Economics

International Commentary — June 24, 2021

International Economic Outlook: June 2021

Mid-Year Update & Outlook

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

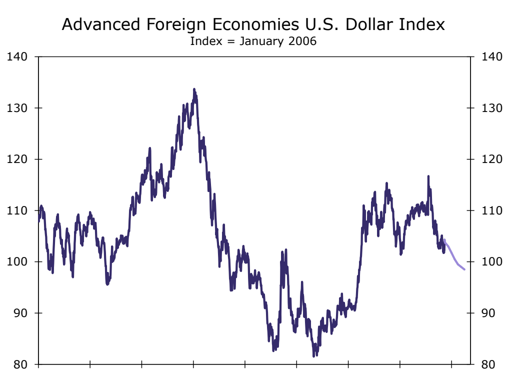
Summary

Forecast Changes

- Our view remains that the U.S. dollar will weaken over time as Fed monetary policy settings remain unchanged for the time being. However, a more hawkish Fed "dot plot" tilts risks around our view toward a more resilient U.S. dollar than we currently expect.
- As far as G10 currencies, we remain broadly constructive; however, we have become slightly less positive on the euro. On the other hand, we have a slightly more favorable outlook for the Norwegian krone as higher oil prices and a more hawkish central bank should contribute to a stronger currency over time.
- In the emerging markets, our views are consistent with last month. We continue to believe currencies associated with hawkish central banks and exposed to higher commodity prices can outperform. Our top emerging market currency recommendations are the Brazilian real, Russian ruble and Mexican peso.

Key Themes

- An uneven pace of respective economic recoveries has resulted in diverging paths of monetary policy from major central banks. Despite a modest hawkish shift at its latest meeting, the Fed is likely to keep monetary policy accommodative for the time being, while many international central banks are likely to continue their monetary policy normalization cycles.
- We believe the renewed strength in the U.S. dollar will prove temporary, and we maintain our view for a weaker dollar over the medium-to-longer-term. A patient Fed relative to more proactive foreign central banks, should weigh on the greenback over time. We continue to be optimistic on the prospects for G10 and emerging market currencies going forward.
- While we believe there is upside in many emerging market currencies, shifts in local political dynamics can weigh on certain currencies, particularly in Latin America. The rise of left-leaning populist leaders in Chile and Peru could restrain the peso and sol, while demonstrations across Colombia could result in a socialist candidate emerging ahead of next year's Presidential election and inject new volatility into the Colombian peso.



Source: Bloomberg LP and Wells Fargo Securities

Reflections on Twenty-Twenty-One

The past year and a half has been one of the more challenging periods in modern history. We have experienced a health crisis that has arguably changed the way we live forever. We also witnessed economic and financial market shocks of magnitudes far greater than we thought possible. However, the light at the end of the tunnel is getting brighter and the end of the COVID crisis seems near. Vaccine distribution has allowed economies around the world to reopen, and for the global economic recovery to not only begin, but also pick up pace. In addition, persistent and aggressive policy support, both monetary and fiscal, has allowed for a robust global recovery.

With that said, the speed of the recovery has been uneven across developed and emerging market countries. Over the past few months, we have highlighted how divergences between developed market and emerging market recoveries have become more apparent. Developed market economies such as the United States, United Kingdom, and Canada, where vaccine distribution has been swift, have experienced sharp rebounds in economic activity. On the other hand, large and systemically important emerging market countries such as India and South Africa continue to see their local recoveries disrupted by renewed COVID outbreaks.

But, despite diverging growth prospects we remain optimistic on the path ahead for the global economy. Households around the world are flush with cash as a result of fiscal stimulus and a buildup in personal savings, while pent-up demand for services-type spending and international travel suggest strong consumption for the rest of this year and beyond. As a result, we forecast the global economy to grow over 6% in 2021. Assuming our forecast is accurate, 6% global GDP growth will mark the fastest pace of annual economic expansion in decades.

As the recovery gathers momentum, and we return to a sense of normalcy, new economic policy, and political dynamics have emerged around the world. In our view, these themes can shape the global economy and impact financial markets in the second half of 2021 as well as during 2022. Reflation prospects continue to dominate headlines and create volatility across global markets, while the pace of inflation and local recoveries is creating policy divergence amongst central banks. Finally, the COVID crisis is creating a platform for populist-style leaders to rally support. Latin America, in particular, has already seen a widespread shift toward left-leaning political candidates, while we would not be surprised if another wave of populism spreads to other regions in the emerging markets as well as the developed world this year and throughout the post-COVID era.

In the coming sections, we will touch on each of these themes and how we expect them to evolve going forward. We wish to thank our readers for staying engaged with us throughout these difficult times. Hopefully, we will have a chance to interact with each other again in person in the very near future. Until then, stay safe, and we look forward to seeing everyone again soon!

Monetary Policy Divergences Are Clear

For most of this year, inflation trends and monetary policy have been in the spotlight. Without question, U.S. inflation and the Fed have garnered the most attention, and rightfully so. Inflation in the United States has climbed for most of this year, recently hitting 5.0% year-over-year, the highest U.S. inflation has been in years. Higher inflation and rising inflation expectations has led market participants to believe the Fed may tighten monetary policy earlier than expected, leading to sporadic bouts of volatility in equity, fixed income and currency markets. While one could argue the Fed shifted to a more hawkish outlook at its latest meeting, the FOMC nonetheless opted to leave current monetary policy settings unchanged. Interest rates are still essentially at 0% and the Fed is still purchasing $120B of securities per month. In the eyes of our U.S. economics team, Fed monetary policy settings are unlikely to change until early 2022.

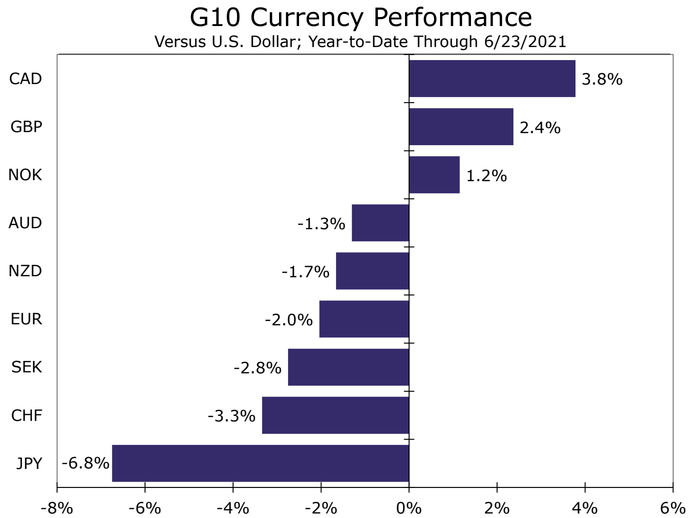
Historically, Fed monetary policy decisions have had a major influence over the path of monetary policy abroad. A Fed keeping monetary policy steady usually results in major central banks keeping policy on hold as well. However, this year, monetary policy trends have followed a different script, with clear divergences developing between major central banks around the world and the Federal Reserve. Just recently, the Bank of England (BoE) and Bank of Canada (BoC) slowed asset purchases, and in our view, will continue scaling back asset purchases over the remainder of the year as local recoveries have progressed quite well. Norway's central bank, the Norges Bank, has also taken more explicit steps to signal the normalization of monetary policy as expectations for rate hikes were brought forward, and the tightening cycle will likely begin in September. Even the Reserve Bank of New Zealand (RBNZ) is turning less accommodative, as strong GDP data have markets now anticipating rate hikes by May 2022, much earlier than previously expected.

The diverging monetary policy theme is more apparent in the emerging markets. Inflation has risen much quicker across the developing world and has forced many emerging market central banks to proactively raise interest rates. In some cases, the policy rate hikes have been rather aggressive, particularly from the Brazilian Central Bank (BCB) and the Central Bank of Russia (CBR). On a cumulative basis, the BCB has raised its Selic rate 225 basis points this year, while the CBR has lifted its Key Policy Rate 125 basis points. The BCB and CBR are two of the more hawkish central banks in the world as inflation pushes well above their respective inflation targets. In addition, the Czech National Bank and Hungarian Central Bank also raised interest rates in an effort to protect against elevated prices, while the People's Bank of China has guided money market rates higher. In our view, all of these central banks are likely to continue raising interest rates over the second half of this year and into early 2022. We also believe the tightening trend will extend further across the emerging markets as well. Central banks in Mexico, Chile, Colombia and South Africa will likely also look to tighten monetary policy before the end of this year.

These divergences in monetary policy should make for interesting market moves over the next six months, but have already played in a role in identifying currency “winners” and “losers” over the first half of this year. As mentioned, the Bank of Canada slowed asset purchases earlier this year and also maintained forward guidance for a further tapering as the year progresses. This hawkish action and guidance has helped the Canadian dollar to be the top performing G10 currency this year, strengthening over 3% since the start of 2021. Similar dynamics have helped the British pound outperform as well, as slower asset purchases and a shift away from the possibility of negative interest rates pushed the pound up 2% against the U.S. dollar. Bringing forward expectations for rate hikes have also helped the Norwegian krone to modestly strengthen (Figure 1). In the emerging markets, aggressive BCB and CBR rate hikes have allowed the Brazilian real and Russian ruble to be among the top performing emerging market currencies (Figure 2). Also, tighter monetary policy in Hungary and China have pushed the forint and renminbi higher against the U.S. dollar.

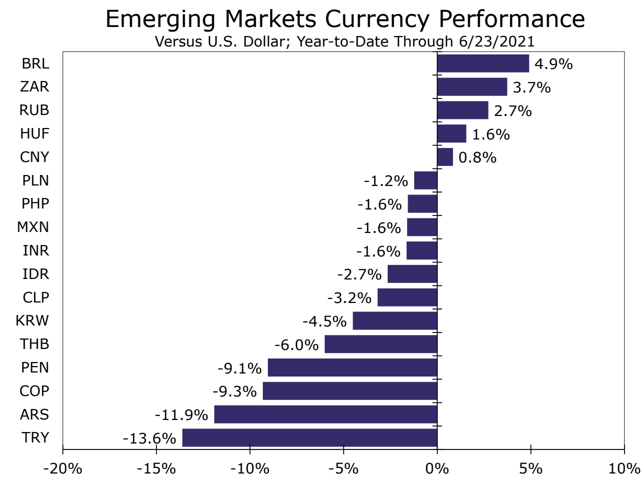
With the Fed opting to keep policy settings unchanged for the time being, and international central banks clearly becoming more active in tightening monetary policy, these dynamics should place broad depreciation pressure on the U.S. dollar going forward. Despite a modest hawkish shift from the FOMC at its last meeting, we believe the recent strength in the dollar will be temporary, and we remain optimistic on the prospects for G10 and emerging market currencies. As far as our forecasts, we believe G10 currencies associated with relatively hawkish central banks and high exposure to the global re-opening should outperform. In that sense, we are most optimistic on the Canadian dollar and Norwegian krone, as well as the Australian and New Zealand dollars. Within the emerging markets, our thought process is similar. Currencies associated with hawkish central banks, highly correlated to elevated commodity prices, and where local politics are stable should outperform over the short- to medium-term. Our top recommendations in the emerging markets space through the end of the year are the Brazilian real, Russian ruble and Mexican peso.

