NUS INVESTMENT SOCIETY

Global Macro Department – United States (UNDERWEIGHT)

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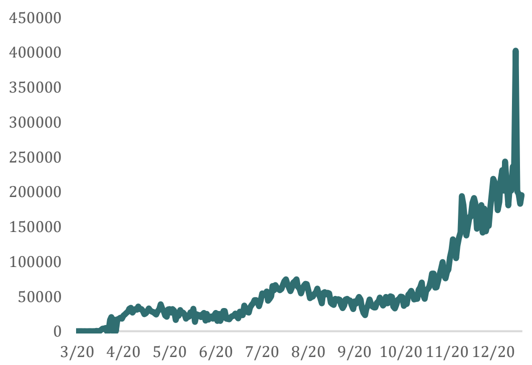
Basic Information

Real GDP(US$)	20.54 trillion
M2(US$)	18,658 billion
CPI	260.21
PPI	118.9
Con. Confidence	81.8
Building Permits	1.54 million
Stock Index	S&P500
Currency	USD

Chart info

Figure 1: U.S. Covid-19 Cases (New), as of 24th Dec 2020



Source: World Health Organization (WHO)

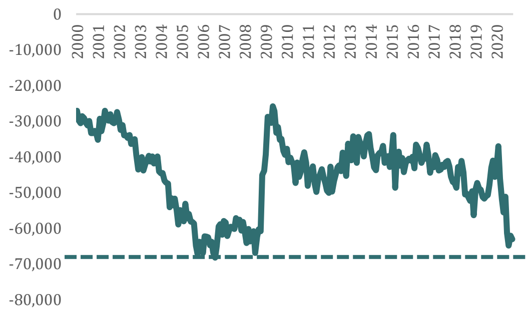
Overview of the U.S. economy

- World's largest economy by nominal GDP, second largest by purchasing power parity (PPP).
- World's largest importer (USD 2.56 trillion), second largest exporter (2.50 trillion).
- GDP per sector: 0.9% Agriculture, 18.9% Industry, 80.2% Services.
- Main economic drivers lie in its domestic demand (70% of its GDP, 1st in Household Final Consumption Expenditure in the world).
- USD is the currency most used in international transactions and is the world's foremost reserve currency.
- One of the most technologically powerful economy in the world, with its firms at or near the forefront in technological advances, especially in computers, pharmaceuticals, and medical, aerospace, and military equipment.
- Main trading partners: China (6.6% exports, 19% imports), Canada (18% exports, 13% imports), Mexico (16% exports, 14% imports).

Summary/Recap of events in the past 6 months

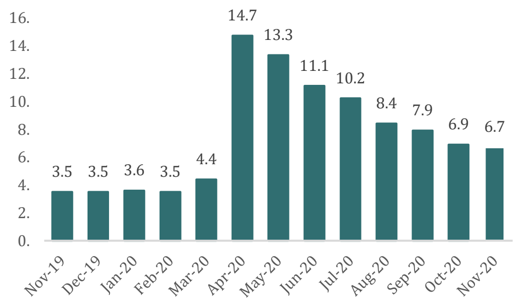
- COVID-19: 329,000 deaths, (1st in world), 18.7 million cases (1st in world) as of 27th Dec 2020
- Trade deficit has largely improved from 2019 to 2020, mainly because of Trump's aggressive agenda and destroying of many trade ties. However, due to the pandemic, balance of trade fell considerably to USD 67 billion in Aug 2020 (lowest in 14 years), largely due to durable goods sector outperforming services sector.
- Since the pandemic broke out at the start of 2021, Trump has continually blamed China for the spread of the virus, which has continued to fuel his "anti-China" stance.
- Feds cut interest rates 2 times: 1.5%-1.75% to 1%-1.25% (3rd Mar 2020 FOMC meeting), and 1%-1.25% to 0-0.25% (15th Mar 2020 emergency meeting).
- Feds launched massive USD 700 billion quantitative easing (QE) program of asset purchases entailing Treasuries and mortgage-backed securities.
- Feds launched the Commercial Paper Funding Facility (CPFF) to support the flow of credit to households and businesses.
- On 14th July 2020, Trump signed the Hong Kong Autonomy Act, which mandates sanctions against foreigners who are deemed to have helped erode rights and freedoms in Hong Kong (HK). This was in retaliation when China passed the National Security Law (NSL) for HK, which many believe to greatly undermine HK's high degree of autonomy. Trump also signed an executive order to revoke HK's special status with U.S.

Figure 2: U.S. Trade Balance in 2020 Near Multi-Year Lows (2000 – 2020)



Source: U.S. Bureau Of Economic Analysis

Figure 3: U.S. Unemployment Rate



Source: U.S. Bureau Of Labour Statistics

- On 22nd July 2020, U.S. orders closure for Chinese consulate in Houston due to national security concerns, with China retaliating back by closing American consulate in Chengdu.

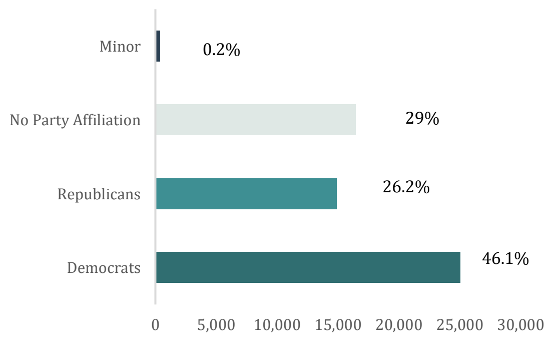
- On 6th Aug 2020, Trump gave executive orders for the ban of Chinese tech companies TikTok and WeChat, restricting the processing of transactions by U.S. citizens and from being downloaded in U.S. app stores

- On 20th Sep 2020, Trump gave preliminary approval to a deal that would sell TikTok's U.S. operations to U.S. companies Walmart and Oracle, with a 14th Nov 2020 deadline for ByteDance to finalize the deal.

- Outcome of the U.S. elections 2020: Biden takes over Trump as president, Republicans holds the majority in the Senate, and Democrats holds the majority in the House of Representatives. Trump has been making unsubstantiated claims about the invalidity of mail-in votes and the electoral fraud it brings, though his long shot efforts to upend the election results have been repeatedly shut down.

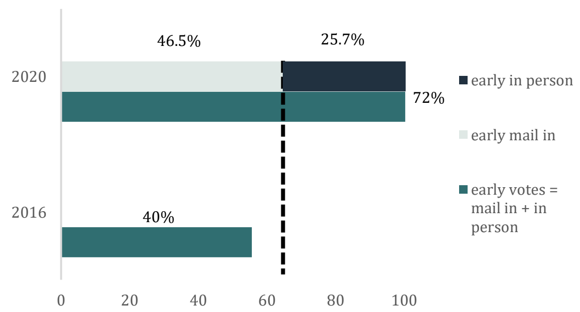
- The impasse for a second fiscal stimulus since Jul 2020 came to an end on 20 Dec 2020 where a USD 900 billion package was agreed upon between the Republican Senate and Democratic House of Representatives.

Figure 4: Mail Ballots Requested By Party Registration Per '000 (As Of 3rd Nov 2020)



Source: U.S. Elections Project

Figure 5: Early Voting Breakdown With Comparison to 2016 Total Votes (As Of 3rd Nov 2020)



Source: U.S. Elections Project

Elections (12th January 2021 Update)

When will the race be truly over?

There are many different complications that added to this November's elections results, on top of the increasingly polarizing sides that Americans have turned to become, especially after COVID-19 hit the U.S hard. With Trump and Biden, two seasoned politicians (assuming that a term in office grants the former that) contesting for the presidency, we would be reviewing what were some of the key highlights during this process that could have caused it to get prolonged and how the election results have affected the markets.

<u>Mail-In Ballots: A Potential Complication if it was a Tight Race</u>

Even though it was a clear Biden win over Trump with 306 to 232 votes respectively (270 votes to win), it would have been a whole different story if it was a tight race. With a historic turn out for early voting, especially as early mail-in ballots have increased in volume because of the pandemic, a tight race could have potentially opened up complications like recounting of votes in required states as well as a slew of court cases. As seen in Fig. 5, early mail-in ballots this year consists of 46.5% of 2016 total votes, beating even *total* early votes (both mail-in and in person) in 2016 which was 40% of its total votes. Mail-in votes typically take longer to count as they have to go through more steps to be verified, such as a signature and address check. Different states also have different regulations on when the mail-in ballots will be processed. Some states, like Pennsylvania and Georgia (swing states), won't be processing mail and absentee ballots respectively until election day itself. On top of that, about half of the states will accept postal ballots that arrive after election day (as long as they are postmarked by 3 November), so some votes won't be counted until days or weeks after the election. There is also an expected rise in provisional ballots - votes cast by people who requested a postal ballot but decided to vote in person instead. These won't be included in the initial count, as they require checks to ensure people don't vote twice. Fig. 4 shows that 46.1% of Democrats had requested for mail in votes, almost twice as much as the 26.2% of Republicans requesting.

This would mean that there would be potentially less credibility in the votes, especially as claimed by Trump, who was losing in key battlegrounds in November. As such, there could have been a recounting of votes in states where the margins were too close to be called, as well as legal challenges filed by the losing party – extending the period of uncertainty given by the elections.

<u>Watching The Senate Compositions Was More Important Than Ever</u>

Who the President is would determine many important policies that they would like to roll out. Between Trump and Biden, the biggest difference that they have would be in terms of taxes, both personal and corporates, trades and the environment. Fig. 6 shows the key policies differences between Trump and Biden. However, more importantly, the outcome on the Senate and the House would be necessary to see if there is any bill to be passed correspondingly.

At the time of writing, the Senate result was just passed – with the Democrats winning and taking control of the Senate. This would mean that the 2020 election sees a Blue Sweep – the first time in a decade. Looking historically at the Obama administration with a Republican Senate, it seemed likely that despite the general public's approval of the President's new policies, the Senate's control was the bigger hurdle. In Biden's term to come, we are expecting a smoother passing of bills, including but not limited to more stimulus checks, taxes for the wealthy, green taxes, etc, with our eyes on the more conservative Democrats like Arizona's Kyrsten Sinema and West Virginia's Joe

Figure 6: Key Policies Differences Between Trump and Biden

Key Differences	Trump	Biden
Tax Rates (Impact: Investors' appetite, consumer spending)	• Remain at 2017 levels Corp: 35% to 21%	• Raise taxes for corp and household making $400k to 28%
Trade (main focus on trade with China)	• Continued and increased tension with China over failed Phase 1 Trade War Deal • Careful allies-picking; remaining tension with Middle East • Economic pressures on NATO allies	• Multilateral approach • Continues with Trump's tariff, with more diplomatic talks • Review troops withdrawal in NATO
Green Bills	• No explicit emphasis on green deals or projects, likely to turn to oil as main power source	• Get U.S back on Paris Agreement • Green-focused policies and taxes

Manchin as possible challenges. Their tendency to remain at as center-right politicians would be the biggest opposition to Biden's plans.

As such, we believe the bottom line is that whoever took over with the Presidency, contested elections or not, all eyes would still be on the Senate. We are of the view that despite the latest election being a Blue Sweep, with the razor thin margin of more Democratic Senators to Republican ones, our optimism for more predictable bills passed and generous stimulus checks is dampened. Hence, there is a fundamentally bearish view on the Dollar with vaccine for the pandemic and (bigger) financial support from the government in the medium term (6m), with unsupportive Senate as a risk still.

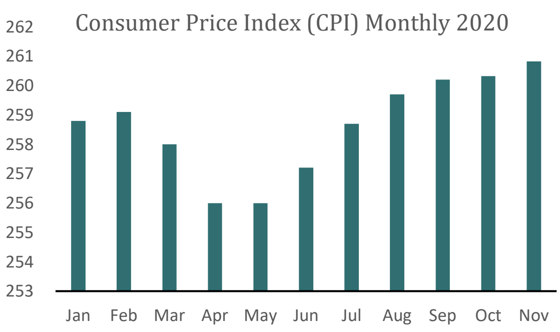
Lame Duck Session: Not So Lame?

Following the elections, there will be a "lame duck" session, which is the period of transition between election day and when the new party is officially in control. For the presidential candidates, it would be until 20th Jan 2021 which is the day of presidential inauguration. During this period, the outgoing president and the president-elect will embark on a transition of power, which Trump initially refused a peaceful transition of power. It is traditionally also not recommended to pass any major legislations during this "lame duck" session, as doing so undermines representative government by weakening the accountability link between the American people and their elected representatives.

However, the economic situation in U.S. (or the world) has been far from the norm, with thousands of small business and consumers still relying on the aid from the government. This prompted Congress and the White House to align their differences to hash out a much needed second fiscal package even during the lame duck session. On 20th Dec 2020, the Senate and House finally managed to come to an agreement on a USD 900 billion fiscal package to jumpstart the U.S. economy, with support from both Trump and Biden. More on the stimulus package given different combinations of Presidency and Senate composition would be discussed below.

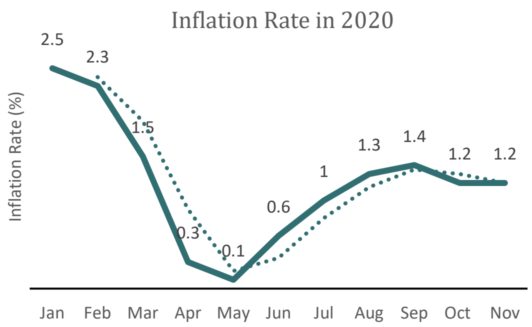
All in all, it is important to note that regardless of who won the election, fundamentals still point towards a bearish dollar and it is not unlikely to reverse in the medium term. This is due to the Fed's loose monetary policies (to be discussed below) such as unlimited Quantitative Easing (QE) and very low interest rates for a long time, that indicate the dollar indeed has lost steam ever since the COVID-19 pandemic liquidity crisis in March. It is important to note also that the global pandemic has brought not only the U.S' balance sheet to be in deficit in great amounts, but similarly so in other countries. As such, the U.S would need capital inflows from foreign savers, but due to their deficits themselves, there needs to be a discount on U.S. assets in the form of higher yields or lower USD, or both, such that U.S investments would still be favourable and attractive. Besides, historically post-election months tend to show a dollar rally, but this is short-lived (we expect to see a slight rally in the weeks in January leading up to Biden getting sworn in) and would not hold because of the deficits from the two aspects: fiscal and current account. Hence, the elections would only set up the pace as to how economic recovery would pan out in the U.S, but we believe that over the medium term, there would be small chances of reversing the greenback's weakness. Several possible headwinds for the greenback's weakness would be bettering corporate earnings, smooth presidential transition and gradual COVID-19 vaccine rollout and consequent risk-off market sentiment in the U.S and around the world as the new strain of COVID-19 multiplies and cause further possible lockdowns (as seen in the UK).

