CIBC

Economics and FICC Strategy

MONTHLY FX OUTLOOK

February 27, 2023

Dollar weakening delayed

Currency	What's changed
USD	The USD could be supported in the near-term by resilience in the economy and continued Fed hikes, and although we may add a hike to our existing forecast, we still expect the Fed to undershoot the market's hiking expectations, weighing on the USD into mid-year, as attention turns to other advanced economies that are raising interest rates.
CAD	There is scope for near-term softness on the policy divergence that's underway between the Fed and BoC, but a broad weakening trend in the USD by mid-year will give CAD a lift.
EUR	We expect further ECB activism and a building recovery story to maintain a constructive medium-run EUR outlook.
GBP	Signs of political instability and a correction in implied rates point towards a correction in recent GBP gains, but we look for an appreciation in the medium term.
JPY	Policy normalization and higher JGB yields leaves bias for USD/JPY to test towards 120 into year-end.
Commodity FX	Both AUD and NZD have given up ground to a firmer USD over recent weeks, and we anticipate some further consolidation before lows are established.
LATAM FX	Central banks dial up cautious/hawkish stances.
FX Asia	Initial market confidence and upbeat sentiment on the outlook for the Chinese economy upon its emergence from zero-COVID has been tempered, while a rebound in the USD has lifted USD/CNH back toward 6.90. We anticipate some near-term consolidation.

Currency outlook

End of period:	Feb 27, 2023	Q2 '23	Q3 '23	Q4 '23	Q1 '24	Q2 '24	Q3 '24	Q4 '24
USD / CAD	1.36	1.32	1.32	1.31	1.31	1.30	1.29	1.28
EUR / USD	1.06	1.10	1.11	1.13	1.14	1.15	1.15	1.16
USD / JPY	136	125	123	121	120	118	116	115
GBP / USD	1.20	1.24	1.24	1.26	1.27	1.28	1.28	1.30
USD / CHF	0.94	0.91	0.91	0.90	0.91	0.90	0.91	0.91
USD / SEK	10.44	9.77	9.55	9.29	9.17	8.96	8.91	8.84
AUD / USD	0.67	0.69	0.70	0.71	0.72	0.74	0.75	0.76
NZD / USD	0.62	0.62	0.64	0.66	0.67	0.68	0.69	0.70
USD / NOK	10.35	9.64	9.41	9.07	8.90	8.74	8.65	8.49
USD / ZAR	18.36	17.45	17.10	16.85	16.60	16.40	16.25	16.10
USD / BRL	5.19	5.05	5.20	5.40	5.20	5.20	5.40	5.00
USD / MXN	18.32	20.00	20.50	19.80	20.00	20.50	21.50	21.00
USD / COP	4812	5100	4800	4800	4600	4600	4800	4700
USD / CLP	829	900	920	940	920	900	920	880
USD / CNY	6.95	6.85	6.81	6.79	6.75	6.73	6.71	6.69
USD / KRW	1323	1280	1250	1220	1190	1170	1140	1120
USD / INR	82.8	82.0	81.0	79.5	78.0	77.0	76.5	75.5
USD / SGD	1.35	1.33	1.33	1.32	1.31	1.31	1.30	1.29
USD / TWD	30.5	30.4	30.3	30.1	30.0	29.8	29.7	29.5
USD / MYR	4.48	4.40	4.30	4.20	4.05	4.00	3.90	3.80
USD / IDR	15270	15100	15000	14900	14800	14700	14550	14500