Figure 1



Source: Bloomberg LP and Wells Fargo Securities

Figure 2



Source: Bloomberg LP and Wells Fargo Securities

Latin America's Shift Left

While our view on emerging market currencies is generally positive, we do have a pessimistic outlook on developing market currencies where political risk has risen, in part related to the pandemic. For most of the COVID-crisis, we highlighted how politics could be ripe for a dramatic turn as wealth inequality and unemployment rises. We mentioned how we expected populist-style candidates, as well as more socialist-type platforms, to gain momentum, similar to the populist movement the world experienced in the aftermath of the Global Financial Crisis. In our view, these dynamics were likely to evolve and materialize over the next few years; however, changes on the political front have come quicker than we thought, particularly within Latin America. While Latin America has turned into a "hot spot" for elevated political risk over the years, recent elections and developments suggest political risk is set to deteriorate even further. Recent elections reveal an anti-establishment movement is underway across the continent, and in our view, elevates political risk in each impacted country and is likely to weigh on their respective currencies going forward.

A recent referendum vote tied to the constitutional rewrite in Chile represents a dramatic shift in Chilean politics, while Daniel Jadue of the Communist Party of Chile is making enormous headway and could be the candidate to beat in November's Presidential election. In Peru, the self-proclaimed Marxist Pedro Castillo seems to have won the Presidency on a platform built on the political ideologies of Hugo Chavez and Fidel Castro. While Castillo has tried to reassure investors he will pay Peru's debts and not expropriate assets, financial markets remain uncertain, and have pushed the Peruvian sol to all-time lows against the U.S. dollar. Colombia has also experienced anti-government protests and a violent anti-establishment movement that has disrupted local financial markets. In our view, Colombia's protests are likely to spill over into next year's Presidential election, and we would not be surprised to see a left-leaning candidate gather momentum. And in Brazil, the return of Lula could complicate Presidential elections in 2022. As of now, Lula has not formally declared his candidacy; however, Lula is wildly popular in Brazil and his running for office could weigh on the longer-term prospects for Brazil's economy as well as the Brazilian real.

As political risk permeates across the region and in these specific countries, we have either maintained our bearish view or developed a more negative outlook on these currencies. In Chile, we believe the political road ahead will turn more contentious as it relates to the constitutional rewrite, and we now have concerns regarding the possibility of Jadue winning the Presidency. We maintain our view that the Chilean peso will steadily depreciate well into 2022 as a result of elevated political risk. In Peru, we maintain our view that the recent political shift will hurt sentiment toward the sol and believe the currency will continue to set new record lows against the dollar going forward. Demonstrations in Colombia have turned our once optimistic view on the peso slightly negative, and the evolution of demonstrations going forward will certainly have an impact on our USD/COP exchange rate forecasts.

For now, radical shifts in political dynamics have been concentrated in Latin America and have not spread to other parts of the emerging world. As economies recover at differing speeds, it is still possible populist-style candidates will emerge in other parts of the developing world as well. A shift to left-leaning socialist platforms could also spread into the developed world. We saw a clear populist and nationalist movement in the years following the Global Financial Crisis in the United States, United Kingdom and other parts of Europe. In our view though, developed market currencies are less at-risk to political developments, and we expect emerging market currencies, Latin American currencies specifically, to be most vulnerable to political shifts.

Global Economic Forecasts

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP				CPI			
	2019	2020	2021	2022	2019	2020	2021	2022
Global (PPP Weights)	2.8%	-3.3%	6.3%	4.0%	3.5%	3.2%	3.7%	3.6%
Advanced Economies[1]	1.6%	-4.7%	5.8%	5.0%	1.4%	0.7%	2.8%	2.3%
United States	2.2%	-3.5%	7.3%	5.8%	1.8%	1.2%	4.0%	3.1%
Eurozone	1.3%	-6.6%	4.3%	4.2%	1.2%	0.3%	1.9%	1.5%
United Kingdom	1.4%	-9.9%	7.0%	5.8%	1.8%	0.9%	1.8%	2.0%
Japan	0.3%	-4.8%	2.4%	2.8%	0.5%	0.0%	0.0%	0.5%
Canada	1.9%	-5.4%	6.1%	4.1%	1.9%	0.7%	2.6%	2.3%
Switzerland	1.1%	-3.0%	3.3%	3.0%	0.4%	-0.7%	0.3%	0.4%
Australia	1.9%	-2.4%	5.4%	3.3%	1.6%	0.9%	1.8%	1.8%
New Zealand	2.4%	-3.0%	6.0%	3.2%	1.6%	1.7%	1.6%	1.4%
Sweden	1.4%	-2.8%	4.6%	3.6%	1.6%	0.7%	1.7%	1.4%
Norway	0.9%	-0.8%	3.6%	3.9%	2.2%	1.3%	2.6%	2.0%
Developing Economies[1]	3.6%	-2.2%	6.7%	3.2%	5.1%	5.1%	4.5%	4.7%
China	5.8%	2.3%	8.7%	5.2%	2.9%	2.4%	1.5%	2.3%
India	4.0%	-8.0%	9.9%	3.4%	4.8%	6.2%	4.8%	4.5%
Mexico	-0.1%	-8.2%	5.3%	2.7%	3.6%	3.4%	5.0%	4.0%
Brazil	1.4%	-4.1%	5.1%	2.2%	3.7%	3.2%	5.5%	4.0%

Forecast as of: June 24, 2021

[1]Aggregated Using PPP Weights

Source: International Monetary Fund and Wells Fargo Securities

Interest Rate Forecasts

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	2021			2022		
Central Bank Key Policy Rate	Q2	Q3	Q4	Q1	Q2	Q3
United States	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
Eurozone[1]	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%
United Kingdom	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Japan	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%
Canada	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%
2-Year Note	Q2	Q3	Q4	Q1	Q2	Q3
United States	0.15%	0.20%	0.25%	0.30%	0.40%	0.50%
Eurozone[2]	-0.65%	-0.65%	-0.60%	-0.60%	-0.55%	-0.55%
United Kingdom	0.05%	0.10%	0.10%	0.15%	0.15%	0.20%
Japan	-0.10%	-0.10%	-0.05%	-0.05%	-0.05%	-0.05%
Canada	0.45%	0.45%	0.60%	0.75%	0.85%	0.95%
10-Year Note	Q2	Q3	Q4	Q1	Q2	Q3
United States	1.70%	1.85%	2.00%	2.15%	2.20%	2.25%
Eurozone[2]	-0.10%	-0.05%	0.00%	0.05%	0.15%	0.25%
United Kingdom	0.90%	1.05%	1.15%	1.20%	1.30%	1.40%
Japan	0.10%	0.10%	0.15%	0.15%	0.15%	0.20%
Canada	1.55%	1.75%	1.90%	2.00%	2.10%	2.15%

Forecast as of: June 24, 2021

[1] ECB Deposit Rate [2] German Government Bond Yield

Source: Bloomberg LP and Wells Fargo Securities

Currency Forecasts

Currency Pair*	Current rate	Q2-2021	Q3-2021	Q4-2021	Q1-2022	Q2-2022	Q3-2022
G10							
EUR/USD	1.1948	1.1900	1.2000	1.2200	1.2400	1.2500	1.2600
USD/JPY	110.72	111.00	112.00	113.00	114.00	115.00	116.00
GBP/USD	1.3924	1.3900	1.4100	1.4300	1.4500	1.4700	1.4900
USD/CHF	0.9178	0.9200	0.9150	0.9050	0.8950	0.8900	0.8900
USD/CAD	1.2306	1.2300	1.2100	1.1900	1.1700	1.1500	1.1400
AUD/USD	0.7590	0.7600	0.7700	0.7800	0.7900	0.8000	0.8100
NZD/USD	0.7070	0.7100	0.7200	0.7300	0.7500	0.7600	0.7700
USD/NOK	8.5085	8.5300	8.4175	8.2375	8.0650	7.9600	7.8975
USD/SEK	8.4630	8.4875	8.4175	8.2375	8.1050	8.0000	7.9375
Asia							
USD/CNY	6.4682	6.4500	6.4200	6.3900	6.3600	6.3300	6.3000
USD/CNH	6.4724	6.4500	6.4200	6.3900	6.3600	6.3300	6.3000
USD/IDR	14440	14400	14300	14200	14100	14000	13900
USD/INR	74.17	74.25	74.50	74.50	75.00	75.00	75.50
USD/KRW	1134.75	1130.00	1120.00	1110.00	1100.00	1090.00	1080.00
USD/PHP	48.74	48.50	48.25	48.00	47.75	47.75	47.50
USD/SGD	1.3425	1.3400	1.3300	1.3200	1.3100	1.3000	1.3000
USD/TWD	27.99	27.75	27.75	27.50	27.50	27.25	27.25
USD/THB	31.87	32.00	31.00	30.50	30.25	30.00	29.75
Latin America							
USD/BRL	4.9261	4.9000	4.8000	4.9000	5.0000	5.1000	5.2000
USD/CLP	728.96	740.00	750.00	770.00	780.00	790.00	800.00
USD/MXN	20.0396	20.0000	19.5000	19.2500	19.0000	19.0000	18.7500
USD/COP	3785	3800	3900	4000	3900	3800	3700
USD/ARS	95.5557	96.0000	98.0000	100.0000	102.0000	104.0000	106.0000
USD/PEN	3.9754	3.9800	4.0000	4.0200	4.0000	3.9800	3.9600
Eastern Europe/Middle East/Africa							
USD/CZK	21.28	21.25	20.75	20.50	19.75	19.50	19.00
USD/HUF	293.72	294.00	287.50	278.75	270.25	264.00	258.00
USD/PLN	3.7857	3.7825	3.7250	3.6400	3.5325	3.4875	3.4450
USD/RUB	72.25	72.00	70.00	68.00	66.00	64.00	62.00
USD/ILS	3.2439	3.2400	3.2400	3.2200	3.2000	3.1800	3.1600
USD/ZAR	14.1987	14.0000	14.2500	14.2500	14.5000	14.5000	14.7500
USD/TRY	8.6877	8.7500	9.0000	9.0000	9.5000	9.5000	10.0000
Euro Crosses							
EUR/JPY	132.29	132.00	134.50	137.75	141.25	143.75	146.25
EUR/GBP	0.8581	0.8550	0.8500	0.8525	0.8550	0.8500	0.8450
EUR/CHF	1.0966	1.0950	1.1000	1.1050	1.1100	1.1150	1.1200
EUR/NOK	10.1663	10.1500	10.1000	10.0500	10.0000	9.9500	9.9500
EUR/SEK	10.1120	10.1000	10.1000	10.0500	10.0500	10.0000	10.0000
EUR/CZK	25.43	25.25	25.00	24.75	24.50	24.25	24.00
EUR/HUF	350.96	350.00	345.00	340.00	335.00	330.00	325.00
EUR/PLN	4.5232	4.5000	4.4700	4.4400	4.3800	4.3600	4.3400

Forecast as of: June 24, 2021

Source: Bloomberg LP and Wells Fargo Securities

United States/USD

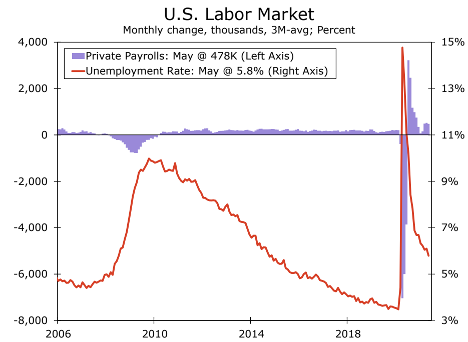
Outlook

We see a stable U.S. dollar in the near-term and renewed U.S. dollar weakness over time. Hawkish hints from the Federal Reserve have contributed to unsettled markets, which is supporting the greenback for now. Strong growth, which has also helped the U.S. currency, may now be nearing a peak. It may, however, still be a little while before the Fed follows through with actual policy adjustments, suggesting a return of market calm in the interim. With international economic growth also firming and many international central banks likely to move ahead of the Fed, we see that as a combination for a return to a softer U.S. dollar trend over time, and still expect gains in many G10 and emerging currencies over the medium-term.