Figure 7: U.S Consumer Price Index 2020



Source: U.S Bureau of Statistics

Figure 8: U.S Inflation Rate 2020



Source: Trading Economics

Monetary Policy

Has the Fed run out of ammunition?

Average Inflation Rate Targeting (AIT) Until Inflation Picks Up

The COVID-19 pandemic has flattened demand for a longer period than expected, as reflected by the inflation rate which took a deep dive to 0.1% in May and has remained slightly above 1% from July-present period. As such, the Fed has decided to go forth with a new approach to monetary policy, in which it would let inflation and reemployment rates run higher for longer in order to first and foremost increase people's consumption and spending appetite. This policy was taken in order to boost riskier financial assets over the longer term so that the Fed would have a longer runway before it needed to start intervening in the economy.

However, this "new" policy is not to be confused to be the same as that of yield curve control, in which the central bank would have a target on a longer-term interest rate and would then purchase and sell bonds as necessary in order to hit the target. Instead, AIT aims to give flexibility to let inflation rate run above the 2% target rate, even if that means that there will be higher unemployment rate in the short term. Moreover, with AIT, if inflation still undershoots, the Fed will directly enact monetary policy to push the inflation rate above the 2% for some time to compensate for it, hence the name average inflation targeting (over a longer time period). With flexible AIT, the markets' expectations of inflation rate will smooth out eventually to 2% on average, thus hitting the Fed's target. However, the lack of details in what exactly are the kinds of tools that the Fed may enact to push the inflation rate higher is still murky, leaving room for uncertainty.

Besides that, although AIT may seem like a supportive and accommodative policy that the Fed can use, it also means that the Fed needs the support of consumption spending to balance its zero-lower-bound (ZLB) 0.0-0.25% interest rate which is here to stay until late 2022 to 2023, as confirmed by the last Fed meeting in September before the elections. This is such that the markets would be able to better price the extent as to how much direct monetary policy can be enacted to support the inflation rate in itself. As such, the only thing certain is the Fed's dovish stance for monetary policy for the coming couple of years given the current weak demand economy that the U.S is facing, especially when compared to its main Asian partners, with China heading the pack with IMF projection of 1.9% GDP growth in 2020.

Upon the decision to go with AIT, the markets have already priced in this decision, with some of the opinion that the Fed could have done more in terms of forward guidance. Future plans by the new administration in terms of fiscal policy is extremely important especially since the velocity of dollar has sharply dipped from 1.381 in Q1 to 1.104 in Q2 before sluggishly picking up to 1.146 (ratios) in Q3. This dip is drastic, and when coupled with a close to 20% growth in money supply ($18.3 trillion in July as compared to $15.3 trillion in December 2019) due to quantitative easing (QE), it reflects how alarming the problem of lack of consumer spending and consumer and business lending is in the U.S despite the loose monetary policy since March onwards. If this is to remain, the ballooning of the Fed's balance sheet may remain so for longer.

However, we believe that although the demand-side of things may be more out of the control of the central bank, Biden's nomination of Janet Yellen as the Treasury Secretary is a reassuring move for Powell's ultra-loose monetary policies, and would be a major headwind for the Fed's dovish stance and for flexible AIT continuing for longer consequently. With her track record in keeping monetary policy loose for longer and the surprisingly quick vaccine rollout by Moderna and

Pfizer, there could be hope that inflation would actually pick up in 2021. Hence, with loose monetary policy favoring inflation to pick up, we are expecting the dollar to continue its rally down although at a slower pace in the medium term. The only downside risk would be the fear that since Yellen would sit in the Treasury side of the administration, she may be forced to take a stronger dollar stance due to the U.S' current account deficit from this year alone. Even so, we still believe that in the medium term, Yellen's influence, if true, would not shift the Fed's dovishness and would hence contain the dollar's slowing depreciation in favor of its exports and inflation.

<u>Asset purchases on hold for the rest of 2020</u>

Currently, the Fed has been purchasing bonds at an average of $120 billion-a-month, with the last Fed meeting signalling the possibility of adjusting the purchase down, diminishing the possibility of more asset purchases for the rest of the year. However, this did not mean that there was no support for increased asset purchases, as central bankers are still looking at the 11 millions of jobs lost as compared to pre-pandemic level as the main concern of sluggish demand being here to stay in the U.S. This view was resonated most strongly by Charles Evans, a Chicago Fed President who is one of the most dovish Central Bankers, who sounded that "we have the capacity to do more asset purchases" in order to stimulate demand. However, although there was a divergence among the central bankers on whether to buy more bonds to support the economy or at least until inflation rate picks up to its target rate at 2%, the general consensus is for monetary policy to remain at its current level and for fiscal policies to support consumption instead. This is cemented by the Fed's beefed-up promise to keep rates at ZLB for years, with a (dim) possibility of expanding its $7 trillion balance sheet at a faster pace.

As such, we are of the view that there will be a steepening pressure in the US yield curve. This is mainly due to the longer term bond (e.g. 10Y UST) increasing its yield to possibly ~1% by the end of 2020 (UST10Y was at 0.8% in October but has increased significantly to 0/94% at the time of writing in late December 2020) and possibly continuing its momentum to go higher than 1% by Q12021, given higher inflation breakevens – the difference between nominal yield and real yield – as the economy recovers further, hinging on the hope that more fiscal stimulus that consumers, businesses and the markets have been eagerly waiting for after the smaller-than-expected $900+bn bill that barely passed by the time of writing. Moreover, investors will demand higher premiums given higher inflation expectations, hence the increase in yield. As such, we are of the view that the inflation breakeven will widen in the coming months, especially with a best case scenario of even more stimulus as Biden became the acting president.

Moreover, looking at how the Fed has been maintaining its positioning on bonds buying – which is on hold – until at least Spring 2021, we are of the view that there will be reduced Fed support and growth in UST issuance in the coming months. However, if the inflation runs too high, the Fed would ensure that the back end of the longer tenor bonds would not increase too high, and would adjust the rate down accordingly using other QE tools. This would thus lead to a "cap" (since the Fed probably has a limited threshold to higher inflation, although unspecified) in the nominal yield increase. This would be covered in more details in the Trade Idea below.

Figure 9: Expiry Dates Of Key Programs In CARES Act

Program	Expire(d)
Eviction relief	25th July 2020
Enhanced Unemployment Benefits / Federal Pandemic Unemployment Compensation (FPUC)	31st July 2020
Paycheck Protection Program (PPP)	8th Aug 2020
Mortgage Forbearance	31st Aug 2020
Student Loan Payment Suspension	30th Sep 2020
401(k) Hardship Loans and Withdrawals	31st Dec 2020

Source: CNBC, Forbes

Figure 10: Outlook of Fiscal Stimulus With Regards To Election Outcomes

President/ Congress	*Republicans*	*Democrats*
Trump	(Base) Smaller stimulus, but Rep Congress supports Trump Expect: USD 1 trillion	(Bull) Both expressed keenness for “bigger” stimulus Expect: USD 2.5 trillion
Biden	(Bear) Misalignment of incentive structure, Rep Congress does not support Biden Expect: < USD 1 trillion	(Bull) Objectives aligned, clear path to bigger fiscal stimulus Expect: > USD 2.5 trillion

Source: NUSInvest Global Macro Dept

Fiscal Policy

Light At The End Of The Tunnel

Fiscal Stimulus More Important Than Ever

Ever since the Federal Pandemic Unemployment Compensation (FPUC) program of USD 600/week in extra unemployment benefits expired 31st July 2020 and Paycheck Protection Program (PPP) expired 8th Aug 2020, a second fiscal stimulus was vital to continue to sustain unemployed individuals as well as businesses to continue keeping workers on payrolls. Trump’s attitude towards the virus pre-election has not changed (even after testing positive), and it seems like the White House is still relying on hopes of a vaccine to end the pandemic. With daily virus cases not simmering down, and even hitting highs (402,270 new cases on 20 Dec 2020, highest single day number of cases recorded for any country), the state of the US economy continues to look grim. Along with the Feds being mostly out of ammunition after massive Quantitative Easing (QE) and introducing Average Inflation Targeting (AIT), the importance of a successfully signed second fiscal stimulus needed to prop up the economy in the meantime has been increasingly vital.

How Election Results Affects Fiscal Stimulus

For a quick outline: Republicans generally tend to be hawkish while Democrats dovish in terms of pushing for a fiscal stimulus. The fiscal stimulus bill has to be passed by the House of Representatives, then by the Senate, and finally signed into law by the President.

Ever since late July, talks for a second fiscal stimulus has been at an impasse between the Republican Senate, Democratic House of Representatives, U.S. Secretary of Treasury, and White House Chief of Staff. As it got closer to election day, negotiations also seemed more symbolic rather than purposeful, as if both sides were buying time and hoping for the best for votes to be in the favour of whoever they were supporting. The 6 key differences in what the Republicans and Democrats has been fighting over in the fiscal stimulus are as follows: (1) state and local funding, (2) liability protection for businesses and schools from Covid-19-related illness lawsuits, (3) funding for testing, tracing, treatment, (4) school and child care funding, (5) tax credits for working families, (6) unemployment insurance. Negotiations died down during the election period and started back up again shortly in mid-November 2020.

One thing to note was that we felt the Senate outcome was actually more important than the Presidential outcome in terms of both size and likelihood of a fiscal stimulus passing. This is because the policy differences between the Republicans and the Democrats in the Senate are far greater than those between the Presidential candidates. Trump, although Republican, has in fact been repeatedly pushing for “much higher numbers” on additional stimulus, promising “a tremendous stimulus package immediately after the election”.

Figure 10 shows a table of outcomes of the size of the second fiscal stimulus with regards to the different combinations of election results. The election results pointed to the bear case: a Biden win with a Republican Senate. This would mean a massive misalignment in the incentive structure between Biden and the Senate, leading a smaller fiscal stimulus passed. With reference to the USD 500 billion GOP “skinny bill”, we were of the view of a much smaller fiscal stimulus (< USD 1 trillion) passing.

Second Fiscal Stimulus: Christmas Miracle or Christmas Scrooge?

On 20th Dec 2020, a USD 900 billion fiscal stimulus agreement was reached, which would deliver a much needed jolt to the US recovery after months of uncertainty and debate over the second stimulus. Key

Figure 11: Comparison Of Key Programs in CARES Act and Second Fiscal Package

Package	CARES (signed into law on 27th March 2020)	Second Fiscal Package (passed by Congress on 20th Dec 2020)
Total Cost	USD 2.2 trillion	USD 900 billion
Stimulus Checks	USD 1,200 per person depending on salary per year	USD 600 per person depending on salary per year
Enhanced Unemployment Benefits / FPUC	USD 600 per week	USD 300 per week
Paycheck Protection Program (PPP)	USD 659 billion in forgivable loans for small businesses, who must use 75% on payroll to be eligible for forgiveness	USD 284 billion for forgivable PPP loans Expanded PPP eligibility Allocated USD 15 billion for the entertainment industry
Eviction Protections and Moratorium	Bans late fees and evictions on properties backed by federal mortgage programs	Extends previous moratorium till 31st Jan 2021 USD 25 billion in emergency assistance to renters
Covid-19 testing, tracing, treatment	Does not address	USD 20 billion for vaccine purchases USD 8 billion for vaccine distribution USD 20 billion for virus testing
School funding	USD 30.75 billion for Education Stabilization Fund	USD 82 billion

Source: CNET, The Washington Post, National Conference of State Legislatures

contents of the package can be found in Figure 11, which shows the comparisons of several key programs with the CARES act in March 2020. What was left out in the second fiscal stimulus would be (1) state and local funding and (2) liability protection for businesses and schools from Covid-19-related illness lawsuits, which were arguably the most fought-over issues between the Republicans and Democrats. At the time of writing, the Democrats and Trump have been pushing for larger stimulus checks of up to USD 2000 from the agreed USD 600, likely in a standalone bill, which will be voted on by the Democratic House on 28th Dec 2020, likely without support from the Republican Senate after. Note that the validity of the current bill passed by Congress would be terminated once the new Congress is sworn in on 3rd Jan 2020, so Trump would have to sign it before then for the second fiscal package to be official.

However, assuming the second fiscal stimulus is signed in to law, we are of the view that the second fiscal stimulus was too little too late. Yes, a second fiscal stimulus was passed, but how big and how in time was it? The answer: not so much. In fact, the second fiscal stimulus (USD 900 billion) was more than half as small as the CARES act in March 2020 and the Heroes 2.0 bill passed by the House in Oct 2020 (both USD 2.2 trillion). Granted, USD 900 billion is not a small amount: it is the second largest economic relief package after the CARES act, and exceeds the USD 787 billion fiscal stimulus by Obama in 2009 during the financial crisis. However, as previously mentioned, the unusual and bizarre economic situation the virus brings upon the world calls for more unconventional policies (in this case, the size of the fiscal package to be much bigger). Furthermore, it took Congress almost 6 months to hash out this second fiscal package. When negotiations started in July 2020, it could be said that they realised then that a second fiscal stimulus would be necessary to continue propping up the U.S. economy. However, an agreement was only reached in Dec 2020. The delay could also be attributed to the U.S. elections in November 2020 to an extent, which forced Congressional leaders to halt negotiations for a period of time, but it was mainly due to the policy differences and spending in the fiscal package between the Republicans and Democrats.