Other crosses

End of period:	Feb 27, 2023	Q2 '23	Q3 '23	Q4 '23	Q1 '24	Q2 '24	Q3 '24	Q4 '24
CADJPY	100.3	94.7	93.2	92.4	91.6	90.8	89.9	89.8
AUDCAD	0.91	0.91	0.92	0.93	0.94	0.96	0.97	0.97
GBPCAD	1.63	1.64	1.64	1.65	1.66	1.66	1.65	1.66
EURCAD	1.43	1.45	1.47	1.48	1.49	1.50	1.48	1.48
EURJPY	144	138	137	137	137	136	133	133
EURGBP	0.88	0.89	0.90	0.90	0.90	0.90	0.90	0.89
EURCHF	0.99	1.00	1.01	1.02	1.04	1.04	1.05	1.06
EURSEK	11.04	10.75	10.60	10.50	10.45	10.30	10.25	10.25
EURNOK	10.94	10.60	10.45	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	0.9	6.4	-3.4	4.625
Canada	3.9	5.9	-1.6	4.500
Eurozone	1.9	8.5	-0.3	2.500
Japan	0.6	4.0	2.1	-0.100
UK	0.4	10.1	-4.2	4.000
Switzerland	0.7	3.3	8.1	1.000
Sweden	2.5	11.7	4.0	3.000
Australia	5.9	7.8	1.0	3.350
New Zealand	0.8	7.2	-7.9	4.750
Norway	1.3	7.0	27.6	2.750
South Africa	4.2	6.9	0.7	7.250
Brazil	3.6	5.8	-3.3	13.750
Mexico	4.3	7.9	-0.7	11.000
Colombia	7.8	13.3	-6.4	12.750
Chile	0.3	12.3	-9.8	11.250
China	2.9	2.1	2.5	2.750
South Korea	1.4	5.2	2.9	3.500
India	6.3	6.5	-2.7	6.500
Singapore	2.2	6.6	17.7	n/a
Taiwan	-0.4	3.0	13.5	1.750
Malaysia	7.0	3.8	2.6	2.750
Indonesia	5.0	5.3	1.1	5.750

CAD

Katherine Judge and Avery Shenfeld

CAD prospects to improve by mid-year

Q2 2023: 1.32 | Q3 2023: 1.32 (USDCAD)

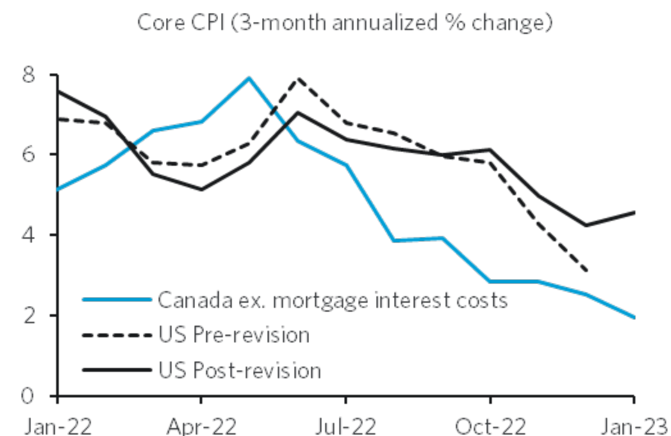
The loonie could stay under a bit of pressure in the near term with risks of a move towards 1.37 on dollar-Canada, as markets focus on the divergence in policy that is underway between the Fed, which is still expected to take rates a quarter point higher at least two more times, and the BoC that is currently on hold.

On the US side, the economy hasn't shown the anticipated deceleration in early 2023, and the Fed could have to hike further than we now expect should we not see definitive signs of a trend towards a cooling in the labor market in upcoming payrolls data. North of the border, where household debt is elevated and mortgages are renewing more readily at higher interest rates, policymakers remain cautious, as the bulk of that impact has yet to be realized. Moreover, more progress has been made in containing inflation in Canada (Chart), and we therefore don't expect rates to move any higher, especially given the additional room for non-inflationary growth afforded by high immigration levels.

