CIBC

CIBC CAPITAL MARKETS

Economics and FICC Strategy

MONTHLY FX OUTLOOK

February 2, 2022

USD Consolidates, with a further push ahead

Currency	What's changed
USD	Look for USD gains following consolidation as the Fed starts hiking rates, causing the market to price in more hikes post-2023 as hawkish rhetoric ramps up.
CAD	Loonie to depreciate ahead as the USD strengthens and markets move to price matching rate hike cycles across the Canada-US border.
EUR	The absence of an uptick in wages data points towards EUR shorts being rebuilt as EURUSD heads towards 1.10.
GBP	The extension of UK political uncertainty, while markets look to be pricing in too much BoE tightening, point towards a negative GBP/USD bias into mid-year.
JPY	With inflation in Japan showing no signs of approaching the BoJ's 2% target, the central bank will remain a policy laggard, weighing on the yen.
Commodity FX	We see RBA turning more hawkish ahead, and RBNZ continuing their hawkish tone, both of which should provide some support for respective currencies.
LATAM FX	New constitution processes in Chile and election cycles in Brazil and Colombia should dominate sentiment in BRL, CLP, and COP, respectively.
FX Asia	In light of a more hawkish Fed and a more accommodative PBoC, we have tempered future CNH appreciation targets slightly.

Currency outlook

End of period:	Feb 2/22	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23
USD / CAD	1.27	1.28	1.30	1.32	1.31	1.31	1.31	1.30	1.29
EUR / USD	1.13	1.12	1.11	1.10	1.10	1.11	1.12	1.13	1.15
USD / JPY	114	115	116	115	114	113	112	111	110
GBP / USD	1.36	1.34	1.33	1.33	1.33	1.33	1.33	1.35	1.36
USD / CHF	0.92	0.94	0.96	0.98	0.99	0.99	0.99	0.99	0.99
USD / SEK	9.20	9.15	9.01	8.91	8.77	8.65	8.57	8.54	8.43
AUD / USD	0.71	0.73	0.74	0.75	0.76	0.76	0.77	0.77	0.78
NZD / USD	0.66	0.68	0.68	0.69	0.70	0.71	0.71	0.72	0.73
USD / NOK	8.77	8.79	8.78	8.77	8.68	8.51	8.39	8.27	8.13
USD / ZAR	15.31	15.75	16.00	15.80	15.50	15.25	15.10	14.85	14.50
USD / BRL	5.30	5.70	5.70	6.00	5.70	5.90	5.70	5.50	5.30
USD / MXN	20.5	21.0	21.5	22.0	21.5	21.0	21.5	21.3	21.5
USD / COP	3923	4200	4100	4000	4000	3900	3800	3800	3800
USD / CLP	805	780	800	800	780	790	780	780	780
USD / CNY	6.36	6.30	6.25	6.20	6.15	6.10	6.05	6.00	5.95
USD / KRW	1206	1180	1170	1160	1150	1140	1130	1120	1110
USD / INR	74.8	75.5	74.5	74.0	73.0	72.5	72.0	72.0	71.8
USD / SGD	1.35	1.35	1.34	1.33	1.32	1.31	1.31	1.30	1.30
USD / TWD	27.8	27.5	27.1	26.8	26.8	26.7	26.6	26.5	26.5
USD / MYR	4.19	4.15	4.10	4.05	4.00	3.90	3.80	3.70	3.65
USD / IDR	14358	14300	14200	14050	14000	13900	13850	13820	13800

Other crosses

End of period:	Feb 2/22	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23
CADJPY	90.1	89.8	89.2	87.1	87.0	86.3	85.5	85.4	85.3
AUDCAD	0.91	0.93	0.96	0.98	0.99	1.00	1.00	1.00	1.00
GBPCAD	1.72	1.72	1.73	1.76	1.74	1.74	1.74	1.76	1.75
EURCAD	1.43	1.43	1.44	1.45	1.44	1.45	1.47	1.47	1.48
EURJPY	129	129	129	127	125	125	125	125	127
EURGBP	0.83	0.84	0.83	0.83	0.83	0.83	0.84	0.84	0.85
EURCHF	1.04	1.05	1.07	1.08	1.09	1.10	1.11	1.12	1.14
EURSEK	10.41	10.25	10.00	9.80	9.65	9.60	9.60	9.65	9.69
EURNOK	9.93	9.84	9.75	9.65	9.55	9.45	9.40	9.35	9.35

