and policymakers committed to stabilizing China's economy, returning to an annual GDP growth rate of 6% may not be out of the question. And as always, we expect political developments to be potential sources of financial market volatility. Next year, the United States will host midterm

elections and the balance of political power in the U.S. Congress could potentially shift. In Europe, presidential elections in France could in a risk scenario yield populist, Euro-skeptic leadership, while elections in Italy could yield a new governing coalition and direction for Italian policy. Even Brexit, once thought to be over and done with, could reappear and rattle U.K. financial markets. And in the emerging markets, elections in Brazil and Colombia could see populist and left-leaning politicians emerge, while the constitutional rewrite process in Chile should prove to be contentious and keep downward pressure on the peso. We also expect U.S.-China geopolitical tensions to continue, especially as President Xi seeks to break with historical political trends, while tensions between the United States and Russia could also persist well into next year.

Considering all of these factors, the question we have been asking ourselves is: will the global economy be able to restore a form of balance come 2022? Despite all of these risk factors, we are somewhat optimistic on the outlook for the global economy, and as of now, believe economies around the world will evolve and restore some semblance of balance next year. In the following pages, we will touch on each of the themes laid out above that should come to define 2022. We will highlight our views on the global economy amid another wave of COVID infections and the evolution of monetary policy against an environment of elevated inflation, as well as how political developments could change the economic landscape for many countries.

We wish to thank our readers for staying engaged with us during these times. In the coming year, we hope to see many of you in person again, and share our views on the world as well as financial markets. But, until then, stay safe and stay in touch.

Returning to More Balanced Growth

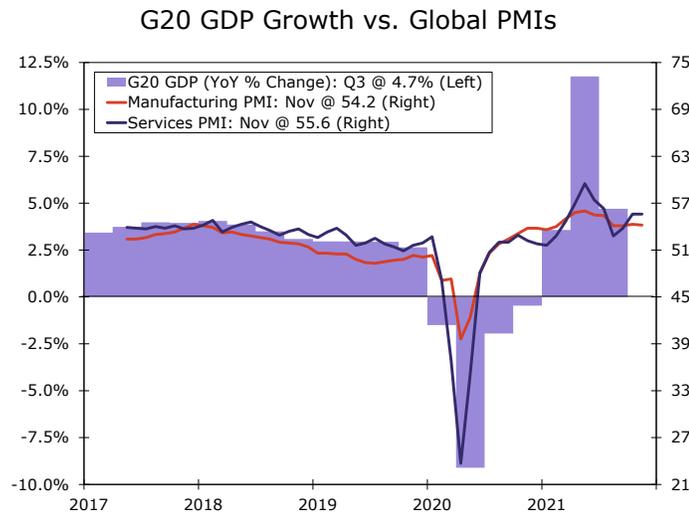
During 2021, the global economy continued to feel aftershocks and ripples—both economic and otherwise—from the various waves of the COVID crisis. After an initial surge in activity growth, recently there has been a somewhat notable global economic deceleration. We believe this slowdown indicates a shift toward a more balanced and trend-like pace of growth, which at a global level, is reflected in multiple relevant metrics. First, with respect to global growth, Q3 G20 GDP data showed the economy grew 1.7% quarter-over-quarter, but slowed to 4.7% on a year-over-year basis ([Figure 1](#)). While that pace of growth is still faster than typical growth prior to the pandemic, output nonetheless is much closer to trend-like rates of expansion. Overall, the global manufacturing and service sector PMIs have also eased from their peaks seen in early 2021, again toward levels more consistent with trend-like growth. This shift toward a steadier pace of economic growth is also reflected in our evolving GDP forecasts for 2021. At the beginning of this year—before some of the more recent waves of COVID cases had hit—we projected global GDP growth of as high as 6.5%. However, as several economies have been subject to COVID-related restrictions at varying times and to varying degrees, and as rising prices have weighed on consumer purchasing power, we have repeatedly revised our outlook lower. By the time we close the books on 2021, we expect global GDP to have expanded by 5.7% ([Figure 2](#)).

In 2022, we expect a further deceleration in global GDP growth to 4.4%, notably slower than this year, but still slightly above trend. This outlook assumes that COVID cases continue to rise as a result of the Omicron variant and takes into account winter months in the Northern Hemisphere as well as elevated holiday season travel. However, we also assume that widespread lockdowns like those experienced in early 2020 will not be repeated. We assume travel limitations regarding select Southern African nations and idiosyncratic lockdowns are the extent of the restrictions, and consumer activity is only mildly disrupted. We anticipate mobility remaining above pre-pandemic levels and that households will continue to deploy excess savings they built up over the last 18 months. We expect global growth to be led by the emerging markets as these economies, once lagging the global rebound, should start to gather recovery momentum over the course of the year.

In this base case scenario, we believe there are important factors that will contribute to more balanced growth, which for most countries, will mean slower growth. First, we expect a return to more normal household income and savings trends. Since early 2020, there have been large swings in household incomes and savings across the major developed economies, a reflection of large employment declines, sizable fiscal stimulus and income support, and at times, a forced retrenchment in consumer spending. As we head into 2022, employment growth for many economies appears to be returning toward a more typical path. Meanwhile, household savings rates across the United States, the Eurozone, Canada and the United Kingdom are still elevated, but are down substantially from the peaks seen during the pandemic ([Figure 3](#)). Thus, while consumer activity could still benefit from

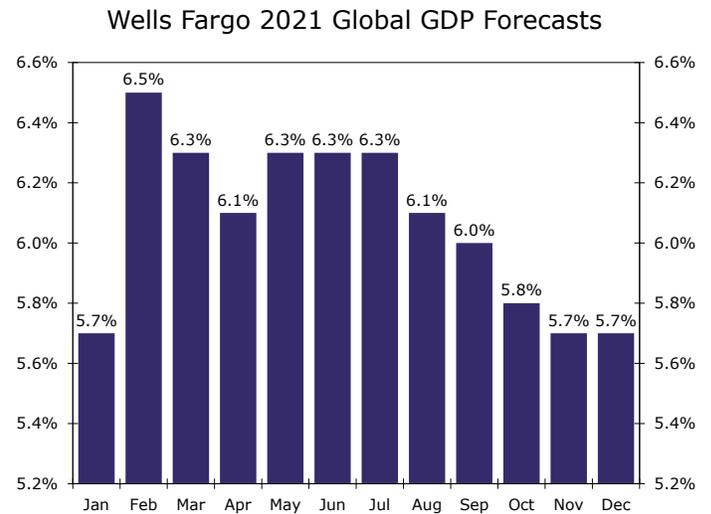
elevated savings rates and the stockpile of “excess” household savings, there is reason to believe consumer spending could return to steadier and more gradual trends in the quarters ahead.

Figure 1



Source: Datastream and Wells Fargo Securities

Figure 2

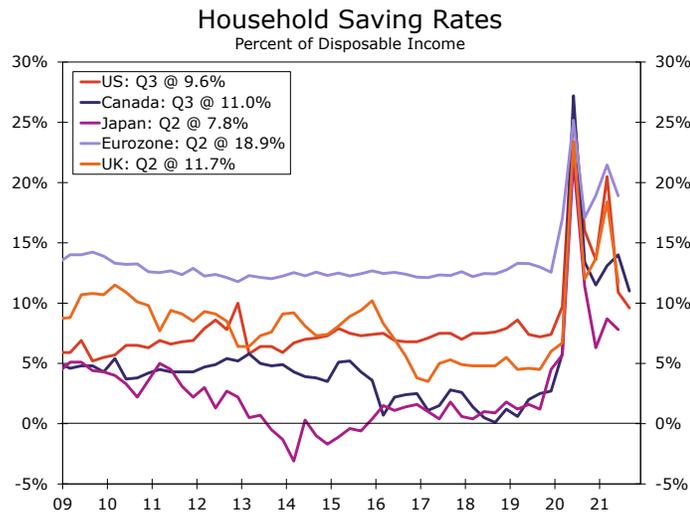


Source: Wells Fargo Securities

Second, there has been a significant uptick in inflation across many developed and emerging market economies (Figure 4). These price pressures are likely to last well into 2022 for many countries. Elevated inflation will likely contribute to a slowdown in global economic growth, both directly as higher inflation acts as a restraint on consumer purchasing power, and indirectly as global central banks respond with a shift to less accommodative monetary policy. Still, while more balanced economic expansion in most cases means slower growth, in a couple of instances that greater balance could be achieved by policy actions aimed at supporting economic activity. One notable example is Japan. The Japanese government's sizable fiscal stimulus should boost activity and has seen us lift our 2022 GDP growth forecast for Japan to 3.7%. We also anticipate monetary and fiscal policy actions from Chinese authorities to support activity in China. While we currently forecast the Chinese economy to grow 5.5% next year, more aggressive fiscal stimulus could see growth restored toward the more normal and balanced government target of 6% growth.

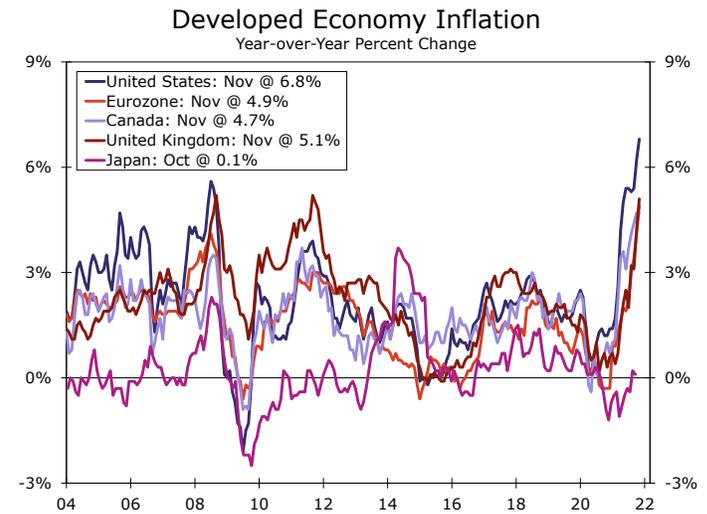
Still, while we see an orderly deceleration as the most likely outcome, the risks around our global GDP outlook are tilted to the downside. For example, an adverse scenario related to the Omicron COVID variant could see that variant being easily transmissible and resulting in more severe patient symptoms. As a result, governments around the world put more stringent restrictions and lockdown measures back into place. Global mobility falls below pre-pandemic levels and consumer spending patterns are significantly altered as “COVID fears” rise. In our view, the probability of this scenario unfolding is quite low at this time. To that point, we place a 10%-20% likelihood of this scenario materializing. Still, in this scenario, as restrictions rise, consumption patterns change, and investors become more risk-averse, the global economy would likely slow. In our view, this scenario would have a more pronounced impact on the global economy and could shave as much as 0.75-1.00 percentage points off global growth in 2022, and see growth slow to 3.5% next year.

Figure 3



Source: Datastream and Wells Fargo Securities

Figure 4



Source: Bloomberg LP and Wells Fargo Securities

Central Banks to Continue "Normalizing" Policy in 2022...

Another area where we see a shift toward greater balance next year is monetary policy. After many central banks adopted ultra-accommodative monetary policy through the pandemic, most central banks have already started to move toward less accommodative policy, and we expect those that started to continue, and for more to do so in 2022. Indeed, after waiting patiently on the sidelines, the Federal Reserve has now moved much closer to the forefront in terms of monetary tightening among the major developed central banks. At its December announcement, the Fed doubled the pace at which it is slowing its monthly bond purchases to a reduction of \$30 billion each month. At that pace, it will see its bond purchases come to an end by March next year. We also expect the Federal Reserve to begin raising interest rates in the second half of 2022 and see a cumulative 125 bps of Fed hikes between Q3-2022 and Q3-2023 (Figure 5). The Fed action's should broadly match those of the Bank of England, where we see 50 bps of rate hikes next year, but slightly lag the Bank of Canada, where we anticipate 75 bps of rate increases in 2022. We also forecast multiple rate increases from New Zealand and Norway, while in emerging markets, Brazil, Mexico, Chile and Korea are among the central banks that are likely to raise interest rates further in the coming year.

Of course, there are some exceptions to this theme of less accommodative monetary policy, and we do not, for example, expect the Bank of Japan and the Swiss National Bank to make any meaningful changes to their monetary policy stance in 2022. In addition, we expect the European Central Bank (ECB) to shift only gradually to a less accommodative monetary policy stance. Overall, the ECB is still viewing the current spike of inflation as temporary and forecasts inflation to return below 2% in 2023 and 2024. Thus, given some near-term uncertainties around growth, at its December announcement, the ECB said it would end its Pandemic Emergency Purchase Program in March 2022 as previously signaled, but would extend its regular Asset Purchase Program (APP). Specifically, the ECB said it would conduct APP purchases at a pace of €40 billion per month in Q2-2022, €30 billion per month in Q3-2022, and €20 billion per month from October 2022 for as long as necessary. We do not expect the ECB's quantitative easing to be concluded before the end of 2022.