That said, by June, we still expect to see enough evidence of a cooling in US growth and inflation to have markets looking past the end of a US tightening cycle, a development that should put the US dollar on the defensive. Investor attention will turn to countries overseas that aren't as far along in their hiking cycles as the Fed, particularly in Europe, where growth expectations have been buttressed by the avoidance of an energy crisis, and China's re-opening is benefitting its manufacturing sector. The debt ceiling deadline could also weigh on the USD temporarily into mid-year, although we ultimately expect a resolution that avoids a government shutdown or default. Those factors will see the greenback unwind its safe-haven bid to come into better alignment with trade fundamentals in H2, benefitting the loonie in the process. We see USDCAD ending 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 also start to cut policy rates towards neutral, and higher commodity prices benefitting Canada's export sector, look for USDCAD to reach 1.28 in 2024.

Chart 1: Core inflation (excluding mortgage interest costs) has slowed to target in Canada on 3-month annualized basis, in contrast to the US situation



Source: BLS, Statistics Canada, CIBC

USD

Bipan Rai

USD weakness delayed, but not denied

Q2 2023: 100.4 | Q3 2023: 99.5 (DXY)

Markets have been caught off guard by stronger than expected US data of late. Indeed, the latest readings of non-farms, and core CPI (among others) have led many to recalibrate Fed policy going forward. Rate cuts have now been pushed out of 2023 as markets distance themselves from the 'hard landing' narrative, but the by-product is that there's a growing chorus of voices now espousing a 'no landing' narrative for this year. That's meant an extension higher for Fed terminal, and a stronger USD.

But unlike last year, the revision to terminal carries less gravitas for the USD. After all, policy settings are far less loose now (relative to 2022) and the effects of prior tightening should still easily push back against the flimsy 'no landing' storyline. The Fed is still within breathing space of terminal, which implies that the current momentum higher for the greenback is tactical in nature. Additionally, higher rates in capital exporting economies like Germany and Japan still suggest that medium-term USD risks are to the downside.

EUR

Jeremy Stretch

ECB Hawkishness underlines support for euro

Q2 2023: 1.10 | Q3 2023: 1.11 (EURUSD)

Although flash German manufacturing PMI snapped a run of three straight gains, such disappointment notwithstanding, we would view the broad euro recovery narrative as remaining well supported. In this context, we note that the eurozone composite PMI registered its highest reading since May at 52.3, driven by strong service sector gains. The services rebound appears to be a function of consumer confidence benefitting from the substantive energy price correction, as eurozone natural gas prices are trading below levels seen throughout 2022.

Lower energy prices benefit both business and investor confidence alike. Gains in both German investor and business sentiment (ZEW and Ifo) validate presumptions of ongoing ECB hawkishness. The rebound in forward-looking service sentiment suggests that core inflation may prove increasingly sticky. In this regard, we would note recent comments from ECB hawk Knot who underlined the probability of core CPI prices crossing above the headline reading. The correction in headline prices will be a function of energy-related base effects. Should core prices remain elevated, in line with current cyclical highs around 5.2%, we would expect to support the hawkish policy narrative of ECB Governing Council members, such as Isobel Schnabel.

ECB President Lagarde has telegraphed that the March ECB meeting will result in another 50bps of policy tightening, taking the deposit rate to 3.00%. Beyond the March meeting, we expect the bank to remain increasingly data-dependent. That the next ECB meeting comes with updated ECB staff forecasts underlines the risk of a potential policy inflection point. However, the presumption of price pressures remaining elevated amidst an improved macro backdrop leaves us comfortable in terms of looking for a 3.50% ECB terminal rate. While the market may have overreacted in terms of recent implied policy presumptions, we expect further ECB activism and/or a building recovery story to maintain a constructive medium-run EUR outlook.

JPY

Jeremy Stretch

BoJ policy normalization to boost JPY valuations ahead

Q2 2023: 125 | Q3 2023: 1.23 (USDJPY)

The nomination of Kazuo Ueda to replace Haruhiko Kuroda as BoJ Governor was something of a wildcard. We anticipated, alongside most of the market, that current Deputy Governor Masayoshi Amamiya was likely to be elevated to the top job. Amamiya was perceived to be the continuity candidate, namely being perceived to perpetuate the pursuance of Abenomics, a process consistent with ultra-easy monetary policy and a preference for a cheap Yen. While Kuroda was intimately associated with Abenomics we would not expect Ueda to be so tainted. Consequently, we would anticipate policy normalization should macro conditions warrant it.