Key indicators – Latest data point

End of period:	Quarterly real GDP (y/y %)	CPI (y/y %)	Current acct (% of GDP)	Central bank rate (%)
US	5.5	7.0	-3.7	0.125
Canada	4.0	4.8	0.2	0.250
Eurozone	3.9	5.1	2.8	0.000
Japan	1.2	0.8	3.4	-0.100
UK	6.8	5.4	-3.3	0.250
Switzerland	3.3	1.5	8.7	-0.750
Sweden	4.7	3.9	4.6	0.000
Australia	3.9	3.5	3.9	0.100
New Zealand	-0.3	5.9	-2.8	0.750
Norway	5.1	5.3	14.8	0.500
South Africa	2.9	5.9	4.1	4.000
Brazil	4.0	10.1	-1.5	9.250
Mexico	4.5	4.6	1.0	5.500
Colombia	13.2	5.6	-5.1	4.000
Chile	17.2	7.2	-3.5	5.500
China	4.0	1.5	1.9	3.700
South Korea	4.1	3.7	5.9	1.250
India	8.4	5.6	-0.4	4.000
Singapore	5.9	4.0	19.5	n/a
Taiwan	4.9	2.6	14.3	1.125
Malaysia	-4.5	3.2	3.8	1.750
Indonesia	3.5	1.9	0.2	3.500

CAD

Katherine Judge and Avery Shenfeld

Loonie flies lower if BoC fails to outgun the Fed, and oil prices ease

Q1 2022: 1.28 | Q2 2022: 1.30 (USDCAD)

The loonie strengthened alongside crude prices into mid-January but has since eased off, as the Bank of Canada decided to forgo a January rate hike as we had expected. Still, Governor Macklem was pointedly hawkish and set the stage for a March hike. That leaves market participants still anticipating 150bps of BoC rate hikes in 2022, and an additional 60bps in 2023.

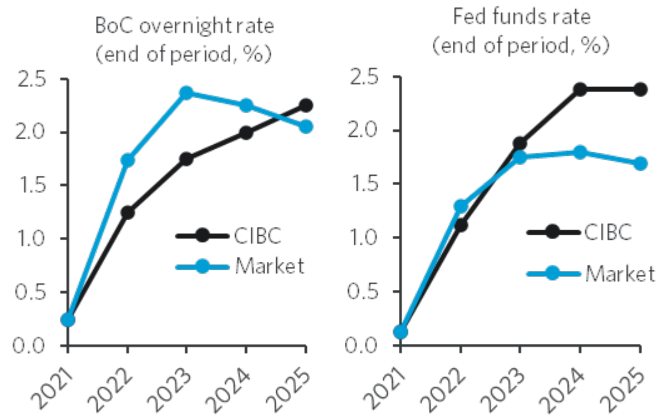
With quantitative tightening providing a bit of a substitute for overnight hikes, we expect a more moderate does of 150bps of BoC hikes through the end of 2023, starting in March (Chart 1, left). In contrast, while the market is aggressively priced for the Fed's first moves, there's room for the market to bring its expectations for mid-decade fed funds levels into line with the FOMC's dot plot estimates, and our forecast (Chart 1, right).

Economic fundamentals don't support the market's view that the BoC will outgun the Fed. Canada's labor market isn't seeing wage growth reach the same heights as it is stateside, with immigration helping to add to labour supply. Even after allowing for measurement differences, inflation has not run on as hot during the pandemic north of the border. Moreover, Canada's debt-burdened households require a cautious approach to raising rates in order to avoid squeezing too much discretionary spending from the economy.