...But, Expect U.S. Dollar Strength

Given our evolving outlook for U.S. and international monetary policy, and in particular faster Fed tapering and faster Fed rate hikes, our outlook for the U.S. dollar has also evolved. We now forecast a stronger U.S. dollar through all of 2022 and into 2023. As the Fed and foreign central banks become more active over the next several quarters, we believe monetary policy differences will become increasingly important for currency performance during that period. In fact, one prime example of how monetary policy divergence could be very consequential for currency performance is the ECB and the euro. Although the ECB has certainly paid attention to quickening inflation trends across the region, so far it sees that uptick in prices as temporary and has expressed less concern about inflation pressures than most other major central banks. That is reflected in the ECB's December monetary

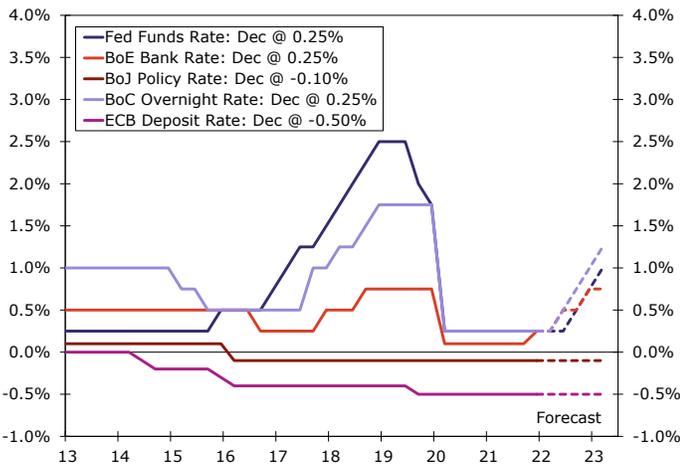
policy announcement, where it also gave no indication policy rates would rise any time soon. This divergence between the outlook for ECB policy and a faster acting Federal Reserve underpins our forecast for a weaker euro and for the EUR/USD exchange rate to fall to \$1.0500 by early 2023. In a similar vein, we expect Bank of Japan monetary policy to remain on hold for the foreseeable future. As the Fed tightens policy and U.S. bond yields rise over time, we target a USD/JPY exchange rate of JPY123.00 by early 2023.

Even for some G10 currencies where the relevant central banks are likely to be more active, we still see potential for currency weakness over the next several quarters. Regarding the Bank of England (BoE), even after a spike in inflation prompted a 15 bps rate increase in December, we expect only a gradual pace of tightening going forward as the economic recovery is likely to be uneven. As a result, we see only a cumulative 50 bps of BoE rate hikes over the next 12 months, compared to almost 90 bps currently priced in by market participants. We also view market pricing for several other developed economy central banks as modestly aggressive, including the Bank of Canada, Reserve Bank of Australia and Reserve Bank of New Zealand, in the sense that we do not expect those central banks to fully deliver on market tightening expectations. This view is in contrast to our outlook for the Fed. We now expect a faster pace of tapering from the Federal Reserve, and see a cumulative 125 bps of rate hikes from mid-2022 through 2023, which is quite close to that currently priced in by market participants. Given this backdrop and if, as we expect, foreign central banks take a relatively gradual approach to monetary tightening, then we believe currencies, such as the British pound and the Australian, Canadian and New Zealand dollars, could be susceptible to weakness over the coming quarters.

This dynamic of aggressive monetary policy pricing is also evident in Brazil and Mexico, while we see India's central bank keeping policy interest rates rather accommodative as the Reserve Bank of India still prioritizes growth. We also view emerging market currencies as generally more sensitive to rising U.S. yields, a pattern we believe is likely to repeat itself through 2022 and into 2023. Part of that sensitivity stems from the fact that higher yields in the U.S. dampen the "reach for yield" mindset. As yields in the U.S. rise, the need for investors to search for higher returns in the emerging markets may dissipate. In addition, rising U.S. yields often pressure government financing costs. With some emerging market sovereigns already facing precarious public finance positions, elevated financing costs could place additional pressure on debt burdens and fiscal balances across the emerging markets. And finally, local political developments may also play into the narrative of emerging currency weakness during 2022. Presidential elections in Brazil and Colombia, as well as the constitutional rewrite in Chile, will likely weigh on respective currencies, while ongoing concern about policy credibility in Turkey should keep the lira under extreme pressure throughout 2022 and early 2023.

Figure 5

Major Central Bank Policy Rates



Source: Bloomberg LP and Wells Fargo Securities

China to Flip on the Stimulus Spigots

As mentioned earlier, China's economic deceleration weighed on global economic growth in 2021. To put China's COVID zero policy and regulatory crackdown into context, at the beginning of 2021 we forecast China's economy to grow around 9.5% this year. As authorities imposed lockdowns and restricted movement in response to infection outbreaks, and as the effects of common prosperity and the three red lines policies took hold, we revised our China growth outlook sharply lower. As of our most recent update, we expect China's economy to grow 7.8% this year, almost two percentage points lower than where we started the year. In our view, the downward revisions made to China's growth prospects over the course of 2021 were significant and sharp, and moreover, we believe the risks around our 2021 growth forecast are still tilted to the downside. November activity data were once again mixed, with retail sales missing consensus expectations by a wide margin, rising only 3.9% year-over-year. Fixed asset investment and property investment also rose less than market participants expected, while alternative measures of GDP suggest China's economy is still in deceleration mode during Q4. Even our proprietary gauge of China's activity and sentiment indicators tells us the economy is still struggling to gather momentum and, at present, is a source of downside risk to global GDP growth.

Many of the issues that plagued China's economy this year are likely to persist in 2022. We highly doubt Chinese authorities will adjust policy toward COVID, and instead will maintain lockdown protocols in an effort to contain any outbreaks. Omicron cases have already been detected in China, and should the outbreak intensify and infections spread across multiple provinces, we would expect mobility restrictions to be put back in place. Should harsh restrictions be imposed, sequential growth rates could indicate little to no growth in China's economy and annual GDP growth would moderate even further next year. Aside from COVID, we also doubt the property sector slowdown will abate in 2022. In our view, China's "three red lines" policies, which are designed to limit property developer borrowing power to the strength of each firm's financial position, are unlikely to be lifted. Regulatory restrictions aimed at over-speculation and potential asset bubbles in China's real estate sector are also likely to persist. With the debt of many property developers already in distressed territory and yields for non-investment grade issuers elevated, we would not be surprised to see additional Chinese real estate firms default on their obligations, especially as the Chinese government maintains its position that it will not provide state capital to firms on the brink of collapse.

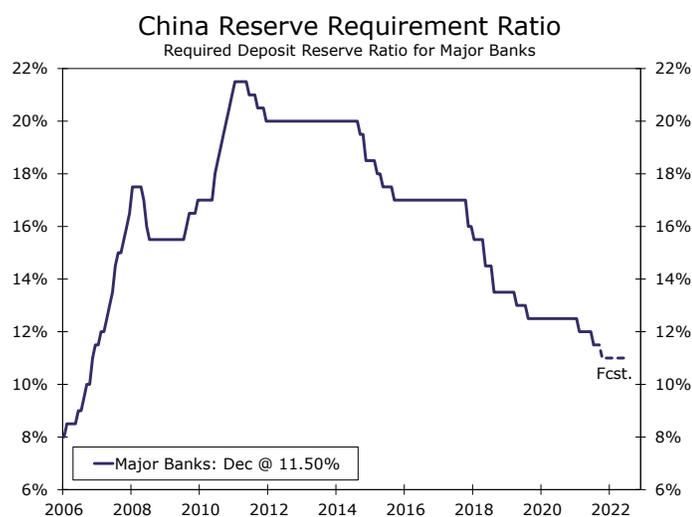
But despite these assumptions, we believe China's economy will stabilize next year amid a shift toward monetary easing and expansionary fiscal stimulus. Recent policymaker actions and commentary suggest policy will turn more accommodative in 2022 and will be sufficient to not only stabilize, but support economic growth. Just recently, the People's Bank of China (PBoC) lowered the Reserve Requirement Ratio (RRR) for major banks in an effort to increase lending activity and support the broader Chinese economy. In our view, PBoC officials are likely to lower the RRR another 50 bps to 11% in Q1-2022 (Figure 7). We also believe the Chinese central bank could lower its repurchase rate at some point next year. On the fiscal side, we believe authorities are likely to move forward with expansionary spending. The statement from China's annual Central Economic Work Conference indicated that fiscal stimulus, particularly aimed at infrastructure, is likely in 2022 in the context of ensuring economic stability. Monetary easing and fiscal stimulus would be a sharp change in policy settings relative to 2021. Over the course of this year, Chinese officials were focused on furthering their deleveraging campaign in an attempt to reduce financial stability risks. In our view, the state of the Chinese economy warrants a temporary pause in deleveraging, and we believe credit impulse will rise over the course of 2022. If history is any indicator, as China's economy decelerates, encouraging credit and lending as well as infrastructure spending are Chinese officials' "go-to" move to support the economy. In 2019, amid trade tensions with the U.S., and in 2020 during the depths of the COVID crisis, China reverted to increasing the credit impulse (Figure 8). Given the current health of China's economy, similar policy actions are likely in 2022.

Given our view for aggressive economic support, we forecast China's economy to expand 5.5% percent next year. As of now, our 2022 China growth forecast is above consensus, as we believe accommodative policy will offset the myriad of issues facing China's economy. In our view, even more aggressive policy stimulus than we currently expect could push China's annual growth rate back up toward the government's stated goal of 6%. Stable and possibly stronger Chinese growth should in turn act as a pillar of support for global economic output given China has the second largest economy in the world. In addition, a stable Chinese economy can also support economies reliant on Chinese demand. In that sense, commodity exporting emerging market economies, such as Chile and Peru,

could see growth supported, while regional economies such as Singapore, South Korea and Thailand could also see economic upside from a stable Chinese economy.

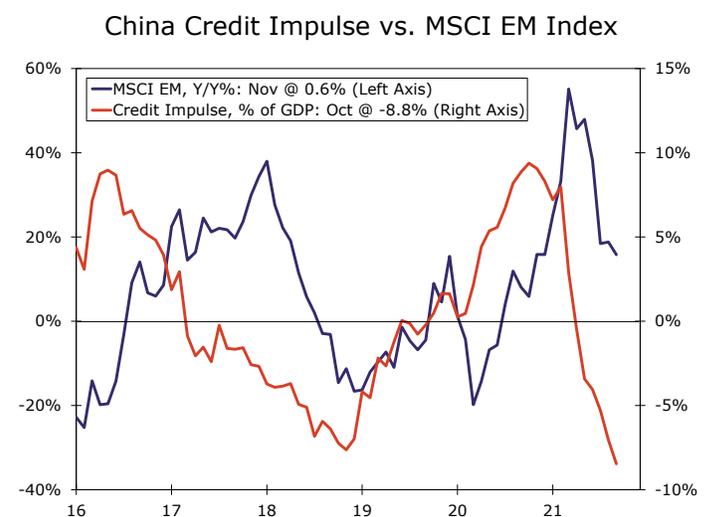
While we expect a broad stabilization in China's economy next year, the prospects for the Chinese renminbi are not as sanguine. In a further effort to support the economy, we believe the PBoC will look to facilitate a weaker currency to enhance the competitiveness of China's export sector. PBoC officials have set the daily fix for the currency weaker than market participant forecasts, while the central bank also raised the foreign exchange reserve requirement for local banks. In our view, these actions indicate the PBoC may be uncomfortable with the current strength of the Chinese currency. In addition, shifting toward accommodative monetary policy settings should also contribute to depreciation pressure building on the renminbi. With the Fed tightening policy at a quicker pace than initially expected and the PBoC likely to lower interest rates, these diverging paths for monetary policy should result in capital flows out of China and toward the United States. As these dynamics materialize, we forecast the renminbi to weaken toward the CNH/CNY6.45 level by the end of 2022, a modest depreciation, but a weaker Chinese currency nonetheless.

Figure 7



Source: Bloomberg LP and Wells Fargo Securities

Figure 8



Source: Bloomberg LP and Wells Fargo Securities

The 2022 Political Environment Is Ripe for Disruption

Political developments typically have the potential to disrupt and inject volatility into global financial markets, and 2022 is likely to be no different. Next year's political calendar is busy with multiple elections set to take place over the course of the year, while geopolitical event risk seems especially prevalent next year. In our view, the most market-moving political development is likely to be U.S. midterm elections in November. 2021 ushered in a new administration in the United States, with President Joe Biden winning the White House and the Democratic Party sweeping both houses of Congress. Up until now, President Biden has had modest success implementing his political agenda. Campaigning on a platform for additional fiscal support as well as tax rate hikes for wealthy individuals and corporations, President Biden recently signed into law the Infrastructure Investment and Jobs Act. This legislation authorizes about \$1 trillion in spending over the next 10 years, of which roughly \$550 billion is "new" spending above previously authorized levels. The bill will direct spending toward hard infrastructure (roads, bridges, tunnels, etc.), while the Build Back Better Act focused on soft infrastructure is still being debated in the Senate. As of now, we are not incorporating the passing of the Build Back Better Act into our forecasts, as the Senate is evenly divided and there is no clear overwhelming support for the bill. But, with midterm elections around the corner, we expect negotiations around Build Back Better to intensify as time is of the essence and the Republican Party, as of now, is seemingly placed to take back one or both the House of Representatives and the Senate. Betting markets currently have the odds heavily in favor of a "Red Sweep" outcome, which, should this scenario materialize, would likely result in political gridlock in Washington. In the eyes of our equity strategy team, this policy paralysis scenario could be positive for risk sentiment and give U.S. equities, and possibly global equities, a boost toward the end of the year.

As far as issues on the minds of voters ahead of U.S. midterms, fiscal spending will certainly be a topic of debate; however, we expect China policy to also be top of mind. Granted, policy directed toward combating China is bipartisan at this point; however, we believe President Biden and the Democratic Party may look to appeal to voters by applying more pressure on China in an effort to force a change in behavior. To that point, we expect U.S.-China tensions to escalate over the course of 2022 as the Biden administration looks to take more decisive action against China. Sources of tension are likely to include trade inequalities and possible human rights abuses, as well as hostile sentiment by mainland China toward Taiwan and Hong Kong. For most of 2021, President Biden allocated time and effort restoring relationships with key allies, most notably the European Union. In 2022, we expect Biden may utilize these relationships and take coordinated action against China. These actions are likely to include trade-related restrictions, limiting Chinese corporations to U.S. and select international financial markets, de-listing Chinese companies from American and potentially European financial exchanges, as well as sanctions directed at certain Chinese corporations. While we are not explicitly calling for additional tariffs to be placed on Chinese exports, we do not believe a roll back of current tariffs is likely. In addition, at this time, we see the likelihood of a Phase II trade deal as low, as tensions build and relations between the U.S. and China sour over the course of next year.