Fundamental Focus: Economics, Policy & FX

U.S. Growth Peaking, U.S. Inflation Firming

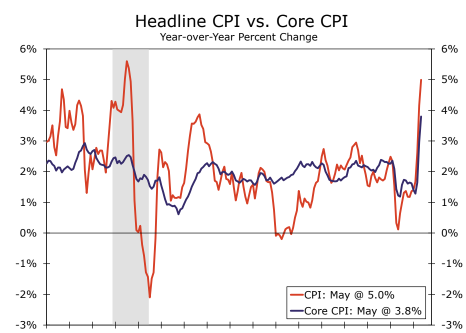
- The U.S. economy is throwing off mixed signals with some signs GDP growth may be closing to peaking, but with inflationary trends still intensifying.
- Confidence surveys suggest the underlying trend of growth will remain sturdy. In particular, the May ISM services index rose to a record high 64.0, while the ISM manufacturing index also rose to 61.2.
- That said, there are hints Q2 economic growth could be the high point. There are modest hints of softening on the consumer front. April disposable personal income fell 14.6% month-over-month, partly reversing a March surge, and the effect of one time stimulus checks dropped out. Meanwhile, May retail sales fell 1.3% month-over-month, reversing the April gain.
- Other areas of the economy are also showing mixed trends. May nonfarm payrolls were a downside surprise, showing an increase of 559,000, although the unemployment rate did fall further to 5.8%. May industrial output rose 0.8% month-over-month, but the April increase was revised lower.
- For full-year 2021 we forecast a sturdy GDP gain of 7.3%, before a moderation of GDP growth to 5.8% in 2022.
- While activity data are mixed, inflation data continue to accelerate, prompting an upward revision to our U.S. inflation forecasts. The May headline CPI quickened to 5.0% year-over-year and the core CPI quickened to 3.8%, with higher used car prices once again a contributing factor.



Source: Datastream and Wells Fargo Securities

A Hawkish Hint From the Federal Reserve

- The June Federal Reserve monetary policy announcement was a significant event, as there were hints the U.S. central bank could eventually shift towards less accommodative monetary policy.
- The Fed made no change to its monetary policy stance. The target for the fed funds rate was maintained at 0% to 0.25%, although the Fed did modestly tweak some of its short-term operational rates. The Fed also maintained the pace of its bond purchases at $80 billion of Treasury securities and $40 billion of mortgage-backed securities per month.
- The Fed's updated projections, and in particular the “dot plot” that reflects what policymakers view as an appropriate path for policy interest rates, attracted significant attention. The dot plot now shows the median policymaker anticipating two 25 basis point rate increases in 2023, compared to the prior dot plot which did not see an initial rate increase until 2024.
- Although the announcement was clearly a hawkish tilt, an actual policy shift is likely still some way away. Whether there is a lasting impact on shorter-term yields or the U.S. dollar could depend on whether there is any follow through—for example, the tone of upcoming Fed minutes or any signals from the Fed's annual Jackson Hole event.



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

Economic & FX Risks

Upside FX Scenario

- Our forecast is for the U.S. dollar to resume a softening trend after a brief period of corrective strength. However, there is plausible risk scenario which incorporates longer lasting U.S. dollar gains.
- The greenback could gain further if the Fed follows through on its hawkish hints in its June announcement. In particular, if FOMC minutes reveal a more serious discussion of a potential slowing of bond purchases, or a clear tapering signal is delivered from the Fed's Jackson Hole event, U.S. yields and the U.S. dollar could gain further.
- A quicker move towards tapering could also see a more significant and longer lasting correction in equity markets. In this scenario, as a safe-haven currency, the U.S. dollar would likely benefit with gains versus emerging currencies in particular, but also versus many G10 currencies.

Central Bank Outlook

Fed Funds Rate Forecast			
Current: 0.125%	**3M**	**6M**	**12M**
Wells Fargo	0-0.25%	0-0.25%	0-0.25%
Market Implied	0.12%	0.12%	0.19%

Source: Bloomberg LP and Wells Fargo Securities

- Even with the hawkish hints from the Fed's June meeting, we expect the Fed to maintain its current target range for the fed funds rate between 0% and 0.25% through at least the end of 2022. We also look for the Federal Reserve to continue its quantitative easing program, in which it purchases $80 billion worth of Treasury securities and $40 billion worth of mortgage-backed securities every month, through the end of this year, before reducing the pace of its bond purchases early next year.

Eurozone/EUR

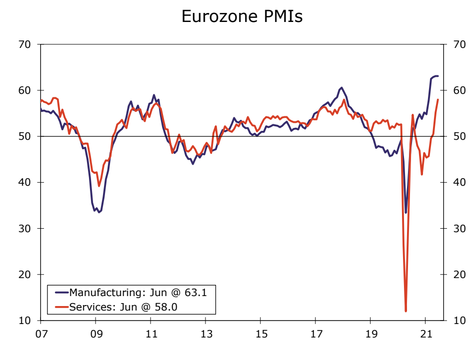
Outlook

We expect the euro to gain moderately versus the greenback over time, though we have become slightly less positive on the currency over the recent weeks. Improving confidence surveys point to stronger growth ahead, which should also lead to eventual euro gains. Still, trends in economic activity remain mixed well in Q2, while inflation trends are moderate overall, and as a result, the European Central Bank remains among the most dovish of the major central banks. The combination of mixed data, dovish European monetary policy and hawkish hints from the Fed should restrain the euro for now, and could even lead to some downside risk. Moderate growth and a gradual ECB path to policy normalization could also limit the extent of euro gains over the medium-term.

Fundamental Focus: Economics, Policy & FX

Eurozone Activity on an Upswing, But Economic Concerns Linger

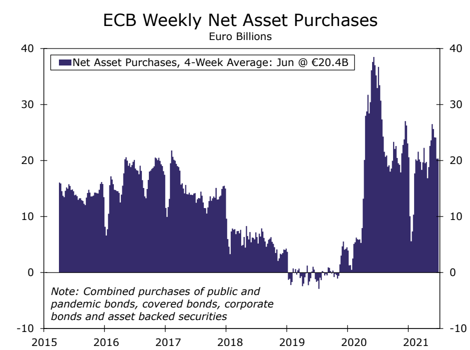
- Recent data have offered the clearest signs yet that a more meaningful Eurozone economic upturn is underway, prompting an upward revision to our Eurozone GDP growth outlook. We now forecast Eurozone GDP to grow 4.3% in 2021 (compared to 3.9% previously), while our GDP growth forecast of 4.2% for 2022 is unchanged.
- Confidence surveys offer encouraging economic signals. The Eurozone June manufacturing PMI held steady at 63.1. Significantly however, the services PMI rose to 58.0, the highest level since January 2018. June consumer confidence also rose further to -3.3.
- While survey data offer encouraging signals about the future, activity data point to some residual economic concerns. Eurozone Q1 GDP was revised to show a smaller 0.3% quarter-over-quarter decline. The details where underwhelming though, as a 2.3% fall in consumer spending was only partly offset by a rise in investment spending. As a result, our estimate of underlying final domestic demand fell 1.1% quarter-over-quarter in Q1.
- April activity data were something of a mixed bag as retail sales fell 3.1% month-over-month given some COVID related restrictions that were still in place, while industrial output rose 0.8%. The good news is that a marked drop in new COVID cases, further easing of restrictions, and a faster pace of vaccinations, should also help the growth outlook in the months and quarters ahead.



Source: Datastream and Wells Fargo Securities

European Central Bank Doves Still Rule Monetary Policy Roost

- There has been some pickup in Eurozone inflation trends, though not on the scale of the price pressures seen in the United States. The Eurozone May CPI quickened to 2.0% year-over-year, and the core CPI rose 1.0%.
- Given the still moderate overall inflation trends, the European Central Bank (ECB) maintained an overall accommodative monetary policy stance at its June monetary policy meeting.
- The central bank was more upbeat on the economic outlook, lifting its GDP growth and CPI inflation projections, and saying the risks to the growth outlook were now broadly balanced. The ECB kept its Deposit Rate at -0.50% and, for now, continued with an accelerated pace of bond purchases at least through the third quarter.
- The ECB's relatively dovish comments could restrain the euro's prospects to some extent over both the near- and medium-term.



Source: Bloomberg LP and Wells Fargo Securities

Economic & FX Risks

Downside FX Scenario

- We forecast only modest gains in the euro over time, and see the risks as tilted towards even smaller gains than we currently project.
- Easing COVID restrictions and improving sentiment surveys point to a strong pickup in activity ahead. However, any renewed COVID outbreak that slows the re-opening and restrains activity could also restrain the euro.

- Eurozone disposable income trends are steady rather than strong, but should still be sufficient to support a consumer-led recovery. However, if Eurozone employment or income trends disappoint, that could also weigh on the euro.
- We anticipate that ECB bond purchases will slow to a more typical pace from Q4 2021. If the economy disappoints, there remains a risk that accelerated bond purchases could continue for longer, and indeed, the total size of the bond purchases envelope could be increased further—both are factors that could weigh on the euro.
- In this downside scenario, we expect the EUR/USD exchange rate could struggle to gain much past a $1.2100-$1.2200 range over the medium-term.

Central Bank Outlook

ECB Deposit Rate Forecast			
Current: -0.50%	**3M**	**6M**	**12M**
Wells Fargo	-0.50%	-0.50%	-0.50%
Market Implied	-0.51%	-0.51%	-0.49%

Source: Bloomberg LP and Wells Fargo Securities

- Our outlook for ECB policy is unchanged—we expect the central bank to hold policy interest rates steady through all of 2021 and 2022. We also expect the ECB to complete its €1.85 Pandemic Emergency Purchase Program by Q1 2022. After and accelerated pace of bond purchases through Q2 and Q3, we expect the ECB to announce a slower pace of bond purchases at its September meeting and for the pace of ECB bond purchases to return to a more “typical” level from Q4 2021.

Japan/JPY

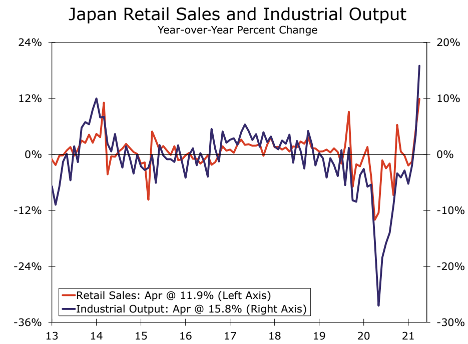
Outlook

We expect the yen to soften versus the U.S. dollar over time. With COVID-related restrictions having been in place for an extended period, Japan's rebound from its Q1 contraction has been slow and uneven. As a result we expect Bank of Japan monetary policy to stay on hold for an extended period. Slow growth and steady monetary policy is likely to see the yen soften as the global economy recovers and many central banks begin to move to less accommodative policy, while even periods of financial market uncertainty seem likely to provide less support than usual to the safe-haven Japanese yen.

Fundamental Focus: Economics, Policy & FX

Japan Still Struggling to Reach Recovery Velocity

- Japan remains something of a laggard amongst the G10, as residual COVID concerns continue to limit the strength of economic recovery.
- With new COVID cases elevated through much of 2021, a state of emergency for Tokyo, Osaka and other areas have only recently been lifted on June 20, which should limit growth during Q2. The government said it will maintain focused restrictions through July 11.
- The effect on the ongoing restrictions are clearly evident in recent economic figures. April retail sales fell 4.5% month-over-month, much more than expected, and the level of sales in April was 2.9% below the Q1 average. April tertiary activity, which captures the broader services sector, fell 0.7% month-over-month. April industrial output was firmer with a 2.5% gain, although that was still less than the consensus forecast.
- Confidence surveys also hint at lingering economic concerns even as the outlook begins to improve. For the May economy watchers survey, the current conditions component fell to 38.1, but the outlook component rose to 47.6.
- The rescheduled Tokyo Olympics are expected to proceed as planned, although it is not clear how much that will boost economic activity, especially with the government limiting attendance at Olympic venues to 10,000 people.
- We forecast moderate GDP growth of 2.4% in 2021 and 2.8% in 2022, the softest among the major developed economies.