The Omicron wave in both Canada and the US is expected to be short lived. A March 25bps hike by the Fed is more than priced in, and won't move the needle materially on CAD. But as we move further into the year, we look for the market to add room for more Fed tightening post-2023. That should support a broad strengthening in the USD, and the loonie will follow the pack in weakening, compounded by a paring of BoC rate hike expectations as the year progresses.

To break 1.30 on CAD, we'll need substantial relief on crude oil prices. That could come if Russia-Ukraine tensions ease, the US reaches a nuclear deal with Iran, US shale output continues to ramp up, or OPEC+ countries redistribute some quota room to countries that have the capacity to deliver more oil.

Chart 1: Markets expecting too much tightening from the BoC (l), and too little from the Fed (r)



Source: Bloomberg, CIBC

USD

Bipan Rai

USD Consolidates, but further gains ahead

Q1 2022: 96.9 | Q2 2022: 97.7 (DXY)

The greenback rallied following the January Fed statement and press conference. Chair Powell struck a hawkish tone by not only indirectly supporting extant market pricing for four rate hikes this year, but also by pushing back against the idea that the recent volatility in the equity market was something that would factor into the committee's decision making. Powell pointed out that his focus is still very much on the real economy and to contain inflation risk, which has "gotten worse" since December.

A rate hike for March is now in the price, and the market is now also pricing in a 30% chance that the Fed will hike by 50bps at that meeting. While we expect the Fed to hike rates four times this year, the market is now leaning towards five. Given the aggressive taper, and signals being sent on quantitative tightening, we don't see the Fed hiking by 50bps increments. With the market already pricing the Fed's first move aggressively, and USD longs a consensus view, we see a period of consolidation in the near-term before the USD finds it's footing again.

EUR

Jeremy Stretch

ECB Doves to keep the euro under pressure

Q1 2022: 1.12 | Q2 2022: 1.11 (EURUSD)

Real money investors moved net long of EUR into early 2022, for the first time since mid-September, a move that coincided with an uptick in implied rate expectations. The market is currently pricing in around 18bp of tightening by year-end, as market-rate assumptions have advanced by around 20bp over the last couple of months. We remain unconvinced of the risk of early ECB action, and see a more resolutely dovish central bank as likely to keep the euro under pressure.

True, the hawks on the Governing Council have become more vociferous of late, but we expect the doves, led by President Lagarde and Chief Economist Lane, to remain in the driver's seat. Chief Economist Lane has suggested that CPI could stabilise around the 2% threshold should some of the pre-crisis disinflationary dynamics not return. Nevertheless, Lane and the bulk of the Governing Council still anticipate CPI easing below the 2% threshold in both 2023 and 2024. Lane has argued that unless wage growth can reach 3%, CPI will not sustain the 2% threshold, underlining policy inertia. The current absence of material second-round wage effects underpins our assumption of ECB policy inertia well into next year.

We entered the year with the market consensus heavily predicated towards a cheaper EUR. The early year EUR short-covering rally has shaken out some of the weaker shorts. The failure to breach the mid-point of the trading range seen over the last two years at 1.1492 supports our notion of EUR weakness. An extension in ECB bond purchases, beyond the expiration of PEPP, precludes early ECB action. The absence of an uptick in wages data points towards EUR shorts being rebuilt as the currency heads towards 1.10 and levels not seen since Q2 2020.

JPY

Jeremy Stretch

Contained inflation below target precludes BoJ policy tightening

Q1 2022: 115 | Q2 2022: 116 (USDJPY)

The BoJ bank has revised its inflation outlook for the first time since October 2014. No longer is its price risk assessment viewed as “skewed to the downside”, but rather “generally balanced”. Nevertheless, inflation is expected to remain well shy of the bank’s 2% inflation target over the next two fiscal years, as the BoJ assumes 1.1% in both periods.

