CIBC

CIBC CAPITAL MARKETS

Economics and FICC Strategy

MONTHLY FX OUTLOOK

January 23, 2023

USD to fall out of favour over 2023

Currency	What's changed
USD	With the Fed set to undershoot market expectations for the peak fed funds rate, and attention turning to policy tightening in other advanced economies, look for the USD to weaken in 2023.
CAD	C$ stuck in neutral in Q1 as markets are almost fully priced for BoC and Fed action, before gaining ground over the rest of 2023 as the USD falls out of favour.
EUR	An improving macro backdrop and continued policy tightening from the ECB portend euro strength in 2023.
GBP	Markets likely expecting too much tightening from the BoE this year, eliminating any GBP upside in the next few quarters.
JPY	BoJ tightening and interest rate spread compression favour JPY strength ahead.
Commodity FX	AUD and NZD have both made strong starts to 2023, underpinned significantly by a revival in optimism regarding the Chinese economic outlook.
LATAM FX	Colombia and Mexico are near the end of their tightening cycles, while Brazil's slight dissipation of political and fiscal uncertainties favour the BRL.
FX Asia	Broad policy support for activity and easing of restrictions in the property and technology sectors suggest further strength to play out this year for CNY.

Currency outlook

End of period:	Jan 23, 2023	Q1 '23	Q2 '23	Q3 '23	Q4 '23	Q1 '24	Q2 '24	Q3 '24	Q4 '24
USD / CAD	1.34	1.34	1.32	1.32	1.31	1.31	1.30	1.29	1.28
EUR / USD	1.09	1.07	1.10	1.11	1.13	1.14	1.15	1.15	1.16
USD / JPY	130	130	125	123	121	120	118	116	115
GBP / USD	1.24	1.21	1.24	1.24	1.26	1.27	1.28	1.28	1.30
USD / CHF	0.92	0.92	0.91	0.91	0.90	0.91	0.90	0.91	0.91
USD / SEK	10.24	10.28	9.86	9.64	9.34	9.17	8.96	8.91	8.84
AUD / USD	0.70	0.68	0.69	0.70	0.71	0.72	0.74	0.75	0.76
NZD / USD	0.65	0.63	0.63	0.65	0.66	0.67	0.68	0.69	0.70
USD / NOK	9.83	9.91	9.55	9.32	9.07	8.90	8.74	8.65	8.49
USD / ZAR	17.15	17.25	16.90	16.70	16.50	16.35	16.20	16.10	16.00
USD / BRL	5.2	5.2	5.1	5.2	5.4	5.2	5.2	5.4	5.0
USD / MXN	18.8	20.0	21.0	20.5	19.8	20.0	20.5	21.5	21.0
USD / COP	4543	5000	5100	4800	4800	4600	4600	4800	4700
USD / CLP	811	900	920	920	960	920	900	920	880
USD / CNY	6.78	6.85	6.85	6.81	6.79	6.75	6.73	6.71	6.69
USD / KRW	1236	1250	1250	1200	1185	1150	1140	1130	1120
USD / INR	81.4	82.0	82.0	81.0	79.5	78.0	77.0	76.5	75.5
USD / SGD	1.32	1.33	1.33	1.33	1.32	1.31	1.31	1.30	1.29
USD / TWD	30.4	30.5	30.5	30.3	30.1	30.0	29.8	29.7	29.5
USD / MYR	4.29	4.40	4.40	4.30	4.20	4.05	4.00	3.90	3.80
USD / IDR	15075	15250	15250	15000	14900	14800	14700	14550	14500

Other crosses

End of period:	Jan 23, 2023	Q1 '23	Q2 '23	Q3 '23	Q4 '23	Q1 '24	Q2 '24	Q3 '24	Q4 '24
CADJPY	97.5	98.6	94.7	93.2	92.4	91.6	90.8	89.9	89.8
AUDCAD	0.94	0.93	0.91	0.92	0.93	0.94	0.96	0.97	0.97
GBPCAD	1.65	1.63	1.64	1.64	1.65	1.66	1.66	1.65	1.66
EURCAD	1.45	1.44	1.45	1.47	1.48	1.49	1.50	1.48	1.48
EURJPY	142	142	138	137	137	137	136	133	133
EURGBP	0.88	0.88	0.89	0.90	0.90	0.90	0.90	0.90	0.89
EURCHF	1.00	0.99	1.00	1.01	1.02	1.04	1.04	1.05	1.06
EURSEK	11.13	11.15	10.85	10.70	10.55	10.45	10.30	10.25	10.25
EURNOK	10.69	10.62	10.51	10.35	10.25	10.15	10.05	9.95	9.85