Source: Datastream and Wells Fargo Securities

Another Modest Bank of Japan Policy Tweak

- The Bank of Japan (BoJ) kept its key policy parameters unchanged at its June meeting, while announcing some modest adjustments to other measures.
- The BoJ kept its Policy Balance Rate at -0.10% and maintained the target for the 10-year Japanese government bond yield near 0%.
- The central bank did however extend its COVID-related funding program, which had been due to end in September 2021, through until March 2022. The BoJ also announced a new funding measure for climate change, the details of which will be outlined in July, with the measure to be launched later this year.
- Overall we do not expect any change in the Bank of Japan's main policy levers for the foreseeable future, and expect the central bank to maintain its very accommodative monetary policy stance.

Economic & FX Risks

Downside FX Scenario

- We view the risks as tilted toward a faster-than-expected decline in the yen versus the U.S. dollar.
- Japan's economy is showing only tentative signs of recovery, suggesting that monetary policy will remain easy, or become easier, in the period ahead.
- A faster than expected U.S. policy normalization could have mixed influences for the yen. It is a potential negative in that rising global yields could weigh on Japan's currency, but also a potential positive in that a longer-lasting equity correction could support the safe Japanese yen.
- That said, we note the yen's correlation with yield spreads has remained stronger and more stable than the yen's (historically typical) safe-haven relationship with global equities. Thus, we expect in a scenario of early Fed normalization yield trends would dominate, weighing on the Japanese currency.

- In this downside scenario for the Japanese currency, the yen could depreciate more than we currently expect, with the USD/JPY exchange rate perhaps reaching as high as JPY118.00-120.00 over time.

Central Bank Outlook

BoJ Policy Rate Forecast			
Current: -0.10%	**3M**	**6M**	**12M**
Wells Fargo	-0.10%	-0.10%	-0.10%
Market Implied	-0.03%	-0.04%	-0.06%

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 and 2022, and to make no major changes to its quantitative easing program. While our base case is for an eventual move toward less accommodative monetary policy, the underwhelming performance of Japan's economy suggests the more significant near-term risk scenario remains a further reduction in the Bank of Japan's already negative policy interest rate.

United Kingdom/GBP

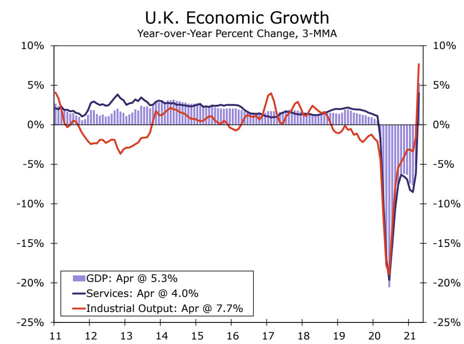
Outlook

We expect the pound to strengthen against the U.S. dollar over the medium-term. The U.K. may be restrained in the near-term given a brief pause in re-opening and mildly unsettled global markets. However, the U.K.'s steady economic recovery continues and indeed has strengthened. With inflation also firming modestly, we expect the Bank of England to continue along its path to less accommodative monetary policy. Overall, growth and monetary policy fundamentals are favorable for the pound, which should lead to gains against the U.S. dollar and the euro.

Fundamental Focus: Economics, Policy & FX

U.K Upswing Should Remain on Track

- We believe an impressive U.K. upturn that began earlier this year is likely to remain on track, even if some recent events hint at a temporary pause in momentum.
- U.K. April GDP rose 2.3% month-over-month, coming on top of a 2.1% gain in March. Services activity was especially strong, rising 3.4%. Industrial output fell 1.3%, although that was due to a planned shutdown of oil field production sites for maintenance.
- The June PMI surveys suggest the underlying trend of growth should remain sturdy. The manufacturing PMI fell to a still solid 64.2 while the services PMI fell to 61.7.
- On the softer side, May retail sales show an unexpected 1.4% month-over-month decline, although this must be viewed in the context of a 9.2% surge in April sales.
- The U.K. government delayed the fourth and final phase of its plan to ease pandemic rules in England by one month, pushing it to July 19 from the previous June 21 date. Subsequently, Prime Minister Boris Johnson said the COVID data is looking good for those restrictions to be lifted in July.
- Overall, we see nothing that would alter our outlook for a strong GDP gain for full-year 2020 of 7.0%.



Source: Datastream and Wells Fargo Securities

Bank of England's Gradual Path to Policy Normalization to Continue

- In addition to strong growth, U.K. inflation trends have picked up, although not excessively so. The May CPI quickened to 2.1% year-over-year, while the core CPI also quickened more-than-expected to 2.0%.
- The Bank of England made no change to monetary policy in June, keeping its policy rate at 0.10% and its asset purchase target at £895 billion. Still, given the firming growth and inflation trends, we expect the Bank of England to announce a further tapering of its asset purchases at its August meeting.

Economic & FX Risks

Upside FX Scenario

- Despite some recent pause in momentum, the U.K. economic outlook remains favorable and the risks to the pound likely remain tilted to the upside.
- The pause in the phased re-opening of the U.K. economy appears likely to be one month at most, suggesting any growth lost in Q2 will likely be made up in Q3. Accordingly, we doubt activity data will significantly dent the pound.
- Inflation trends have also started to pickup, meaning the U.K. could maintain, or even quicken, its path towards policy normalization. This could entail completing its bond purchase program earlier than the previously expected end of this year, or delivering an initial policy rate increase some time in 2022. Any such developments would be positive for the pound.
- We suspect that U.S. dollar strength from the Fed's hawkish hints will prove relatively temporary. A return to more stable market sentiment would likely weigh on the greenback and be supportive of the GBP/USD exchange rate.
- In this favorable scenario, the GBP/USD exchange rate could trade above $1.50.

Central Bank Outlook

BoE Bank Rate Forecast			
Current: 0.10%	**3M**	**6M**	**12M**
Wells Fargo	0.10%	0.10%	0.10%
Market Implied	0.11%	0.11%	0.22%

Source: Bloomberg LP and Wells Fargo Securities

- The Bank of England (BoE) kept its key policy parameters unchanged in June, holding its policy rate steady at 0.10% and maintained its asset purchase target of £895 billion.
- We expect a further moderate tapering of asset purchases to be announced at the August policy meeting, and for the asset purchase program to end broadly as scheduled around the end of 2021. We believe an initial interest rate increase is still some way off, likely not until sometime during the first half of 2023.

Switzerland/CHF

Outlook

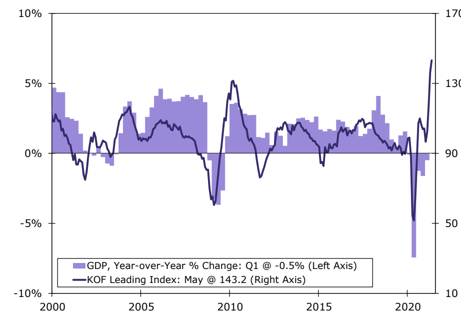
We expect a mildly softer Swiss franc versus the euro and a mildly stronger franc against the greenback over the medium-term. After a challenging start to the year the Swiss economy is now on a clear upswing, although inflation pressure remain very muted. As a result, Swiss monetary policy should stay very accommodative, in contrast to many international central banks, which could begin to normalize policy. Economic strength could offset easy policy and see only modest Swiss franc declines versus the euro. Meanwhile, any EUR/USD gains could see the franc gain versus the U.S. dollar as well.

Fundamental Focus: Economics, Policy & FX

Swiss Growth Picking Up, Swiss Policy Stays Steady

- After a challenging start to 2021, the economic signals are pointing to an improving growth outlook as 2021 progresses.
- Q1 GDP contracted broadly as expected, by 0.5% quarter-over-quarter, and 0.5% year-over-year. In terms of sequential quarterly growth, domestic activity was quite soft as consumer spending fell 3.3% quarter-over-quarter, and fixed investment spending dipped 0.2%.
- More recent economic signals have been much more encouraging. The May KOF leading indicator rose to a multi-decade high of 143.2, while the May manufacturing PMI also rose to 69.9.
- April real retail sales also surged 35.7% year-over-year, helped by favorable comparisons to weak sales from April 2020. And although seasonally adjusted sales fell 4.4% month-over-month, the level of sales in April is still 7% above the Q1 average.
- Given the encouraging recent signals, we expect Swiss GDP to grow 3.3% for full-year 2021.
- Inflation has also ticked higher, but only very modestly and certainly not by enough to prompt any expectation of changes to Swiss monetary policy.
- The May CPI edged up to 0.6% year-over-year, while the trimmed mean CPI also edged higher to 0.3% year-over-year.
- The Swiss National Bank also lifted its CPI inflation forecasts slightly at its June monetary policy announcement. Still, the central bank kept its policy rate at -0.75%, repeated that the Swiss franc remains highly valued, and said it remains willing to intervene in the foreign exchange market as necessary.

Swiss GDP and KOF Leading Indicator



Source: Datastream and Wells Fargo Securities

Economic & FX Risks

Upside FX Scenario

- Our outlook is for gradual weakness in the franc versus the euro over the medium term and relative stability versus the U.S. dollar, however, there are upside risks to this scenario.
- Confidence surveys have picked up markedly in recent months, suggesting upside risk to our Swiss GDP growth forecasts. While any monetary policy response is unlikely, we still expect that stronger than forecast GDP growth would be positive for the Swiss currency.
- Slightly faster inflation might also make the central bank more accommodating of Swiss currency strength, at the margin.
- Financial markets have been unsettled in the wake of hawkish hints from the Federal Reserve. While we expect that volatility will be temporary, if equity and other financial markets were to remain unsettled for an extended period the safe-haven Swiss franc should benefit.
- In this scenario, the franc could strengthen versus the euro, with the EUR/CHF exchange rate potentially revisiting a CHF1.06-1.07 range seen in late 2020.

Central Bank Outlook

SNB Policy Rate Forecast			
Current: -0.75%	**3M**	**6M**	**12M**
Wells Fargo	-0.75%	-0.75%	-0.75%
Market Implied	-0.74%	-0.72%	-0.69%

Source: Bloomberg LP and Wells Fargo Securities

- We expect the Swiss National Bank policy interest rate to remain steady at -0.75% for all of 2021 and 2022. Current market pricing also points to steady interest rates over the next 12 months.

Canada/CAD

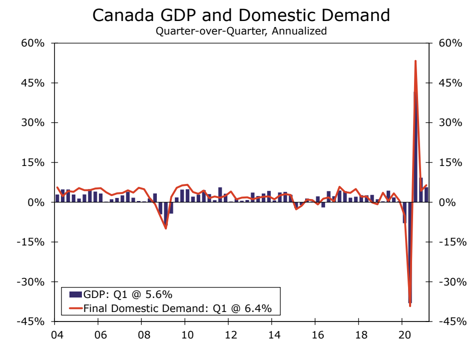
Outlook

We believe the medium-term outlook for the Canadian dollar remains constructive. The economy is experiencing a brief soft patch amid a renewed spread of COVID cases, and that slowdown should be short-lived. Consumer fundamentals, including income trends, remain favorable and should support the economy over time, as should elevated commodity prices. With inflation also quickening, the Bank of Canada should continue to taper its bond purchases in the months ahead, and start raising interest rates in the latter part of 2022. Altogether growth, interest rate and commodity price fundamental should see the Canadian dollar strengthen over time.