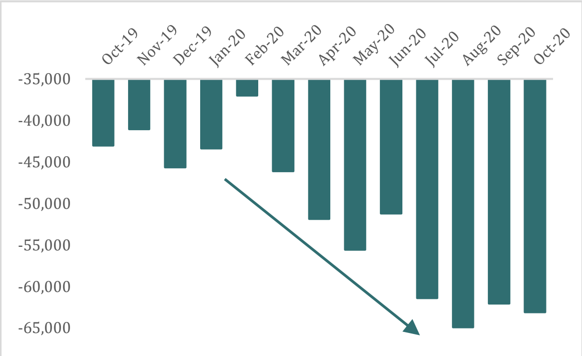
Therefore, we are of the view that a bigger fiscal stimulus was needed in order to properly save those heavily affected in the U.S., and with this smaller fiscal stimulus, it would lead to the further weakening of the Dollar, which will be explained below.

<u>Effect on the Dollar: Downside</u>

A Biden and Republican Senate outcome gave a much smaller fiscal stimulus due to policy gridlocks. This would lead to a further weakening of the USD. Consumer expenditure and imports would increase from having the fiscal package itself, as people spend more after receiving the stimulus checks. Exports would likely continue to decrease as we are of the view that the fiscal package was not big to successfully provide a sweeping aid for small businesses and SMEs. Comparatively, since March 2020 when the CARES act was signed, we can see from Figure 12 that the U.S. trade balance has been seeing a decline, which shows that imports have been rising more compared to exports (note that only a small extent of comparison can be drawn from this, as supply chains was mainly affected by the virus and not the fiscal package). With imports increasing and exports decreasing, there would be an increase in demand for foreign currencies comparatively to the Dollar, therefore weakening the Dollar.

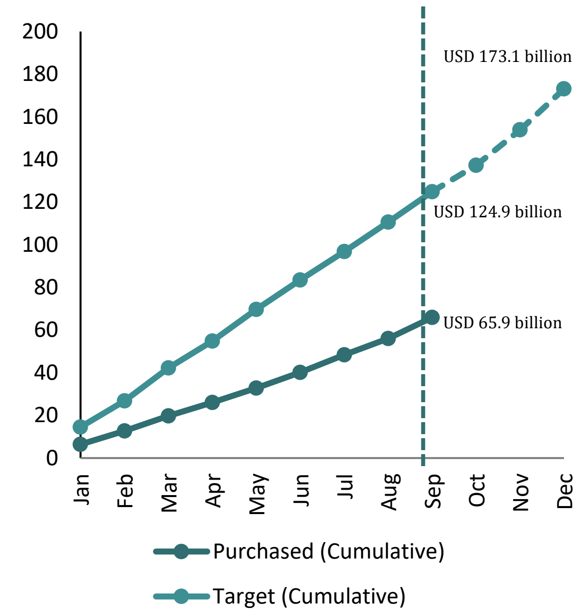
However, because of the smaller fiscal stimulus, Feds may be forced to step up. While the Feds are likely to hold off any immediate easing action for now, they probably would be willing to at least consider an increase in its bond purchase program if push comes to shove. This would lead to some USD weakness as QE increases money supply in the economy, which provides some resistance in the potential strength

Figure 12: U.S. Trade Balance Decreasing Since Jan 2020



Source: U.S. Bureau Of Economic Analysis

Figure 13: China's Imports Of All Covered Goods From U.S. In 2020 (As Of Sep 2020)



Source: Peterson Institute For International Economics (PIIE)

of the USD brought about by the emergency possible dollar strengthening policies taken by the Treasury to minimize the size of U.S' debt. However, upon looking at December's Fed meeting, Powell has again reiterated that there would be no change in the $120bn bonds-buying program and its composition despite investors' expectation of the Fed buying longer-tenor bonds to keep the yield from rising higher. This confirms the Fed's reliance on the smaller fiscal stimulus released to help economy recovery instead of going for monetary policy changes now, as usually it takes longer for the latter to bear results. Hence, the Fed is taking a cautious approach with its bonds-buying and we expect it to keep at its current pace in the medium term, making fiscal stimulus and consequent better economic data to rule the USD bearish run.

US-China relations

Biden Win: Can U.S. and China Ever Be Friends?

First, it was the trade war. Now, it seems like it's a tech war. After a slew of bans on Chinese tech companies like Huawei, WeChat, and TikTok, tensions took a breath as a month before Nov 2020, as Trump shifted his focus on punishing China to preparing for the elections. Unfair trade practices, national security, and human rights are some of the issues U.S. would want addressed. With Biden in and Trump out, what would this spell for the Chinese economy?

<u>Trump or Biden – China Still Wins</u>

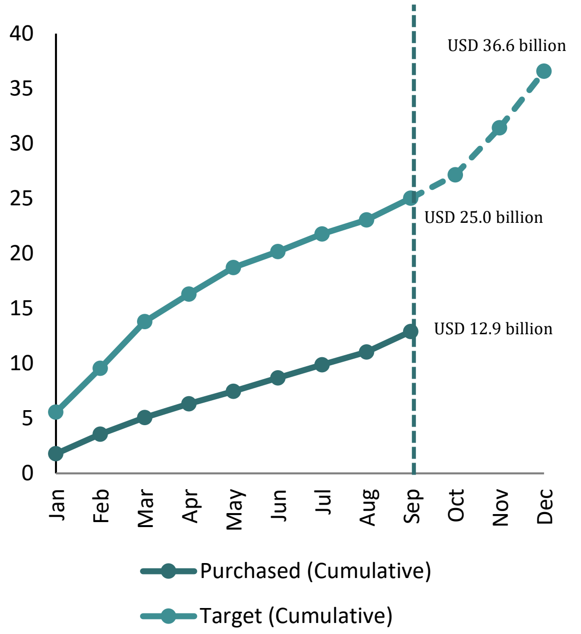
Given Trump's track record of polarizing the American population, abandoning international organizations, and disrupting trade relations with its European allies, China would have wanted a Trump win as they would continue to benefit from its greater division and discord internally as well as with its allies. Deteriorating trade relations with US, along with the global pandemic, could also be said to have "forced" China to improve: its recent dual circulation policy focuses on tapping on its domestic demand which has huge potential, relying less on unpredictable external demand. All in all, Trump as President has arguably been accelerating the fall of American hegemony, and China is close behind in the race between the two superpowers.

A Biden win, meanwhile, does not guarantee that the U.S. will quickly recover from all the severed ties with its allies. Until the presidential inauguration which is only on 20th Jan 2021, there would be a "lame duck" session following election day. Trump losing but failing to have a smooth transition of power would continue to be a win for China. The U.S. also has to continue fighting the virus back home (which China has shown to be quite successful on that front), and to settle the terms of the second fiscal stimulus. As U.S. is distracted by internal politics, China would continue to focus on its strong economic recovery through its 14th 5th year plan and dual circulation policy.

<u>Sour Relations Likely To Stay Sour</u>

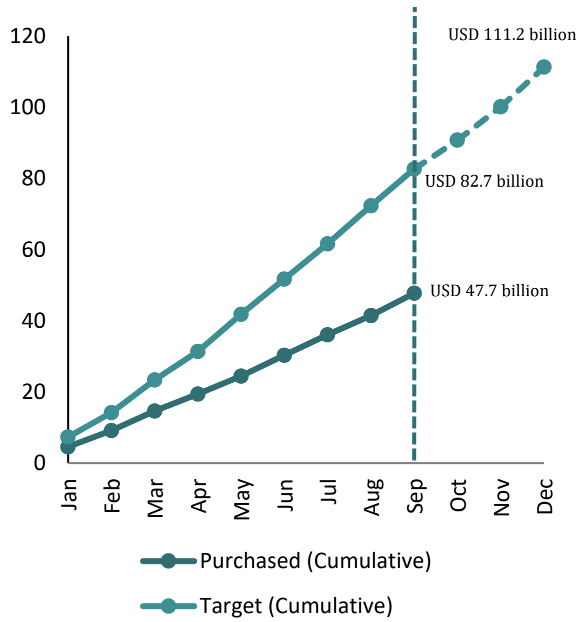
Although Biden would have a less confrontational approach in his relations with China compared to Trump, a tough stance on security and trade issues would likely still be maintained. We expect that even a Democratic administration would still accept the direction of a competitive China strategy that Trump has deeply ingrained. U.S. Secretary of State Mike Pompeo even declared on 23rd July 2020 that the "traditional approach to American engagement with China has failed". Another example would be the NSL in HK. Some HK democratic protestors have feared that a Biden win would spell further erosion in

Figure 14: China's Imports Of Agriculture From U.S. In 2020 (As Of Sep 2020)



Source: PIIE

Figure 15: China's Imports Of Manufactured Goods From U.S. In 2020 (As Of Sep 2020)



Source: PIIE

the democratic freedom in HK, because Biden is less aggressive and risks being manipulated. However, we feel that the threats to human rights and the agenda of "holding the Chinese Communist Party (CCP) accountable" has been a pressing enough issue, one enough for whoever in the White House to take action. Thus, tensions between U.S. and China will still continue, though the speed and approach will be less aggressive, as well as more predictable.

Trade War: Paused For Now, But Was It Worth It?

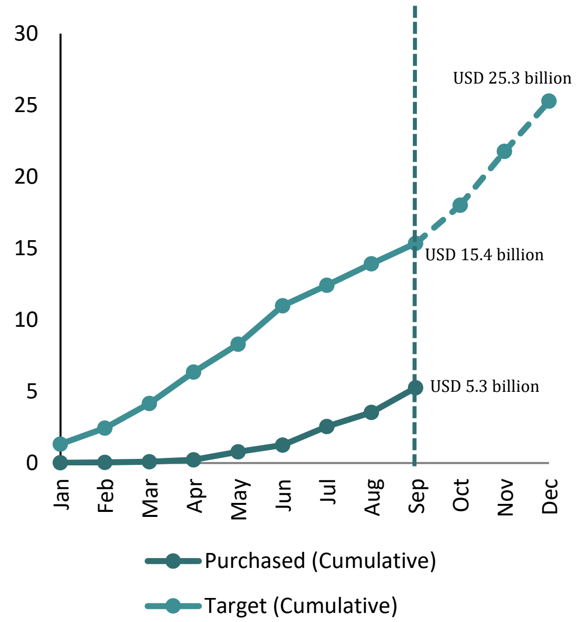
On 14th Feb 2020, the phase one trade deal went into effect, with China pledging to expand purchases of certain US goods and services by an additional USD 200 billion over 2020 and 2021, on top of the USD 186 billion in 2017. Main sectors includes agriculture, manufactured goods, and energy. Focusing on the current year, China has committed to purchase no less than an additional USD 63.9 billion of covered goods from the U.S. by the end of 2020 relative to these 2017 baselines. Figure 13 to 16 shows how far behind China is in keeping to its promise in 2020, with monthly purchase commitments seasonally adjusted based on 2017 data.

While part of this is attributable to trade flow disruptions caused by Covid-19, much of the gap owes to the impracticality of the agreement from the start. In our opinion, Beijing had essentially paid for the deal with a promise of a windfall in purchases of American goods, and it appears that President Trump accepted an IOU as a declaration of victory. Biden also views Trump's signing of the phase one agreements as a loss for the U.S. economy, that Trump got "little in return for the significant pain and uncertainty he has imposed on our economy, farmers, and workers", with China still being able to maintain its illegal and unfair trade practices. Moving forward, Biden will only be able to take any significant action after the presidential inauguration on 20 Jan 2021, after power has fully transitioned to him. Biden has said he would work with democratic allies to "set the rules of the road and push back on China's aggressive and predatory behaviour, instead of alienating and insulting our friends." He will also push back on China's human rights record while also cooperating with China on issues like climate change and nuclear non-proliferation.

Diving deeper, despite Trump's claim that "trade wars are good, and easy to win", the ultimate results of the phase one trade deal between China and the U.S. have significantly hurt the American economy without solving the underlying economic concerns that the trade war was meant to resolve: the trade deficit. Aug 2020 data shows that the trade gap has widened to USD 67.1 billion, the biggest trade deficit since Aug 2006. Looking further, Trump's prioritization on the trade deal and de-prioritization of all other dimensions of the relationship produced a more permissive environment for China to advance its interests abroad and oppress its own people at home. In Nov 2019, Trump repeatedly shied away from criticizing China about the HK protests in order to maintain good trade negotiations, further describing Xi as "a friend of mine" and an "incredible guy". There were some controversies about how Trump allowed Xi to go ahead with detaining the 1 million Uyghur Muslims in Xinjiang, in exchange for Xi to increase purchases on soybeans and wheat. All these has allowed for even more China aggression and suppression.

Ultimately, the phase one agreement disappointed because it, along with the trade war, severely damaged the U.S. economy while failing to make significant progress in fundamentally resolving the structural imbalances of the U.S.-China trade relationship. A Biden presidency could mean having a more significant and targeted result, especially if U.S. is successful in garnering support from its allies.

Figure 16: China's Imports Of Energy From U.S. In 2020 (As Of Sep 2020)



Source: PIIE

Tech War – Trump Gave Biden A Leg To Stand On

On 6th Aug 2020, Trump gave executive orders for the ban of Chinese tech companies TikTok and WeChat, restricting the processing of transactions by U.S. citizens and from being downloaded in U.S. app stores by 20th Sep 2020, due to national security concerns. On 14th Aug 2020, Trump gave another executive order that TikTok would face a complete ban if it was not sold to a U.S. company by 14th Nov 2020. Ultimately, a judge blocked the WeChat ban (on 19th Sep 2020) and the TikTok ban (on 27th Sep 2020) with preliminary injunctions, mainly due to lack of substantial evidence and "irreparable harm" on the Chinese companies.