Although inflation may peak in Q1, albeit at a forty-year high, we would expect policy normalization to remain a function of the upcoming wage round. We would note that when Ueda moderated a BoJ panel debate on ‘The wage formation mechanism in Japan’ he underlined “it was difficult to predict the pace at which wages might rise in the future since this would depend on a variety of factors, such as developments in inflation expectations,….. the annual spring wage negotiations, and structural changes in the labour market. In summing up, he concluded that “the BOJ would need to continue to carefully monitor wage and price developments.”

Should the annual wage round result in nominal wage deals well in excess of 3%, expect increasing pressure on Ueda to start to normalize policy in Q2. Indeed, should 10-year swap rates head back towards 1.0% ahead of Kuroda’s final policy meeting on 10 March, expect the market to look for an additional YCC adjustment, easing the immediate policy burden on Ueda. A further YCC adjustment, potentially widening the threshold to +/- 100bps, will ease JGB curve distortions. Such an outturn will have material implications for UST-JGB spreads and broader capital flows, except a reduced appetite for higher-yielding overseas assets from Japanese investors. Policy normalization and higher JGB yields, easing spreads versus UST, leaves bias towards USD/JPY testing towards 120 into year-end.

GBP

Jeremy Stretch

Sterling under pressure in the near-term as market rate expectations look overdone

Q2 2023: 1.24 | Q3 2023: 1.24 (GBPUSD)

Recent data, such as January retail sales and flash February services PMI have helped pare UK recession risks. In terms of the latter we would note that the reading witnessed the strongest monthly advance since February 2022, sentiment is back above the 50 threshold for the first time since August.

The improved macro backdrop comes as UK public finances also appear to be in a better condition than anticipated. Lower UK borrowing numbers are a function of higher income tax receipts, a function of employment remaining elevated amidst rapid private sector wage growth, lower public investment, and a lower-than-expected cost of UK government energy price support. As a consequence, the government has something of a £30bn windfall compared to November OBR estimates. The upshot of better-than-expected public finances is a likely modest fiscal ease in the upcoming 15 March Budget.

We would anticipate that the UK Chancellor will eschew calls for immediate tax cuts, they may be held back to 2024, prior to an election, likely in late H2. However, signs of potential movement on public sector wage negotiations point towards a modest fiscal injection, keeping policy pressure on the BoE. The combination of better data and potential fiscal adjustment has impacted terminal rate assumptions spiking well beyond 4.50%.

Beyond the improved macro dynamics, including signs of a moderation in inflationary influences, easing pressure on UK terminal rate expectations, underlying political uncertainty remains a residual GBP risk parameter. UK Prime Minister Sunak is currently attempting to walk a tightrope between his hardline backbenchers and the EU over the Northern Ireland Protocol. However, political uncertainties notwithstanding after a period of looking to sell GBP/USD rallies improving macro fundamentals, including a reduction in inflationary concerns, moderating fears of BoE overtightening, favours increasing consideration of GBP/USD looking to retest early 2023 highs, north of 1.24, into Q2.

CHF

Jeremy Stretch

Widening policy rate differential with ECB suggests CHF weakness ahead

Q2 2023: 1.00 | Q3 2023: 1.01 (EURCHF)

An unexpected uptick in January CPI, the annual rate spiked to 3.3% on the back of a 0.6% monthly advance, validates warnings from SNB vice Chairman Martin Schlegel regarding it being too early to sound the “all-clear” on inflation. Key to the unexpected upward move in prices proved to be a 1.8% monthly advance in housing and utility costs. Rising utility prices underline the need for additional policy tightening at the 23 March SNB quarterly meeting. We would expect another 50bps with an additional 25bps in June, resulting in a terminal rate of 1.75%.