The revision to the inflation language was well discounted. Yet despite the adjustment, the BoJ left its forward guidance unchanged, namely that it expects rates to remain at current or lower levels and will expand the monetary base until inflation exceeds 2% and stays above the target in a stable manner. Moreover, the bank reiterated that it stands ready to ease further, without hesitation, as necessary.

The restatement of the commitment to act as necessary underlines the fact that irrespective of the inflation language revision, the monetary stance remains unchanged. The publication of the BoJ statement of monetary opinions from the January meeting underlines that several BoJ officials want to push back against market speculation that it's prepared to shift towards policy normalization later this year.

While the CPI forecasts may have been modestly raised, revisions to the growth outlook remain mixed. The bulk of Japanese prefectures are under a quasi-emergency situation, as daily Omicron cases continue to register record highs, pointing to an ongoing drag on activity. As BoJ Governor Kuroda continues to detail that Japan remains very far from reaching the 2.0% CPI target, it seems that the bank remains comfortable with a weakening JPY bias.

GBP

Jeremy Stretch

Negative Sterling bias maintained

Q1 2022: 1.34 | Q2 2022: 1.33 (GBPUSD)

In the four weeks following the BoE reversing the emergency 15bp rate cut from March 2020, Sterling appreciated by more than 2% versus the USD and the EUR. The rebound in Sterling valuations proved a function of an aggressive acceleration in 2022 rate expectations. The by-product of the rate repricing was that leveraged players moved net GBP long, for the first time since the start of November.

The GBP position switch was in line with a substantive uptick in the economic surprise index. The above expectations gain in November GDP of 0.9%, resulted in the economy regaining pre-pandemic levels. However, we expect provisional Q4 GDP to reveal that the economy ended 2021 still below pre-pandemic levels, in large part due to the correction in December retail spending.

The moderation in January flash services PMI, marking a third straight reduction, points towards consumers becoming increasingly wary ahead of a prospective slide in real earnings. Headline CPI ended 2021 at a near 30-year high of 5.4%. Prices could peak above 7% into early Q2, in large part due in part to higher energy prices. Under such circumstances, we would be unsurprised should consumer spending be compromised by sliding disposable incomes.

The BoE is set to consider their own balance sheet moderation once rates reach 0.5%, and we expect February to witness back-to-back rate hikes for the first time since 2004. BoE QT will see the bank no longer looking to reinvest maturing gilt proceeds, and that balance sheet . The combination of slower growth and QT points towards a period of policy inertia, potentially for at least six months, in contrast to the 59bp of hikes discounted by May. The correction in assumptions is likely to drag on Sterling valuations. UK political uncertainty is set to remain evident while the current account deficit status of the UK remains a concern should hot money inflows prove to be compromised, pointing towards maintaining a negative GBP/USD bias into mid-year.

CHF

Jeremy Stretch

CHF Underperformance expected as economic growth and inflation to moderate

Q1 2022: 1.05 | Q2 2022: 1.07 (EURCHF)

The broad downtrend in EUR/CHF extended into early 2022, as the cross tested the 1.03 threshold for the first time since May 2015. While we have witnessed a pick up in sight deposits, since an early Q4 trough, the acceleration has proved relatively modest, certainly when compared to Q2 2020 when EUR/CHF threatened the 1.05 threshold. For now, it appears the central bank is less concerned by immediate currency strength. The reticence is likely in large part due to the fact that robust economic performance is prompting a closure of the output gap while headline inflation has accelerated to 1.5%, a level not seen since November 2008.

Currently, it appears that the SNB is happy to tolerate CHF gains against its primary trading partner, the EU. Over the last 12 months, the CHF has appreciated by nearly 4% versus the euro. The presumption is that the bank tolerates CHF gains as it helps preclude imported inflationary pressures. Yet while the SNB may be happy to limit inflation via the currency, (allowing rates to remain at -0.75% well into 2023, in line with the ECB), we expect inflationary pressures to dissipate into the end of the year. We are looking for headline CPI to moderate from the current 1.5% level to back towards 0.6% into year-end.