We also expect new political developments within China as Xi Jinping is likely to break precedent and continue as president beyond the 20th National Congress. In our view, President Xi has been preparing for such an outcome for years. Starting in 2018, President Xi strongly advocated for constitutional changes to end China's two-term limit for presidents. Indeed, Xi's proposal to end term limits was ultimately rubber-stamped, paving the way for Xi, in theory, to be president of China forever. This year, Xi took his pursuit of another term in office a step further by issuing China's third-ever historical resolution. The first two historical resolutions, issued by People's Republic of China founder Mao Zedong in 1945 and his successor Deng Xiaoping in 1981, were used to break with the past. Mao used the first historical resolution to consolidate authority ahead of formally declaring the creation of the People's Republic in 1949, while Deng used the second resolution to lay out China's economic reform agenda following "errors" during Mao's Cultural Revolution. Xi issuing a third historical resolution, designed to address the Chinese Communist Party's achievements over the last 100 years as well as lay out future ambitions, likely was an attempt to make Xi as significant a figure as Mao and Deng. This is all important, as China will host its 20th National Party Congress in November 2022, a twice-a-decade conference to declare China's leadership over the next five years. At the 20th National Party Congress, we expect President Xi to formally receive a third term in office. A third term likely means the direction of policy in China will be unchanged going forward. With Xi at the helm, we would expect tensions with the United States and U.S. allies to persist, while hostilities toward Taiwan and Hong Kong could continue. A President Xi's third term could lead to volatility in Chinese financial markets. Investors may anticipate Xi's mandate to implement common prosperity measures to strengthen, while no retrenchment in geopolitical tensions could contribute to volatility and renminbi weakness.

Putting China aside, elections will also be prevalent across the emerging markets and likely to weigh on respective currencies. In Brazil, we expect next year's election to place sharp depreciation pressure on the Brazilian currency as we believe President Bolsonaro will enhance and extend social spending even further in an effort to rally support for his re-election. Additional fiscal stimulus would likely place Brazil's debt and fiscal trajectories on an even more unsustainable path. In addition, new fiscal stimulus could compromise Brazil's constitutional spending cap, which would be a significant negative event risk for Brazil. As additional fiscal stimulus gets deployed, we expect sentiment toward Brazil to turn negative and forecast the Brazilian real to hit new lows against the U.S. dollar. While still too early to call an outcome of the election, should former President Lula da Silva be elected, we would expect the Brazilian currency to come under even more pressure and sustain those losses going forward. Also in Latin America, left-leaning politicians and policy is likely to continue gathering momentum. In Chile, we expect the constitutional rewrite process to turn contentious next year and weigh on Chilean financial markets. Over the course of 2022, we expect Chile's Constitutional Convention to experience delays drafting a new document and believe the Chilean population will struggle to ratify a new constitution within the government's timeframe. As a result, we forecast a weaker peso next year, with risks tilted to more depreciation should Gabriel Boric take office. And in Colombia, we expect a populist leader to emerge as a likely candidate ahead of presidential elections in May. Given the violent protests and demonstrations this year, we expect the left-leaning and self-proclaimed "anti-establishment candidate" Gustavo Petro to gather significant support. As Petro emerges as the next likely president of Colombia, we expect the Colombian peso to come under pressure amid risks to the country's current economic model.

Global Economic Forecasts

Wells Fargo International Economic Forecast

	GDP				CPI			
	2020	2021	2022	2023	2020	2021	2022	2023
Global (PPP Weights)	-3.1%	5.7%	4.4%	3.2%	3.2%	4.2%	4.5%	3.5%
Advanced Economies ¹	-4.5%	5.3%	4.3%	2.8%	0.7%	3.4%	4.0%	1.9%
United States	-3.4%	5.7%	4.4%	3.0%	1.2%	4.7%	5.3%	2.1%
Eurozone	-6.3%	5.2%	3.9%	2.2%	0.3%	2.6%	3.0%	1.7%
United Kingdom	-9.8%	6.9%	4.3%	2.2%	0.9%	2.6%	3.8%	2.1%
Japan	-4.6%	1.6%	3.7%	1.8%	0.0%	-0.2%	0.5%	0.7%
Canada	-5.3%	4.7%	4.7%	2.6%	0.7%	3.4%	3.2%	2.1%
Switzerland	-2.5%	3.7%	3.1%	2.0%	-0.7%	0.5%	0.6%	0.7%
Australia	-2.4%	4.1%	3.1%	3.1%	0.9%	2.5%	2.3%	2.2%
New Zealand	-2.1%	5.3%	3.2%	2.9%	1.7%	3.7%	3.9%	2.2%
Sweden	-2.8%	4.8%	3.5%	2.2%	0.7%	2.0%	2.1%	1.5%
Norway	-0.8%	4.0%	4.2%	2.1%	1.3%	3.3%	2.2%	1.9%
Developing Economies ¹	-2.1%	6.0%	4.5%	3.5%	5.1%	4.8%	4.9%	4.6%
China	2.3%	7.8%	5.5%	5.4%	2.4%	1.0%	2.1%	2.2%
India	-7.3%	7.8%	9.2%	5.0%	6.2%	5.0%	4.6%	4.8%
Mexico	-8.3%	5.6%	3.0%	2.1%	3.4%	5.7%	5.1%	3.8%
Brazil	-4.1%	4.8%	1.0%	2.0%	3.2%	8.5%	6.0%	3.8%

Forecast as of: December 17, 2021

¹Aggregated Using PPP Weights

Source: International Monetary Fund and Wells Fargo Securities

Interest Rate Forecasts

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	Central Bank Key Policy Rate				
	2022				2023
	Q1	Q2	Q3	Q4	Q1
United States	0.25%	0.25%	0.50%	0.75%	1.00%
Eurozone ¹	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%
United Kingdom	0.25%	0.50%	0.50%	0.75%	0.75%
Japan	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%
Canada	0.25%	0.50%	0.75%	1.00%	1.25%
	2-Year Note				
	2022				2023
	Q1	Q2	Q3	Q4	Q1
United States	0.75%	1.00%	1.20%	1.40%	1.60%
Eurozone ²	-0.65%	-0.60%	-0.60%	-0.55%	-0.55%
United Kingdom	0.75%	0.90%	1.05%	1.20%	1.30%
Japan	-0.10%	-0.10%	-0.10%	-0.05%	-0.05%
Canada	1.05%	1.20%	1.35%	1.50%	1.60%
	10-Year Note				
	2022				2023
	Q1	Q2	Q3	Q4	Q1
United States	1.80%	2.00%	2.10%	2.15%	2.20%
Eurozone ²	-0.20%	-0.10%	0.00%	0.15%	0.30%
United Kingdom	1.15%	1.35%	1.45%	1.55%	1.60%
Japan	0.10%	0.15%	0.15%	0.20%	0.20%
Canada	1.85%	2.05%	2.15%	2.25%	2.30%

Forecast as of: December 17, 2021

¹ ECB Deposit Rate ² German Government Bond Yield

Source: Bloomberg LP and Wells Fargo Securities

Currency Forecasts

Currency Pair*	Current rate	Q4-2021	Q1-2022	Q2-2022	Q3-2022	Q4-2022	Q1-2023
G10							
EUR/USD	1.1291	1.1300	1.1100	1.0900	1.0700	1.0600	1.0500
USD/JPY	113.39	114.00	115.00	117.00	119.00	121.00	123.00
GBP/USD	1.3268	1.3300	1.3100	1.2900	1.2700	1.2600	1.2500
USD/CHF	0.9216	0.9200	0.9375	0.9575	0.9775	0.9900	1.0000
USD/CAD	1.2844	1.2800	1.2900	1.3000	1.3100	1.3200	1.3200
AUD/USD	0.7139	0.7100	0.7000	0.6800	0.6700	0.6600	0.6500
NZD/USD	0.6745	0.6700	0.6600	0.6500	0.6400	0.6300	0.6300
USD/NOK	9.0239	9.0275	9.1000	9.1750	9.2525	9.2450	9.2375
USD/SEK	9.1090	9.1150	9.2350	9.3575	9.4850	9.5275	9.5725
Asia							
USD/CNY	6.3743	6.3800	6.4000	6.4200	6.4400	6.4500	6.4600
USD/CNH	6.3870	6.3800	6.4000	6.4200	6.4400	6.4500	6.4600
USD/IDR	14368	14400	14600	14800	15000	15200	15400
USD/INR	76.09	76.25	76.50	76.75	77.00	77.25	77.50
USD/KRW	1181.00	1190.00	1200.00	1210.00	1220.00	1230.00	1240.00
USD/PHP	50.03	50.25	50.50	50.75	51.00	51.25	51.50
USD/SGD	1.3659	1.3700	1.3800	1.3900	1.4000	1.4100	1.4200
USD/TWD	27.77	28.00	28.25	28.25	28.50	28.50	28.75
USD/THB	33.35	33.50	33.75	34.00	34.25	34.50	34.75
Latin America							
USD/BRL	5.6827	5.7000	5.8000	5.9000	6.0000	6.1000	6.2000
USD/CLP	846.11	870.00	890.00	900.00	910.00	920.00	930.00
USD/MXN	20.7282	21.0000	21.5000	21.7500	22.0000	22.2500	22.5000
USD/COP	4010	4050	4100	4200	4300	4400	4500
USD/ARS	101.9462	102.0000	105.0000	108.0000	111.0000	114.0000	117.0000
USD/PEN	4.0374	4.0500	4.0800	4.1100	4.1300	4.1500	4.1700
Eastern Europe/Middle East/Africa							
USD/CZK	22.32	22.50	23.25	23.50	24.25	24.50	25.00
USD/HUF	325.12	327.50	337.75	348.50	359.75	368.00	376.25
USD/PLN	4.1065	4.1150	4.2350	4.3575	4.4850	4.5750	4.6675
USD/RUB	74.16	75.00	76.00	77.00	78.00	79.00	80.00
USD/ILS	3.1322	3.1500	3.2000	3.2200	3.2400	3.2500	3.2500
USD/ZAR	15.8437	16.0000	16.5000	16.7500	17.0000	17.2500	17.5000
USD/TRY	16.4861	17.0000	18.0000	19.0000	20.0000	21.0000	22.0000
Euro Crosses							
EUR/JPY	128.03	128.75	127.75	127.50	127.25	128.25	129.25
EUR/GBP	0.8510	0.8500	0.8475	0.8450	0.8425	0.8425	0.8400
EUR/CHF	1.0406	1.0400	1.0400	1.0450	1.0450	1.0500	1.0500
EUR/NOK	10.1893	10.2000	10.1000	10.0000	9.9000	9.8000	9.7000
EUR/SEK	10.2855	10.3000	10.2500	10.2000	10.1500	10.1000	10.0500
EUR/CZK	25.20	25.50	25.75	25.75	26.00	26.00	26.25
EUR/HUF	367.11	370.00	375.00	380.00	385.00	390.00	395.00
EUR/PLN	4.6369	4.6500	4.7000	4.7500	4.8000	4.8500	4.9000

Forecast as of: December 17, 2021

Source: Bloomberg LP and Wells Fargo Securities

United States/USD

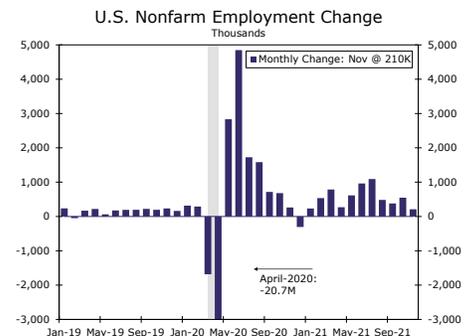
Outlook

We expect U.S. dollar strength to persist through all of 2022 and into 2023. U.S. economic growth has been steady enough, while confidence surveys suggest the pace of expansion should remain quite firm going forward. With supply disruptions contributing to persistent inflation pressures, the Federal Reserve accelerated the tapering of its bond purchases at its December announcement, while policymakers also signaled the likelihood of earlier and faster rate hikes than previously expected. A more active Federal Reserve is likely to support the greenback in the quarters ahead, both against other G10 currencies where central banks might not fully deliver on their own rate hike expectations, and against emerging currencies, which have been historically sensitive to rising yields.

Fundamental Focus: Economics, Policy & FX

Federal Reserve Accelerates Monetary Policy Tightening Path

- The Federal Reserve announced an acceleration to its path for monetary policy tightening at its December announcement. In November and December, the Fed has slowed the pace of its overall bond purchases by \$15 billion each month, equating to overall purchases of \$90 billion for the current month.
- From January, the Fed said it would slow its overall bond purchases by \$30 billion each month which, if it continues at that pace, would see the Fed's quantitative easing come to an end by the end of March next year. Meanwhile, the Fed made no change to the target range for the fed funds rate, which was kept steady at 0%-0.25%.
- The updated "dot plot" saw policymakers indicate a faster pace of rate hikes than previously. The median policymaker forecast was for three rate hikes in 2022, three rate hikes in 2023, and another two rate hikes in 2024. That sees the median policymaker forecast for the funds rate at 2.125% by the end of 2024, compared to 1.75% previously.



Source: U.S. Department of Labor and Wells Fargo Securities

U.S. Economic Momentum Remains Solid Overall

- For the most part, the past month's data has pointed to solid growth and persistent inflation, encouraging the Federal Reserve to accelerate its plans to move towards less accommodative monetary policy.
- Business confidence surveys have been upbeat as the November ISM manufacturing index rose to 61.1 and the ISM non-manufacturing index rose to a record high 69.1. November activity data were just steady, as retail sales rose 0.3% month-over-month and industrial output rose 0.5%.
- One important exception to the generally solid trends was the November employment report. Nonfarm payrolls rose by just 210,000, much less than expected, although the unemployment rate did fall further to 4.2%.
- Meanwhile, inflation quickened further, as expected, in November. CPI inflation increased further to 6.8% year-over-year, the fastest pace since 1982, while the core CPI quickened to 4.9% year-over-year.