We anticipate that the SNB will continue to tighten until the bank is confident that the long-run CPI profile is set to come in well below the 2% threshold. In view of the higher-than-expected January CPI print, we have only witnessed three higher annual CPI outturns in the last two decades, we can expect the inflation profile in the upcoming quarterly bulletin to remain elevated, underlining why the SNB is unlikely to prove comfortable pausing the hiking cycle at 1.50%. Beyond the prospect of ongoing monetary tightening, we can expect the central bank to remain potentially activist in the FX space. However, we would expect any activity to be commensurate with the pursuance of the goal of price stability rather than attempting to reduce the balance sheet.

We expect additional SNB policy activity, resulting in a 1.75% terminal rate. However, in view of the assumption of the ECB hiking rates towards 3.50%, the widening in nominal rate differential favours a modest uptrend in EUR/CHF.

SEK

Jeremy Stretch

Hawkish Riksbank to support SEK

Q2 2023: 10.75 | Q3 2023: 10.60 (EURSEK)

Over the last month, only the MXN has outperformed the SEK versus both the USD and EUR. The SEK has benefitted from its high beta status allied to an increasingly hawkish central bank. The transition to new Governor Erik Thedeen, after sixteen years of Ingves at the helm of the Riksbank, has witnessed a renewed determination to bear down on price pressures that remain “far too high”.

Although January CPIF resulted in annual prices easing back to 9.3%, from 10.2%, core CPIF, ex-energy, advanced to a three-decade high of 8.7%. Elevated core prices underline the warning from central bank member Ohlsson who detailed in the February meeting minutes, following the 50bps hike to 3.00%, that “It is clear to me that monetary policy needs to become much less expansionary……. further increases are very desirable.” In the context of elevated core prices, we would expect the Riksbank to tighten by a further 50bps at their 26 April meeting. Although headline prices are set to sharply decline, due to base effects, core prices remain at risk of remaining firmer than expected.

The main concern for the central bank is the reaction of the real economy to continued policy tightening. Although real estate prices have registered a modest rebound from November lows, they remain well below their mid-2022 peak. The combination of a continued softening in the labour market through 2023 allied with a rising interest rate burden risks compromising consumer sentiment. However, it seems the central bank is increasingly mindful of monetary policy constraints. In this context, we note that the hawkish central bank is now intent on encouraging a stronger SEK as an offset to policy adjustment; remember the SEK was the worst-performing major through 2022. The combination of a hawkish central bank intent on boosting the currency looks set to extend a more constructive SEK bias through upcoming quarters.

Commodity FX
NOK

Jeremy Stretch

Lower natural gas prices limit NOK upside

Q2 2023: 10.60 | Q3 2023: 10.45 (EURNOK)

Underlying inflation surged to a fresh cyclical high of 6.4% in January; this compares with median estimates of 6.0%, while the central bank had assumed 5.9%. In light of core prices exceeding the Norges bank assumption by 0.5%, the central bank is set to revise up their rate trajectory at their next policy-setting meeting on 23 March. In view of the upside CPI surprise we expect another 25bps. Moreover, the prospect of another 25bps in June looks an increasing probability as households now expect inflation to remain elevated. The latest quarterly central bank inflation survey revealed that consumers expect inflation to be at 6% a year ahead, this compares with a 4.1% assumption previously.

While price pressures remain elevated, the central bank faces the policy conundrum in view of the fact that the recent regional central bank survey revealed that domestic macro prospects are the weakest since 2009. However, despite weakening survey assumptions, the mainland economy expanded by a robust 0.8% in Q4. Although base effects dragged on the annual reading, moderating activity from 2.7% in Q3 to 2.2%, macro momentum remains well underpinned by still tight labour markets. Headline jobless claims data points towards an unemployment rate which remaining around below 2%.