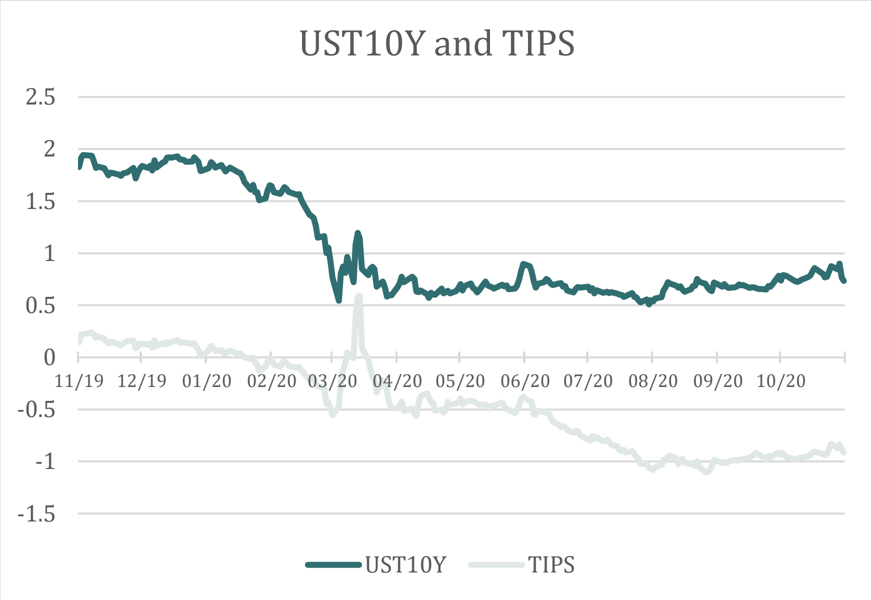
On 20th Sep 2020, Trump gave preliminary approval to a deal that would sell TikTok's U.S. operations to U.S. companies Walmart and Oracle, with a 14th Nov 2020 deadline for ByteDance to finalize the deal. Currently, ByteDance will spin off US operations into a new company called TikTok Global. Oracle will serve as a data host for the new operation and hold a 12.5% stake in it. Walmart will hold another 7.5%, but the remaining 80% will be held by ByteDance.

A shift from trade tariffs to economic sanctions was how Trump has lately been putting pressure on China, especially on big Chinese tech companies. We believe Trump's aggression on Chinese tech companies can potentially be beneficial for the U.S. In a sense, the myriad of bans on China's tech companies by Trump has given Biden some negotiating ground to stand on. A Biden administration would not be able to a 180 reversal on all the sanctions that Trump has done. However, Biden would be able to make *some* changes, and only if China does something in return, but we would still not expect any drastic de-escalation in the tech war. With a less confrontational approach, Biden just might be able to get China to cooperate.

Effect On The Dollar: Downside

A more multilateral approach from Biden mentioned above would push the Dollar lower. There would be a certain degree of cooperation with China, which would help inject predictability into the relationship as well. As trade relations improve to a certain extent, the big trade deficit US already has (USD 67.1 billion in Aug 2020, biggest trade deficit since Aug 2006) could potentially widen even further. A widening trade deficit traditionally hurts the country's currency as investors see imports increasing (demand for foreign currency increasing) and exports decreasing (demand for domestic currency decreasing).

Figure 17: UST10Y and TIPS chart



Source: Bloomberg

Figure 18: Inflation Breakeven (Spread between UST10Y – TIPS)

Source: Bloomberg

Table 19: 1Y (2020) Spread Summary

Category	Value (Basis Points)
Last Spread (21/12/2020)	195.0
Mean	147.7254
Median	161.5
Standard Deviation	29.915
High (18/12/2020)	195.00
Low (03/19/2020)	55.1269

Source: Bloomberg

Trade Idea: Long UST10Y-TIPS

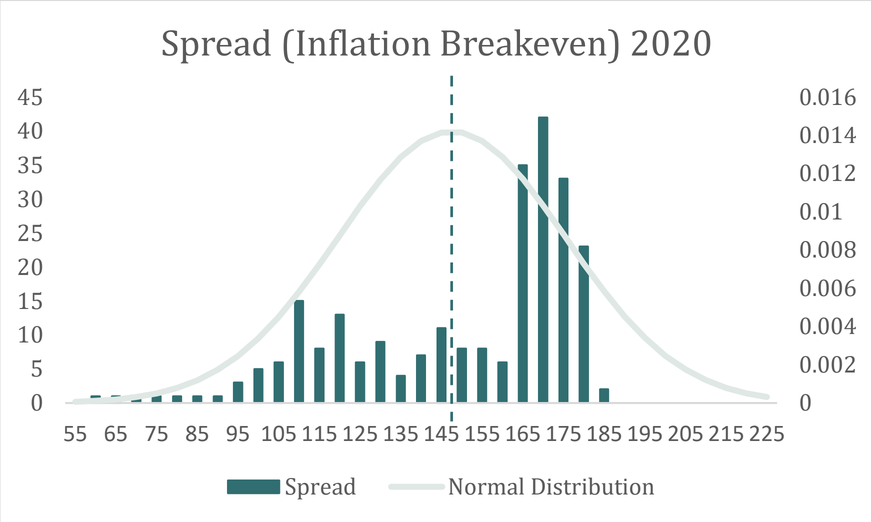
The TIPS Dip

This trade idea is a combination of both fundamental and technical views. Looking at the fundamentals, we are seeing how COVID-19 has affected consumer demand worldwide. This has resulted in the Fed scrambling to loosen their monetary policy such that there is room for consumer spending to pick up and for business lending to increase instead of a massive saving behavior that the U.S witnessed back in Q2. As such, all eyes are on the inflation expectation since flexible AIT has been one of the main drivers for the bonds' movement as a way to gauge what kind of QE measures the Fed would take consequently.

Currently, after the election risks are meted out, the vaccine being sent on its way and the Fed confirming that they would be keeping asset purchases at current levels, we are expecting the bear steepening of the yield curve, where the longer maturity bonds have a higher yield rate as compared to shorter maturity bonds, to remain until Q1 of 2021 due to gradual economic recovery in the U.S and the rest of the world. Moreover, we believe that the delivery of vaccine would be patchy throughout the globe, potentially due to supply chain bottleneck in the first half of 2021 at least. As such, inflation driven by this could be possible too. Besides that, macroeconomic landscape of loose monetary policy under the Yellen-Powell pair and (possibly more) smaller than expected fiscal stimulus would increase inflation expectations, although it would not reach the expected 2% in such a short period of time.

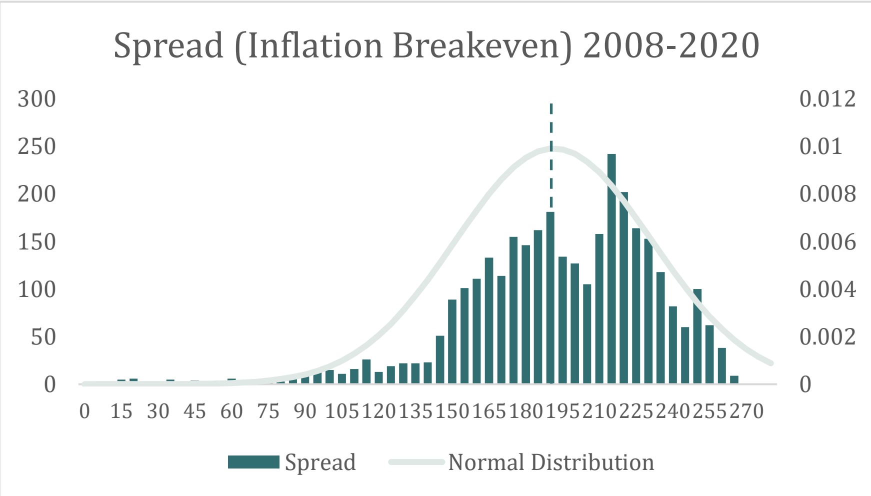
Pivoting our trade idea on higher inflation expectations, we chose to watch the Treasury Inflation-Protection Security (TIPS). TIPS are indexed to the Consumer Price All Urban Non-Seasonally Adjusted Index (CPI) with a three-month lag. Given that the price of TIPS are highly correlated to change in real yields, we want to capture the opportunity that a higher nominal yield (in this case UST10Y maturity bond) would have as inflation expectation increases, especially after the biggest uncertainty, the elections, has been lifted and the Fed letting inflation rate to run higher than 2% before adjusting it. However, bearing in mind the Fed's QE adjustments, we believe that the increasing inflation breakevens would be reflected in the TIPS dipping lower as instead of the UST10Y soaring, as we believe that Fed intervention would lower the steepening of the UST10Y.

Figure 20: Inflation Breakevens



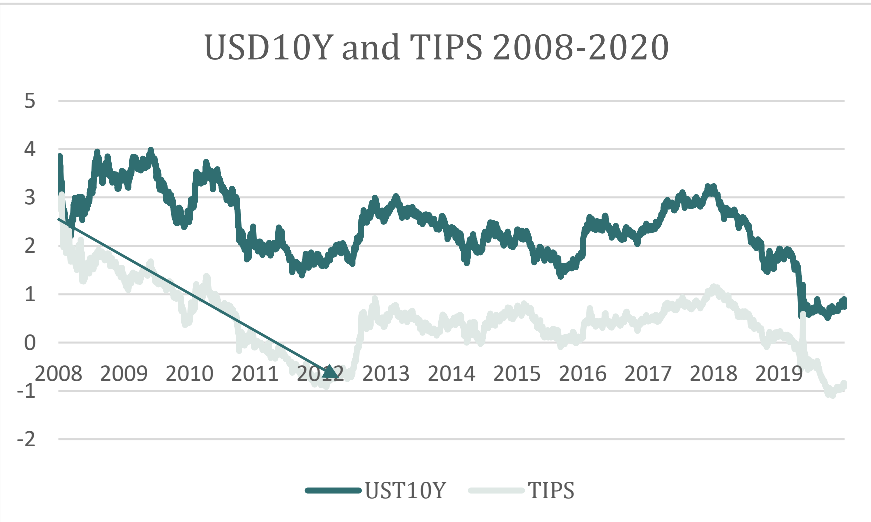
Source: Bloomberg

Figure 21: Inflation Breakevens 2008-2020



Source: Bloomberg

Figure 22: Historical UST10Y and TIPS 2008-2020



Source: Bloomberg

Moving on to the technical analysis, we are comparing the Spread (inflation breakeven) in 2020 as compared to that in 2008. From a technical perspective, the narrative of increasing inflation breakeven and the steepening of the long tenor yield curve remains.

After the dip in the inflation breakeven as the market tumbled in March, the spread between UST10Y and TIPS have climbed back up, with a yearly mean of 147.7254 basis points and have been trading sideways in the last 3 months. However, there is also a diverging trend between the UST10Y and TIPS more recently. Although longing on TIPS may seem like an oversold trade idea due to the fact that TIPS is already -0.913% rate, in December the spread shot up to the highest in the year at 195 basis points, showing relentless rally. Moreover, the fact that the Fed's AIT would support the steepening of the yield curve would be interesting to watch, challenging the perception that the TIPS may still have room to dip despite its record low levels.

The room for TIPS to dip is indeed a downside risk to this trade, especially if we look at the spread's distribution within 2020, as it is a rightly skewed already as of now. However, if we look at historical data in 2008 when the U.S economy tumbled due to the Lehman Brothers' fall and the Global Financial Crisis, it can be seen that the differentials in TIPS dipping and the divergence between the UST10Y and TIPS are far wider in the months and years to come, further supporting our trade idea that the spread will widen in the months to come, after the elections frenzy, at least. Moreover, looking at the spread distribution from the 2008-2020 time frame once more, we see that the mean is at around ~187 basis points, hence supporting a mean reversion trade as there is still room for the spread to widen to its historical mean.

Entry: UST10Y at 0.95%

Take Profit: UST10Y at 1.1%

Stop Loss: UST10Y at 0.85%

NUS INVESTMENT SOCIETY

Global Macro Department – Mexico (OVERWEIGHT)

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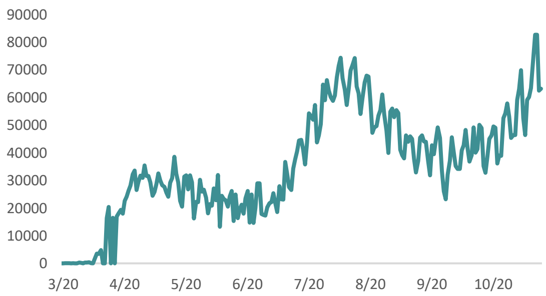
Basic Information

Real GDP(US$)	1072bn
M2(US$)	475.717bn
CPI	108.856
PPI	104.286
Con. Confidence	36.7
Stock Index	MEXBOL
Currency	MXN Peso

Chart info

Figure 1: US Covid-19 Cases (New), as of Oct 2020



Source: World Health Organization (WHO)

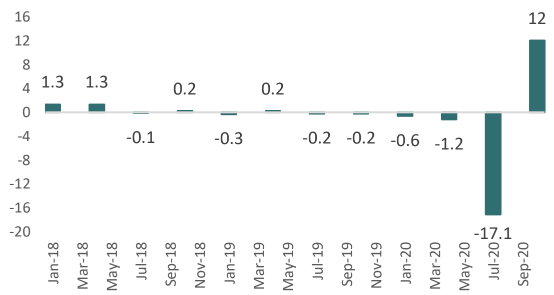
Overview of Mexico's economy

- Main economic drivers lie in its exports (12th largest exporter in the world), with its exports composition as follows: Autos/Vehicles (25%), Electrical Equipment (17%), Machinery (17%), Mineral fuels/Oil (5.6%). Its main trading partner is the U.S (83%).
- On its current account, Mexico's current account balance reliance on revenues from commodities for balance of payments and fiscal purposes is a source of volatility for the country
- Besides its focus on trade, services sector also contributes significantly to Mexico's GDP (63%) and employs 61% of its population, particularly in the tourism and hospitality sector.
- As an emerging country in Latin America, Mexico has a fairly large informal sector which supports the economy too