Economic & FX Risks

Upside FX Scenario

- Given persistent inflation and earlier Fed rate increases, our base case anticipates a prolonged period of U.S. dollar strength. However, it is possible the greenback's gains could still be longer lasting or more pronounced than we anticipate.
- U.S. inflation continues to surprise to the upside. The Fed had already accelerated the tapering of its bond purchases and could conceivably start raising interest rates even earlier than the second half of next year—should that occur, it should be U.S. dollar supportive.
- Relatively solid U.S. growth momentum could also offer some direct support for the U.S. currency.

- Finally, robust inflation, along with associated rate increases, could also unsettle U.S. and global equity markets. That could weigh on risk sensitive currencies, and offer support to the safe haven U.S. dollar.
- Should these scenarios play out, U.S. dollar strength could be of greater magnitude than we currently forecast. We already see U.S. dollar strength lasting until late 2023; however, it is possible under this scenario the U.S. dollar's gains could be larger than we currently forecast.

Central Bank Outlook

Fed Funds Rate Forecast			
Current: 0.125%	3M	6M	12M
Wells Fargo	0-0.25%	0-0.25%	0.50%-0.75%
Market Implied	0.19%	0.39%	0.75%

Source: Bloomberg LP and Wells Fargo Securities

- Given the Fed's December announcement, we now expect the central bank to reduce the pace of its bond purchases by \$30 billion each month, which would see the Fed end its net bond purchases by March 2022, earlier than the previous target date of June 2022.
- Given solid activity data and elevated inflation, we expect the Fed to begin raising its policy interest rate more than previously anticipated. We forecast a 25 bps rate increase in Q3-2022 and another 25 bps rate increase in Q4-2022. We also forecast a cumulative 75 bps of rate hikes during 2023.

Eurozone/EUR

Outlook

We forecast a softer euro through 2022 and into 2023. While the Eurozone economy rebounded strongly during the middle of this year, confidence surveys have softened overall in recent months and a rebound in COVID cases has added some uncertainty to the near-term outlook. Meanwhile, inflation has spiked higher, although price increases are not as broad-based as some other developed economies. Against this backdrop, the European Central Bank announced plans in December to move only gradually towards less accommodative monetary policy. That is a stark contrast to a faster moving Fed, and should see the euro follow a weakening trend in the quarters ahead.

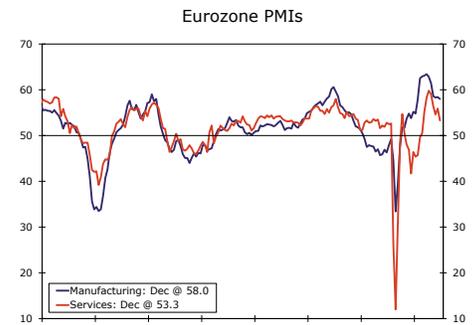
Fundamental Focus: Economics, Policy & FX

European Central Bank Signals Gradual Shift Towards Less Accommodative Monetary Policy

- The European Central Bank (ECB) signaled an initial and moderate shift towards less accommodative monetary policy at its December monetary policy meeting.
- The ECB confirmed that net purchases under the Pandemic Emergency Purchase Program (PEPP) would end in March 2022, as previously signaled, and said for Q1-2022 that purchases would be conducted at a lower pace than the previous quarter. As a result, PEPP purchases should come in slightly below the €1.85 trillion purchase envelope.
- Following the completion of PEPP purchases, the ECB said it would quicken the pace of its regular Asset Purchase Program (APP) from the current €20 billion per month to achieve a gradual overall tapering in bond purchases. The ECB said net APP purchases would be €40 billion per month in Q2-2022, €30 billion per month in Q3-2022, and €20 billion per month from October 2022 for as long as needed.
- There were also some dovish elements in the ECB's policy guidance. The central bank extended the reinvestment horizon for its PEPP holdings until at least the end of 2024, and also said net purchases under the PEPP program could also be resumed if necessary to counter negative shocks related to the pandemic.
- The ECB held its policy interest rates steady and gave no indication it would raise interest rates anytime soon, and did not announce any new targeted long-term refinancing operations.
- The ECB's updated economic projections forecast CPI inflation at 2.6% for 2021 and 3.2% for 2022, but saw inflation slowing back to 1.8% for 2023 and 1.8% for 2024. With respect to GDP growth, the ECB lowered its forecast for 2022 to 4.2% but raised its forecast for 2023 to 2.9%. In particular, the prospect of inflation returning below the 2% target over the medium term allows the ECB to taper its bond purchases only gradually during 2022.

Cross Currents for the Eurozone Economy

- Incoming Eurozone data are showing divergent trends of slowing economic growth but faster inflation. Still, the spike in prices has been significant, and enough for the European Central Bank to announce plans to begin to move (gradually) to less accommodative monetary policy.
- The full Eurozone Q3 GDP details showed growth of 2.2% quarter-over-quarter and 3.9% year-over-year. In terms of the details, Q3 consumer spending was strong, rising 4.1% quarter-over-quarter; however, fixed investment spending fell 0.9%.
- The fourth quarter appeared to get off to a moderate start, as October retail sales rose just 0.2% month-over-month, although industrial output did rise a stronger 1.1% month-over-month.
- The December PMI surveys also suggested slower growth momentum ahead. The services PMI fell to 53.3, while the manufacturing PMI eased to 58.0. The renewed



Source: Datastream and Wells Fargo Securities

spread of COVID cases and imposition of restrictions in some countries is likely to weigh on service sector activity in particular, at least temporarily.

- Inflation continues to pick up in the Eurozone, although inflation pressures do not appear to be quite as broad-based as some other major developed economies. The November CPI rose 4.9% year-over-year. However, the core CPI, which excludes food and energy among other things, rose around half as fast, by 2.6% year-over-year.

Downside FX Scenario

- We forecast a period of extended euro weakness; however, the risks are tilted toward an even larger decline than we currently anticipate.
- The economy could slow more dramatically than expected in Q4 and into 2022. Confidence surveys have already softened across the region, while the recent renewed spread of COVID cases could be a further restraining factor on growth.
- Eurozone inflation could potentially ease more quickly than is currently forecast. Energy prices have driven much of the overall inflation increase, with gains in the core CPI more moderate so far. As long as price pressures do not become too broad-based, there remains some potential for the current inflation spike to reverse more quickly than expected.
- Against this backdrop, the tapering of the ECB's bond purchases could be even more gradual than currently expected, while the ECB may continue to push back against the market's rate hike expectations.
- This combination of factors would add to negative influences for the euro. In this downside scenario, the EUR/USD exchange rate could fall close to \$1.0000.

Central Bank Outlook

ECB Deposit Rate Forecast			
Current: -0.50%	3M	6M	12M
Wells Fargo	-0.50%	-0.50%	-0.50%
Market Implied	-0.49%	-0.49%	-0.43%

Source: Bloomberg LP and Wells Fargo Securities

- The ECB's announced at its December monetary policy meeting that it will end its PEPP program by March 2022, as scheduled. Upon completion of the PEPP program, we expect the ECB to increase the pace of its regular asset purchase program (APP) to €40B per month for Q2-2022, from €20B per month currently. For Q3-2022, we forecast APP purchases to be conducted at a pace of €30B per month and then €20B per month from October 2022 for as long as needed.
- We continue to expect interest rates to remain unchanged for an extended period. We forecast the ECB's Deposit Rate will remain at -0.50% through all of 2021, 2022 and 2023.

Japan/JPY

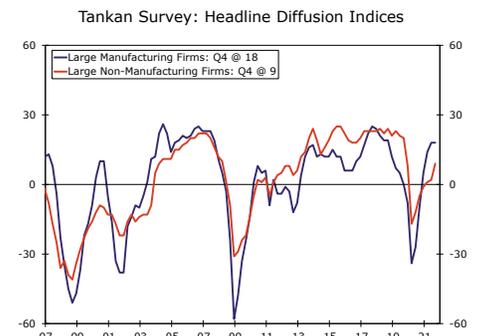
Outlook

While a brief period of yen stability is possible, we expect a weaker Japanese currency over the medium term. A reopening of the economy from early October and the impending passage of additional fiscal stimulus have seen us lift our economic growth forecast for 2022, and could provide temporary support for the yen. However, with inflation absent we still expect Bank of Japan policy to remain on hold for the foreseeable future, with the contrast between broadly steady Japanese yields versus rising U.S. yields likely to see the yen soften versus the greenback over time.

Fundamental Focus: Economics, Policy & FX

Japan's Economy on the Mend

- Following a contraction in Q3 GDP, economic indicators for the fourth quarter so far point to a fairly solid rebound as the economy reopens.
- In terms of hard data, October retail sales rose 0.9% month-over-month and industrial output rose 1.8% month-over-month. The broader measure of service sector activity rose 1.5%.
- Confidence surveys have been encouraging overall. The Q4 Tankan survey showed the large manufacturers' diffusion index steady at +18, but a seven point jump in the large non-manufacturers' diffusion index to +9. Capital spending intentions did soften slightly, however.
- The November economy watchers survey improved to 56.3. However, the December manufacturing PMI eased to 54.2, while the services PMI fell to 51.1.
- The government fiscal stimulus package is expected to pass soon. The package includes, among other things, actual government spending of ¥49.7 trillion, and ¥6 trillion in loans and investment. The scale of the stimulus measures, at around 10% of GDP, should provide a sizable boost to growth in 2022. As a result we have lifted our Japanese GDP growth forecast for next year to 3.7%.
- The Bank of Japan kept its policy rate at 10-year government bond yield target steady at its December meeting. The central bank extended its COVID-related funding program for another six months to September 2022 for small and medium-sized businesses. Also, starting in April the central bank said it would gradually lower its holding of corporate bonds and commercial paper to around ¥5 trillion. The drawdown in corporate bonds could take several years.



Economic & FX Risks

Downside FX Scenario

- We expect the yen to weaken versus the greenback over the medium term. However, there is a scenario that could see the yen soften more than we currently forecast.
- Inflation pressures remain absent in Japan. Globally however, should price pressures prove more persistent than expected, and with the Fed now expected to taper bond purchases and raise interest rates more quickly than we previously forecast, an environment of rising global bond yields could see the yen weaken more sharply than we currently expect.
- While the reopening of Japan's economy and fiscal stimulus should provide some support to Japanese growth, that boost could be relatively transitory, suggesting the yen could lose support over the longer term.
- In this downside scenario for the Japanese currency, the USD/JPY exchange rate could reach JPY126.00 or beyond.

Central Bank Outlook

BoJ Policy Rate Forecast			
Current: -0.10%	3M	6M	12M
Wells Fargo	-0.10%	-0.10%	-0.10%
Market Implied	-0.05%	-0.05%	-0.05%

Source: Bloomberg LP and Wells Fargo Securities

- Our outlook is for the Bank of Japan to hold its policy rate steady at -0.10% through all of 2021, 2022 and 2023, and to make no major changes to its quantitative easing program. Despite the modest performance of Japan's economy, we do not expect a further reduction in the Bank of Japan's already negative policy interest rate.

United Kingdom/GBP

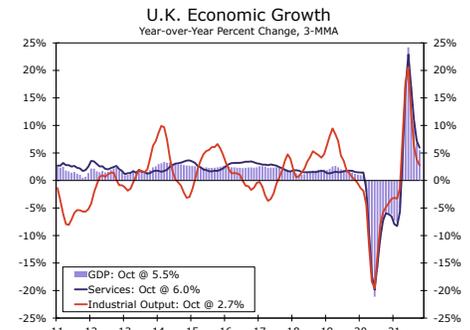
Outlook

We expect a weaker U.K. currency over the medium term. Despite some areas of strength, the overall balance of U.K. activity data points to slower growth in recent months, while softening confidence surveys also suggest a moderate pace of growth going forward. Thus, even though the Bank of England delivered an initial rate increase in December in response to a spike in inflation, we expect only a moderate 50 bps of rate hikes in 2022. That would broadly match the pace of the Fed tightening but perhaps fall short of the tightening expected by market participants. Uneven economic recovery and moderate tightening should, in our view, weigh on sterling sentiment, and see the pound soften versus the U.S. dollar over time.

Fundamental Focus: Economics, Policy & FX

COVID Concerns Could See U.K. Economy Slow After a Solid Spurt

- The performance of the U.K. economy has been mixed during the fourth quarter, with only some pockets of strength within a sluggish overall economy. In addition, the spread of new COVID variants and the reintroduction of some restrictions means there are concerns the pace of growth could slow further going forward.
- U.K. October GDP disappointed, edging up just 0.1% month-over-month. Within the details, services activity rose a steady 0.4%, with the subdued overall GDP result in part due to a 0.6% fall in industrial output.
- Other activity indicators were also mixed. November retail sales rose 1.4% month-over-month, but employment rose by 149,000 for the three months to October compared to the prior three months, a slowing from recent months.
- The December PMI surveys softened as COVID concerns have risen in recent weeks. The manufacturing PMI fell to 57.6, while the services PMI fell more sharply to 53.2.
- The PMI surveys indicate ongoing supply disruptions and price pressures, which are also being reflected in consumer price inflation. For November, the CPI quickened further to 5.1% year-over-year, while the core CPI also quickened to 4.0%.



Source: Datastream and Wells Fargo Securities

Bank of England Delivers Initial Rate Hike at December Meeting

- The Bank of England (BoE) sprung another surprise in December, raising its policy interest rate by 15 bps to 0.25%, in contrast to the consensus expectation for interest rates to remain on hold. The central bank cited a tight labor market that continues to tighten further, and said there are some signs of greater persistence in domestic cost and price pressures.
- The Bank of England repeated that some modest further tightening of monetary policy would likely be needed over time, but there were also hints that any tightening would be gradual. The BoE said its forecast for the level of Q4 GDP has been lowered by around 0.5%. The central bank also said the Omicron variant would likely weigh on near-term activity and that it would review developments, including evidence of implications of Omicron on the economy, as part of its forecast for the February 2022 Monetary Policy Report.
- We expect the U.K. economic recovery to remain somewhat uneven, and see only 50 bps of cumulative rate increases during 2022.