Key indicators – Latest data point

End of period:	Quarterly real GDP (y/y %)	CPI (y/y %)	Current acct (% of GDP)	Central bank rate (%)
US	1.9	6.5	-3.4	4.375
Canada	3.9	6.3	-1.6	4.250
Eurozone	2.3	9.2	-0.3	2.000
Japan	1.5	3.8	2.4	-0.100
UK	1.9	10.5	-4.2	3.500
Switzerland	0.7	2.8	8.1	1.000
Sweden	2.5	12.3	4.0	2.500
Australia	5.9	7.3	1.0	3.100
New Zealand	6.4	7.2	-7.9	4.250
Norway	2.5	5.9	27.4	2.750
South Africa	4.2	7.4	0.7	7.000
Brazil	3.6	5.8	-1.5	13.750
Mexico	4.3	7.8	-0.7	10.500
Colombia	7.0	13.1	-6.5	12.000
Chile	0.3	12.8	-9.8	11.300
China	2.9	1.8	2.5	2.750
South Korea	3.1	5.0	2.8	3.500
India	6.3	5.7	-2.7	6.250
Singapore	2.2	6.7	19.5	n/a
Taiwan	4.0	2.7	13.8	1.750
Malaysia	14.2	4.0	2.1	2.750
Indonesia	5.7	5.5	0.8	5.500

CAD

Katherine Judge

CAD Stuck in neutral, but not for long

Q1 2023: 1.34 | Q2 2023: 1.32 (USDCAD)

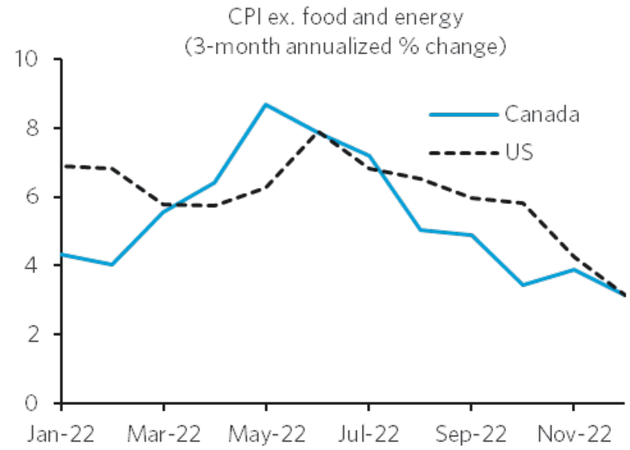
With markets almost fully priced for both the Bank of Canada and Federal Reserve over the rest of Q1, expect the loonie to be stuck in neutral in the near term, with USDCAD likely ending the quarter at 1.34. We expect to see a final 25bp hike from the BoC in January, and for the Fed to deliver two 25bp hikes over Q1. With each central bank likely to hold rates steady thereafter for the rest of 2023, movements in CAD in the latter part of 2023 will be driven by the general direction of major currency moves against the USD.

On that score, three months of good news on the inflation front in the US, and a weakening in growth indicators at the end of 2022, should be a sign that the fed funds rate doesn't have to head much higher. In Canada, the resilience in the labour market in December will likely be enough to justify a final quarter-point hike from the BoC, with risks to the housing market and elevated household debt levels a barrier to further increases, especially with the lagged impacts of past rate hikes still to come. That would leave the ceiling on the fed funds range at 5.0%, and the BoC's overnight rate at 4.5%. Indeed, both central banks are seeing core CPI trend in the right direction on a three-month annualized basis (Chart).

Despite that expected interest rate differential, we see a broad weakening trend in the USD unfolding this year as attention turns to policy tightening in other advanced economies, and the greenback unwinds some of its safe-haven currency bid to come into better alignment with trade fundamentals. We also expect the Fed's peak policy rate to undershoot market expectations slightly, and the loonie could therefore gain a tailwind in the second half of 2023, mirroring the strength expected in other majors. We expect USDCAD to end the year at 1.31.