Major events that has impacted Mexican economy

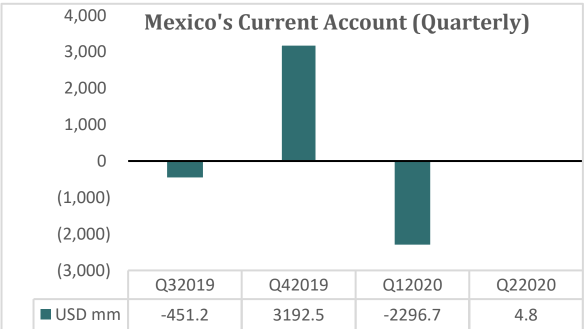
- COVID-19: 82k deaths, (4th in world), 900k cases (9th in world).
- President Andrés Manuel Lopéz Obrador (AMLO) hurried to re-open the economy from May 18 onwards by relaxing COVID-19 measures which has positive and negative impacts on economies.
- GDP contracted by 17.1% in Q2 due to major shutdowns in companies and businesses due to COVID-19 measures.
- Despite the high number of COVID-19 cases, Mexico's economy picked up sharply in the third quarter, with industrial production leading the rebound (increase by 22% since Q2). GDP expanded by 12% in seasonally adjusted terms from Q2.
- Increase in GDP is mostly due to recovery in industry fuelled by external demands (exports) in autos and construction, domestic demand remains weak
- Banco de México (Banxico) has cut rates 3 times since May 2020, from 5.5% to 4.25% in October 2020.
- Annual headline inflation rose from 3.62% to 4.10% between July to September 2020 due to increases both on non-core and core components. Headline inflation for the end of 2020 rose, but for longer term (12-24 months horizon) remains at a stable 3% target.
- Fitch has kept Mexico's rating at BBB- (the lowest level of the investment grade), up from junk level rating earlier in March.
- USDMXN volatility in the past 6 months, but in the past month of October, USDMXN outperformed EMFX, appreciating 5.4%

Figure 2: Mexico's Annual GDP Growth Rate



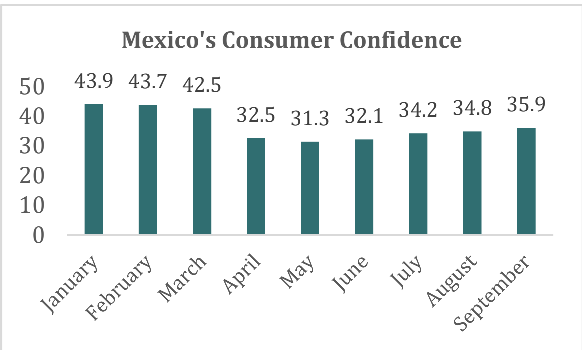
Source: Trading Economics

Figure 3: Mexico's Current Account Balance



Source: Trading Economics

Figure 4: Mexico's Consumer Confidence



Source: Trading Economics

Monetary Policy

Increasing Liquidity as a Coping Mechanism

In 2020 alone, Banxico has seen dramatic rate cuts. However since May, after the government enacted lockdown, the rate cuts have been subtler. From May, there have been 3 rate cuts of 25 to 50 basis points from 5.5% to 4.25%, putting Mexico as the top three country in Latam with the highest interest rate as of the time of writing. For Mexico, these rate cuts were not seen as dramatic, but given the rampaging COVID-19 cases still occusing (they have never truly overcome the first wave, the economy was forced to open due to executive orders), it is likely that Banxico would keep it at current rates in order to stimulate consumer demand while keeping a healthy differential with its main trading partner, the U.S, in order to stay afloat.

<u>Unsustainable Rebound for Mexican Economy</u>

Knee-jerk recovery is most likely what Mexico is experiencing, especially looking at its better than expected Q3 results, in which it rebounded significantly from a 18.7% contraction in GDP in Q2 by 12% in Q3. This rebound in GDP is mainly attributed to its increasing trade via exports, with industrial production increasing by 22% since Q2 due to reopening of manufacturing plants for autos and vehicles as the rest of the world opens up its economy from the improvement of COVID-19.

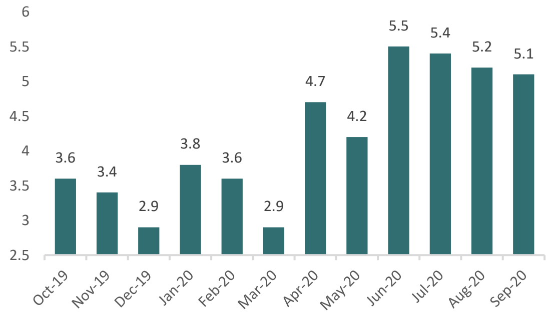
We are of the view that this rebound is unsustainable for the rest of 2020, with expectation of Q4 results to be lacklustre comparatively. This is as such due to the limited amount of fiscal policies that the government has given to boost its domestic consumption, with businesses scrambling to find their footings. Moreover, Mexico's left-wing populist President AMLO also did not plan on supporting the private sector by saying that his focus would be on "helping ordinary Mexicans". Despite that, the numbers for consumer confidence did not reflect his dedication to help ordinary Mexicans, as consumer confidence numbers have only grown humbly at 10.4% from April-September, as compared to the big drop by 23.5% from 42.5 (March) to 32.5 (April) when the virus hit Latin America the hardest. Indeed, boosting domestic consumption is likely to remain a problem for Mexico given the meagre fiscal support the government provides.

<u>Preparing for Turbulent Months Post-Elections</u>

Mexico recorded a stellar performance in the considerably volatile EMFX market, with USDMXN outperformed EMFX with a 5.4% appreciation. This is mostly attributable to the peso's high beta and the fact that its real rates remain relatively high, even with nominal rates which have continued to drop.

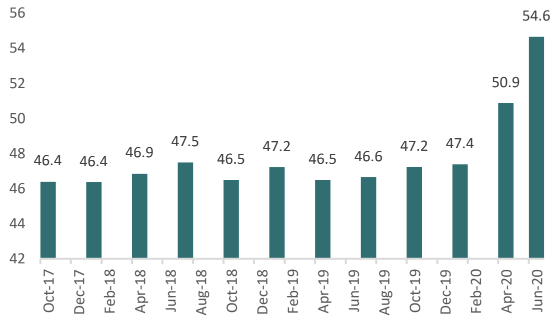
Moreover, Banxico has been shoring up on asset liquidity, in which it had close to 194 million pesos as of September 25, close to its record high of 196 million pesos in 2015. This would mean that there is a strengthening of assets in dollars, as seen in how Pemex have been selling dollars to Banxico, on top of gains in portfolio of dollar securities. There were also increased swap lines (size USD 7.5 billion) with the Fed done in September 15 and 21, with a 84 days maturity to again ensure liquidity for the short term. Hence, coming in the months to the elections where there are a lot of uncertainties (with mail-in ballots, popular votes favoring Biden who are pro-green energies, etc), we are of the view that Banxico is trying to shield itself from further external shocks by having liquid international dollar-denominated assets. This is particularly important for Mexico, since there has been a divergence in cash demand for pesos, which has been slowing down in Q3. We view this as a way for Banxico to possibly liquidate international assets as a cushioning for a weakened demand for peso domestically. This is exacerbated by the fact

Figure 5: Mexico's Unemployment Rate



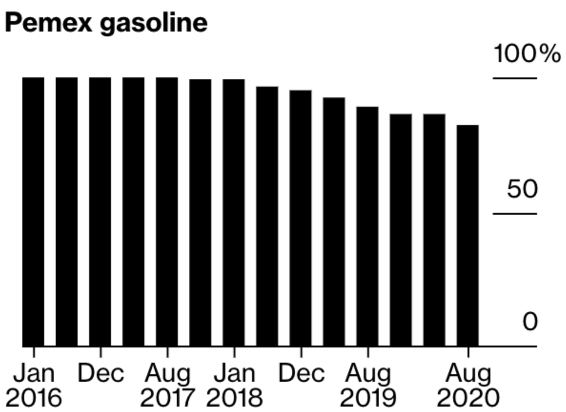
Source: Trading Economics

Figure 6: Mexico's Debt To GDP Ratio



Source: Trading Economics

Figure 7: Declining Pemex Gasoline Share



Source: Bloomberg

that there is also weakened FDI into Mexico, with it dipping by 5%, from USD 35bn last year to USD 33bn this year.

Indeed, Banxico has announced during its last meeting that it would extend its dovish stance on monetary policy until the end of February 2021, aiming to continue providing liquidity for the financial markets. Moreover, Banxico also detailed that the size of the repo facility with government securities has increased by 50,000 million pesos such that commercial banks are given more liquidity without needing to sell securities in order to facilitate consumer and business lending. This is also coupled by an expansion in the securities eligible for the so-called Ordinary Additional Liquidity Facility (FLAO), exchange and credit hedging operations in dollars. Bottom line is that Banxico would shore up liquidity and hope for the rallying of the peso to not go too high with not much clues on fiscal stimulus.

Government's Grand Plan

AMLO's Penny-Pinching Plan For The Economy

Impractical Plans

On 5th Apr 2020, AMLO announced that 2 million jobs would be created from his infrastructure plan in just 9 months, doubling down on his infrastructure plans instead of giving emergency packages to combat the virus.

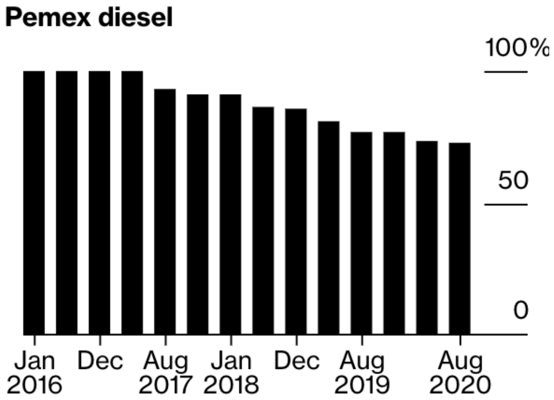
Up till September 2020, unemployment rate is still high at 5.1%, in fact even higher than the 4.7% in April 2020 when the plan was announced. This questions the validity and efficacies of AMLO's promises. Apart from the quixotic sheer size of new jobs promised, the quality of the jobs that would be created would not be able to compare with the jobs lost. Most of these would be temporary, with very low salaries and without benefits.

Rather than being helpful for the economy, the infrastructure plans potentially poses many risks. Instituto Mexicano para la Competitividad (IMCO), a public policy research center, suggested that the USD 8 billion refinery AMLO had pushed for had a less than 2% chance of being worth its cost. Many analysts also expect the USD 8 billion price tag to increase, after the initial concession yielded no private sector bids that fit the president's time and cost requirements. Government agencies and state oil firm Pemex were eventually tasked to oversee construction. According to México Evalúa, a Mexican public policy think tank, Mexico lacks the institutional strength and planning mechanisms to meaningfully control costs on major infrastructure projects. In contrast to the Mexico City airport, budget execution for the train and refinery projects so far has been below expectations, which is a possible indicator of complexities that could delay construction progress and increase costs.

Stingy on Fiscal

On 22nd Apr 2020, AMLO announced a USD 25.6 billion spending plan on social programmes and infrastructure projects. The package would be financed through spending cuts in non-essential areas and a reduction of up to 25% in high-level bureaucrat's salaries, including his own. AMLO wanted to send a signal to avoid further indebting the country, or increase revenue through higher taxes or fuel price hikes. Although this was viewed as a welcome relaxation of AMLO's rigid fiscal spending during the first few weeks of the pandemic, we feel there is still a lot of room for spending. Mexico's stimulus plans that was announced was equivalent to 3% of GDP, significantly smaller than in other LATAM countries. On top of that, most of the plan announced was actually based on reshuffling previously planned spending, and the estimated

Figure 8: Declining Pemex Diesel Share



additional spending for the pandemic was only approximately 0.6% of GDP.

There are 2 main reasons behind AMLO's fiscal conservation. Firstly, AMLO truly believes that increasing debt is detrimental to the economy. His views, as some call it "old-fashioned", does not believe in using debt in bailing out a country as high debt ratios would likely lead to crisis in the future. However, fiscal expansion during a recession can in fact lower debt ratios if it helps mitigate the negative impact on output. Secondly, AMLO has this belief that supporting large companies will lead to corruption, even if that could increase the chances of keeping workers employed. Therefore, AMLO wants to assist small firms and the low-income population, while moving on with his investment projects and minimizing debt issuance.

Mexico has been hit hard by the Covid-19 pandemic, with the country recording the world's fourth largest number of deaths. Yet AMLO has still repeatedly rebuffed economists' calls (even the IMF has been calling on Mexico to spend more) for spending big on a fiscal stimulus, instead choosing to focus on his infrastructure plans, which will be discussed below.

Lavish On Infrastructure

On 5th October 2020, AMLO presented a package of USD 14 billion for 39 infrastructure projects that he intends to move forward in conjunction with the Mexican private sectors: (1) USD 9.52 billion in the communications and transportation sector, (2) USD 4.8 billion in the energy sector, and (3) USD 110 million in the water and environment sectors. This announcement represents the reactivation of the previous plan of USD 44 billion that was presented in November 2019, but postponed by the global pandemic.

AMLO's big ticket infrastructure projects were already controversial before the pandemic, with concerns on its financial viability and environmental impact. AMLO has also claimed that the infrastructure projects are estimated to add to 1% of Mexico's GDP and generate 185,000 of the 2 million jobs it has pledged to create in his announcement in Apr 2020. Other than how this casts doubts because of how somewhat unrealistic the initial aim was, as explained above, one should consider if his campaign is a stubborn misuse of limited resources. This is especially the case when the country needs a fiscal stimulus now more than ever, and we think that AMLO should divert funds intended for his infrastructure plan to deal with the economic effects of the virus instead.

Most of AMLO's development plans are concentrated in Mexico's southeast, which trails the rest of the country in GDP and most social indicators. AMLO's emphasis on the southeast is driven in part by his own experience growing up in the region at a time when oil was viewed as synonymous with prosperity. The president also cited the significance of passenger trains in connecting the region to the rest of the country during the Mexican Revolution, on railways that were cancelled. Some critics, however, believe the president is drawing the wrong lessons from Mexico's past, believing that the southern states haven't developed because they have never been brought into the modern economy, and these infrastructure plans aren't going to change that.