Economic & FX Risks

Downside FX Scenario

- Our base case is for a softer pound over the next several quarters, in part due to faster Fed tapering and faster Fed rate hikes. However, the risks are likely tilted towards an even larger fall in the pound.
- Growth indicators have been mixed during Q4, and the rebound in COVID cases recently means the growth outlook remains somewhat uncertain. The Bank of England raised its policy interest rate in

December, although we expect only a gradual pace of rate hikes through 2022. Moreover, if growth disappoints the Bank of England may raise rates even more gradually than we currently anticipate.

- Market expectations for rate hikes remain somewhat aggressive, with almost 90 bps of tightening priced in over the next year. If, as we expect, the Bank of England fails to fully deliver, the recalibration of interest rate expectations should be a negative for the pound.
- In this more pessimistic scenario, the pound could fall towards a \$1.2000-\$1.2100 range.

Central Bank Outlook

BoE Bank Rate Forecast			
Current: 0.25%	3M	6M	12M
Wells Fargo	0.25%	0.50%	0.75%
Market Implied	0.52%	0.82%	1.13%

Source: Bloomberg LP and Wells Fargo Securities

- The Bank of England sprung something of a surprise at its December meeting, raising its policy rate 15 bps to 0.25%, saying the economy had evolved broadly as expected and the labor market has continued to tighten, noting the persistence of cost and price pressures.
- In 2022, we see only a gradual pace of monetary tightening, and forecast 25 bps rate hikes at the May 2022 and November 2022 announcements. We also expect Bank of England tightening will continue in 2023, with further rate increases slated for that year.

Switzerland/CHF

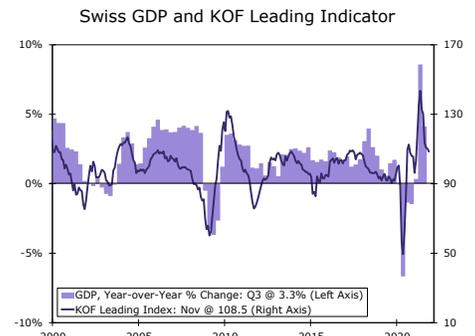
Outlook

We forecast a broadly steady franc versus the euro, and a softer franc versus the U.S. dollar, over the medium term. Recent data point to some slowing in Swiss economic growth, meaning that even with a moderate firming of inflation, Swiss National Bank policy interest rates should remain on hold for an extended period. That should limit any gain in the franc versus the euro, even given accommodative ECB monetary policy, while the potential for Swiss FX intervention should also see a broadly stable franc versus the euro, but a softer franc versus the greenback, given the euro's overall weakening trend.

Fundamental Focus: Economics, Policy & FX

Switzerland's Economic Moderation Continues

- Incoming data points to an ongoing moderation in Swiss economic growth, although the deceleration remain very orderly.
- Q3 GDP rose 1.7% quarter-over-quarter, similar to the growth seen in Q2, and slowed to 3.3% year-over-year. With respect to sequential growth, Q3 saw consumer spending increase 2.7% but fixed investment spending fell 0.8%.
- More recent figures point to a further moderation in Q4. The November KOF leading index fell to 108.5 and the November manufacturing PM fell to 62.5, while October real retail sales slowed to 1.2% year-over-year.
- Swiss inflation, in contrast, has firmed to levels that are moderate by international standards, but elevated by Swiss standards. The November CPI quickened to 1.5% year-over-year, while the October trimmed-mean CPI rose 0.6% year-over-year. Still, we do not expect the uptick of inflation to be enough to prompt monetary policy action from the Swiss National Bank (SNB) for the foreseeable future.



Source: Datastream and Wells Fargo Securities

Swiss National Bank Maintains Easy Monetary Policy

- The Swiss National Bank made no change in monetary policy at its December announcement. It kept its policy rate at -0.75% and repeated that the Swiss franc remains highly valued and that it remains willing to intervene in foreign exchange markets as needed to counter upward pressure on the currency.
- That said, even with the strengthening of the franc versus the euro over the past several weeks, there is little evidence of increased intervention activity. In fact, Swiss foreign exchange reserves actually fell 17.3B francs during the October-November period.
- The Swiss National Bank raised its CPI inflation forecasts slightly, and now sees inflation at 0.6% for 2021, 1.0% for 2022 and 0.6% for 2023. The central bank expects GDP growth of 3.5% this year and 3% for 2022.

Economic & FX Risks

Upside FX Scenario

- Our outlook is for gradual weakness in the franc versus the euro and U.S. dollar over the medium term; however, there is an upside scenario that could see gains versus the euro and more gradual losses versus the greenback.
- Despite concerns surrounding the Omicron variant, COVID concerns are expected to ease during 2022. That said, should spread of COVID became more worrying than expected and weigh on economic activity and financial markets, the Swiss franc could get a boost from safe haven support.
- We expect the European Central Bank to shift only gradually towards less accommodative monetary policy. Still given the possibility of downside risks to the Eurozone economy and potentially even more gradual moves from the ECB, there is some potential for the franc to gain further versus the euro.
- In this scenario, the franc could strengthen, with the EUR/CHF exchange rate perhaps falling as close to CHF1.0000.

Central Bank Outlook

SNB Policy Rate Forecast			
Current: -0.75%	3M	6M	12M
Wells Fargo	-0.75%	-0.75%	-0.75%
Market Implied	-0.70%	-0.67%	-0.56%

Source: Bloomberg LP and Wells Fargo Securities

- We expect the Swiss National Bank's policy interest rate to remain steady at -0.75% for all of 2021, 2022 and 2023.

Canada/CAD

Outlook

We expect moderate weakness in the Canadian dollar through 2022 and into 2023. Canadian economic fundamentals are sound, including a strongly recovering labor market and indication that activity is picking up more broadly as well. With inflation elevated, we expect a steady series of rate hikes next year, though likely still less than what is currently priced in by market participants. The moderate drop in oil prices could also weigh on the Canadian currency, meaning that even with a relatively favorable Canadian economic outlook, we still expect some softening of the Canadian dollar versus the greenback, especially given the prospect of faster Fed tightening than previously anticipated.

Fundamental Focus: Economics, Policy & FX

Canada's Economy Continues Along Sturdy Path

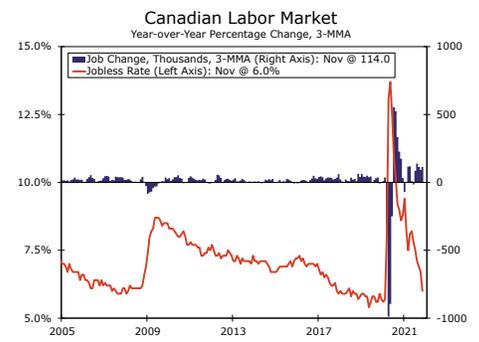
- Canada's economy has enjoyed increasingly solid gains during the second half of 2021.
- Q3 GDP grew by 5.4% quarter-over-quarter annualized, more than reversing the Q2 decline. The consumer sector was particularly strong as household consumption grew at a 17.9% pace, although business fixed investment shrank at a 17.7% pace. The report also showed another solid increase in household disposable income.
- Growth in Q4 looks likely to be even firmer. The November jobs report was a blowout as overall employment rose 153,700, including a 79,900 gain in full-time jobs and a 73,800 gain in part-time jobs. The unemployment rate fell more than expected to 6.0%.
- The November manufacturing PMI rose to 61.2, while October manufacturing sales rose 4.3% month-over-month.
- On a slightly less upbeat note, oil prices have receded in recent weeks, which could be a mild restraint on incomes and growth going forward.

Bank of Canada Holds Steady in December

- The Bank of Canada's (BoC) December monetary policy announcement passed with only modest fanfare. The BoC held its overnight rate steady at 0.25%, as expected, and said the economy continues to require considerable monetary policy support.
- There were some mildly hawkish elements in the accompanying statement. The central bank dropped a reference to inflation pressures being temporary and noted that employment gains have been broad-based and have returned to their pre-pandemic levels.
- The November CPI figures showed persistent inflationary pressures. Headline CPI inflation was steady at 4.7% year-over-year, while the average of the core CPI measures was steady at 2.7% year-over-year.

Downside FX Scenario

- Our base case is for the Canadian dollar to weaken moderately versus the U.S. dollar in the context of persistent U.S. inflation pressures and faster Fed tapering and rate hikes. However, there is a scenario in which the Canadian dollar could soften more than we currently forecast.
- We expect a slower pace of rate hikes than what is currently priced in by market participants. If inflation recedes more quickly than expected and Bank of Canada tightening falls well short of market expectations, the Canadian dollar could come under additional downside pressure.
- Oil prices have receded in recent weeks. If that decline were to extend further, perhaps in response to economic uncertainty related to COVID developments, the Canadian dollar could also fall further than we expect.
- In this less favorable scenario, the Canadian dollar could soften more than we forecast, with the USD/CAD exchange rate potentially moving into a CAD1.3500-1.3700 range over time.



Source: Datastream and Wells Fargo Securities

Central Bank Outlook

BoC Overnight Rate Forecast			
Current: 0.25%	3M	6M	12M
Wells Fargo	0.25%	0.50%	1.00%
Market Implied	0.58%	0.97%	1.49%

Source: Bloomberg LP and Wells Fargo Securities

- Our outlook for Canadian monetary policy is unchanged. We expect an initial 25 bps rate hike at the April 2022 meeting, followed by another 25 bps hike in July 2022 and another 25 bps hike in October of next year. With these moves, we forecast the Bank of Canada's policy interest rate to end 2022 at 1.00%.

Australia/AUD

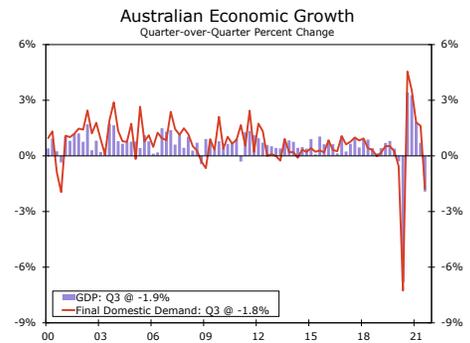
Outlook

We expect the Australian dollar to weaken moderately in the quarters ahead. The economy appears to be rebounding strongly, including gains in employment and consumer spending. That could lead the Reserve Bank of Australia to taper its bond purchases more quickly than expected, though we still think rate hikes are some ways off, perhaps not until late 2023. That's slower than what is currently expected by market participants, which should weigh on the Australian currency, especially against a backdrop of Fed tightening. Chinese uncertainties could also be a drag on the Australian dollar, although to the extent policy action by authorities supports Chinese growth, it could also help to moderate Australian dollar weakness.

Fundamental Focus: Economics, Policy & FX

Resilient Australian Economy Begins to Bounce Back

- Australia's economy shrank in the third quarter when COVID restrictions were in effect; however, the decline was less severe than expected. Q3 GDP fell 1.9% quarter-over-quarter. Within the details, consumer spending slumped 4.8%, but final domestic demand fell a more moderate 1.8%.
- All indications point to the economy rebounding strongly during Q4. Of particular note, November employment surged by 366,100, with full-time jobs up 128,300 and part-time jobs up 237,800. The unemployment rate fell to 4.6%.
- October retail sales also jumped 4.9% month-over-month, more than twice as much as the consensus forecast.
- November business sentiment was somewhat mixed, as business conditions rose two points to +12 but the forward-looking business confidence measure fell eight points to +12. December's surveys were also mixed. The December services PMI fell to 55.1 and the manufacturing PMI fell to 57.4, while December consumer confidence fell 1.0% month-over-month.
- While we see the Q4 economic rebound as broadly consistent with our outlook, it does suggest some upside risks to our 2022 GDP growth forecast of 3.1%.
- The Reserve Bank of Australia held its Cash Rate at 0.10% at its December meeting and repeated that accommodative policy is still necessary. While acknowledging that wage growth has picked up, the central bank said a further firming was expected and needed.
- The RBA noted new COVID variants as an additional uncertainty, but also said they were unlikely to derail the recovery. Finally, the central bank said it would continue buying government bonds at a pace of A\$4B per week until mid-February, at which time the bond purchase program would be reviewed.



Source: Datastream and Wells Fargo Securities

Economic & FX Risks

Upside FX Scenario

- Our base case is for a softer Australian dollar over time. However, the risks appear tilted toward a smaller decline than our base case forecast.
- The economy appears to be bouncing back strongly in late 2021. Should that continue through 2022, GDP growth should surprise to the upside, which should also provide some direct support to the Australian dollar.
- We expect the RBA to continue its bond purchase program until at least May 2022 and not begin raising interest rates until late 2023. However, there is risk the central bank could taper its bond purchases more quickly than we forecast. That could validate the market's more aggressive monetary tightening expectations and limit the extent of Australian dollar declines.
- While perhaps less likely, to the extent China's economy stabilizes and strengthens, that would also be a positive for the Australian dollar.

- In this less pessimistic scenario, the AUD/USD exchange rate could fall only moderately, with losses limited to a \$0.6800-\$0.7000 range.

Central Bank Outlook

RBA Cash Rate Forecast			
Current: 0.10%	3M	6M	12M
Wells Fargo	0.10%	0.10%	0.10%
Market Implied	0.41%	0.42%	0.99%

Source: Bloomberg LP and Wells Fargo Securities

- We expect the RBA to hold its Cash Rate steady at 0.10% through all of 2022. However, we now see modest rate hikes as possible by late 2023, and expect a 15 bps rate hike in Q3-2023 and a 25 bps rate hike in Q4-2023.
- Australia's economy is returning to a steadier growth path. As a result, we expect the next tapering of the RBA's bond purchases to occur in February, at which time we expect the weekly pace of bond purchases to slow to A\$2B from the current A\$4B. We expect that reduced pace of bond purchases to continue until at least May 2022, at which time the RBA would conduct a further review.