Fundamental Focus: Economics, Policy & FX

Canadian Outlook Remains Constructive Despite Soft Spot

- Canada's economy made a steady enough start to 2021 and, despite some temporary softness of the renewed spread of COVID cases and imposition of related restrictions, the economic outlook remains favorable overall.
- Q1 GDP grew 5.6% quarter-over-quarter annualized, a bit less than expected. However, final domestic demand grew at a stronger 6.4% pace, with notable strength in business investment, as well as gains in consumer spending.
- Slower growth is likely in Q2 given COVID-related restrictions. Among the indicators of softer activity, May employment fell a further 68,000, although most of the fall was in full time jobs, and the unemployment rate rose to 8.2%.
- April retail sales dropped 5.7% month-over-month, while Statistics Canada's flash estimate for May suggests a further decline in sales of 3.2%.
- The May IVEY manufacturing PMI was upbeat, rising to 64.7.
- The longer-term outlook remains favorable given elevated overall commodity prices, most notably oil, and high household saving rates. We forecast GDP growth of 6.1% for full-year 2021.
- Meanwhile, inflation trends have moved higher, which should keep the Bank of Canada on the path towards less accommodative monetary policy. The May CPI quickened to 3.6% year-over-year, while the average of the core CPI inflation measures quickened to 2.3%.



Source: Datastream and Wells Fargo Securities

Downside FX Scenario

- We remain constructive on the Canadian dollar and expect the currency to strengthen against the greenback over time. However, the risks are tilted toward a more modest pace of Canadian dollar appreciation.
- We expect the current soft patch for the Canadian economy, including weakness in employment and retail sales, to be temporary. To the extent that weaker activity is more persistent, it could slow the rate at which the Bank of Canada tapers it bond purchases, or delay an initial rate increase. Either of those would weigh on the Canadian dollar.
- Equity markets and commodity prices have been unsettled recently, in part due to hawkish hints from the Federal Reserve. Some commodity prices, such as lumber, have fallen precipitously, while other prices such as oil have held up better. We expect unsettled markets to be transitory. However, if the market correction lasts longer and commodity prices show a larger decline, that should hold back the Canadian dollar.
- In this less favorable scenario, we would expect a more moderate Canadian dollar appreciation, with the USD/CAD exchange rate perhaps not moving much below the CAD1.2000 level over the medium-term.

Central Bank Outlook

BoC Overnight Rate Forecast			
Current: 0.25%	**3M**	**6M**	**12M**
Wells Fargo	0.25%	0.25%	0.25%
Market Implied	0.27%	0.23%	0.52%

Source: Bloomberg LP and Wells Fargo Securities

- The Bank of Canada held monetary policy steady at its June meeting and said Canada's economy had evolved broadly as expected. There was nothing in the statement that hinted at any change in the central bank's monetary policy outlook. We expect the Bank of Canada to slow the pace of its government bond purchases further at its July meeting, probably by another C$1 billion, to C$2 billion per week. We expect net purchases to slow to zero by early next year, and an initial 25 basis point rate increase from the Bank of Canada in Q3-2022.

Australia/AUD

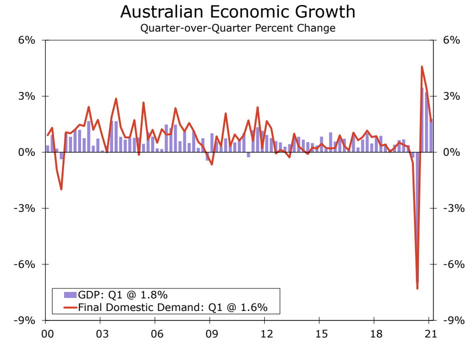
Outlook

Our outlook remains for moderate gains in the Australian dollar over the medium-term. The early part of 2021 saw solid growth, and monthly activity data and confidence surveys indicate that momentum has persisted so far this year. A potential end to quantitative easing in the months ahead could also provide temporary support to the Australian currency. However, we expect the Australian dollar's medium-term gains will be limited to some extent with the central bank's policy interest rate on hold for the foreseeable future, and with economic trends for China—a key export market—somewhat mixed.

Fundamental Focus: Economics, Policy & FX

Australia's Sturdy Economic Expansion Continues

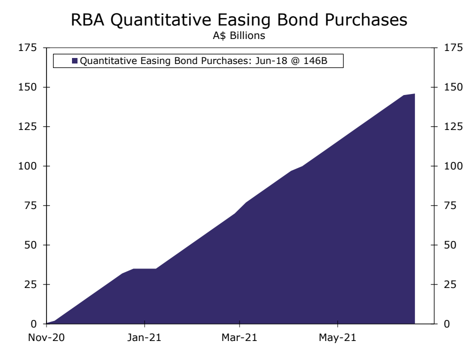
- Australia's economy continues to enjoy an impressive recovery from the COVID-induced downturn in 2020.
- Q1 GDP rose 1.8% quarter-over-quarter, slightly more than expected, and gained by 1.1% year-over-year. In terms of sequential quarterly growth, consumer spending rose 1.2% quarter-over-quarter and fixed investment spending rose 4.7%, contributing to a 1.6% gain in final domestic demand for the quarter.
- Consumer fundamentals remain broadly favorable, including a 1.0% quarter-over-quarter gain in Q1 household disposable income and a still elevated household saving rate of 11.6%.
- Activity data and confidence surveys suggest growth remained solid in Q2. May employment jumped 115,200, driven by a rise in full-time jobs, while the unemployment rate dropped to 5.1%. May retail sales edged up 0.1% month-over-month after a sizable April gain.
- May business conditions rose to a record high 37, while the forward-looking business confidence measure fell to 20. Finally, the June manufacturing PMI fell to 58.4 and the services PMI fell to 56.0—levels still consistent with solid growth.
- Given these sturdy economic signals we have revised our 2021 GDP growth forecast higher to 5.4%.



Source: Datastream and Wells Fargo Securities

Reserve Bank of Australia Nearing the End of Quantitative Easing

- The central bank's next monetary policy announcement on 6 July will be closely watched at the Reserve Bank of Australia (RBA), and has signaled that it will be providing an update on its future monetary policy plans.
- We expect the RBA will keep the three-year bond yield target at 0.10%, and shift to the November 2024 bond as the targeted purchase bond for that policy objective.
- With respect to quantitative easing, we expect the RBA to announce that it will complete its second A$100 billion purchases by late this year as scheduled, but we do not expect the central bank will announce a further increase in the bond purchase target.
- Finally, with respect to its policy interest rate, we expect the RBA to repeat that it will likely be 2024 at the earliest before the central bank begins raising interest rates.



Source: Reserve Bank of Australia and Wells Fargo Securities

Economic & FX Risks

Downside FX Scenario

- We expect the Australian currency to appreciate against an overall soft U.S. dollar over time; however, downside risks persist.
- Should wages and prices fail to accelerate, monetary policy could remain easier for longer, with an even longer delay before an initial rate increase is a possibility.
- Chinese economic activity has been mixed in 2021 and prices for some of Australia's commodity exports have declined—both potential negatives for the Australian currency.
- Financial markets have been unsettled in the wake of hawkish hints from the Federal Reserve. Should that market correction prove longer lasting than we expect, that could weigh on the Australian dollar.

- In this less favorable scenario, the AUD/USD exchange rate may not gain much beyond $0.7800 over the medium term.

Central Bank Outlook

RBA Cash Rate Forecast			
Current: 0.10%	**3M**	**6M**	**12M**
Wells Fargo	0.10%	0.10%	0.10%
Market Implied	0.10%	0.18%	0.13%

Source: Bloomberg LP and Wells Fargo Securities

- The RBA has repeatedly stated that it will take time for the labor market to tighten and wages and prices to accelerate, and that it does not expect to raise interest rates until at least 2024. That broadly concurs with our thinking. During our formal forecast horizon (through 2021 and 2022) we expect the policy interest rate to remain steady. The current implied market pricing of around 50 basis points over the next 24 months appears slightly premature, in our view.
- We also expect the RBA to confirm at its July meeting that it will end its quantitative easing program later this year, as previously scheduled.

New Zealand/NZD

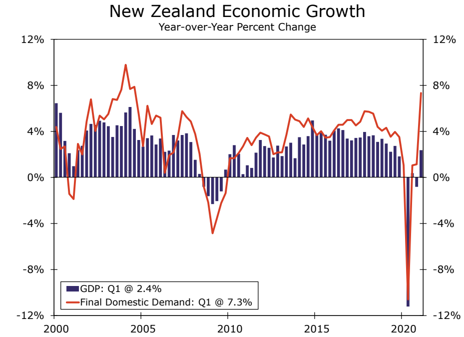
Outlook

We expect the New Zealand currency to appreciate versus the U.S. dollar over the medium-term. After a back-and- forth economy during the second half of last year, the domestic economy has surged since the start of 2021 even as the country's border remains largely closed to international travel. Against this backdrop the central bank has turned hawkish overall, and we now anticipate an initial rate hike during the first half of 2022. Given supportive growth and monetary policy fundamentals the medium-term outlook for the New Zealand currency is favorable, even with somewhat unsettled markets given hawkish Federal Reserve hints.

Fundamental Focus: Economics, Policy & FX

Economy Surges in Early 2021, Growth Set to Continue

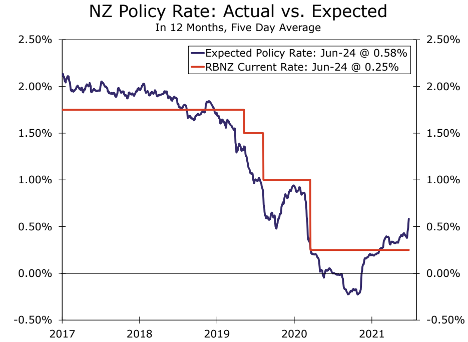
- The New Zealand economy surged at the beginning of 2021 and the indications are that sturdy growth is likely to continue—trends which are likely to see the Reserve Bank of New Zealand start tightening monetary policy earlier than previously expected.
- Q1 GDP rose 1.6% quarter-over-quarter, much more than expected, and 2.4% year-over-year. Even more impressive than the headlines, the detail showed sturdy domestic demand. Household consumption rose 5.5% quarter-over-quarter and investment spending rose 6.4%. In fact, the main drag on GDP was a large drop in services exports as still-closed borders prevented the typical influx of tourist.
- Monthly data suggest that the upswing in consumer spending has continued into the second quarter. May retail card spending rose 1.7% month-over-month after a large April increase, while May credit card spending jumped 8.5%.
- Confidence surveys are also consistent with a robust pace of growth. June business confidence eased to -0.4, but firms' expectations for their own activity outlook rose to 29.1. The May manufacturing PMI eased to 58.3, while the services PMI fell to 56.1.
- Given the strength of the Q1 GDP outcome, as well as monthly activity data and confidence surveys, we have revised our full-year 2021 GDP growth forecast to 6.0%.



Source: Datastream and Wells Fargo Securities

Hawkish Signals From the Reserve Bank of New Zealand

- The Reserve Bank of New Zealand (RBNZ) shifted to a hawkish policy bias at its May monetary policy announcement. The RBNZ held its Official Cash Rate steady at 0.25% and kept the limit for its Large Scale Asset Purchase program at NZ$100 billion.
- However, in publishing conditional projections for the Official Cash Rate for the first time since the pandemic begin, the central bank signaled that interest rates could begin to rise in the second half of 2022, and that it might not fully utilize its NZ$100 billion purchase limit.
- Given the hawkish policy bias and subsequent strong economic data, a 25 basis point hike is more than fully priced in by market participants within the next 12 months.



Source: Bloomberg LP and Wells Fargo Securities

Economic & FX Risks

Upside FX Scenario

- We expect moderate appreciation in the NZ dollar over time, although recent events hint at a possible upside scenario.
- While activity data have been firm, consumer data hint at the possibility for even further upside momentum and stronger-than-forecast GDP growth, which would be positive for the NZ dollar.
- While we now expect an initial RBNZ rate hike in Q2-2022, it is possible a rate increase could come even earlier than that, which would also be supportive of the NZ currency.
- In this strong growth/rising interest rate scenario, the NZ dollar could gain close to $0.8000 over the medium term.