Institutional Challenges Posing as Key Risks (Again)

Known to be a populist is not enough for AMLO and his administration, as there have been continuous deterioration of Mexico's institutional framework moving forward. Not only are they idiosyncratic in nature due to AMLO's erratic decision of keeping to his plan of opening 2 oil refineries despite Pemex's losses this year, we are looking at similar incidents coming in 2021 due to complex electoral processes too. With a gloomy political landscape, recent controversy on the Mexican Supreme

Court's rulings that got people questioning about its independence also painted a picture of politically-laden economic policies to come.

These key political issues are going to impact risk metrics and Mexico's credit ratings, especially in government securities. Given the election of Biden, should everything goes smoothly and he is able to enact his green plans, Latam, much less Mexico, would be at the back of his considerations for trade deals. This would be bad news for Mexico since the one that pulled its economy in a rebound in Q3 were largely autos manufacturing and trade exports. Moreover, with the halting of the USMCA trade talks this year due to COVID-19 and AMLO's possible breaching of prior agreements due to his plan on boosting coal and oil (or anything remotely linked to green energy), Mexico's bottom line would be bleak.

Pemex (still) in Trouble

AMLO's saving grace during his election campaign was his promise to free Mexico from its corrupt government, and to bring back the glory days of Pemex, which has become symbolic of the nation's pride. However, in the past ~2 years of AMLO's administration, Pemex has lost close to 13% of Mexican gasoline market to private companies, a number significantly lower as compared to the previous 35 months since Mexico liberalized its fuels market. As such, AMLO is doing as much as he could in damage control in order to keep off the biggest world players to wrest business from Pemex.

In October, Fitch Ratings gave Pemex a long-term rating of BB- to the proposed unsecured debt issuance of USD1 billion, a definite upgrade from what we saw in our earlier report where the bonds were downgraded to junk level at the crash of the oil market earlier in the year. These bonds are due to mature in 2025, and its proceeds would be used for capex, working capital needs and to service debt refinancing too.

Looking at the health of Pemex, the current Mexican crude basket price is at USD 37/barrel, and Pemex's upstream business are expected to cover operational and financial half-cycle costs of more than USD 25/barrel. This does not mean that Pemex is healthy and are producing with great returns. The upstream business in fact, does not generate enough cash flow to cover before-tax-full cycle costs, including capex of approximately USD 60/barrel. As such, we expect that there needs to be high government intervention still in the near term to keep it afloat. If we were to rewind to earlier in the year, it was clear that Pemex's struggle to keep afloat is no surprise to us, especially since the rest of the world was slashing capex by half in order to stop losses in oil refineries, but Pemex continued with its plan to fund the upstream refinery. This could have been one of the possible reasons as to why there was a complaint filed by the American Petroleum Institute (API) for accusing Mexico of not fulfilling its ends on the deals signed under USMCA, for there have been allegations that there were discriminations against US Petroleum companies in Mexico's fuel markets. This could have jeopardized the U.S' diminishing FDI to Mexico if the allegations were true that the AMLO administration has sneakily been trying to find loopholes in the deal such that Pemex could benefit. Again, it is the political agenda of keeping Pemex running and energy as the silver lining of the nation that may keep the peso from continuing its bull run as seen in the latter half of the year.

Figure 9: USDMXN Weekly Chart (if there is a near term bullish run)

Source: TradingView

Figure 10: USDMXN Daily Chart

Source: TradingView

Trade Idea: Short USDMXN

We analyzed the technicals for USDMXN using multi timeframe analysis. As seen from the weekly chart in Figure 9, the pair is in a downward channel, with the 9EMA crossing below the 26EMA on 31st Aug 2020, as well as the 50EMA on 19th Oct 2020, providing bearish signals for the pair. More recently, the 26EMA has also crossed below the 50EMA on 7th Dec 2020, which provides confirmation of the bearish trend. This is in line with our medium-long term (6 months) bearish view of the pair.

However, moving on to the daily chart in Figure 10, there are some signals of a near term (1 month) bullish run before its continuance of its overall bearish trend, which is in line with our short-lived near term bullish fundamental views discussed above after the Biden inauguration on 21st Jan 2020. In the daily chart, we see a bullish divergence forming between the price and MACD. Price is seeing two consecutive lower lows, while the MACD seeing two consecutive higher lows. This would indicate that a bullish reversal is about to happen.

<u>If there is a near term bullish run (Figure 9)</u>

Our stop loss, take profit, and entry points are based on previous key levels on the weekly chart. For our stop loss of 20.82, price has seen past resistance twice at that price range. For our take profit of 18.55, there has been past supports tested quite strongly four times at that price range. For our entry point of 20.08, we are of the view discussed in the daily chart above that there would be a short-lived near term bullish view. We would wait for the current price of 19.90 (as of 27th Dec 2020) to finish its near term bullish run before entering, thus we would use a sell stop order at 20.08 (order is placed only when price *falls* below 21.08), which is also at the 0.786 Fibonacci retracement level.

<u>If there is NO near term bullish run (Figure 11)</u>

We would watch the price closely, especially during the 21st Jan 2020 U.S. presidential inauguration period. In the case price does not complete its short-lived near term bullish run, we would still likely take entry at the price level of anywhere around 19.66 and above, with stop loss at 20.21 just above the 0.786 Fibonacci level, and the same take profit of 18.55. This will still give us a risk-reward ratio of at least 2.02.

Fundamentally, a significant driver in Peso strength would mainly be the relatively high interest rates Mexico currently has, leading

Figure 11: USDMXN Weekly Chart (if there is NO near term bullish run)

Source: TradingView

Figure 12: Interest Rates In LATAM Countries

LATAM countries	Interest Rates (Last) %	Interest Rates (Previous) %	Date last reported
Venezuela	38.76	38.51	Sep-20
Argentina	36	37	Oct-20
Suriname	25	25	May-20
Haiti	17	17	Sep-20
Nicaragua	10.59	10.96	Sep-20
Ecuador	9.02	9.02	Sep-20
Uruguay	6.39	6.03	Sep-20
Guyuna	5	5	Oct-20
Mexico	4.25	4.5	Sep-20
Brazil	2	2	Oct-20
Colombia	1.75	1.75	Oct-20
Guatemala	1.75	1.75	Sep-20

Source: Trading economics, The Global Economy, FX Empire, Country Economy

to an attractive carry trade for investors. On top of any profits gained from movement in the USDMXN itself, investors can also benefit from the interest rate differential between US and Mexico, especially with the U.S. interest rates at ZLB of 0-0.25% at least until 2023 along with AIT introduced by the Feds in Sep 2020. Comparing Mexico with the 33 countries in Latin America, Mexico stands at having the 9th highest interest rate of 4.25%. With the narrative of increasing inflation at the end of 2020 (even during the pandemic) and then stable at 3% in the next 12-24 months, we are of the view interest rates are not likely to be cut in the next 6 months. As such, the carry trade would remain as lucrative as it is now, especially with investors seeking yield moving forward.

Apart from the fundamentals explained above which points to an overall bearish Dollar, a Biden win would also mean improved trade relations with Mexico, which can lead to an increase in Mexican exports. This leads to an increase in demand for the Peso, especially with U.S. making 83% of Mexican exports. However, risks would include that if Biden's clean bills gets passed, there would be less demand for Mexican imports to the U.S. due to political misalignment with what AMLO views the country should go for (strong Pemex and no clean energy plans) and what Biden wants for the states.

<u>(If there is a near term bullish run)</u>

Entry: 20.08 (sell stop)

Take Profit: 18.55

Stop Loss: 20.82

Risk Reward Ratio: 2.07

<u>(If there is NO near term bullish run)</u>

Entry: 19.66 and above

Take Profit: 18.55

Stop Loss: 20.21

Risk Reward Ratio: 2.02

NUS INVESTMENT SOCIETY

Global Macro Department –Brazil (UNDERWEIGHT)   Date: 27th December 2020

Analysts
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Global Macro Analyst
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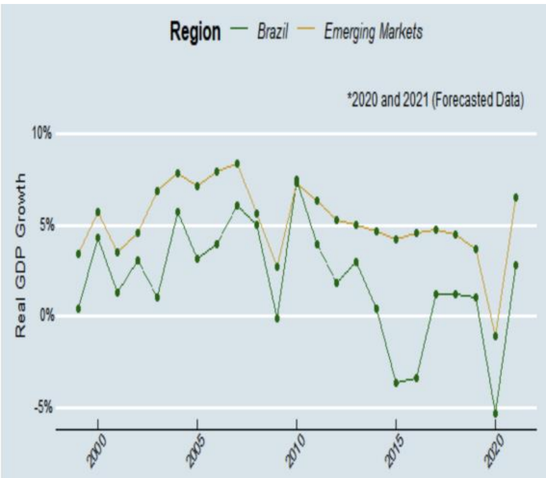
Basic Information

Real GDP(US$)	$1.713 trillion
M2(US$)	USD 707.146
CPI	185
PPI	191.91
Con. Confidence	43
Building Permits	98
Stock Index	BOVESPA
Currency	BRL

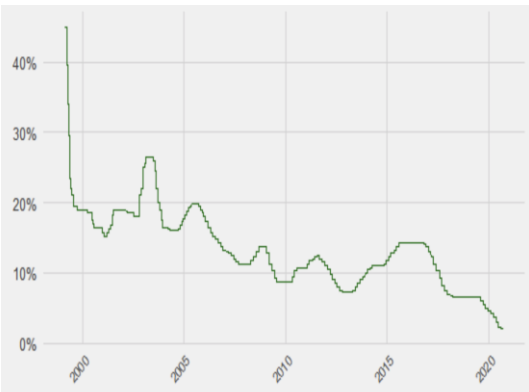
Chart info

Figure 1: Brazil and EM Real GDP Growth



Source: IMF

Figure 2: Interest Rate Target % p.a



Source: Banco Central do Brazil

Overview of Brazil's Economy

- Brazil occupies about half of Latin America's land mass and is the 8th largest economy in the world by nominal GDP and 9th largest by purchasing power parity.
- The economy is largely dependent on the services sector which comprises about 72% of GDP with the main players being hospitality, IT and retail sales.
- It has one of the largest income inequalities in the world with the top 10% of the population owning 42% of the country's wealth. Issues of corruption, unemployment and poverty have been plaguing the country.
- Brazil is a world giant for natural resources and income from natural resources constitutes 5% of the GDP of the country.
- Main trading partners of Brazil for exports are China, United States, Argentina, Netherlands and Japan and for imports are China, United States, Argentina, Germany and Korea.
- Brazil's top exports include Soybean, Crude petroleum, iron etc. while imports include cars, refined petroleum etc. Brazil is one of the largest coffee producers in the world.

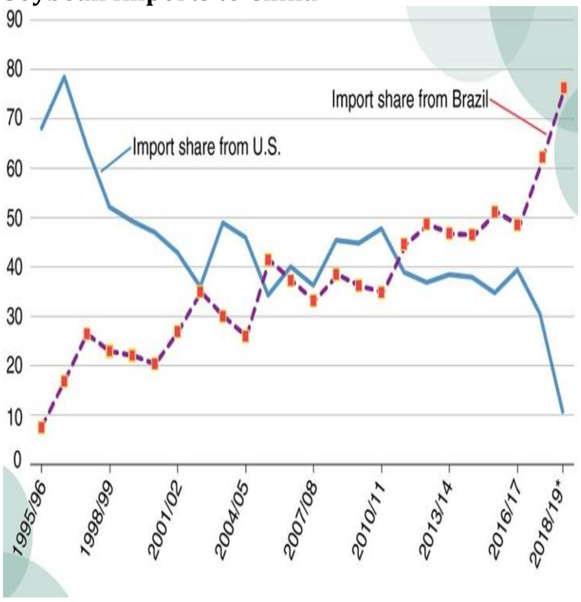
Summary/Recap of events in the past 6 months

- Brazil has been making use of discretionary fiscal policy by means of various stimulus packages and unemployment benefits to its citizens. Due to this its fiscal and inflation risks have been rising. As per forecasts, Fiscal policy will be the main tool in fighting post-pandemic risks. The government has been signalling towards fiscal consolidation and the monetary stimulus is contingent on that.
- Brazil's monetary easing has been sharp vis-a-vis other emerging market countries. Currently standing at 2% as compared to the ten-year historical average of 10%
- Brazil's response to the Covid-19 virus has been untimely and undisciplined with increasing fiscal pressure. It has eased out restrictions faster than other contemporaries and the GDP is expected to contract by 9.1% in 2020. Head of state has been undermining virus
- The Central Bank of Brazil has reduced the policy rate from 4.25% to 2% per annum. Capital requirements have also been lowered. About 17.5% of Brazil's GDP has been injected to the economy via various channels to boost growth
- Investor confidence has been low in the economy, though the Ibovespa Stock exchange index has recovered from it's all time low in March, investors are still not confident to park their money here, making Brazil the world's second worst performing market in 2020 after Columbia's Colcap.

- Brazil’s trade surplus has reached $47,6bn with agricultural exports falling by $36.93 million as compared to last year, coupled with a significant retraction in overall imports as well.

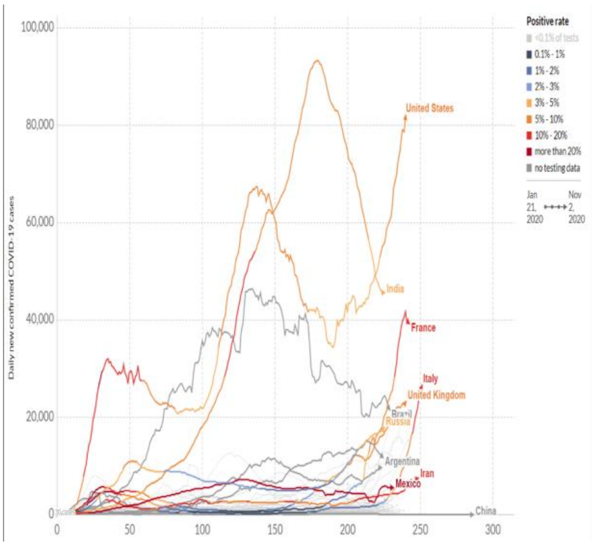
- Committee for monetary policy has decided to maintain current interest rates (Taxa Selic) at 2% p.a with inflation being below the Central Bank’s target rate of 4%

Figure 3: % of U.S and Brazil's share of Soybean Imports to China



Source: USDA

Figure 4: Daily new confirmed cases covid19 cases



Source: European CDC

Beneficiary by Chance: The Soybean Story

In the midst of the U.S-China trade war where both countries are at loggerheads with each other and have been slapping tariff rates on various goods, a tariff increase on soybean eventually led to benefitting Brazil in an unexpected way. Since China imposed a 25% duty on the import of soybean from the U.S, it is Brazil which has been catering to increasing Chinese demand.