New Zealand/NZD

Outlook

We expect the New Zealand dollar to soften versus the greenback in the coming quarters, though with some stability in the currency eventually possible over the longer term. As the economy reopens and activity rebounds gradually, we see prospects for higher inflation and stable growth. Against this backdrop, we expect the Reserve Bank of New Zealand (RBNZ) to continue tightening policy in February and beyond, although slightly less aggressively than what is currently priced into markets, which may contribute to NZ dollar weakness compared to the U.S. dollar.

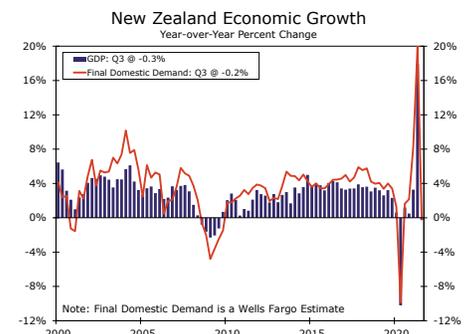
Fundamental Focus: Economics, Policy & FX

New Zealand Economy Continues to Gradually Reopen

- The outlook for New Zealand's economy in 2022 has improved, and we expect steadier growth and elevated inflation as the country continues to reopen.
- Restrictions continue to be relaxed in Auckland, New Zealand's largest city. The city will transition from the most restrictive red alert level to orange at the end of December, which will lift gathering limits for the hospitality sector and allow some close-contact public activities to resume. Vaccine passes and masks will still be required in most public venues. In addition, fully vaccinated citizens and other eligible travelers will face easier border restrictions from February, while all fully vaccinated individuals will be able to travel to New Zealand at the end of April, which should boost the country's tourism industry. Currently, 90% of the country's eligible population is fully vaccinated.
- Q3 GDP fell by less than expected, declining 3.7% quarter-over-quarter and 0.3% year-over-year, as the economy went into a lockdown after a community COVID outbreak. This decrease, less severe than the RBNZ's forecast for a 7% drop, should be followed by what we anticipate will be a steady rebound in growth.
- Retail card spending increased 9.6% month-over-month in November, as the rebound in consumer spending remained strong even after October's 10% gain. On year-over-year basis, card spending for services is still down 12.2%, although this number has improved in each of the past three months, indicating that consumers are starting to spend more as the economy reopens.
- December business confidence softened to -23.2, while firms' assessment of their own activity outlook also fell to +11.8. Firms' inflation expectations rose to 4.42% from 4.24%.
- Global whole milk powder prices are up around 30% from a year ago. Fonterra raised its forecasted payment to New Zealand dairy farmers, citing that milk supply is down 3% compared to one year ago, and while demand from China has softened, global demand should remain strong in the short to medium term. The projected payment would add around NZ\$13.2B to the New Zealand economy, which should support incomes and growth, given that dairy is a key export earner.

Reserve Bank of New Zealand Raises Rates & Signals More to Come

- The RBNZ delivered a second rate hike at its November meeting, raising its policy rate by 25 bps to 0.75%. The central bank signaled that it would likely raise interest rates faster than previously expected in 25 bps steps, citing above-target headline inflation, a labor market that is operating above its maximum sustainable level, and capacity pressures that continue to tighten.
- RBNZ Assistant Governor Hawkesby has said that in terms of rate hikes, "Inflation expectations are going to be absolutely key for us. There are some things that could make us go faster, and I think inflation expectations is one." The central bank raised its inflation forecast to 5.7% year-over-year in both Q4-2021 and Q1-2022, before it sees inflation gradually easing back down to 2% in late 2024. The RBNZ now projects that its policy rate will peak at 2.6% in late 2023 and remain at that level until the end of its forecast horizon, compared to its previous forecast of a 2.1% peak in early 2024.



Source: Datastream and Wells Fargo Securities

- Overall, the continued reopening of the economy combined with rising inflation expectations and encouraging retail spending data are factors that suggest another rate hike in February.

Economic & FX Risks

Downside FX Scenario

- As we now forecast sustained U.S. dollar strength through late 2023, we also expect a softer NZ dollar over the medium term, though the risks are potentially tilted towards a weaker currency than we currently anticipate.
- If the Omicron variant becomes more severe than expected, this could result in a slower pace of reopening and a slower-than-expected rebound in economic activity, which could weigh on the NZ dollar.
- The currency could face additional downward pressure if the RBNZ does not increase rates by as much as market participants expect.
- In this less favorable scenario, the NZ dollar could fall below \$0.6000 in the coming quarters, and could struggle to rebound meaningfully over the medium term.

Central Bank Outlook

RBNZ Official Cash Rate Forecast			
Current: 0.75%	3M	6M	12M
Wells Fargo	1.00%	1.50%	2.00%
Market Implied	1.10%	1.69%	2.27%

Source: Bloomberg LP and Wells Fargo Securities

- Following its 25 bps rate hike in November, we expect another 25 bps rate increase from the RBNZ at its February 23 meeting, bringing the Official Cash Rate to 1.00%.
- We anticipate 125 bps of rate hikes in 2022, which would see the Official Cash Rate finish next year at 2.00%. Our projected pace of monetary tightening is only slightly slower than what is currently priced into markets.

Sweden/SEK

Outlook

We expect modest gains in the Swedish krona versus the euro over the medium term, but weakness versus the greenback. Sweden's economy has rebounded from a brief summer pause, which should provide some modest support for the krona. Moreover, given the ongoing recovery, the central bank has begun to signal an eventual shift to less accommodative monetary policy, also a krona positive, while an end to brief period of political uncertainty could also help Sweden's currency. Together, these factors should see the krona gain modestly versus the euro, but likely fall versus the greenback given the prospect of Fed tightening.

Fundamental Focus: Economics, Policy & FX

Solid Economic Rebound Sees Riksbank Signal Eventual Tightening

- After the brief interruption during the summer, the latest data from Sweden continue to point to a solid rebound in the economy.
- Q3 GDP rose 2.0% quarter-over-quarter, more than expected, and slowed 4.7% year-over-year. In terms of sequential growth, consumer spending rose 2.4% and fixed investment spending rose 2.6%.
- The momentum of the third quarter has carried over into Q4. October private sector production rose 1.5% month-over-month and firmed to 6.4% year-over-year. Growth in services output was stronger, while growth in industrial activity was broadly steady. Consumer activity also remained solid in October as household consumption rose 0.8% month-over-month.
- The November PMI surveys were mixed, although they remain at historically elevated levels. The services PMI rose to 68.7, while the manufacturing PMI fell to 63.3.
- Prices also moved modestly higher in November, as CPI inflation quickened to 3.6% year-over-year, and CPI inflation excluding energy edged up to 1.9% year-over-year.
- Following a period of political uncertainty, including the loss of a parliamentary vote over the budget, Social Democrat leader Magdalena Andersson was re-elected as Prime Minister in late November, restoring calm to the political environment.



Source: Bloomberg LP and Wells Fargo Securities

Riksbank Signals Eventual Rate Hike

- The Riksbank's monetary policy announcement in late November did not portend any imminent change in monetary policy, but did signal and eventual shift to a less accommodative policy stance.
- The central bank kept its repo rate at zero percent, as expected, and reaffirmed that it would complete its asset purchase program by the end of this month.
- However, the Riksbank also signaled some modest eventual moves towards less accommodative monetary policy. The central bank said its asset holdings would remain broadly unchanged through 2022 and would then start to decrease gradually from 2023. The projected interest rate path also indicated an initial rate increase in the latter part of 2024.
- Sweden's strong economic recovery, along with signals of eventual tightening, could provide moderate support for the krona versus the euro.

Central Bank Outlook

Riksbank Interest Rate Forecast			
Current: 0.00%	3M	6M	12M
Wells Fargo	0.00%	0.00%	0.00%
Market Implied	0.13%	0.18%	0.30%

Source: Bloomberg LP and Wells Fargo Securities

- Our outlook for Swedish monetary policy remains unchanged. We expect the Riksbank to hold its policy rate steady for an extended period and see the repo rate remaining steady at 0.00% through the rest of 2021, and for all of 2022 and 2023.

Norway/NOK Outlook

We expect a stronger Norwegian krone versus the euro, but some weakness versus the U.S. dollar. While Norway's economic recovery continues, activity data and confidence surveys both suggest some slowing in growth in recent months, while underlying inflation trends remain contained for the time being. Thus, while the Norges Bank raised interest rates in December and should continue to do so in 2022, an unchanged projected rate path from the central bank suggests steady rather than rapid rate increases. Modestly lower oil prices could also be a restraining factor for Norway's currency, which we expect to weaken versus the greenback, though still gain versus the euro given easy ECB policy.

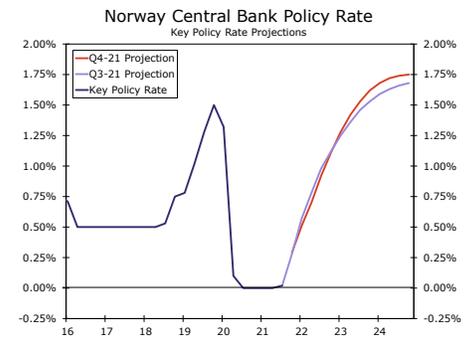
Fundamental Focus: Economics, Policy & FX

Norway's Economy Slows, Norway Rate Hikes Continue

- The latest economic figures from Norway, while mixed, point to a moderate slowing from what had been a very sturdy pace of growth earlier in 2021.
- On the stronger side, October retail sales rose 1.0% month-over-month, well above the consensus forecast, while the November manufacturing PMI rose to 63.7.
- However, other indicators point some moderation in activity growth. October mainland GDP was flat for the month, undershooting versus expectations for a monthly increase, while October manufacturing output fell 0.9% month-over-month. Meanwhile, the Norges Bank's November Regional Network Survey portended a slower pace of growth in the months ahead. The survey reported a decline in the next six months output index to 0.95.
- Inflation pressures have firmed a bit, but remain contained overall for now. The November headline CPI quickened more than expected to 5.1% year-over-year, but the underlying CPI firmed broadly as forecast to 1.3% year-over-year.
- The Norges Bank announced in late November that it would continue the halt to its krone purchases through December, compared to the daily purchases of 700M krone that it had been conducting in recent months.

Norges Bank Raises Interest Rates and Signals More to Come

- Even with the prospects of slower growth ahead, the Norges Bank raised interest rates at its December monetary policy meeting and signaled that further rate hikes would be forthcoming.
- The central bank raised its policy rate 25 bps to 0.50%, as widely expected. The central bank's projected rate path signaled further rate increases in the quarters ahead, with the policy rate expected to average 1.75% in Q4-2024, just slightly higher than its previous forecast. At the same time, the Norges Bank signaled a slightly slower pace of hikes in the year ahead through the end of 2022.
- The Norges Bank also updated its economic projections. The changes to the growth outlook were mixed, with the 2021 mainland GDP growth forecast raised to 4.1%, lowered to 3.5% for 2022, and raised to 2.0% for 2023. The Norges Bank raised its inflation forecasts across the board, to 1.7% for 2021, 1.7% for 2022, and 2.0% for 2023.
- The central bank said the policy rate will most likely be raised again in March, although that March hike was not quite as clear-cut as a few months ago. On the flip side, the central bank also noted the possibility of faster inflation, and said if there were prospects of persistently high inflation, the policy rate could be raised more quickly.



Source: Norges Bank and Wells Fargo Securities

Central Bank Outlook

Norges Bank Deposit Rate Forecast			
Current: 0.50%	3M	6M	12M
Wells Fargo	0.75%	1.00%	1.25%
Market Implied	0.70%	0.87%	1.25%

Source: Bloomberg LP and Wells Fargo Securities

- The Norges Bank raised its policy rate this month by 25 bps to 0.50%, as expected. We expect a relatively steady pace of rate increase to continue in 2022, and forecast a 25 bps rate increase in each of Q1, Q2 and Q3 of next year.

Mexico/MXN

Outlook

We expect the Mexican peso to weaken over the course of 2022 as the Fed quickens the pace at which it tapers its asset purchases and eventually lifts interest rates next year. As the Fed normalizes policy earlier than markets previously expected, emerging market currencies should come under pressure, the Mexican peso in particular. We also believe financial markets are priced too aggressively for Banxico rate hikes, and as markets adjust their expectations for interest rates, the peso should weaken throughout 2022 and into 2023.

Fundamental Focus: Economics, Policy & FX

Fed Moving Quicker and the Peso to Suffer

- The Federal Reserve has picked up the pace of unwinding policy accommodation and has turned more hawkish amid strong inflationary pressures and an improving labor market. As inflation and labor market dynamics have evolved, our U.S. economics team believes the Fed will raise rates two times in 2022 and three times in 2023. As the timing for an initial Fed rate hike and future rate hikes has been brought forward in recent months, we expect the peso to remain under pressure through 2022.
- In addition to Fed monetary policy, the global economy continues to demonstrate a less robust recovery, with risks further tilted to the downside amid the emergence of the Omicron variant. As the global economy slows and the recovery loses momentum, emerging market currencies should weaken amid a flight to safe havens such as the U.S. dollar.

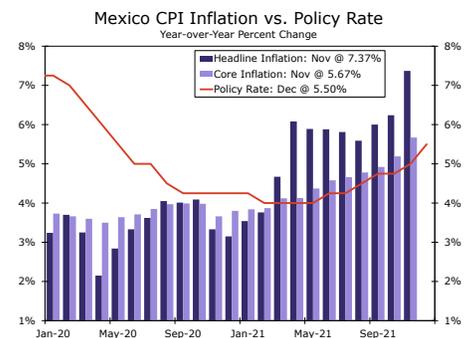
Inflation Spikes; Banxico Gradually Responds

- Inflation has showed few signs of cooling, as headline prices rose 7.37% year-over-year in November. Core inflation also rose again with the core CPI climbing 5.67% year-over-year. Elevated inflation has been a key issue in Mexico this year as prices have climbed well above the central bank's target range. Next year, we expect inflation to come down, but remain above the 4% upper bound of Banxico's inflation target.
- In response to high inflation central bankers have tightened monetary policy, but have only just recently picked up the pace of rate hikes. At its most recent meeting in December, Banxico opted to raise the Overnight Rate 50 bps to 5.50%. A 50 bps hike was a surprise to market participants, and the peso experienced a rally in the immediate aftermath of the decision.
- Now that the precedent is set for 50 bp rate hikes, Banxico policymakers may stick to the script and tighten policy at a more aggressive pace. Tighter policy from the Fed could also give Banxico rationale to maintain a quicker pace of rate hikes as well. However, with board members turning over in 2022, in our view into a dovish direction, we are not yet convinced Banxico has adjusted course. We continue to believe markets are priced for too much tightening in Mexico, and as markets adjust, the peso will weaken.