Downside FX Scenario

- Equally, there is also a potential downside scenario for the NZ dollar.
- Financial markets have been unsettled in the wake of hawkish hints from the Federal Reserve. Should that period of market instability last longer than expected, that would likely weigh on the NZ dollar.
- Unsettled markets could also see commodity prices decline more significantly, which would be a negative for the NZ currency.
- One downside risk to the growth outlook is the ongoing and extended closure of New Zealand's borders, which is hitting the key tourism sector very hard, and could restrain the NZ dollar.
- Should these risks transpire, the NZ dollar might not gain much beyond $0.7200 over time.

Central Bank Outlook

RBNZ Official Cash Rate Forecast			
Current: 0.25%	**3M**	**6M**	**12M**
Wells Fargo	0.25%	0.25%	0.50%
Market Implied	0.27%	0.37%	0.59%

Source: Bloomberg LP and Wells Fargo Securities

- The RBNZ's hawkish monetary policy signals, along with firm data, have brought forward the timing of expected rate central bank tightening. We now expect an initial 25 basis point rate increase in Q2-2022, with and 25 basis point hike also in Q4-2022.

Sweden/SEK

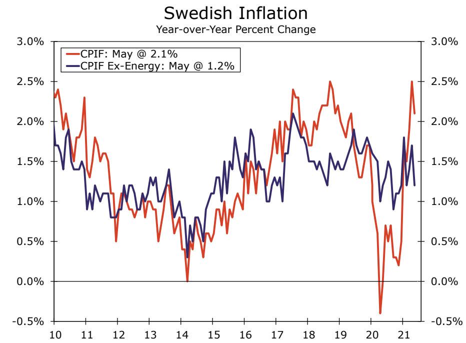
Outlook

We expect moderate gains in the Swedish krona over time. While activity data have mixed during the early part of the second quarter, the economy has been reasonably solid through 2021 and upbeat confidence surveys suggest a return to a steady expansion path. Despite economic improvement, Swedish krona gains will likely be moderate. Inflation trends remain contained and the central bank appears comfortable keeping policy interest rates on hold for an extended period. That will likely see the Swedish krona lag some other G10 currencies, where central banks appear closer to monetary tightening.

Fundamental Focus: Economics, Policy & FX

Swedish Economy Heating Up After a Mild Spring

- Although some recent activity data have been mixed, Sweden's economy remains on course for a solid performance in 2021.
- Q1 GDP rose 0.8% quarter-over-quarter, slightly less than suggested by the monthly GDP indicator, with consumer spending and exports both contributing to growth. However, the April GDP indicator fell 1.4% month-over-month, signaling a soft start to the second quarter.
- The sluggishness in early Q2 appears to be quite broad-based, as April household consumption fell 5.1% month-over-month, and industrial output fell 1.4%.
- The prospect is for stronger growth later in 2021, especially as the spread of new COVID cases has receded in recent weeks, and confidence surveys are consistent with stronger growth. For example the May PMI indices remain at elevated levels, as the manufacturing PMI fell to 66.4 but the services PMI rose to 71.7. May economic confidence rose to 119.3, with consumer and manufacturing confidence both higher.
- The Swedish government recently lost a no-confidence vote in Parliament, however we doubt a temporary period of political uncertainty will significantly affect the economic outlook.
- Finally, Sweden's central bank appears in no rush to move towards less accommodative monetary policy with inflation still relatively contained. May CPIF inflation slowed to 2.1% year-over-year, while CPIF inflation excluding energy slowed to 1.2%.



Source: Bloomberg LP and Wells Fargo Securities

Central Bank Outlook

Riksbank Interest Rate Forecast			
Current: 0.00%	**3M**	**6M**	**12M**
Wells Fargo	0.00%	0.00%	0.00%
Market Implied	0.01%	-0.01%	0.11%

Source: Bloomberg LP and Wells Fargo Securities

- We expect the Riksbank to hold its repo rate steady at zero percent for at least the next 12 months. We also expect the Riksbank to fully complete its SEK700 billion bond purchase program. Market participants currently see around a 50% chance of a 25 basis point rate hike over the next 12 months, and have fully priced in one 25 basis point hike over the next 24 months.

Norway/NOK

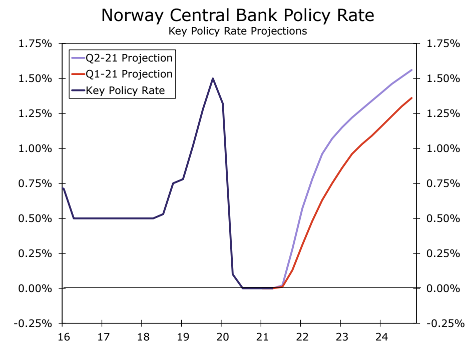
Outlook

Following a brief period of uncertainty, we are now modestly more constructive on the outlook for the Norwegian krone. After a mixed start to the year, strengthening confidence surveys point to a much improved outlook for Norway's economy over the second half of this year, while still elevated oil prices are a positive for the economy as well. Elevated oil prices should also support the krone as should central bank tightening, with the Norges Bank now expected to begin a rate hike cycle in Q3 this year. This favorable mix of fundamental factors supports the view of a stronger Norwegian krone versus both the euro and U.S. dollar over time.

Fundamental Focus: Economics, Policy & FX

Norges Bank Confirms Rate Hike Plans

- The most significant event over the past month, and one which could be supportive of the Norwegian currency, is the central bank's confirmation of its plans to begin raising interest rates later this year.
- The Norges Bank held its Deposit Rate steady at 0.00% at its June meeting, but in the accompanying statement said that after a slow start to this year, economic activity now appears to be rebounding somewhat faster than previously projected. With a further loosening of COVID-related restrictions helping a return to more normal economic conditions, the central bank said it would soon be appropriate to raise its policy rate from the current level. Indeed, updated projection indicate an initial rate increase in Q3-2021.
- The latest data are consistent with a stabilizing economy, and an improvement in the months ahead. April mainland GDP rose 0.3% month-over-month, largely reversing the March decline. Meanwhile, the Norges Bank's regional survey measure of output growth for the next six months rose to 1.88, the highest level since 2007. Historically, this indicator has often been a good indicator of future GDP trends.
- The prospects for stronger growth have kept the central bank on track to tighten monetary policy, even as inflation trends have eased somewhat. The May CPI slowed modestly to 2.7% year-over-year, while underlying inflation also slowed to 1.5%.



Source: Norges Bank and Wells Fargo Securities

Central Bank Outlook

Norges Bank Deposit Rate Forecast			
Current: 0.00%	**3M**	**6M**	**12M**
Wells Fargo	0.25%	0.25%	0.50%
Market Implied	0.34%	0.61%	0.92%

Source: Bloomberg LP and Wells Fargo Securities

- The Norges Bank kept its policy interest rate steady at 0.00% in June, but signaled that rate increases are not far away. We now expect an initial policy rate increase to occur in Q3-2021, earlier than we previously forecast. We also forecast two 25 basis point rate increases next year, in Q1-2022 and Q3-2022.

Mexico/MXN

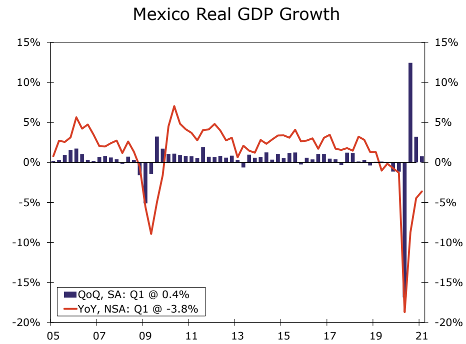
Outlook

Despite the peso coming under pressure as a result of a more hawkish Fed, we believe the currency can recover loses in the short-term and strengthen over the medium- to longer-term. In our view, elevated and less transitory Mexican inflation should result in tighter Central Bank of Mexico monetary policy in the near future, which should support the peso. In addition, higher oil prices should provide a boost to the economy, while local political developments could also boost sentiment toward the Mexican currency.

Fundamental Focus: Economics, Policy & FX

Global Upswing Is Mexican Peso Supportive

- Evidence continues to mount regarding a global economic recovery picking up momentum. In our view, as the global economy broadly recovers, sentiment and capital flows toward emerging market currencies should pick up. These dynamics should result in a weaker U.S. dollar and also help the Mexican peso strengthen over time.
- The Mexican economy demonstrated a solid recovery as Q1-2021 GDP growth beat expectations. GDP data revealed the local economic recovery is still intact, and in our view, should gather momentum as this year progresses. U.S. consumer demand for Mexican made products should rise as households remain flush with cash, which should allow for robust growth in 2021. As of now, we forecast Mexico's economy to grow over 5% this year.



Source: Bloomberg LP and Wells Fargo Securities

Inflation Not So Transitory

- At its next meeting, we believe the central bank will keep its policy rate steady at 4.00%; however, with inflation still elevated and proving not to be as transitory as previously expected, we believe the central bank will start to signal rate hikes are imminent. The process to normalize monetary policy will likely be gradual, and we expect only one 25 basis point rate hike by the end of this year.
- The Central Bank of Mexico is typically one of the more conservative emerging market central banks. In that sense, normalizing monetary policy in Mexico could result in a sharp peso rally. In our view, the peso is currently oversold, and with a view of tighter monetary policy in the near future, we believe now is a good time to gain exposure to the Mexican peso.

Political Risk Diminishing

- Local elections took place in early June and the outcome severely diminishes AMLO's ability to move forward with his unconventional platform agenda. AMLO's MORENA Party lost its majority in the lower house of congress, which should limit the administration's ability to implement constitutional changes. In our view, the outcomes of local elections reduces political risk and can support the peso going forward.
- Within Latin America, political risk has risen significantly as recent elections have resulted in left-leaning and socialist platforms gaining popularity. Mexico's shift back toward more conservative politics could result in Mexico becoming a political risk safe-haven in the region. As political developments outside of Mexico deteriorate, capital flows could return to Mexico and help the peso strengthen over the course of 2021 as well as 2022.

Economic & FX Risks

Downside FX Scenario

- Risks around our peso forecasts are now tilted to the downside as the Fed has turned slightly more hawkish. Our downside scenario is still centered around an earlier path to less policy accommodation from the Federal Reserve. A type of "taper tantrum" scenario would likely result in large capital outflows from emerging market currencies, while the Mexican peso is particularly vulnerable to Fed shifts in monetary policy.
- In a "taper tantrum" scenario, USD/MXN could test all-time highs of MXN25.78. The peso sold-off in the immediate aftermath of the most recent Fed meeting; however, a more explicit shift to tighter monetary policy in the U.S. could have a more pronounced impact on the currency.

Upside FX Scenario

- An upside scenario is also centered on Fed monetary policy. We forecast peso strength; however, the peso could reach our targets quicker if the Fed demonstrates commitment to easy monetary policy and talks down the possibility of a sharp move to less accommodative monetary policy.
- This combination could result in USD/MXN moving toward MXN19.50 before the end of this year.

Central Bank Outlook

Banxico Overnight Rate Forecast			
Current: 4.00%	**3M**	**6M**	**12M**
Wells Fargo	4.25%	4.50%	5.50%
Market Implied	4.24%	4.61%	5.71%

Source: Bloomberg LP and Wells Fargo Securities

- We believe interest rates in Mexico will be raised 25 basis points in September as inflation remains above the central bank's target. Financial markets have adjusted to our view and are now pricing in rate hikes three months out as well. Further out, we believe the tightening cycle will pick up pace and now believe Banxico will look to raise interest rates to 5.50% over the next 12 months.