In 2024, both the BoC and the Fed will likely be cutting interest rates towards neutral in lock step starting in Q1, making other factors, namely commodity prices and broad moves in the USD against other currencies, the main driving forces behind an expected appreciation in the CAD. With global growth likely to receive a lift as central banks outside of North America start to normalize policy rates, and higher commodity prices benefitting Canada's export sector, look for USDCAD to reach 1.28 in 2024.

Chart 1: Good news on the inflation front in Canada and the US



Source: BLS, Statistics Canada, CIBC

USD

Bipan Rai

Downhill for the USD in 2023

Q1 2023: 103.2 | Q2 2023: 100.3 (DXY)

It's been a rather inauspicious start to the year for the USD. And for good reason of course, as there are more than a few shifts happening in the macro space right now that are driving valuation lower for the greenback. First, key policy pivots in China (on zero Covid, rapprochement with the US) have supported commodity prices – most notably metals. Second, the Bank of Japan's slow shift away from Abenomics-era policy continues to buttress the JPY as considerable portfolio flows migrate back to Japan. Third, the ECB is now more hawkish than the Fed, which is helping extend gains for the EUR.

Looking ahead, we see some modest upside in the USD from potential data surprises that might tilt market pricing for Fed rate hikes at the margin. However, we'd look past that as the upcoming 'step down' to 25bps hikes has been telegraphed by the market for now. Instead, the USD should continue to come under pressure in the quarters ahead as the protracted showdown over the debt ceiling leads to an increased premium on USD valuation. When layered with a much better backdrop outside of North America, this year is shaping up to be a difficult one for USD bulls.

EUR

Jeremy Stretch

Euro to appreciate in 2023, supported by improved macro backdrop and ECB tightening

Q1 2023: 1.07 | Q2 2023: 1.10 (EURUSD)

The combination of perceived ECB activism, particularly relative to the Fed, allied to an improved macro backdrop, as eurozone recession risk have dissipated, have paced the 10% EUR rebound versus the USD since the start of Q4. Contingent to the uptick in EUR valuations has been a jump in real money long positions. Real money investors have switched from modest net short positions to the largest net EUR holding since February 2021.

Key to the recovery narrative has been the combination of the unexpected Chinese re-opening, boosting German manufactured exports, while the continued retreat in the European benchmark gas contract, prices are now below levels seen prior to the Russian invasion of Ukraine, has provided support. Beyond mere price concerns, the easing of supply fears, European gas tanks remain at more than 80% of capacity, well above usual levels for the time of year, is beneficial for the macro backdrop. Moreover, the opening of Germany's first floating LNG terminal extends the transition from a greater than 50% reliance on Russian-supplied gas. Reduced gas prices and security of supply materially contrast previous energy-related headwinds.

The improved macro backdrop comes as the ECB now details that "rates will still have to rise significantly at a steady pace to reach levels that are sufficiently restrictive to ensure a timely return of inflation to the 2% medium-term target." Breaking down the language suggests that the bank is looking at adjusting policy in 50bps clips, at least across Q1. Despite source stories suggesting that the ECB could consider easing back to 25bps in March, we would treat such stories with caution as even doves such as ECB Chief Economist Philip Lane acknowledge the need for policy to become restrictive. Overall, we would be wary of EUR gains proving potentially over-extended, albeit we would expect any correction to be short lived.

JPY

Jeremy Stretch

BoJ tightening to boost JPY valuations ahead

Q1 2023: 130 | Q2 2023: 125 (USDJPY)

After an unprecedented two terms at the head of the BoJ, the transition away from the policy leadership of Governor Kuroda underlines an increasing probability of the bank pivoting away from uber-dovishness characterized by Abenomics. In our year-ahead publication, we detailed that the soon-to-depart BoJ Governor, (his replacement will take over on 9 April), looked "intent on maintaining an easy policy stance until current cost-pull inflation turns into demand-pull price gains. Moreover, Kuroda determined that current monetary easing remains appropriate, at least until there are sustainable wage gains. However, in view of concerns over market functioning, relating to the government bond market, the BoJ unexpectedly accelerated progressive policy normalization via December's unexpected monetary policy adjustment.

After the December policy surprise, the bank adjusted its Yield Curve Control (YCC) target by 25bps to +/- 50bps; the market attempted to pressure the bank into a further policy adjustment at the January policy meeting. Although the bank pushed back against further policy changes, we would regard policy normalization as being merely delayed not derailed. Key to further policy normalization is a sustainable upward adjustment to inflationary pressures. The key variable as regards the broad policy outlook relates to the spring wage round. Should upcoming wage deals prove inflation busting, we can expect the next round of CPI forecast adjustments, due in April, to point toward CPI testing the 2% threshold; such a scenario warrants policy tightening.