The easing in inflation will be helped along by a moderation in GDP growth, as we expect a deceleration in both exports and household consumption. The softening in both growth and inflation could bring back the need for an acceleration in SNB intervention. A rebuild in CHF shorts, as investors consider the ramifications of a slowing in activity and moderation in inflation, points towards CHF underperformance.

SEK

Jeremy Stretch

Riksbank action to give SEK wings in 2022

Q1 2022: 10.25 | Q2 2022: 10.00 (EURSEK)

The last three months have seen a disconnect between SEK performance and domestic fundamentals. Since the start of November, the SEK has proven to be the worst performing major, as the currency has depreciated by almost 9% versus the USD and over 5% versus the EUR. The depreciation contrasts with the economic surprise index which is testing one-year highs. With both the manufacturing and services PMIs remaining well above 60, Q4 GDP likely advanced by around 1.0% in the quarter, twice the pace of the corresponding quarter in 2020.

The SEK remains highly correlated with risk assets, as the weekly inverse correlation between the S&P 500 and EUR/SEK has reached all-time extremes in recent weeks. Equity uncertainty, as investors fret over the combination of US monetary tightening, liquidity withdrawal, and geopolitical risk, have compromised SEK valuations. SEK underperformance has been abetted by the continued push back against early tightening by Riksbank Governor Ingves, as the bank does not intend to tighten ahead of 2024.

Riksbank policy inertia has been partly vindicated by the latest Prospera inflation expectations survey. Medium-run inflation expectations, over a two and five-year time horizon remained at 2.0%, in line with the CPIF target. Moreover, CPIF base effects will soon become more favourable, prompting the targeted CPI rate to retreat from more than double the target, 4.1%, at year-end. Yet despite central bank conviction over an easing in price pressures, we expect CPI to remain above target through the year ahead, ultimately pushing the Riksbank to act earlier than they currently anticipate. While we will need to see a stabilization in risk sentiment prior to a rebound in the SEK, we maintain a constructive bias, predicated upon economic fundamentals and a bias towards a more pro-active central bank.

Commodity FX

NOK

Jeremy Stretch

All signs point to NOK outperformance as Norges Bank continues hiking rates

Q1 2022: 9.84 | Q2 2022: 9.75 (EURNOK)

Over the last two months, the NOK has been an outperformer, gaining almost 3% versus the EUR. The advance comes as Norges bank maintained its tightening bias, and rates were hiked for a second time in this cycle, to 0.50% in December. We look for another 25bp at the 24 March meeting, given supportive macro indicators. Above expectations CPI, and strong mainland GDP allied to an easing in Covid restrictions underlines a constructive outlook for 2022. Robust economic data, including a tight labour market, have sent the economic surprise index towards levels not seen since mid-2020.

Against the backdrop of underlying macro activity likely matching the 4.0% GDP growth trajectory seen in 2021, we expect pressure on the Norges bank to accelerate the pace of tightening, adding extra impetus to the NOK. Beyond a positive growth narrative, inflationary pressures continue to outpace expectations. Although a core rate of 1.8% may appear less of a concern than in many other jurisdictions, it remains above central bank expectations. Headline CPI at 5.3%, above the 4.5% level projected by the Norges Bank, underlines the risk of tighter monetary policy boosting the NOK.

Moreover, we can expect ongoing fiscal support, as the government is set to spend some NOK355bn from the sovereign wealth fund this year, above the NOK322bn from a year ago. While the fiscal boost may be smaller than that implied in the October budget, it does imply ongoing government NOK purchases as the government translates flows from the wealth fund. The combination of monetary and fiscal support maintains a positive NOK backdrop. Hence we are looking for EUR/NOK to trade back towards November lows at 9.84 by the end of the quarter.