Continued policy tightening and macro resilience come against the realization of reduced domestic natural gas revenues. The correction is undoubtedly positive for the eurozone, via the improvement in macro competitiveness and reduction in inflationary expectations. That being said the reduced revenue stream into NOK, due to lower selling prices and revenues, remains a potential NOK headwind. Norway smooths out variations in oil and gas revenues and royalties via the "petroleum buffer portfolio" (PBP). During February it would appear that the material reduction in revenues and tax royalties, (natural gas prices are now well below year-ago levels) suggests excess NOK selling, potentially limiting NOK gains.

AUD & NZD

Patrick Bennett

Further consolidation before lows established

Q2 2023: 0.69 | Q3 2023: 0.70 (AUDUSD)

Q2 2023: 0.62 | Q3 2023: 0.64 (NZDUSD)

We retain a medium-term positive outlook for both the Australian and New Zealand dollars. But a combination of a recovery in the USD and previously identified caution that strong early gains this year leant disproportionally on the market enthusiasm for a rapid recovery in China, has recently played out in some consolidation and weakness. We anticipate further downside is possible in both AUD/USD and NZD/USD before eventual basing and rebounds develop.

The leverage of both the AUD and NZD to a recovering China will remain an important market consideration this year. But we caution that China’s recovery is likely to be uneven and thus support for the respective currencies should not be overplayed at the present time. Once hard data gives confirmation of a sustained Chinese recovery, and at present we are concerned at prospects of both weaker external demand and sluggish consumer activity, we see AUD outperforming NZD and other high beta currencies. That will be via Australia’s advantage in exporting industrial commodities and in providing education and tourism to China.

Both the RBNZ and RBA are seen tightening policy rates further. We forecast the RBNZ to raise rates to 5.25% from the current 4.75%, and the RBA to reach 4.10% from the current 3.35%. The terminal spread is in line with recent experience. The greater degree of tightening

still to be delivered by RBA relative to RBNZ is something we see supporting AUD vs NZD, and we target a move to 1.1200. Also supporting AUD over NZD, we assess the RBNZ hawkishness to be slightly more acute, and thus see the headwinds as a result of policy in New Zealand being more restrictive than in Australia.

Both economies have seen sharp slowdowns in housing markets, though not significantly more than had been anticipated. Both also continue to have risks from overall slower global growth. A confirmed recovery in China and eventual turn lower in the USD does provide some counter to that risk. Though we see that more of a 2Q-3Q story than during the current period.

ZAR

Jeremy Stretch

ZAR Gains likely as utility issues fade

Q2 2023: 17.45 | Q3 2023: 17.10 (USDZAR)

The ZAR remains the major currency laggard in the year to date. Investor outflows from domestic bonds reflect macro headwinds amplified by extensive utility load shedding. The broadening power crisis, magnified by extensive machinery breakdowns, underlines manufacturing output weakness. Utility-related headwinds likely underline why the manufacturing PMI dipped to 48.7 in January. Beyond the headline slide, new orders dipped to 46.2 from 48.4. In view of the manufacturing PMI correction, business confidence witnessed its biggest month-on-month retreat in five months. However, the correction has to be set against the backdrop of Covid re-opening optimism having previously encouraged business sentiment to register levels not seen since October 2015.

Beyond activity levels being compromised by power outages, state utility Eskom continues to warn of “further load shedding at short notice”; the prospect of state-guaranteed utility debt dragging on government finances remains a concern. In an effort to preclude the state-backed utility from suffering a deepening liquidity and solvency crisis, energy prices are set to increase by 18.7%. Political opposition to the prospective price hike, boosting inflation and pressuring business sentiment, could result in a looming financial crisis according to the South African Treasury. For now, we would not overplay concerns relating to IMF assistance being required should tariff increases prove to be compromised by Parliamentary opposition.