China/CNY & CNH

Outlook

The combination of Peoples Bank of China (PBoC) FX intervention and a hawkish shift from the Fed has resulted in a modest renminbi sell-off; however, we expect the currency to rebound in the short-term. Over the longer-term, we expect further renminbi strength as China's financial markets continue to open to foreign investors and as local Chinese assets get included in global bond and equity indices going forward. While we maintain our bullish view on the currency, we have revised our GDP forecast lower to reflect a softening in activity and sentiment data over the last few months.

Fundamental Focus: Economics, Policy & FX

China's Economic Outperformance Fading?

- For over a year, the strength and outperformance of China's economy has been notable. However, in recent months activity data has revealed an economic slowdown is underway and becoming more pronounced. PMI surveys have softened, while May retail sales, industrial production and investment data missed expectations once again.
- As the deceleration becomes more apparent, China's economic outperformance relative to peer emerging market, as well as G10 countries, is fading. In that context, we revised our 2021 GDP forecast lower and now expect the Chinese economy to grow 8.7% this year.
- Prior to this downward revision, risks around our GDP forecast were tilted to the downside. Given the downward revision, we now view risks around our growth forecast as balanced.

Source: Bloomberg LP and Wells Fargo Securities

Short-term Renminbi Bounce

- The renminbi has come under modest pressure over the last few weeks. Part of the rationale for the sell-off has been stepped up FX intervention from the PBoC, while a more hawkish Fed “dot plot” resulted in broad pressure on emerging market currencies. In just the past few weeks CNY/CNH moved from 6.36 to 6.47, a somewhat notable depreciation.
- Given our view that recent dollar strength will be relatively temporary, we expect the renminbi to bounce back in the coming months. We do still expect the PBoC to be active in FX markets; however, we believe broader market forces should be more influential over the path of the renminbi. Overall, we expect the currency to strengthen back toward CNY6.40 by the end of the year.

Renminbi Prospects Still Attractive

- Despite a slowdown in the economy, it is likely the PBoC continues to guide money market rates higher, which can also support the Chinese currency. The PBoC has been adamant in regard to protecting against over-speculation and asset bubbles. In our view, the PBoC is likely to create an environment of tighter liquidity and more restrictions to credit. Tighter monetary policy conditions should attract capital flows toward RMB denominated assets.
- Chinese assets are also likely to become more accessible to foreign investors going forward. Local bonds and equities are set to become included in global indices, which should attract large capital inflows to China. In addition, it is possible Chinese authorities look to raise the renminbi's status on a global stage. Doing so would entail more access to local markets as well as less FX intervention from the central bank.

Economic & FX Risks

Downside FX Scenario

- Risks around our renminbi forecasts are moderately tilted toward a weaker renminbi than we forecast. It is possible the PBoC seeks to intervene more aggressively than we expect and maintain the renminbi at current levels, while the Fed shifts toward a more explicit hawkish stance on monetary policy. While not our base case, an escalation in U.S.-China tensions could also result in a weaker renminbi.
- While not our base case scenario, it is possible that a U.S.-led coordinated approach against China could result in geopolitical tensions rising. In a scenario where China digs in against not just the

United States, but the European Union, the United Kingdom and Canada, the currency could experience renewed downside. We do not believe this will materialize at this point, but risks are certainly rising.
- In the event this combination materializes, 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.

Upside FX Scenario

- Our upside scenario is centered around the Fed maintaining a dovish stance on monetary policy for longer than we expect. In this scenario, market sentiment is likely to remain positive and should attract capital flows into emerging market countries and currencies. If China's economy remains relatively sound, the PBoC could scale back liquidity and tighten policy more aggressively than we expect.
- In addition, a Biden-led White House would have to take explicit action to de-escalate tensions with China. These actions could include the removal of Trump-era tariffs as well as lifting recent sanctions.
- In this scenario, USD/CNY and USD/CNH could reach CNY/CNH6.20, a level not seen since 2018.

Brazil/BRL

Outlook

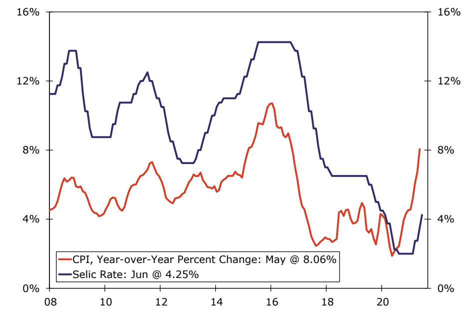
Current dynamics have made the Brazilian real the top performing emerging market currency this year. Aggressive rate hikes, fiscal and political stability, and higher commodity prices have pushed the Brazilian real to pre-pandemic levels. In the short-term, we believe the real can continue to strengthen as interest rates move in favor of the Brazilian currency and government spending is under control; however, the long-term outlook is more concerning. Political risks tied to the Presidential election in 2022 lead us to believe the real's recent fortunes could reverse next year, especially as we get closer to the election.

Fundamental Focus: Economics, Policy & FX

Brazil's Central Bank to Remain Center Stage

- At its latest meeting, the Brazilian Central Bank (BCB) lifted the Selic rate another 75 basis points to 4.25%. This year, the BCB has raised rates a cumulative 225 basis points, making the Brazilian Central Bank one of the most hawkish central banks in the world. Minutes from the June meeting, along with forward guidance, suggest the BCB is not done tightening policy and will look to raise the Selic rate at least another 75 basis points in August.
- Elevated inflation is playing a major role in the BCB's decisions to hike interest rates as CPI is now above 8% on a year-over-year basis. Higher commodity prices have fueled inflation; however, fiscal stimulus as well as a severe drought that has pushed electricity prices higher, are contributing as well. While higher interest rates may not be able to offset these specific developments, tighter monetary policy can help the currency strengthen over the next few quarters.
- As the carry appeal of the Brazilian real improves and local politics are stable for the time being, we forecast the USD/BRL exchange rate to move below BRL5.00. That BRL5.00 area has proved to be an important technical level; however, additional rate hikes could be the catalyst for a more sustained break.

Brazilian Inflation and Interest Rates



Source: Bloomberg LP and Wells Fargo Securities

Political Risk Reason to Worry in 2022

- Longer term, we have concerns regarding political risks and a stalled reform agenda, especially as we get closer to 2022 presidential elections. In our view, President Bolsonaro is likely to pause unpopular reform items such as Brazil's tax system and freezing public sector wages. We also believe Bolsonaro could look to extend household support payments, all of which could complicate Brazil's already fragile fiscal position.
- To this point, Brazil has made solid progress on reforms, recently achieving congressional support to privatize Eletrobras, the state-owned power company. But with Lula now eligible to run and likely to campaign on a similar left-leaning platform, we expect risks around further reform items to rise.
- In our view, a stalled reform agenda and extended household support could damage sentiment toward Brazil and the currency. We believe campaigning for the election will start at the end of this year when Lula formally announces himself as a candidate. At that point, we would expect local factors to have a larger role over the path of the currency, and for the real to weaken over the course of 2022.

Economic & FX Risks

Downside FX Scenario

- Risks around our Brazilian real forecast are to the downside. For now, fiscal and monetary policy dynamics are encouraging; however, COVID remains a problem and could require additional fiscal support to households. Additional fiscal support could renew concerns over Brazil's public finance position.
- In addition, political uncertainties could create risks associated with the Brazilian real. Support for a Lula presidency is building, while Bolsonaro's approval rating is declining. Should Bolsonaro look toward another cash handout program to gather support and reform items stall, expect a large selloff in the currency to unfold.
- Under this scenario, the USD/BRL exchange rate would likely reach new highs, possibly as high as BRL7.00.

Upside FX Scenario

- A scenario for a stronger Brazilian real includes solid commitment to the constitutional spending cap and to the longer-term reform agenda. It may take COVID containment for the administration to focus on reforms; however, signaling commitment to reforms could result in a currency rally.
- Spending restraints and COVID containment could lead to capital flows returning to Brazil and to a faster economic rebound. The BCB could begin to tighten monetary policy perhaps even faster than markets expect and create positive real interest rate dynamics again in Brazil.
- In this scenario, USD/BRL could move back to BRL4.80, the strongest point during the summer of 2020.

Central Bank Outlook

BCB Selic Rate Forecast			
Current: 4.25%	**3M**	**6M**	**12M**
Wells Fargo	5.75%	7.00%	7.00%
Market Implied	5.94%	7.41%	7.88%

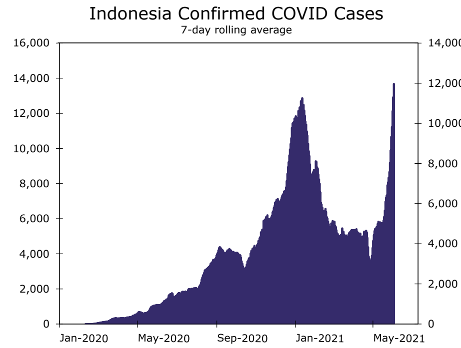
Source: Bloomberg LP and Wells Fargo Securities

- We have lifted our targets for the Selic rate and now forecast the Selic rate to reach 7.00% by the end of the year. As of now, we agree with markets on the direction of policy rates; however, we forecast less tightening than markets expect.

Asia

Indonesia/IDR

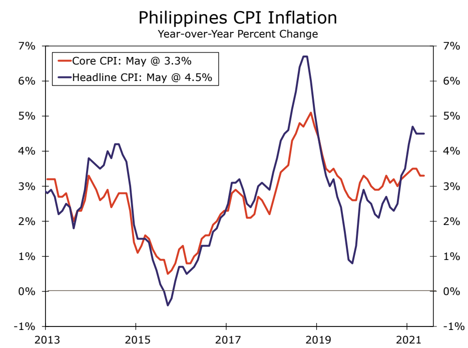
Outlook: Our outlook on the rupiah is little changed as we still forecast a stronger currency over time; however, risks around our forecast are tilted toward a weaker rupiah. The rupiah is particularly vulnerable to tighter Fed monetary policy as a large portion of the government's debt burden is denominated in U.S. dollars and foreign investors hold a sizable amount of sovereign debt. Given the Fed's more hawkish "dot plot," earlier tightening from the Fed could result in a sharp depreciation of the rupiah. In addition, confirmed COVID cases in Indonesia are on the rise once again. Recently, Indonesia experienced the most daily cases on record, which should complicate and extend the local recovery timeline. To that point, activity indicators remain suppressed, while Q1 GDP data improved, but came in below consensus expectations. On a more positive note, Bank Indonesia recently held rates steady despite potentially having room to cut interest rates if it chooses to. In addition, the central bank continues to suggest the currency is undervalued and is committed to maintaining a stable rupiah going forward. Central bank intervention should help support the currency over the short-to-medium-term, while we also believe it is unlikely the central bank cuts interest rates in an effort to protect the value of the currency.