AUD

Patrick Bennett

USD gains & risk aversion

Q1 2022: 0.73 | Q2 2022: 0.74 (AUDUSD)

AUD/USD has been trading lower recently on USD gains, and a general downdraft in risk pairs in the wake of a more hawkish FOMC. The December low of 0.7082 has been broken, though follow-through from there has been limited so far. The low 0.7000 range found strong support in early December, and our view since then is that the outlook for the Australian economy has improved, both outright and relative to the US and other major economies. We expect the RBA to deliver a more upbeat message at their February meeting, particularly in the wake of strong employment and above expectation CPI data. We see that as countering some of the USD influence in AUD/USD, and the pair eventually finding support.

Australian bond yields are keeping pace with moves in other major markets. The spread AU10s-US10s has been broadly stable the last couple of months, averaging around 10bps. We see potential for slight widening toward 20-25bps. That move will be encouraged by RBA very likely ceasing bond buying in mid-February. We expect the bank to end its purchase program without any graduated taper.

Better economic data and the RBA moving to a less-accommodative stance over the next weeks will underpin pricing for hikes to come later this year. As with other currencies, the best gains are often seen in the early stages of pricing for those hikes. We wish to be buyers of AUD weakness, in particular vs other majors including GBP, in preference to vs the USD.

NZD

Patrick Bennett

Looking to RBNZ

Q1 2022: 0.68 | Q2 2022: 0.68 (NZDUSD)

RBNZ hiked rates for the first time in this cycle back in October, and added another hike in November. The bank hasn’t met since, and the next decision is not until February 23rd. We expect rates to be lifted 25bps to 1.00% at that time.

The range of NZD/USD over the last 18 months has been 0.6500-0.7500, and spot is currently trading well toward the low side of that. Extending two years back, that range widens to 0.5500-0.7500. On the basis that the economy continues to recover well, those low levels that were recorded in the early days of the COVID pandemic are not expected to be revisited. We expect 0.6500-0.7500 to hold over coming months.

We expect RBNZ hawkishness exhibited in 2021 will continue this year. The earlier start than other major central banks might have been suggestive of being able to do more now and less later. Though as elsewhere, inflationary pressures, and in the particular the case of New Zealand, labour and wage pressures remain. For the currency, if we consider currently priced terminal rates using 5y5y swaps, and the track with NZD/USD, we note the currency showing as undervalued. It is a similar picture when considering the spread between 10-year bond yields and NZD/USD, i.e. spot undervalued by reference to the previous relationship.

Resolving the current situation of NZD/USD underperformance highlights a greater sensitivity to near-term re-pricing than to the terminal policy rate or term yields. As the market begins to refocus on New Zealand data and the likely path of RBNZ tightening, we expect the NZ policy rate to reach 2.00% in 1Q next year, we see support for NZD/USD building.

ZAR

Jeremy Stretch

Markets expecting too much tightening from the SARB

Q1 2022: 15.75 | Q2 2022: 16.00 (USDZAR)

The South African Reserve Bank has followed the November hike with a second 25bp move, taking rates to 4.0%. After beginning the process of unwinding pandemic-inspired policy easing at their previous meeting, it seems that the central bank remains biased towards a slow and progressive data-dependent tightening cycle. After witnessing CPI threaten the top of the 3-6% CPI target range in December, we expect a potential overshoot in early 2022. Despite energy prices being set to drive CPI well beyond the SARB target threshold in H1, we look for price pressures to moderate in H2, partly due to less aggressive base effects.

The rates trajectory is set to remain data-dependent. Therefore, if the central bank is correct in assuming that prices will be back in line with the mid-point of the CPI target range in two years, 4.5%, this would suggest that the market is overly aggressive in terms of pricing in 100bp of tightening in H1 this year. Although the SARB may have hiked at consecutive meetings, we do not expect another move until the May meeting.

The ZAR has proved a top performer versus the USD and EUR over the last two months. Contingent to that outperformance has been an aggressive spike in nominal rate expectations, over the period implied rates six months forward have advanced by around 75bp. The ZAR is an emerging market currency that is partly sheltered from the impact of Fed hikes due to elevated nominal yields. However, market recognition of too much tightening being discounted, impacting real rates, suggests that the recent rapid accumulation of ZAR real money speculative positions risks correcting. As a result, we look for USD/ZAR to trade back towards 16.00 into mid-year.