Economic & FX Risks

Downside FX Scenario

- Risks around our peso forecasts are tilted to the downside, as emerging market currencies could come under more pressure than we expect amid Fed tightening. With the Fed tapering asset purchases and probably lifting interest rates in 2022, the U.S. dollar should remain on a firm footing. Should the Fed look to raise interest rates in the immediate aftermath of ending asset purchases, emerging market currencies could come under significant pressure. Our analysis suggests the Mexican peso could be particularly vulnerable in this scenario.
- Should another “taper tantrum” situation materialize, the peso could experience a sharp selloff. In this scenario, USD/MXN could test MXN24.50.



Source: Bloomberg LP and Wells Fargo Securities

Upside FX Scenario

- An upside scenario is also centered on Fed monetary policy. For now, we forecast peso weakness throughout 2022 and into 2023; however, the peso could strengthen if the Fed takes a more measured approach to monetary policy, in particular lifting policy rates. Should the Fed successfully decouple tapering from interest rate hikes and push an initial rate hike into 2023, the peso could rally.
- A less hawkish Fed could result in the peso reaching MXN19.50 toward the end of 2022 and hold those gains into 2023.

Central Bank Outlook

Banxico Overnight Rate Forecast			
Current: 5.50%	3M	6M	12M
Wells Fargo	5.75%	6.25%	7.00%
Market Implied	5.97%	6.78%	7.38%

Source: Bloomberg LP and Wells Fargo Securities

China/CNY & CNH

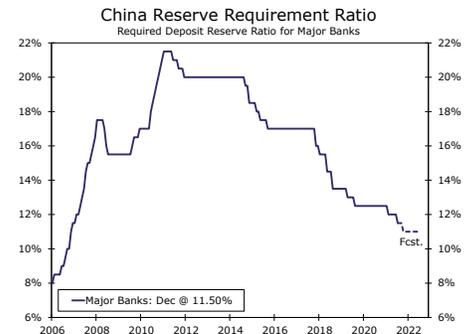
Outlook

Chinese authorities appear keen on supporting the economy next year, with recent comments suggesting fiscal as well as monetary support could be forthcoming in 2022. While we continue to believe the Chinese economy is still under pressure presently, growth could be supported in the second half of next year amid renewed policy support and a broader global economic recovery. People's Bank of China (PBoC) officials may also be turning more cautious regarding the strength of the Chinese currency. In our view, the PBoC is likely to accommodate more renminbi weakness in the short term, while monetary policy divergence with the Fed should keep the yuan under modest pressure over the medium to longer term.

Fundamental Focus: Economics, Policy & FX

China Shifting to Policy Support in 2022

- As China's economy continues to show signs of deceleration, we believe Chinese authorities will adjust monetary and fiscal policy to support the economy in 2022. To that point, PBoC officials recently lowered the Reserve Requirement Ratio (RRR) for major banks by 50 bps to 11.50%, and we now believe another 50 bps RRR cut is likely in the first quarter of next year. Lowering the RRR should allow local banks to increase lending and in turn support the broader Chinese economy.
- In our view, China's annual Central Economic Work Conference suggested authorities will likely temporarily suspend their deleveraging campaign and use fiscal stimulus to stabilize the economy. The conference indicated "stability" is key for China's economy next year, which we interpret as Chinese policy officials attempting to push annual GDP growth up closer to the 6% target. While we forecast 2022 GDP growth of closer to 5.5%, aggressive fiscal stimulus could result in stronger growth than we currently expect.



Source: Bloomberg LP and Wells Fargo Securities

PBoC Uncomfortable with Currency Strength?

- Recent PBoC and Chinese authority actions lead us to believe the Chinese central bank could be uncomfortable with the strength of the renminbi. To that point, the PBoC has set the daily currency fix at modestly weaker levels than market participants had expected, a signal the central bank could be looking to accommodate a weaker currency.
- In addition, Chinese authorities have raised the foreign exchange reserve requirement for local banks. Increasing the amount of foreign exchange local banks must hold (buying USD, selling RMB) should also be interpreted as a sign the Chinese currency may be getting too strong. Chinese officials have commented that bets on the Chinese currency should be two-way, rather than just speculation on Chinese renminbi strength.
- In our view, we expect similar actions to continue over the course of the next few months and for the renminbi to modestly weaken as a result. A weaker currency can also support China's economy by making exports more competitive. While we believe Chinese officials would prefer to see the economy flourish through personal consumption, for the time being, an enhanced export sector could be welcomed as a way to stabilize China's slowing economy.
- Over the course of 2022, we also expect diverging paths of monetary policy to be a source of weakness for the Chinese currency. We believe the Fed is on pace to raise interest rates next year, while as mentioned, we believe China policy will start to turn easier. As interest rates diverge, the U.S. dollar should strengthen against the renminbi.

Evergrande Finally Defaults, but Still No Lehman Moment

- Evergrande, China's largest property developer, has been on the brink of default for months as the housing market has been under regulatory scrutiny. Just recently, Evergrande defaulted on its debt obligations; however, financial markets have taken the default in stride, and we have not seen significant volatility on the back of Evergrande

defaulting. In addition to Evergrande, Kaisa, another large Chinese property developer has also defaulted on its obligations.

- We continue to believe Evergrande is not China's "Lehman Brothers Moment." Our work suggests foreign investor exposure to Chinese debt is rather limited, and much less significant than foreign exposure to U.S. debt ahead of the Global Financial Crisis. Given a lower level of exposure, the risk of significant financial market volatility or a global economic shock is low. We believe that should the Evergrande default trigger cross-defaults, economic implications would be felt mainly in China and possibly a few emerging Asian countries.

Economic & FX Risks

Downside FX Scenario

- Risks around our renminbi forecasts are tilted toward a weaker currency than we forecast. It is possible that, in the short term, the PBoC will seek to intervene and artificially weaken the currency more significantly should the economy slow sharply in Q4 and that momentum appears to carry into 2022. FX intervention would see the currency weaken, and while we do not expect a full-blown devaluation, we cannot rule out the possibility.
- While not our base case scenario, an Evergrande default or bankruptcy could result in widespread contagion across China's economy as well as the global economy. A sustained and prolonged China deceleration combined with a global economic shock could see market participants pull capital out of China and renminbi denominated assets.
- The risk of escalating geopolitical tensions between the U.S. and China in 2022 is also a downside risk for the renminbi. President Biden is still pursuing a coordinated approach against China, while Chinese perceived aggression toward Taiwan could also lead to a strained relationship between the U.S. and China. Should geopolitical tensions escalate further, the renminbi would likely come under pressure.
- Should any or all of these risks materialize, the PBoC could allow the renminbi to depreciate significantly and capital flows could exit China. This combination could result in significant renminbi weakness, in which USD/CNY and USD/CNH could test CNY/CNH7.00.

Brazil/BRL

Outlook

2022 is set to be a challenging year for Brazil. The economy is showing signs of a material slowdown, leading us to revise our GDP forecast lower, while risks associated with the presidential election should result in a weaker currency for the foreseeable future. In addition to local risks, tighter Fed monetary policy also contributes to depreciation pressure building on the Brazilian real and capital flows diverting away from Brazil and toward the United States. A combination of local and external risks should result in the Brazilian real hitting record lows against the dollar in H2-2022.

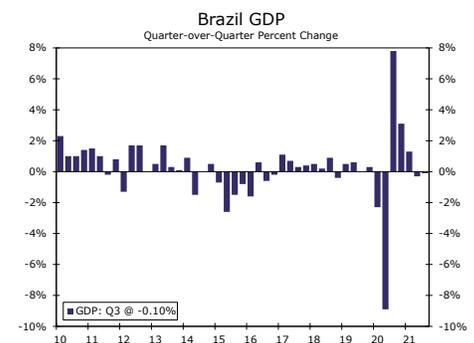
Fundamental Focus: Economics, Policy & FX

Brazil's Economy Back in Recession

- Q3 GDP data revealed Brazil's economy fell back in recession as the impact from a severe drought and significant monetary tightening are taking a toll on economic activity. Recent data indicate the Brazilian economy contracted 0.10% quarter-over-quarter in Q3, while Q2 data were revised lower to show Brazil's economy declined 0.40%. Q3 GDP data were worse than we expected and the size of the Q2 revision was material.
- Economic activity in Q4 is also off to a shaky start, as October industrial production unexpectedly contracted 0.6% month-over-month. Consensus forecasts were looking for industrial production to rise in October. Also, the composite PMI index moved lower in both October and November, and while still in expansion territory, the trajectory of PMI data is somewhat concerning for this year's growth prospects.
- In that sense, we have revised our 2021 and 2022 GDP growth forecasts lower. We now expect Brazil's economy to grow 1.3% in 2021, a below trend growth rate, while 2022 growth should also remain sluggish. In 2022, we expect Brazil's economy to expand 2.3%; however, with the Brazilian Central Bank likely to keep raising interest rates and political risk possibly creating a more cautious investment backdrop, Brazil's economy could experience a recession next year as well.

Brazilian Central Bank Keeps Tightening

- In early December, the Brazilian Central Bank (BCB) lifted policy rates another 150 bps, taking its Selic Rate to 9.25%. Just this year, the BCB has raised interest rates 725 bps as inflation pressures persist and fiscal risks complicate the outlook for future inflation trends. BCB monetary tightening has done little to contain inflation or stem currency weakness. CPI inflation is well above the central bank's target and the Brazilian real has trended weaker for most of this year.
- On inflation, prices are running close to 11% year-over-year. Inflation expectations continue to rise as the real weakens and as additional fiscal stimulus gets deployed. In our view, there is still little BCB policymakers can do at this time to contain inflation. Weather and supply chain disruptions are still issues and commodity prices remain high, while the BCB has little influence over fiscal stimulus decisions. We believe inflation will only come back in line with the BCB's inflation target in 2023 as global inflationary pressures subside.
- Despite ineffective monetary policy and a sluggish local economy, BCB policymakers were more hawkish than expected at the December meeting, committing to at least another 150 bps rate hike in February 2022. We now believe the Selic rate will be lifted to 10.75% in February and expect the tightening cycle will eventually result in the BCB taking interest rates into restrictive territory, topping out at 11.75% and acting as a further drag on Brazil's growth prospects.
- Given the central bank's baseline scenario, we now believe the BCB could begin to unwind rate hikes by the end of 2022. Elevated political risks as well as unsustainable debt and fiscal dynamics are likely to result in a weaker currency, while policy rate cuts further out in 2022 could also exacerbate a currency selloff, especially as the Fed looks to raise rates at the end of next year.



Source: Bloomberg LP and Wells Fargo Securities

Find a Way to Keep Spending

- After multiple iterations and attempts, Brazilian congress has passed constitutional amendments to adjust the details of the spending cap. These adjustments are designed to accommodate President Bolsonaro's Auxilio Brasil social spending program, and will allow the government to distribute R400 per month to millions of households. Technically, the spending cap has not been breached, even though amendments to the nation's constitution had to be made to keep fiscal limitations in place. In our view, respecting the spending cap is a positive.
- However, we expect President Bolsonaro to propose legislation to extend and enhance social spending even further ahead of the election. Bolsonaro may feel a mandate to financially support households, and in turn, rally support for his re-election. Should the spending cap come under pressure next year, as we expect, the Brazilian real is likely to come under pressure as well.

Economic & FX Risks

Downside FX Scenario

- Risks around our Brazilian real forecast are toward more depreciation than we currently expect. Monetary policy dynamics are somewhat encouraging; however, as mentioned, we doubt tighter monetary policy will be enough to offset political and fiscal risks. Should fiscal and debt dynamics worsen further, the currency would likely face significant depreciation pressure, and our targets for the USD/BRL exchange rate would be reached earlier than we anticipate.
- In a scenario where Brazil's spending cap does get breached, the USD/BRL exchange rate would likely reach record levels, possibly as high as BRL7.00 per dollar.

Upside FX Scenario

- A scenario for a stronger Brazilian real includes a solid commitment to the constitutional spending cap and to the longer-term reform agenda. Despite falling approval ratings, Bolsonaro would need to push back against any additional fiscal stimulus for the currency to rally materially.
- Spending restraints could lead to capital flows returning to Brazil and support the currency. In addition, should Bolsonaro retain office, a longer-term relief rally for the currency is possible, especially if markets do not question the spending cap or believe Brazil has a plan to put public finances on a more stable trajectory.
- In this scenario, USD/BRL could move below BRL5.00 and would likely sustain gains over the course of 2023.

Central Bank Outlook

BCB Selic Rate Forecast			
Current: 9.25%	3M	6M	12M
Wells Fargo	10.75%	11.75%	11.25%
Market Implied	11.64%	12.44%	13.57%

Source: Bloomberg LP and Wells Fargo Securities

- Our view on Brazilian policy rates has been adjusted. We now expect a 150 bp rate hike in February 2022, consistent with BCB revised guidance. Over the course of 2022, we expect the BCB tightening cycle to bring the Selic rate to 11.75%. By the end of 2022, we expect the BCB to begin unwinding rate hikes consistent with its baseline scenario for the economy.
- In our view, financial markets are still priced for the Selic rate to be lifted too aggressively. As financial markets adjust to a lower Selic rate, the currency could come under pressure.