We expect the BoJ to tighten policy, potentially including an exit from negative rates into H2. We expect spread differentials to continue to move in favour of the JPY. Indeed as Japan is the largest foreign holder of UST, should long-end spreads continue to compress, we should expect a reduction in Japanese appetite for higher-yielding overseas assets, this points towards a stronger JPY.

GBP

Jeremy Stretch

Market expecting too much from the BoE

Q1 2023: 1.21 | Q2 2023: 1.24 (GBPUSD)

We enter 2023 on the back of the most aggressive BoE tightening since 1988, as the bank hiked by a cumulative 325bps, hiking at each of the eight MPC meetings. The bank looks set to extend the run of policy tightening to ten straight BoE gatherings; remember, they began the cycle in December 2021. However, we anticipate the current 102bps of hikes priced for 2023, the market is pricing a terminal rate of almost 4.50%, remains too aggressive.

The graduated acceleration in the pace of BoE policy tightening through 2022, culminating in November's first-ever 75bps adjustment, underlines the fact that the BoE was playing policy catch-up. However, the December MPC not only witnessed a moderation in the pace of tightening but also a substantive policy spilt. Two members viewed no adjustment as being justified while Mann continued to argue for 75bps. In view of an expected moderation in the BoE CPI profile, we would expect MPC hawks to become increasingly isolated. The primary factors which will influence the BoE's reaction function are domestic price and wage-setting behaviour.

Although there are signs of a graduated easing in the labour market, vacancies dropped by 75,000 in Q4, that average earnings advanced by 6.4% in the three months to November boost to the presumption of the BoE being forced to consider another 50bp move. However, despite elevated headline earnings real wages remain on the retreat. Consumer-driven inflationary pressures remain at risk of being compromised by the fastest decline in living standards on record. Broadening public sector strikes add to consumer headwinds. In the six months between June and November, some 1.6m working days were lost to labour disputes; this marks the highest level since 1990. With further substantive public sector strikes scheduled for February broad macro activity and overseas confidence in UK assets risks being tested.

CHF

Jeremy Stretch

Widening policy rate differential with ECB suggests CHF weakness ahead

Q1 2023: 0.99 | Q2 2023: 1.00 (EURCHF)

The SNB extended policy normalization, taking rates to 1.00%, following a further 50bps hike at the quarterly December policy meeting. Although the SNB may have moderated its CPI profile, they now anticipate a 3.0% peak in the current quarter, as opposed to anticipating a 3.4% back in September, the bank remains predicated towards additional tightening. In that context, we look for another 50bps adjustment in March. The extension of SNB hawkishness is a function of the bank assuming that headline prices are not expected to retreat back below the 2% threshold until early next year. We would note that the bank remains mindful of the risks of a broadening range of price increases, albeit core prices appear to be stalling around 2%.

Although we expect additional SNB pro-activity, we expect the bank to be less activist than its ECB counterpart. Central bank policy reticence, relative to its eurozone counterpart, is due in part to residual Swiss real estate concerns. We would also note that domestic growth assumptions remain relatively modest. While the Swiss economy is expected to expand by around 0.5% in 2023, a widening output gap remains a lasting concern.

While eurozone recession risks continue to dissipate, Swiss macro assumptions remain relatively contained. In this context we would note that the Swiss economic surprise index remains heavily in negative territory, in contrast to the comparative eurozone series. Narrowing growth differentials add to the presumption widening ECB/SNB policy divergence. Policy differential ended 2022 at 100bps, we would expect that to widen to 150bps by the end of Q1. Such policy widening points towards EUR/CHF remaining well supported.

SEK

Jeremy Stretch

Improved risk sentiment should support SEK ahead

Q1 2023: 11.15 | Q2 2023: 10.85 (EURSEK)

The high beta status of the SEK has done little to protect its value of late. Over the last month, the SEK has proved the G10 laggard against both the EUR and USD, moreover the Swedish currency depreciated by more than 13% versus the USD over the last twelve months. The continued uptrend in domestic price pressures, benchmark CPIF came in at 10.2% in December, we have not witnessed a higher CPI print since 1991, points towards a 50bps hike from the Riksbank at the 8 February meeting. Such a hike will take rates to 3.00%, as recently as early Q4 the central bank assumed a 2.50% terminal rate peak.