Source: Bloomberg LP and Wells Fargo Securities

Philippines/PHP

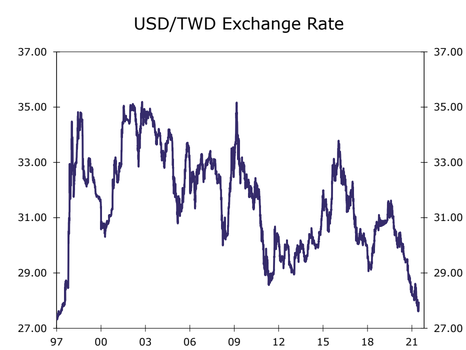
Outlook: A hawkish turn from the Fed and weak overseas remittance data has resulted in the peso giving up all of its gains this year. However, going forward, we expect the peso to strengthen back toward levels seen in late May and early June as the U.S. dollar weakens and sentiment toward emerging market currencies improves. As far as local developments, April remittance data missed expectations by a wide margin, rising only 12.7% year-over-year against expectations for an increase of 19.3%. Remittance data are watched very closely in the Philippines and can result in swings in the currency if data surprises. Going forward, we expect remittances to pick up pace as restrictions across the Philippines are still in place, while lock downs in Europe and other expat destinations are gradually lifted. As more hard currency is sent home, transactions to convert money into pesos should support the currency. Inflation also may have peaked in May as headline and core CPI moved lower last month. With the Philippine economy still struggling to gather momentum, lower inflation could take pressure of the central bank to tighten monetary policy earlier than it would like to. Higher interest rates could also contribute to a stronger peso in the future, although loose monetary policy could facilitate an economic recovery once COVID cases are contained. A robust economic recovery could add positive sentiment toward the peso and push the currency back toward levels seen last month.



Source: Bloomberg LP and Wells Fargo Securities

Taiwan/TWD

Outlook: Amid a modest hawkish shift from the Fed, the Taiwan dollar has given back some gains; however, we remain optimistic on the prospects for the Taiwan dollar over the course of our forecast horizon. Taiwan maintains some of the strongest underlying economic fundamentals in emerging Asia as well as across the broader emerging markets spectrum. The country maintains a healthy current account surplus of 10% of GDP according to the IMF, while government debt levels are relatively low at 35% of GDP. Given these strong underlying fundamentals, the Taiwan dollar has become a "de facto" safe-haven within the emerging markets and within Asia. FX intervention by Taiwan's central bank has restrained the currency; however, fears of being labeled a currency manipulator by the U.S. Treasury has incentivized the central bank to let the currency float more freely. Given our view that recent U.S. dollar strength is temporary, a less active central bank should allow for the currency to gradually strengthen into the second half of 2022. Renewed strength in the Taiwan dollar will result in a currency moving to levels not seen since the late 1990's. A USD/TWD exchange rate around TWD27.00 would make the strongest the currency has been since the Asian Financial Crisis in 1997.

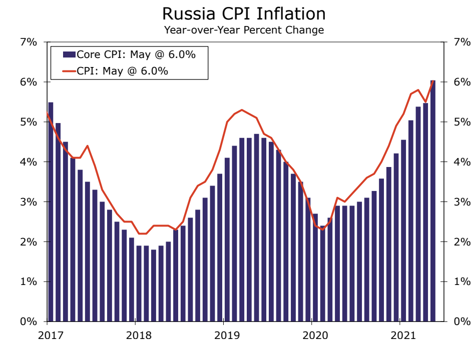


Source: Bloomberg LP and Wells Fargo Securities

Emerging Europe, Middle East & Africa

Russia/RUB

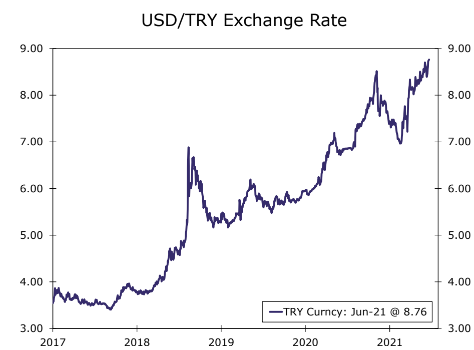
Outlook: The Russian ruble is one of the emerging market currencies we are most optimistic on given geopolitical tensions have eased, oil prices remain elevated, and the Central Bank of Russia maintains its hawkish stance on monetary policy. President Biden and President Putin recently met to discuss the future relationship between the two countries, and while nothing concrete was decided, takeaways from both sides seem to suggest the meeting was beneficial. With the first Biden-Putin meeting out of the way and no new tensions as a result, we doubt any new *meaningful* sanctions will be imposed on Russia in the near future. Reduced sanctions risk can lift some uncertainty off the ruble and is a key pillar of our bullish view on the ruble. As the global economy opens up and restrictions get lifted, oil prices should also remain elevated. Higher oil prices should support the Russian economy as well as the ruble. However, elevated oil prices has also pushed inflation in Russia to the highest levels in years. In an effort to control inflation, the Central Bank of Russia has tightened monetary policy a cumulative 125 basis points year-to-date. Forward guidance suggests additional rate hikes are likely, which should add to the carry appeal of the ruble and defend the currency against any hawkish activity from the Fed. In our view, political stability, higher oil prices and a hawkish Russian central bank should make the ruble one of the top performing emerging market currencies.



Source: Bloomberg LP and Wells Fargo Securities

Turkey/TRY

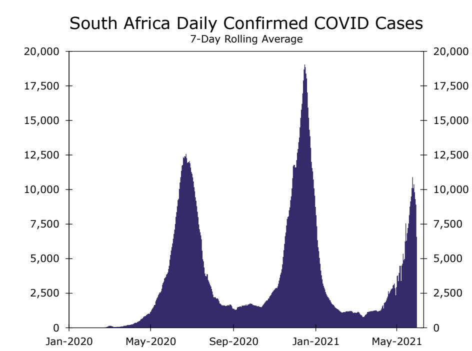
Outlook: As of now, we see little reason to be optimistic on the future prospects for the Turkish lira. President Erdogan continues to influence central bank monetary policy and suggest interest rates should be lowered. In addition, Erdogan continues to purge central bank officials that seem at odds with his view on easier monetary policy. While policy rates have held steady for a few months in a row, we expect previously higher interest rates to be unwound in the near future, which should result in a further depreciation of the lira. Elevated policy uncertainty should also keep sentiment toward the lira negative for the time being, while still weak economic fundamentals should keep the currency under pressure. As far as weak fundamentals, CPI inflation in Turkey remains well above the central bank's 5% target. In May, inflation slowed to 16.6% year-over-year, although a weaker lira and easier monetary policy should push price growth higher over the coming months. We also believe geopolitical tensions between the United States and Turkey can contribute to a weaker currency. President Biden and President Erdogan recently met in an effort to ease tensions; however, little progress was made and the lira sold-off in the immediate aftermath. Assuming tensions remain elevated, geopolitical developments, combined with policy uncertainty and fragile fundamentals should result in the lira hitting all-time lows.



Source: Bloomberg LP and Wells Fargo Securities

South Africa/ZAR

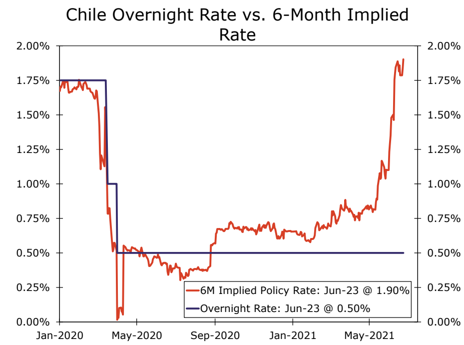
Outlook: The rand is a top performing emerging market currency this year; however, we maintain our bearish long-term view on the currency. This year, a broad rally in emerging market currencies has supported the rand, while progress on South Africa's reform agenda has boosted sentiment toward the currency. As far as reforms, President Ramaphosa sold a majority stake in long-time contingent liability South African Airways. In addition, Ramaphosa cut regulations in the energy sector making the process easier for private companies to produce power. And finally, the debt burden associated with Eskom has been reduced. However, a modest hawkish tilt from the Fed resulted in a sharp sell-off of the rand and the currency backing up beyond the key ZAR14.00 level. While we expect rand weakness as a result of a hawkish Fed to be temporary, longer-term we remain unconvinced progress on debt sustainability can be achieved. We expect debt issues to mount, especially as South Africa is currently experiencing a third wave of COVID infections that has resulted in new restrictions. As the government's public finances erode and the economy struggles to recover, we expect the currency to come under pressure. We would not be surprised if the central bank and other authorities accommodate a weaker currency as a way to limit the impact on the economy. In the short-term, the South African Reserve Bank (SARB) may look to raise policy rates as inflation trends higher, although in our view, rate hikes will do little to halt a longer-term softening of the currency.



Source: Bloomberg LP and Wells Fargo Securities

Latin America

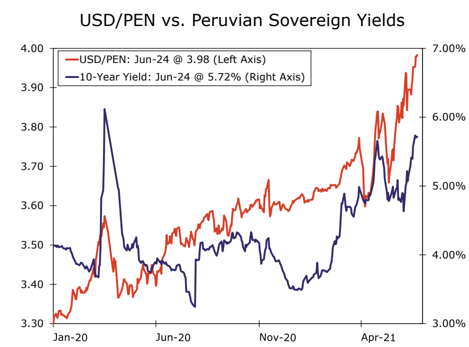
Chile/CLP



Source: Bloomberg LP and Wells Fargo Securities

Outlook: We continue to believe the outlook for the Chilean peso is challenging as political risk tied to the nation's constitutional rewrite and this year's Presidential election is likely to weigh on the currency. Since the redrafting of the constitution in Chile was announced, we have highlighted how political risk in the country is now a concern. As the early steps of the process unfolded, we were surprised at the lack of contention around each referendum vote and the lack of volatility in Chile's local financial markets. However, in May the discord and volatility we anticipated came to fruition. Last month, Chileans held another vote, this time to determine the 155 people, known as the Constitutional Convention, that will be the actual writers of the new constitution. As far as the final composition of the Constitutional Convention, left-leaning coalitions won a strong majority, marking a dramatic shift in Chilean politics. Going forward, anti-establishment groups in Chile have enough power to propose and implement broad economic reforms. We expect the constitutional rewrite process to become contentious and result in a weaker peso, while polls for the Presidential election show Daniel Jadue, a member of the Communist Party of Chile, is gaining significant momentum and could also contribute to a weaker peso. Chile's central bank has started to signal policy rates could rise in the near future and markets are now pricing about 140 basis points of hikes over the next six months. Rate hikes could provide temporary short-term relief to the peso; however, we believe political risks will be more influential for the path of the currency. In our view, the combination of rewriting the constitution along with broad momentum behind Jadue could result in the USD/CLP exchange rate moving toward and above the CLP800 level over the course of our forecast horizon.

Peru/PEN



Source: Bloomberg LP and Wells Fargo Securities

Outlook: Our outlook for the Peruvian sol is unchanged, and we continue to believe the currency will weaken over the short- to medium-term, and experience only a modest recovery over the long-term. The recent Presidential election may have sparked a change on Peru's political front as it appears Peruvians have elected the self-proclaimed Marxist Pedro Castillo as the next President. While the outcome of the election is still not formally declared, Castillo's platform of totally revamping the Peruvian economy based on former policy proposals of Hugo Chavez and Fidel Castro has unsettled financial markets. The Peruvian Congress appears to be highly fragmented and the likelihood of Castillo's full platform being implemented is limited; however, we believe the sticker shock of a Marxist candidate winning the election is likely to hover over the currency for a few more quarters. Going forward, we would not be surprised if foreign direct investment into Peru dried up for the time being and capital flows toward Peruvian equity and debt slowed as political uncertainty clouds the outlook. In that sense, the currency could gradually depreciate and continue to reach new lows against the U.S. dollar. Over the longer-term, political risk could subside as Castillo's platform does not get fully implemented, and some socialist proposals Castillo campaigned on no longer concern markets. In addition, a weaker U.S. dollar could also provide support to the Peruvian currency and contribute to a modest recovery in the second half of 2022.

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

The 2021 Annual Economic Outlook: Aftershocks and Divergence in the Post-Pandemic Economy is available at wellsfargo.com/economicoutlook

Via The Bloomberg Professional Services at WFRE

And for those with permission at research.wellsfargosecurities.com

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	(704) 410-6542	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	(704) 410-1681	shannon.seery@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Nicole Cervi	Economic Analyst	(704) 410-3059	nicole.cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	(704) 410-1437	sara.cotsakis@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

Required Disclosures