Although power issues are taking a toll on retail sales and business confidence the correction in inflation, CPI eased to an eight-month low of 6.9% in January, (this compares to a SARB target range of 3-6%), suggesting that the central bank could hold rates at the current 7.25%. The prospect of an ending of policy tightening underlines a less challenging policy backdrop. Hence should utility issues eventually dissipate we would view the recent uptrend in USD/ZAR as overextended, this underlines the scope for a correction back towards the 200Day MAV over the medium run.

LATAM FX
MXN

Luis Hurtado

Hawkish Banxico signals more hikes

Q2 2023: 20.00 | Q3 2023: 20.50 (USDMXN)

In an unanimous decision on February 9, Banxico increased the overnight rate by 50bps to 11.00% against consensus and our forecast for a 25bp rate increase. Moreover, the central bank signalled another rate hike in March, but suggested this could be of a lower magnitude. Banxico also revised its headline and core inflation estimates higher for the entirety of its forecast period. The CB no longer expects average quarterly inflation to converge to its 3% target by the end of Q4 2024. More interestingly, in a hawkish nod against market expectations of rate cuts in 2023 H2, the CB mentioned that given the dynamics of core inflation, “it is necessary to continue with the magnitude of the reference rate adjustment of the previous policy meeting, in order to be in a better position to tackle a still complex inflation environment”.

On the rates front, market implied rates point to a terminal rate closer to 12.00%, 100bps higher than the current overnight rate. Moreover, note that following the upside surprise in February’s bi-weekly inflation, the decisively hawkish minutes from Banxico on Thursday, February 23, and the repricing (significantly higher) of the Fed’s terminal rate, we now see the terminal rate at 11.50% and the overnight rate to remain at that level throughout 2023. Our expectations of no cuts this year and of only two final 25bps rate increases in March and May reflect the upward revision in Banxico’s inflation forecast, and Banxico’s ex-ante policy rate (overnight rate -1y inflation expectations) reaching 5.85% in February, well above Banxico neutral real rate range (1.8%-3.4%).

We have revised our USD/MXN Q1 forecast lower to 19.50, from the previous 20.00, but kept our year-end forecast at 19.80. Local and external dynamics remain supportive of the peso in the immediate term; nevertheless, Mexico’s large dependence on US growth is likely to prompt quick and sharp rebounds in USD/MXN should US labour/growth indicators deteriorate in the coming months.

BRL

Luis Hurtado

Feud between BCB and Lula puts downward pressure on rates and increases BRL volatility

Q2 2023: 5.05 | Q3 2023: 5.20 (USDBRL)

President Lula has heavily criticized the head of the BCB, Roberto Campos Neto, and the high Selic rate following the increased hawkish stance adopted by the central bank at the start of February. Lula even suggested that the Senate and the National Monetary Council (the only institutions with the power to oust the BCB head) should remain "vigilant". Note that government officials quickly came to the front stating that there was no discussion to change the current central bank law, and no pressure to cut short any mandate for Campos Neto. However, the damage has already been done with USD/BRL switching direction at a rapid pace and gapping on political headlines since the start of February

Rumours about a potential change in the inflation target made the headlines during the week of February 13th, with one news outlet reporting that Lula had asked for the inflation target to be increased by one percentage point to 4.5%. Although the National Monetary Council (CMN) steered away from discussing any changes to the inflation target, its decision does not rule out the discussion of such changes before the end of H1 2023. Moreover, in an interview Thursday afternoon, Lula stated that while the BCB is autonomous, it is not completely independent, and that revising the autonomy of the BCB will be analyzed only after the mandate of Campos Neto ends in 2024.

The additional layer of risks following Lula's comments against the central bank makes us hesitant to reload long BRL positions from current levels. We would wait until the fiscal rule discussion is well underway (likely March) before reassessing our view.