A 50bps hike next month will see the target rate reach 3.00% and levels not seen since Q4 2008. Moreover, in view of CPI having yet to peak, a terminal rate in excess of 3.25% is now being priced in by the market. Part of the reasoning for the higher and later CPI peak comes via the currency, a more constructive SEK backdrop would help ease inflationary pressures and moderate the policy burden on the central bank.

The challenge for Swedish consumers and policymakers alike comes via twin headwinds, elevated household indebtedness allied to a fragile housing sector. In terms of the former according to OECD estimates at the end of 2021 household debt stood at 203% of GDP. Elevated household leverage is a function of housing-related borrowing. However, as house prices have eased by around 15% from the March 2022 peak, it's less than surprising that external investors have remained somewhat circumspect as regards the SEK.

The SEK remains leveraged to both risk and European growth prospects. With the former benefitting from the Chinese re-opening narrative and the retreat in benchmark European gas prices despite domestic risk criteria we would expect graduated SEK gains through 2023.

Commodity FX
NOK

Jeremy Stretch

Norges Bank supports NOK appreciation through lower foreign currency purchases

Q1 2023: 10.62 | Q2 2023: 10.51 (EURNOK)

Although the Norges Bank left rates at 2.75% at its January meeting, the bank remains on course to tighten by a further 25bps in March. However, we would expect the bank to conclude the policy tightening once rates reach 3.00%, remember they were an early adopter of policy tightening, ending zero rates as early as September 2021. Rates are near the terminal rate despite the fact that the December Monetary Policy Report detailed a higher inflation profile, headline CPI is still expected to be above 2.5% by the end of 2025.

We can expect policy tightening to stall as macro assumptions remain relatively downbeat. The central bank's latest Regional Survey detailed macro 'prospects are the weakest since January 2009.' Beyond weakening regional prospects, a leveraged consumer sector remains a source of concern. A retreating housing market continues to post challenges to domestic financial sector stability. House prices ended 2022 at 2.6% yoy, prices peaked at 12.4% in June 2021.

The one obvious macro bright spot remains net trade. Although natural gas prices may have moderated from 2022 extremes, the current account remains elevated. The OECD estimates the current account surplus is likely to be around 23.6% of GDP in 2023. While the trade surplus remains substantive, the moderation in Norges bank daily purchases of foreign currencies is notable. The central bank announced it intends to buy NOK1.5bn a day in January, down from NOK1.9bn in December and a peak of NOK4.3bn in October. The reduction suggests the Norges bank is intent on allowing the NOK to strengthen, easing inflationary pressures via the currency, rather than risking greater economic dislocation via aggressive additional hikes.

AUD & NZD

Patrick Bennett

Early year gains face near-term headwinds

Q1 2023: 0.68 | Q2 2023: 0.69 (AUDUSD)

Q1 2023: 0.63 | Q2 2023: 0.63 (NZDUSD)

We have a medium-term positive outlook for both the Australian and New Zealand dollars, though are currently wary that that the strong gains already seen this year have being leaning disproportionally on market enthusiasm for a rapid recovery in China, and in doing so, have somewhat neglected the looming effects of domestic monetary tightening already seen and still to come, that will be a severe constraint on activity. The current outlook is for some consolidation in both AUD and NZD before gains through the remainder of the year. The near-term prompt for that is a retracement and pause being seen in USD/CNH.

In the medium-term, the leverage of both the AUD and NZD to a significantly more constructive China outlook than previously anticipated is real, and is more so for AUD. A recovery in China and the policy pivots across broad sectors of the economy, have capacity to provide an echo of Chinese support to global activity as was seen post 2008-09. The echo may be faint for now, but responders should eventually be those economies and currencies with greatest leverage to the story. In that vein, AUD stands head and shoulders clear of the pack, by virtue of its position as an exporter of industrial commodities. In the years 2009-10, AUD gained upwards of 40% against the USD.

The RBA looks set to raise rates to 3.50%, somewhat less restrictive than other major economies. The impact on AUD will be a balance between negatives from compressed interest-rate differential support, and the positives of less-restrictive domestic settings. We see the positives having greater medium-term impact. We also see that gains in Australia's terms-of-trade via renewed demand for industrial commodities from China can underpin medium-term AUD strength.