LATAM FX
MXN

Luis Hurtado

Absent local headlines, MXN moving in line with global sentiment

Q1 2022: 21.0 | Q2 2022: 21.5 (USDMXN)

Absent negative local headlines and following the dissipation of concerns regarding the spread and impact of the Omicron variant across markets, MXN enjoyed a sharp rally since December. Although we maintain our call for a much higher USD/MXN for the rest of the year, the risks associated with other regional currencies during the first half of 2022 should favour the peso in the short term, keeping USD/MXN within the 20.30-21.00 range.

On the monetary policy front, carry is still one of the biggest advantages for the MXN given the electoral risks embedded in the COP and BRL, while the CLP, although rebounding, still has to go through the writing of the new constitution. That being said, note that the MXN is quick to react to global market uncertainties, something that we only expect to increase as the Fed approaches its first rate hike. The market is already pricing four hikes this year, one each quarter, but note that calls for a frontloading of the tightening cycle are increasing. Moreover, we have yet to see the repricing of Banxico's monetary policy path to take into account what's likely to be a more dovish view at the central bank starting in 2022, while we expect fiscal risks to resurface next year as the government support to Pemex continues.

BRL

Luis Hurtado

BRL Gains ground as Lula flirts with centrist parties

Q1 2022: 5.70 | Q2 2022: 5.70 (USDBRL)

USD/BRL dropped below the 5.40 mark as Lula stated his intention to have centrist Gerardo Alckmin as his vice president. Although the BRL strengthening was somewhat justified by this development, we do not expect such a stance to persist for long. Note that Bolsonaro has for most of his mandate tried to gather the support of centrist parties, and losing that pillar would increase fiscal risks in the near term as public sector employees ask for further wage increases.

This situation increases the odds of further tweaks to the 2022 budget, or even calling the calamity clause to bypass the spending cap. Moreover, aside from the news of Alckim, Lula and his team have been far from signaling fiscal responsibility, and even suggested moving away from the current fiscal anchors, while a public sector strike is set to begin in February. We maintain our upward USD/BRL bias towards the 5.75 mark.

CLP

Luis Hurtado

BCCh Increases overnight rate by 150 bps

Q1 2022: 780 | Q2 2022: 800 (USDCLP)

The BCCh increased the overnight rate by 150 bps to 5.50% against the market consensus and our forecast for a 125bps rate hike. Furthermore, the BCCh maintained a hawkish tone and the statement did not rule out a similar rate increase at the next meeting (although we have to wait for the minutes on Feb 10 for more details). As in previous rate announcements, the CB highlighted high inflation (420bps above target), above target inflation expectations and higher-than-expected growth as the main reasons behind this decision. With that decision, we increased our terminal rate forecast to 7.00%-7.25%, from the previous 6.75%.

Dissipating electoral uncertainties and persistently high copper prices have supported the CLP since the start of the year. Recent upward surprises in inflation underscore our expectation that the aggressive monetary tightening cycle will continue in Q1, while President-elect Gabriel Boric has shown signs of moderation in recent comments and in the nomination of his Cabinet. Finally, a look at regional currencies shows that the BRL and COP are each entering an election cycle, while the MXN tends to react quite aggressively to risk-off moves, making it the first currency likely to react to any yield surprises from the U.S. Hence, we expect the CLP to continue to outperform for most of Q1 and we maintain our downward USD/CLP bias back to the 790 mark.

Nevertheless, with the market focused on the Fed, geopolitical news and the risks surrounding the new constitution process for the remainder of H1 2022, we do not see much room for USD/CLP to maintain a sustained downward trend below 790 (778-780 is the next level to watch). That being said, for those looking to benefit from the divergence in regional dynamics, we suggest going long CLP/COP, as mentioned in our yearly outlook, with a 5.40 target.