While demand has been rising, production has not been able to keep pace with it. Weather conditions have made it difficult to cater to the exponentially increasing demand owing to which Brazil could only meet 30% of the increased demand.

Alarmingly, Brazil's exports to China were so high that there has been a need to import soybean from the U.S to cater to domestic demand. In 2020-21, Brazil's soybean imports are forecasted at 84 million mt (in total volume). Though Brazil is the biggest exporter and producer of soybean seeds, the drought-like conditions owing to the La Nina have led to delay in the dry weather and thereby a delay in the production cycle of the crop. This will lead to lesser production which means the inability of Brazil to capitalise on an opportunity.

To meet domestic demand, imports are also being made from Paraguay and Uruguay. Brazil has imported about 30,000 metric tonnes of soybean just in the first 3 weeks of September. About 2% of Brazil's soybean imports are from Paraguay.

Although Brazil's imports can be seen rising , Brazil has not been able to capture the U.S's entire share of exports to China, weather conditions are also not favourable to meet future demand which might lead to fall in net exports and thereby aggregate demand. As aggregate demand falls, there will be a further fall in the output of the economy. Weather conditions which can lead to a potential fall in imports will result in less demand for the Real and depreciation of the Brazilian Real in the near future.

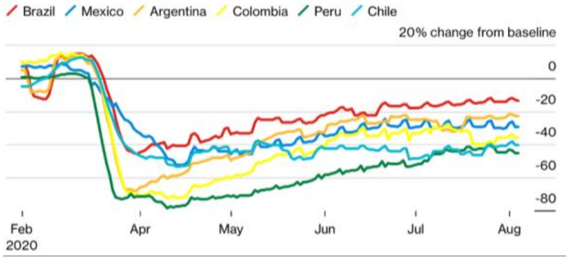
Mass(ive) problem: Covid19

The president, Bolsonoaro has constantly belittled the virus by calling it a "measly cold" which has led to the severity and Brazil being one of the worst hit countries by the pandemic. Even though the numbers are alarming and rising exponentially, the government started to ease down restrictions and continue economic activity thereby not paying heed to the increasing cases.

Limited testing capacity and lack of united efforts from the side of the government have led to the status quo. While the head of state has refused to comply with WHO guidelines, the Health Ministry in Brazil is more cautious. This lack of unification is leading to Brazil's emergence as the new epicentre. Due to this disparity (internal instability), public health measures are regionalised.

As Brazil passes 500,000 cases and 150,000 deaths, the economy and the healthcare sector is not prepared for the potential second wave of the virus. Lack of legislation and serious measures taken by the government like not necessitating the use of a mask etc. might lead to further aggravation of the situation. The flow of financial transfers has been slow and no national plan has been developed to tackle the situation. Brazil's high rates of inequality and slow government response have further worsened the situation.

Figure 5: % of Brazilians returning to work



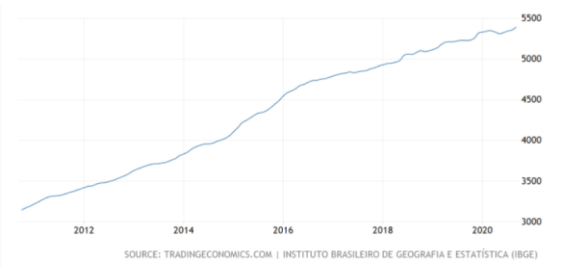
Source: Bloomberg

While the Brazilian economy has shown rates of contraction, it is lesser than its contemporaries in Latin America (Brazil's 5.6% contraction compared to 12.5% and 9.8% in Argentina and Mexico respectively), owing to its refusal to lockdown. While this may seem to benefit the economy in the short term, in the long run and with threats of emergence of the second wave, this may prove to be fatal.

Figure 5: Unemployment as % of labour force

Source: World Bank

Figure 6: Brazil CPI Forecasts



Source: Trading View

Figure 7: Brazil Relief Packages

Relief Measures	Amount
Economic Stimulus Package	$150billion
Bolsa Familia Reinforcement	$620million
Emergency Credit line for SME	$7.7billion
PROGER/FAT (Credit for Micro and Small Enterprises)	$1billion
Emergency Credit Access Program	$3billion
Emergency Aid Program	$8.5b

Source: KPMG

Prioritising fiscal discipline over Unemployment

Unemployment has been looming around the Brazilian economy for over two years now with no serious response from the side of the government. Brazil's "Economic Long term growth strategy" mentions the word "Fiscal" 6 times with absolutely no mention of employment/jobs. With unemployment numbers rising, the government is still prioritizing fiscal discipline and ignoring the millions of jobless people.

Further, prioritisation of fiscal deficit has not been able to yield results as expected (considering the magnitude of the stimulus) due to the large size of the informal economy of Brazil which account for roughly 42% of the total employed population. The informal sector is not protected under the consolidation of labour laws and hence are deprived of social protection as well. As the pandemic leads to more unemployment, people from the formal sector are shifting to the informal sector taking up outsourced jobs to earn a living. In such a case, the effect of the fiscal stimulus dilutes as this sector is outside the ambit of any policy outcome. With regards to employment, the situation calls for public employment and income transfer policies along with development policies that will protect the interest of the informal sector workers.

Rising unemployment rates which have been exceeding forecasts can lead to a long term economic drag and present a pessimistic image for the Brazilian Real as well and trigger a bearish turn. Unemployment touched 14.4% in the Quarter ended August (1.6% rise from the Quarter ended May) further dampening consumer demand and investor confidence in the economy with an eventual negative impact on forex. Brazil has an employment-population ratio of 46.8% which again is a record low. Since 2014 Brazil Economic crisis prices have gone up by as much as 25% without seeing a commensurate increase in wages/ employment rates

Brazil's growing fiscal deficit owing to Covid19 and the stimulus packages (like the government's agency aid programme that provided cash stipends to 23million Brazilian workers--ending in December 2020) which are forecasted to be about 12% of the GDP are a growing concern for the state. With the 2nd wave of the virus hitting various regions of Europe, Brazil too might require further fiscal response as predicted by the IMF. Public debt might close to about 100% of the GDP with the South American and Caribbean average standing at 59%. While this is a grave issue and reflects the need for fiscal consolidation the more pertinent issue at hand (in the short term) needs to be saving lives and livelihoods which will have a direct and positive demand shock in the economy and can spur economic growth.

The pandemic has contributed to the debt being at all all time high and the problem is expected to extend to 2021 as well, with the government facing a $112 billion cliff early next year. S&P has affirmed a BB rating on Brazil's sovereign debt. While the debt maturity in April 2021 might be the highest ever per month, if the social and political situation is under control with positive sentiments about the Covid-19 vaccine, investors would extend their loans providing Brazil a liquidity cushion, easing the problems.

The table on the left breaks down the economic stimulus package of the government which has led to the rising fiscal deficit and the government's increasing concerns about fiscal discipline.

Figure 8: USDBRL Daily Chart

Source: Tradingview

Trade Idea: LONG USDBRL

As previously highlighted in the fundamental analysis, the Brazilian Economy does not seem to be looking forward to an optimistic economic outlook resulting in a bearish run for the real. Surging unemployment rates, public debt as high as 100% of the GDP and the second wave of pandemic which may result in further worsening the situation reflects low consumer confidence with investors pulling out their money from the Brazilian market.

Traders have been negative on the real as a whole due to the increasing cases of COVID19 in South America and specially in Brazil (as it emerges to be 2nd worst hit country). Lack of preparedness for the second wave along with government emergency aid ending on 31st December (government does not have a free hand in providing further stimulus) may result in a long term economic drag.

USD is expected to appreciate vis-a-vis an emerging market currency like Brazil due to the long time it will take to get back to pre-covid production levels. In addition to the threat from the pandemic, Brazil is under high political risk to the mishandling of the virus. This has also further resulted in low interest rates and low investor confidence which is a consequence of rising near-term domestic debt maturities. The greenback is expected to rise as it did in the past ten years (post presidential elections).

Overall the Real's performance is weak and with fiscal uncertainties the Real is further expected to weaken thereby backing up rationale to Long the USDBRL. From a technical point of view, there is a crossover of the 26 day and 7 day EMA signalling a bullish run for the pair. The RSI level too is neither over or under bought. The RSI ranges from 40-50 signalling a strong uptrend .

Entry: 5.5726

Take Profit: 5.7563

Stop Loss: 5.4698

Risk Reward Ratio: 1.79

Analysts

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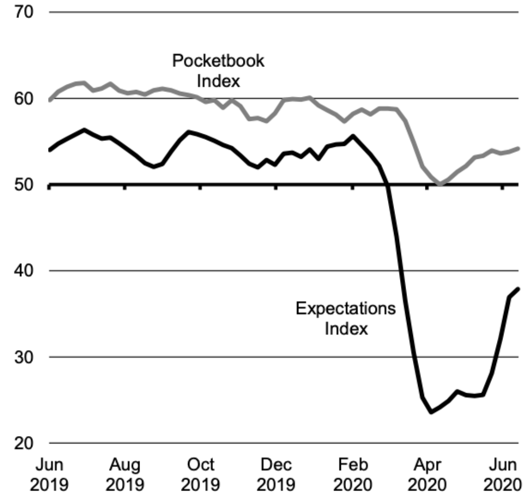
Basic Information

Real GDP(US$)	$1.869 trillion
M2(US$)	$1576b
CPI	137
PPI	114.8
Con. Confidence	42.08
Building Permits	
Stock Index	TSX composite Index)
Currency	CAD

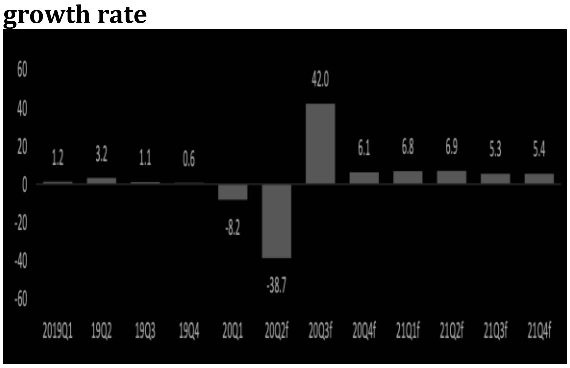
Chart info

Figure 1: Canadian Consumer Confidence



Source: Bloomberg

Figure 2: % change of Real GDP, annualised growth rate



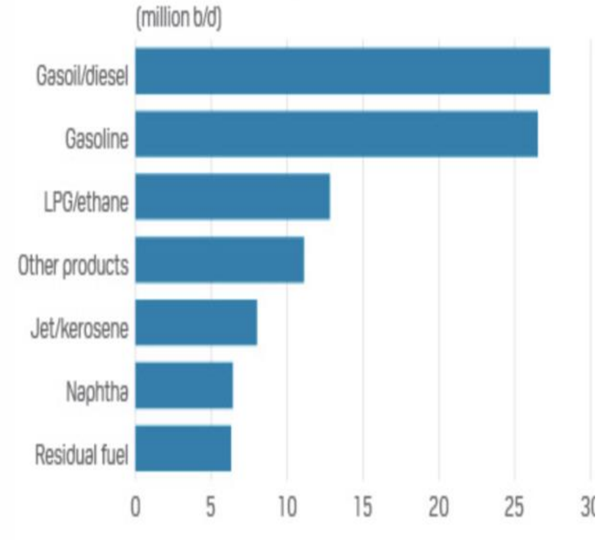
Overview of Canada’s Economy

- Canada is the second largest country in the world and is globally ranked 10th according to its nominal GDP. Household consumption drives 59% of the GDP
- The three major sectors in Canada are services, manufacturing and natural resources. Industries pivotal in the growth of Canada are real estate, oil and gas extraction, healthcare and finance.
- Foreign trade represents 64.9% of the GDP. Canada’s trade balance in August 2020 was CAD-2.45 billion. Its primary trade partner is the U.S and secondary trade partners are China, Mexico and the UK.
- About 75% of the total exports and 51% of the total imports are to and from the USA respectively. Main exports products include petroleum, gold, automobile and machinery while imports range from auto parts and accessories to electrical equipment.
- It is one of the top 5 oil exporting countries in the world along with having the longest coastline is the world ergo making it one of the largest seafood producers across the globe.
- Presence of various trade agreements (like NAFTA, USMCA) have facilitated easy trade of goods and services between Canada, USA and Mexico which have helped in the growth of Canada’s trade driven economy. Crude Oil is the largest single contributor to forex in Canada.

Summary/Recap of events in the past 6 months

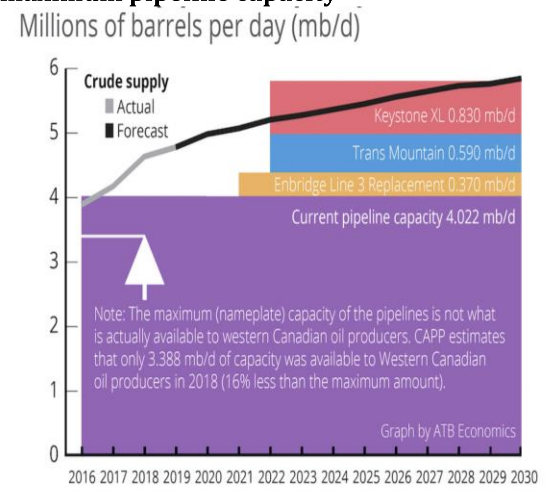
- Covid19 outlier in America, one of the top 20 safest countries in the world during the pandemic with 170k confirmed cases, 1900 tests/million/day
- Effect of covid has been felt on employment, with unemployment rates spiking to 13.7% with approximately 3 million Canadians losing their job due to business facing a cash crunch
- The stock market has established itself with the TSX Composite Index gaining momentum (regained about 60%) after the sharp decline of 38% in late February 2020 owing to the oil price war and energy sector crisis
- Government fiscal response has been unprecedented, rolling out cheques C$2000 to citizens who lost jobs this year, provision of bridge loans etc.
- Increase in public spending has led to increased fiscal deficit. Although Filch downgraded Canada's credit rating from AAA to AA+, Moody’s and Morningstar rate it their highest.