RBNZ hawkishness remained prominent through the last months of the year, concluding with a 75bps hike in

November. The bank has forecast the policy rate being raised to 5.5%, alongside a domestic recession. The faster than expected recovery in China and anticipated turn in the USD does provide some counter to high-beta risks for the NZD from overall slower global growth. Though we see that more of a 2Q-3Q story than the current period.

Any NZD support via a higher domestic rates which widens interest rate differentials with other majors will be countered by headwinds to domestic activity, especially in the housing market as is already being seen.

ZAR

Jeremy Stretch

Improved risk sentiment a positive for the ZAR

Q1 2023: 17.25 | Q2 2023: 16.90 (USDZAR)

The performance of the ZAR remains closely aligned to global risk appetite and broad macro activity. The graduated improvement in the former, paced by a strong bounce in the US S&P index, has prompted speculative investors to return to ZAR longs over the last month. The positioning reversal comes as real money net ZAR shorts tested post-Covid extremes into early December. While the ZAR remains highly correlated with US stocks, notably the S&P, the domestic backdrop also appears to be witnessing a graduated uptrend. Manufacturing sentiment tends to be a lead indicator for USD/ZAR. As a consequence, the near 5-point gain in ABSA manufacturing sentiment across Q4, confidence bounced from a September low of 48.2 to 53.1, we have not seen a stronger quarterly gain since Q1 2021, points towards a constructive backdrop into 2023.

Having seen the SARB hike rates by 325bps in 2022, to the current 7.00%, it seems that the central bank is nearing the end of the tightening cycle. Although the central bank is set to remain vigilant as regards the policy backdrop, we would expect rates to peak at 7.25%. While the SARB looks close to the terminal rate, the macro outlook remains at risk of being compromised by the ongoing domestic energy crisis and localized political uncertainty. The prospect of continued load shedding, (power cuts) risk compromising the recent PMI uptrend. In terms of politics, although current President Cyril Ramaphosa retained ANC party leadership, that allies of the President lost the battle for the deputy leadership suggests the ruling party appears divided. Internal division could undermine external investor sentiment should it manifest itself in continued infighting.

LATAM FX
MXN

Luis Hurtado

Reaching the end of the tightening cycle

Q1 2023: 20.0 | Q2 2023: 21.0 (USDMXN)

Banxico's governor Jonathan Heath stated on January 16th that the central bank should keep the overnight rate at its peak for a minimum of six months. Heath's comments added to his view of at least another 25bp rate hike in February, and a terminal rate between 10.75%-11.50%. Looking at prices, December's CPI came it at 7.82% y/y, slightly above the 7.80% posted in November, but lower than the 7.84% expected by consensus. More importantly, core inflation fell to 8.35% y/y from 8.51% y/y in November. With these numbers, average quarterly inflation reached 8.0% y/y in Q4, below the 8.1% y/y forecasted by the central bank.

Although we agree with Heath's view on the need for at least another 25bp rate increase given above target core and headline inflation, we see Banxico moving to a data dependent stance next month as CPI comes in slightly below the most recent central bank forecast, likely ending it tightening cycle at 10.75%. Moreover, note that the market continues to price aggressive rate cuts during the second half of 2023, bringing the overnight rate closer to 9.25%-9.50% by the end of the year. Hence, though recently breaking lower and pointing to its pre-pandemic level (18.50-18.52), we would not chase the current USD/MXN downward trend from current levels.

BRL

Luis Hurtado

Reduction of fiscal risks supports the BRL

Q1 2023: 5.2 | Q2 2023: 5.1 (USDBRL)

It was an eventful start to January for Brazilian assets. USD/BRL climbed above the 5.30 mark following the chaotic protest on Sunday, January 8th, as Bolsonaro supporters stormed into the capital's government buildings. However, the government's move to secure critical infrastructure, the overall risk-on move driven by lower US yields, and optimism coming from the reopening of China, pushed USD/BRL to its 5.10-12 support by the end of the second week of January.

Moreover, Finance Minister Fernando Haddad announced a series of measures to reduce the 2023 budget deficit to a surplus of BRL11.1bln. Although ambitious and unlikely to be fully met this year, we expect this effort to be well received by the market.

With most of the short-term fiscal risks out of the way, and a still cautious BCB, we expect the BRL to gain ground following the dissipation of protest risks. We see USD/BRL re-testing the 5.01-5.02 level, and breaks below there will mean a move to 4.90 is in play. Nevertheless, from current levels, we prefer to sell USD/BRL spikes at 5.20 as political headlines are likely to remain in place.