COP

Luis Hurtado

USD/COP to test all-time highs ahead of elections

Q1 2022: 4200 | Q2 2022: 4100 (USDCOP)

Banrep increased the overnight rate by 100 bps to 4.00%, against market consensus and our forecast for a 75bps increase. Banrep left the door open for similar rate increases in the short term as inflationary pressures remained in place and both core and headline inflation are above target. Moreover, the central bank revised its 2023 inflation forecast up to 4.3% from the previous 3.7%. We expect Banrep to increase the overnight rate by another 100bps in March and we revised our terminal rate forecast for Q3 to 7.50% (previously 7.25%).

Looking at USD/COP, although we recognize that the global supply shock and recent upside surprises to headline inflation suggest a front-loading of the tightening cycle, current political dynamics should prevent a sustained appreciation of the COP for most of H1. The 2022 legislative and presidential election cycle is marked by a clear move to the left in the region, while locally, the protests at the end of 2019 and in early 2021 have supported the increase in popularity of leftist candidates. Note that, contrary to the rest of the region, Colombia has historically bounced between right and centre-right political parties, with little influence of the left in a congress dominated by government allies over the last few decades. This, is turn, has ensured (for the most part), a stable macroeconomic background.

That all being said, current local and regional trends suggest a much greater representation of the left in the next four years, adding another layer of risk ahead of the May 29 presidential election. We anticipate USD/COP moves that are similar to, if not greater than, those experienced in Chile and Peru in 2021, bringing USD/COP above its historical highs before the end of Q1. Hence, we maintain our long USD/COP target at 4200 (published January 12).

Asia FX
CNY

Patrick Bennett

Appreciation continues, but narrowing differentials suggest caution

Q1 2022: 6.30 | Q2 2022: 6.25 (USDCNY)

USD/CNH spot has continued on a path of stability, and slow but steady downside over the last months. Spot has held within 6.3300-6.4100 since October, recently re-testing the low side of that range before some consolidation. During the same time, market interest has picked up in the forward market. One year USD/CNH forward points have dropped from as much as 1,900 to now be trading near 1,050. The key driver for the move has been the pricing for higher rates in the US, while Chinese policy has again been eased.

For China, PBoC policy messaging is about stability, and we expect any further easing that is delivered this year, and we expect more in 2Q, to be primarily delivered through further reducing banks RRR.

Over a number of years, the spread between China and US yields had a fair correlation with the track of USD/CNH. Our USD/CNH view is for further downside in 2022, extending the move from 2021, in which the CNH and CNY gained around 2.5% against the USD. At first glance, and in consideration of the narrowing interest rate differentials, that might suggest less support for CNH gains against the USD. We agree on that factor, but stress that it is a matter of degree. Though differentials are closing, the yield advantage, both in nominal and real terms, remains in favour of the CNH.

We also note that other factors, including a strong trade surplus, positive current account, and investor portfolio demand, will all continue contributing to projected CNH gains. Nonetheless, in light of a more hawkish Fed and more accommodative PBoC, we have tempered future appreciation targets slightly.

As differentials narrow further, potentially upon the first Fed hike, we anticipate the one-year forward points can trade under 1,000. Left hand side pressure in the forwards seen already may also be reflecting corporate interest to cover future inflows. That is supported by PBoC data on forward cover levels, which show a pick up in the latest months as CNH strengthened. At the same time, the amount of FX sold by banks on behalf of clients, again as reported by the PBoC, has been at relatively low levels given recent wider trade surpluses. The implication is that there is foreign currency on the sidelines that has not yet been converted. That may be partly driven by reluctance to buy the yuan in the spot market at levels presently perceived as strong.

If US terminal rates are found to be under-priced and/or China’s economy loses greater momentum than expected, differentials will narrow and forward points will sell off to a greater degree. For USD/CNH, given levels of currency sold by banks for clients remains somewhat light to recent surpluses, there will still be potential flows to cap spot on any rally. Overall, we look for both a lower USD/CNH, and lower outright levels over coming months.

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