Figure 3: Crude Oil Use by Sectors



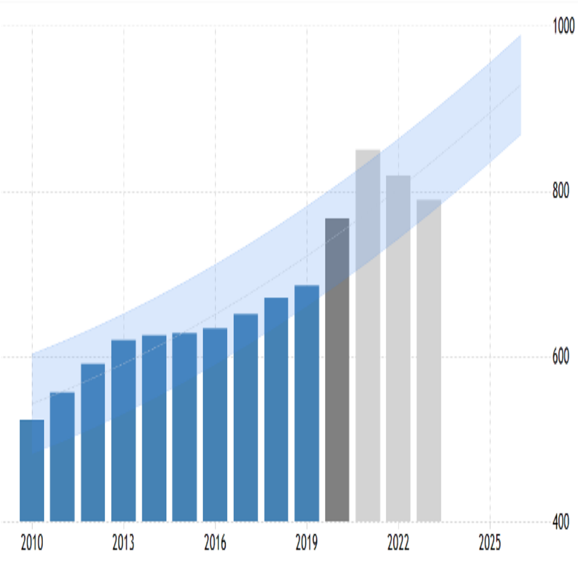
Source: International Energy Agency

Figure 4: Western Canada Oil Supply versus maximum pipeline capacity



Source: ATB Economics

Figure 5: Canadian Government Debt



Source: Trading Economics

The Canadian Oil Mint

Demand for oil witnessed a major dip during the pandemic, but post pandemic forecasts are positive. Energy demand was expected to grow at a rate of 12% between 2019-2030 which has not been cut down by 3% after taking into consideration post-pandemic reactions. While a lower growth means more competition and aggressiveness it does not mean lack of opportunity and can be capitalised on. Though renewable energy is trying to gain a good hold of the global economy and globally many nations have been trying to make the transition, yet it is evident that despite various environmental benefits of renewable energy, oil and gas are here to stay. The global transport sector might take a hit, but the petrochemicals sector will be a driver for global oil demand and a catalyst in driving up the prices.

The pandemic has had an unpropitious impact on the airlines industry which indeed is going to witness a slow recovery, other sectors using crude oil might not be that adversely affected which is evidence of the potential of the demand growth in the future. While one may only tend to focus on the hit the industry will take due to transportation, essentials like sanitizers and mobile phones are produced with the help of the flourishing petrochemical industry (constituting 19% of overall oil demand)

For a country whose currency (CAD) is highly correlated to the price of oil, efforts are consistently being made to accelerate the production. The introduction of the new federal loan programme. "The Large Employer Emergency Financing Facility" is helping the industry address their liquidity concerns due to Covid-19. Since the oil and gas industry employs around 500,000 individuals (both direct and indirect) it is a pivotal part of the economy and therefore will never lack governmental support. The federal government has made available loans worth $750 million for investments in GHG emissions and specifically targeted at methane.

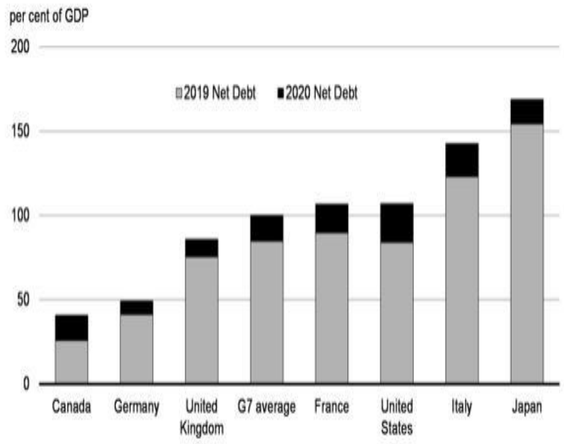
While the pandemic led fall in demand has made the industry face adversity, it also led to less-congested pipelines which (reduced by 1 million barrels of daily output) has been a catalyst in the process of development of new pipelines and thereby solving Canada's chronic problem of transportation of crude oil and pipeline shortage. By the end of 2023 three major pipeline projects (TC Energy Corp.'s Keystone XL, Enbridge's expansion of its Line 3, Canadian government's expansion of the Trans Mountain line) are expected to be completed which can increase shipping capacity by as much as 50% (about an increase of 1.79 million barrels a day).

Debt for development (and a dent?)

In light of the pandemic Canada has actively responded to the virus resulting in containment of the virus and making Canada one of the safest countries during these unprecedented times. The Canadian government's high sovereign debt and Debt/GDP ratio(~63.54%) is at an all-time high which is raising fiscal consultation risks. This high fiscal debt is arising out of large sums spent on amenities for citizens, welfare packages etc. recently the government announced the outflow of $639m on drinking water, stormwater and rainwater projects to ensure the availability of a necessity such as portable water for everyone.

In addition to this there has been an increase federal spending by CAD37 billion (approximately 1.6% of GDP) through an extension of the main income support program, the Canada Emergency Response Benefit (CERB), and the launch of new targeted Employment Insurance auxiliary programs to extend support to those affected by the crisis at hand. The unemployment transfers have actually exceeded the estimated lost wages. While government spending is expected to drop in mid-2021 the already widened deficit will make consolidation even tougher.

Figure 6: G7, General Government Net Debt 2019, 2020

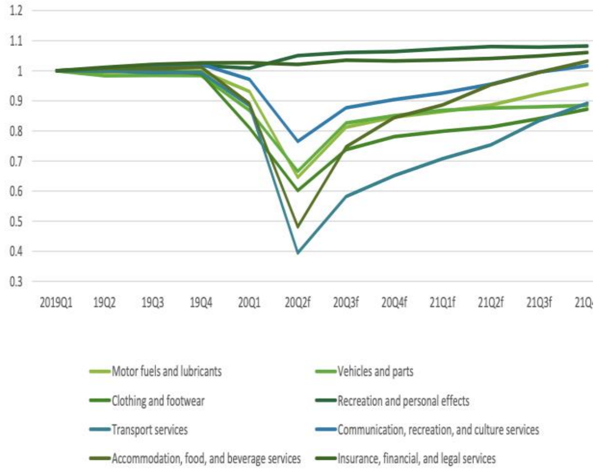


Source: IMF

Even after spending on various welfare schemes, Canada's Net Debt for 2020 does not exceed its contemporaries by a great margin even while the results from economic recovery do (favouring Canada).

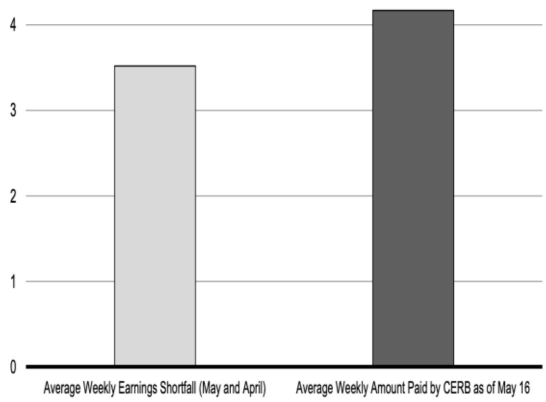
Despite concerns about high fiscal deficit (a red flag for any economy in normal conditions), the deficit seems to yield positive returns in the long run (for economic and social welfare--futuristic capital formation) considering the avenues the money is being spent. Canada has seen one of the fastest recoveries and might return to pre-covid level of trade before its contemporaries due to timely and apt measures being taken by the government. The labour market is also seeing signs of recovery with forecasts of GDP reaching pre-crisis levels by early 2022. According to estimates, Canada's debt-to-GDP ratio will peak at 48.3% in 2022/23. The government is prioritising growth and development over fiscal concerns (and rightly so) which is boosting investor confidence (recovering TSX Composite Index is clear evidence of that, reflecting a strong V-shape recovery).

Figure 6: Real Consumer Spending (by category)



Source: Statistics Canada

Figure 7: Weekly earnings shortfall versus Average weekly CERB (transfer Payment)



Source: Statistics Canada

Recovery with Monetary and Fiscal Policy

Policy Outlook

With housing, labour, aggregate demand and trade showing some positive signals reflecting slow but steady recovery of the economy, the monetary and fiscal policy of the government has a huge role to play in retaining this stabilisation and building the future growth trajectory for Canada. The recent Throne speech reassured people that the government will continue to support families with the help of various stimulus packages and emergency aid funds (an additional $37b were announced recently as part of new income support measures).

Besides these fiscal considerations, monetary policy will take an 'accommodative" stand. Bank of Canada's policy rate is expected to stay at 0.025% until the inflation target of 2% is met. Launch of the government bond buying programme to improve liquidity is unique to the pandemic crisis and was not even seen during the financial crisis of 2008-09. The future is more reliant on fiscal measures and monetary policy has already been greatly capitalised on during the past 6-8 months.

Result of Policies

As an aftermath of these government spendings the deficit will rise by as much as 115% of the GDP in 2020 as compared to 89% in 2019. Results of inability to spend the money provided by the government under the stimulus package in many cases has led to an increase in savings which is reflected in the rise in disposable income by about 28%.

As avenues for spending open up, this money will be injected into the economy in the form of increased consumer spending and will help facilitate movement of money. Owing to these policies and reactions to these policies, the economy is expected to rebound with a growth rate of 6-7% in 2021.

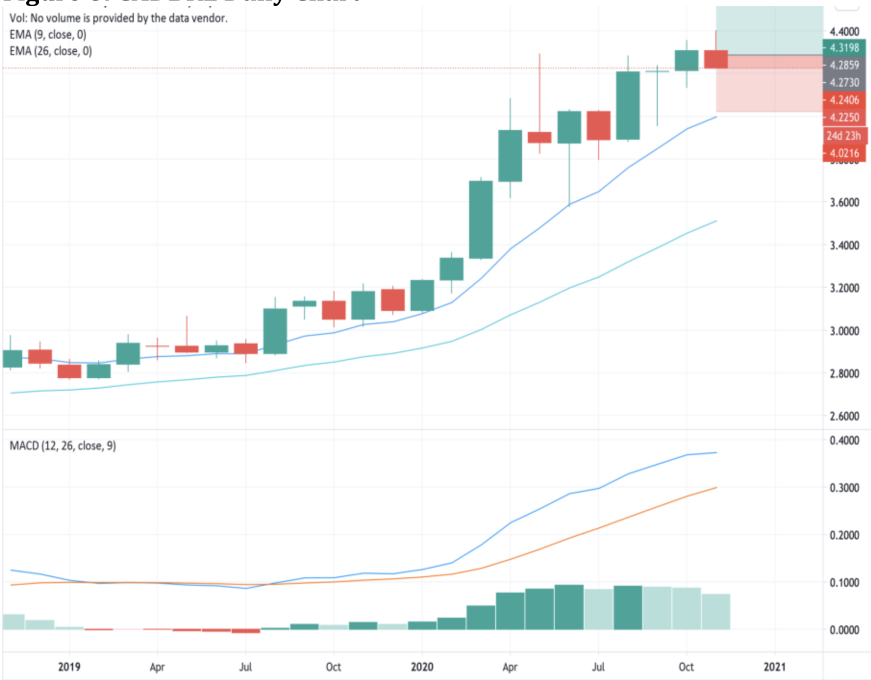
US Elections and Canada

The US Presidential elections with a Biden win have had a multifaceted effect on the Canadian economy. While Trump's administration was known was imposing tariffs on Canadian trade along with various immigration restrictions, Biden has always had pro- Canada sentiments since his last terms as the Vice President.

While the US and Canada had major differences on the Climate Change issue during Trump's administration the same is not likely after Biden takes over. Trudeau and Biden have a lot of commonalities when it comes to Climate Change and going green and see it as a means to creating about 800million jobs for their citizens which will help them overcome the deep rooted unemployment crisis (owing to the pandemic). Such similarities in thought and action will help Canada to further fasten its relations with the US and solidify its trade.

Previous tariffs on steel and aluminium imposed by the US in pretext of National Security in the past had affected Canada's trade deeply as it relies on the US as its primary trade partner. With Biden's electoral win, such differences most likely will be eliminated leading to a smoother trade route for Canada.

Figure 8: CADBRL Daily Chart



Source: Tradingview

Trade Idea: Long CADBRL

As suggested by the fundamentals, the loonie seems to be moving towards a tentative bullish run in the medium and long term due to a variety of reasons ranging from oil exports to the presidential elections and the post-covid supply chain structure.

Increased oil capacity by virtue of the approvals for the new pipelines will be instrumental in facilitating cheaper transport of oil to neighbouring countries and therefore will lead to increased profit margins. The positive impact of the government spending and other fiscal measures coupled with monetary policy that is stimulating economic growth also signals towards a bullish run for the CAD.

Increasing fiscal debt are further increasing risks of fiscal considering when seen from a binary, but relatively compared to other regions there has been an overall spike in government borrowing due to the pandemic and Canada's high public spending and government debt will be offset in the long run. With Bident taking over, Canada is optimistic about its trade relations and using those as a means not only too boost trade but also solve the lurking unemployment problem and boost growth post covid.

Besides growth prospects for the CAD, anaemic growth of the Brazilian Real (one of the worst performing EM currencies) has also been factored in while taking a long stand on CADBRL. The real has been underperforming since the onset of the pandemic which has been further aggravating. With rising political tension, the Real is headed towards a bearish run in the medium term. For the technical analysis to support the trade idea, the 9 and 26 day EMA crossover with 9 being on top is a positive signal. There is a signal line crossover (bullish crossover) further showing appreciation of the pair.

Entry: 4.2864

Take Profit: 4.3198

Stop Loss: 4.0214

Risk Reward Ratio: 1.49

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