CLP

Luis Hurtado

Chilean peso benefits from China's reopening

Q1 2023: 900 | Q2 2023: 920 (USDCLP)

The CLP is benefitting from the reopening of China and the increase in copper prices (the country's largest export). USD/CLP has broken below significant support at 850, bringing the pair within the 810-820 range. Despite the impressive rally to start the year, we do not expect a sustained USD/CLP move lower from current levels as the market is pricing aggressive rate cuts by the BCCh and the country heads into a another new constitution process, following the rejection of the ratification vote last year.

Note that as Chile's economy heads into a recession, we agree on the need to start an easing cycle as soon as March 2023. However, we differ with the market's pricing of the pace and magnitude of the easing cycle this year. Currently, the market anticipates over 550 bps in rate cuts in the twelve months, a situation that we see as unlikely given the still high inflation and the BCCh's forecasts. Moreover, the market expects most of these cuts to occur during the second half of the year, while we expect to see the BCCh spreading its easing cycle more evenly across its eight meetings in the next twelve months, ending the year at 8.25% (300bps lower from its peak) and only reaching 5.00% at the end of 2024, consistent with real rates, reaching the upper band of the BCCh's neutral range.

COP

Luis Hurtado

Lenient Banrep and populist government comments to keep COP under pressure

Q1 2023: 5000 | Q2 2023: 5100 (USDCOP)

The current administration's populist official statements and comments on social media continue to hurt market sentiment. We do not expect this trend to change during Petro's government, supporting large and quick upward moves in USD/COP despite the recent rebound of oil prices.

Looking at recent CPI numbers, December's inflation came in at 13.12% y/y, well above the 12.72% expected by consensus and November's 12.53% y/y. Core inflation came in at 9.99% y/y, accelerating from the 9.48% y/y posted in November. Despite inflation continuously surprising the market and coming above Banrep's own forecast, the central bank has maintained a lenient attitude towards the recent increase in prices. We do not see Banrep increasing the magnitude of rate increases above 100bps, likely ending its tightening cycle with a terminal rate at 13.50% in March (currently at 11.00%).

Asia FX
CNY

Patrick Bennett

Strong gains a shining light

Q1 2023: 6.85 | Q2 2023: 6.85 (USDCNY)

Chinese assets and the currency are, after an absence of a few years, once more top of the hit parade amongst traders and investors. The CNH is the top performing major currency year-to-date, while China equity indices are strongly firmer amidst revived confidence in the economic outlook and significantly, on evidence of a return of portfolio inflow to the equity market.

The revival of confidence toward Chinese markets began in early November, when Premier Li spoke about striving for a better economic outcome, and the first indications that China was looking to exit zero-COVID appeared via social media. Eventual rolling back of restrictions was underway later in the month, along with support measures for the property sector and the wider economy. The overarching significance of the U-turn, is that it was so much more than a pivot on zero-COVID. In addition, the easing restrictions in property and technology, alongside broad policy support, occurred so much sooner than was expected by even the more optimistic of commentators who were pegging the National People's Congress in March as a likely date for relaxation of restrictions.

Portfolio inflow was absent through the bulk of the last year. In fact, large swathes of divestment occurred toward market lows in both equities and the yuan, the occurrence confirming correlation between the markets that is once again in evidence as the flows reverse. The depth of last year's unwinding looks to be feeding into the pace of the sharp reversals and rally being seen of late. The prompt having been a sharply revised outlook for the economy in 2023.

Positioning that may originally have been rebuilt somewhat cautiously over a few months has come in a rush, with just nine days of outflow from Chinese stocks via the HK Stock Connect since mid-November. The current period is the most sustained period of inflow since May and June of last year. Reinforcing the correlation to CNH, that was a period where hitherto weakness in the CNH was stalled and partially reversed.

The swift return of inflow and correlated outperformance of the CNH suggests some sustainability of the moves. And in terming the supporting background shifts to have been significant, we expect the trends to remain in place. But as domestic markets head into Lunar New Year holidays, some slowing or consolidation can play out.

USD/CNH has entered a range of previous consolidation of May to July last year within 6.6170-6.8380. We peg those levels to contain trade, with a preference to be sellers of strength ahead of 6.7950-6.8380, the latter level being the initial cycle high in May of last year.

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