Asia

Indonesia/IDR

Outlook: In our view, the rupiah may come under pressure as a result of Fed monetary tightening and uncertainty over the health of the global economy. With the Fed initiating a quicker taper, and Fed Chair Powell hinting at quicker interest rate hikes, the U.S. dollar should remain supported. We have also revised our global GDP forecast lower multiple times, and the Omicron variant also introduces new downside risks to global growth. As global growth risks remain and rise, we expect the U.S. dollar to attract safe haven capital flows. EM currencies are most sensitive to tighter Fed monetary policy and slowing global growth, and we believe the rupiah can come under particular pressure. In our view, Indonesia is one of the more vulnerable emerging market economies, as the government relies on foreign investors to buy local debt and relies on external investors to fund deficits. A reliance on foreign investors makes the rupiah sensitive to capital outflows, as foreign investors could shift capital toward the U.S. Ultimately, we expect this to materialize and forecast the rupiah to sell off the most relative to emerging Asian currencies. As far as the local economy, Bank Indonesia (BI) is not considering raising rates at this time. COVID cases have receded significantly; however, Omicron-related travel restrictions will likely have an impact on the economy as Indonesia relies on tourism revenues. Should Omicron result in harsh travel restrictions, we expect Indonesia's economy to come under pressure and for BI to push back monetary policy normalization even further.

Philippines/PHP

Outlook: We now forecast a weaker Philippine peso over our entire forecast horizon; however, we believe the pace of depreciation will be gradual relative to peer emerging market currencies. Our peso forecasts are based around our core view of a stronger dollar amid a quicker pace of Federal Reserve monetary tightening, as well as a slowing global economic recovery. However, we forecast a gradual peso depreciation due to stable local politics and sufficient foreign exchange reserves. The Philippine economy has been slow to recover from the pandemic as the Delta variant and elevated oil prices have weighed on most sectors of the economy. Higher oil prices have pushed the trade balance into deficit and have contributed to a rise in inflation over this year. The rise in prices should lead the central bank to consider raising interest rates in the near future; however, with the Fed tapering more aggressively and now likely to raise interest rates next year, tighter Philippine monetary policy may not be sufficient to prevent peso depreciation. Next year, the Philippines will also host presidential elections. For now, we do not envision a significant buildup of political risk ahead of the election. We will be monitoring for any populist-style candidates with unorthodox policy agendas as well as who current President Duterte endorses as he exits office.

Thailand/THB

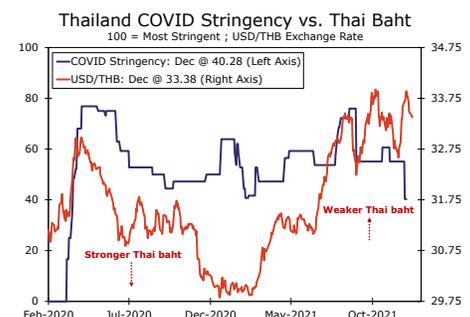
Outlook: We continue to forecast gradual Thai baht weakness as Fed tightening and new travel restrictions are likely to weigh on Thailand's economy and markets. Under our assumptions for tighter Fed policy, we expect most emerging market currencies to weaken next year. Quicker Fed tightening should attract capital flows toward the U.S. dollar and away from emerging markets, and we expect Thailand to experience these dynamics and for the baht to weaken. In addition, governments around the world have imposed modest travel restrictions due to the spread of the Omicron variant. Thailand's economy relies on tourism revenues, and travel restrictions, global or directly related to Thailand, in our view will result in a weaker currency. Over the course of the pandemic, travel restrictions have restrained the economy. In Q3, the Thai economy contracted 1.1% quarter-over-quarter, and while Q3 was better than expected, the economy struggles to gather momentum. Should Omicron result in harsh travel restrictions, the economy could fall into recession in early 2022. While we expect a weaker baht, the pace of depreciation is likely to be gradual. Thailand maintains a healthy current account surplus, and has stable politics as well as sufficient FX reserves to defend the value of the baht. These strong fundamentals should restrain volatility; however, as Fed policy tightens and virus-related developments persist, strong fundamentals are likely not enough to prevent the currency from weakening.



Source: IIF and Wells Fargo Securities



Source: Bloomberg LP and Wells Fargo Securities



Source: Bloomberg LP and Wells Fargo Securities

Emerging Europe, Middle East & Africa

Russia/RUB

Outlook: Downside risks around our ruble forecast are rising as a result of escalating geopolitical tensions between the U.S. and Russia. Reports indicate Russia has amassed troops along the Ukrainian border. International communities as well as the U.S. fear Russia may be preparing to invade Ukraine. Recently, President Biden and President Putin met in an attempt to defuse tensions; however, no clear takeaways have been made. As of now, tensions remain high, and should Russia advance into Ukraine, our ruble forecast would be revised to show material weakness. We would expect sanctions on Russian sovereign debt, while currency conversions into U.S. dollars would also be a target. For now, we place a low probability on these risks materializing and believe the ruble can be one of the top performing emerging market currencies in 2022. Still relatively high oil prices should help the Russian economy and financial markets, while a hawkish Central Bank of Russia (CBR) can support capital flows toward the ruble. As far as monetary policy, the central bank lifted its Key Rate 100 bps to 8.5% in an effort to contain inflation. In November, CPI inflation hit 8.4% year-over-year, above the CBR's target. In 2022, we expect inflationary pressures to continue and for policymakers to keep raising interest rates through Q1. While we forecast a weaker ruble, a hawkish central bank and a low likelihood of new sanctions underpins our view for gradual ruble depreciation in 2022.

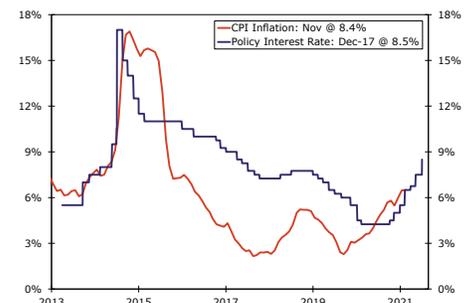
Turkey/TRY

Outlook: Over the course of this year, the lira has experienced two significant depreciations. One in March, where on a peak-to-trough basis the lira sold off over 15% in a week, while the other depreciation is currently underway. Year to date, the currency has weakened 56% against the U.S. dollar making the lira the worst performing emerging market currency in 2021. Going forward, we expect the Turkish lira to continue to significantly depreciate as President Erdogan is likely to exert his influence over monetary policy. To that point, Erdogan has influenced policy rates to be lowered 500 bps since August, even as inflation continues to trend higher. As real interest rates turn more negative and unorthodox policy remains in place, the lira should continue reaching new lows against the U.S. dollar. The central bank has intervened in FX markets in an effort to limit the lira's depreciation; however, foreign exchange reserves are not sufficient to disrupt the lira's weakening trend. As long as unorthodox policy frameworks remain in place, we see little rationale for the path of the lira to deviate from its weakening trend. We do, however, highlight that general elections are taking place in mid-2023. Early tracking of opinion polls and social media suggest regime change is possible. Should Erdogan not retain office or be declared ineligible to run due to term limits, political risk could ease and the lira could experience a material rally.

South Africa/ZAR

Outlook: We continue to forecast a weaker rand over the course of our forecast horizon as the economy remains fragile and as monetary policy dynamics are not in favor of the South African currency. The Omicron variant originated in South Africa, and over the course of the last few weeks, COVID cases have risen dramatically. Just recently, South Africa recorded the most daily infections on record as the country struggles with Delta and now Omicron. Initial research suggests Omicron could be less severe than prior strains, and as of now, authorities have not imposed new meaningful restrictions. In our view, Omicron represents a downside risk to local economic activity; however, with South Africa's recovery struggling to gather momentum, should facts around the severity of Omicron change, the impact on the rand could be significant. Our base case includes an unsustainable public finance position, which should lead to markets placing depreciation pressure on the rand. We feel the South African government's plan to stabilize debt is unlikely to be implemented, and as sovereign finances worsen, the rand could weaken. In addition, with the Fed tightening monetary policy at a quicker pace, the rand could be particularly vulnerable. To date, South African Reserve Bank (SARB) policymakers have lifted policy rates 25 bps, and we believe SARB will take a gradual approach to lifting rates from here. As the Fed quickens policy normalization and SARB is hesitant to lift rates, policy dynamics should benefit the U.S. dollar and weigh on the rand.

Russia CPI Inflation and Interest Rates



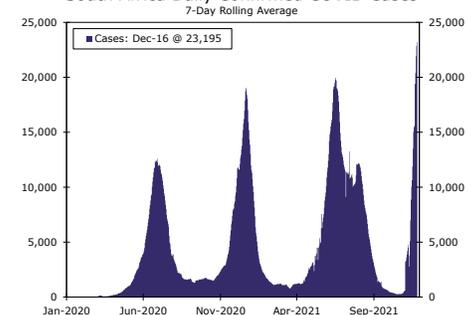
Source: Bloomberg LP and Wells Fargo Securities

USD/TRY Exchange Rate



Source: Bloomberg LP and Wells Fargo Securities

South Africa Daily Confirmed COVID Cases



Source: Bloomberg LP and Wells Fargo Securities

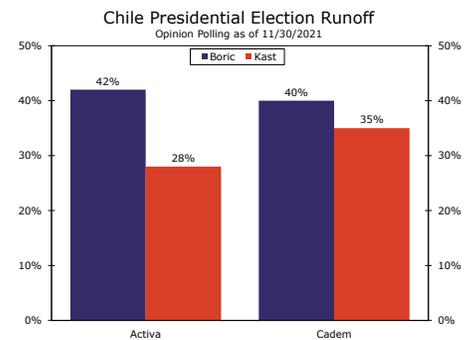
Latin America

Chile/CLP

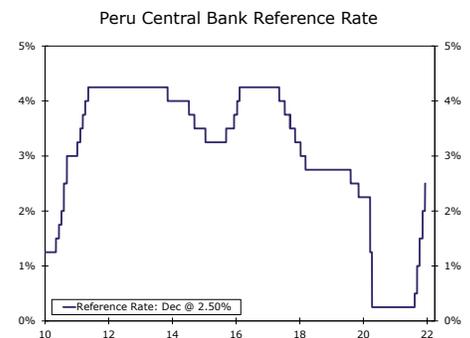
Outlook: Our outlook for the Chilean peso is little changed, and we continue to forecast a weaker currency over the entire forecast horizon, as risks tied to the presidential election as well as the constitutional rewrite should place depreciation pressure on the currency. In late November, Chileans went to the polls to elect a new president as well as members of congress. As far as the presidential election, the first round of voting, as expected, did not yield an outright winner. However, the far-right candidate, Jose Kast, won 28% of the votes, while far-left candidate Gabriel Boric came in second with 26% of the total vote. Despite right-wing politicians performing well in the first round, opinion polls suggest Gabriel Boric is currently the leading candidate to become Chile's next president. While different pollsters have Boric ahead by different margins, the consensus is that he could be in prime position to win the presidency. As of now, we forecast the USD/CLP exchange rate to weaken through the end of this year; however, in the event Boric does win the runoff election, the peso could come under more extreme pressure. On the other hand, a Kast victory could result in a relief rally for the peso and the currency could strengthen below the psychologically important CLP800 level. Regardless of who wins the presidency, the Chilean National Congress is set to be fractured, and we believe either candidate will struggle to implement his full policy agenda. Looking further out the time horizon, the constitutional rewrite could result in more left-leaning policies being engrained into Chilean law, which could have a more profound and longer-term impact on the country's economic and financial market prospects. With a large majority of the Constitutional Convention from "anti-establishment" political parties, more conservative politicians cannot veto any of the convention's proposed policies. However, given how contentious local political developments have been over the last few years, we doubt the rewrite process will be smooth and timely. As the process gets delayed and Chileans struggle to ratify a new document, we expect depreciation pressure to persist on the Chilean peso over the course of 2022 and into 2023.

Peru/PEN

Outlook: Federal Reserve monetary tightening combined with elevated local political risk should keep depreciation pressure on the Peruvian sol over the course of 2022 and into 2023; however, relative to peer Latin American currencies, we expect sol weakness to be somewhat limited. Given our revised forecast for the Fed to taper asset purchases at a quicker pace and for earlier interest rate hikes, we expect the U.S. dollar to broadly strengthen against most emerging market currencies, the Peruvian sol included. In our view, local political developments should also contribute to a weaker currency as uncertainty tied to the Castillo administration remains high. Castillo's rhetoric continues to suggest he would prefer to upend Peru's economic model; however, a fractured congress should yield no major policy changes. Peruvian policymakers also tried to impeach Castillo on grounds of "moral incapacity", and while proceedings were eventually voted down, additional impeachment attempts are likely and should result in sporadic bouts of sol volatility. While we do not expect any major policy changes under Castillo, persistent radical rhetoric and additional attempts at impeachment should weigh on the currency going forward. As mentioned, we expect sol weakness to be more contained compared to peer Latin American currencies. To that point, the Central Bank of Peru has a fairly large stockpile of foreign exchange reserves it can deploy to stabilize the currency. In addition, Peru has a sizable sovereign wealth fund that can also be used as a buffer against currency weakness, while the central bank has shifted to a more hawkish stance on monetary policy, given a spike in Peruvian inflation. While FX reserves, the sovereign wealth fund and monetary policy dynamics are encouraging, we believe Fed tightening and local political developments will be the key drivers of the Peruvian sol. Toward the end of 2022 and early 2023, we expect the Peruvian sol to weaken to new record lows against the U.S. dollar.



Source: Servel and Wells Fargo Securities



Source: Bloomberg LP and Wells Fargo Securities

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Mark Vitner	Senior Economist	704-410-3277	Mark.Vitner@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Charlie Dougherty	Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Shannon Seery	Economist	332-204-0693	Shannon.Seery@wellsfargo.com
Nicole Cervi	Economic Analyst	704-410-3059	Nicole.Cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	704-410-1437	Sara.Cotsakis@wellsfargo.com
Jessica Guo	Economic Analyst	704-410-4405	Jessica.Guo@wellsfargo.com
Karl Vesely	Economic Analyst	704-410-2911	Karl.Vesely@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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