CLP

Luis Hurtado

Market prices out excessive rate cuts in 2023

Q2 2023: 900 | Q3 2023: 920 (USDCLP)

The BCCh left its rate unchanged at 11.25% in line with market expectations and our forecast. However, the central bank's forward guidance stated that "inflation remains very high and its convergence to the 3% target is still subject to risks. The Board will maintain the MPR at 11.25% until the state of the macroeconomy indicates that this process has been consolidated", downplaying the aggressive path of rate cuts currently priced in by the market (over 500bps before the rate announcement).

Note that despite the upward surprise in December's inflation print, and the improved prospects via the reopening of China to the Chilean economy, market expectations were already in the most 'optimistic' area of the most recent MPR corridor before the January meeting. Since then, 1Y market implied rates have corrected considerably, reducing the magnitude of rate cuts expected in 2023 by 100bps to "only" 400bps. In line with the BCCh monetary policy corridor (as per the latest MPR), we see space for another 25bps-50ps correction in rates, bringing the overnight rate to 7.50-7.75% a year from now. Looking at the currency, following the impressive CLP rally over the last sixth months, and the market still digesting the 'higher-for-longer' stance by the Fed, we would not chase the USD/CLP move lower.

COP

Luis Hurtado

Political noise not much better in Colombia, but already priced in

Q2 2023: 5100 | Q3 2023: 4800 (USDCOP)

Populist announcements by President Petro continued in February with the presentation of the health reform. Gladly, Finance Minister Jose Antonio Ocampo reaffirmed his commitment to fiscal consolidation, stating that any of the administration's reforms will be consistent with the fiscal rule. Most importantly, the recent underperformance of Colombia's assets against large high yield countries in the region, such as Brazil, reinforces our assumption that the market has already priced in the political uncertainty and fiscal risks, supporting sharp but brief rebounds in Colombia's assets as the health reform gets diluted in congress and external risks dissipate.

Placing Colombia in a regional context, it is also not difficult to see why the COP has been the underperformer in the region and will likely, albeit tactical rebounds, remain as such for most of 2023. The country has the second largest nominal fiscal and current account deficits, and the second largest debt/GDP ratio. The country also has the highest level of USD debt as a % of GDP, while it remains in line with its regional peers when analyzing its international reserves. Looking at monetary policy, in its last meeting, Banrep hiked its benchmark rate by 75bps to 12.75% against the 100bps expected by BBG consensus and our forecast. The vote was not unanimous, with two out of the seven members voting for only a 25bps rate hike. We now expect Banrep to increase the overnight rate by a final 25bps in March to 13.00%, down from our previous terminal forecast of

13.50%. Moreover, we see the COP remaining under pressure as Banrep maintains a very lenient stance against inflation despite increasing inflation expectations for 2023 and 2024.

Asia FX
CNY

Patrick Bennett

Bullish sentiment tempered

Q2 2023: 6.85 | Q3 2023: 6.81 (USDCNY)

The strong rally in the CNH through the early weeks of this year has taken a pause of late, most recently as the USD has rebounded on the back of upwardly revised expectations for Fed tightening. Our overall view for this year is that recovery in the Chinese domestic economy and return of portfolio inflow will be a source of CNH support. While a slowing external environment will be a prompt for some depreciation pressures. On balance we expect the support to win out, though the presence of conflicting elements suggest that we are unlikely to witness an overly strong trending environment.

The rebound in USD/CNH has tracked the broad USD move and has now reached an important technical level of its 200-day moving average, around 6.9100. Our anticipated range for USD/CNH over the next month is 6.8000-6.9500.

Reports to hand on domestic activity during the Lunar New Year period have been positive. The number of domestic trips taken is reported to have been 23% above 2022 and near 90% of the level in 2019, while domestic tourism revenue is indicated at 30% above last years, and 73% of 2019.

In light of policymakers attention on domestic demand as a cornerstone of economic recovery, the rebound in holiday activity will be welcome. It has also been reflected in the January PMI services numbers, with the official reading climbing to 54.4 vs 41.6p and the Caixin series recording 52.9 vs 48.0p.

The emphasis on domestic demand is warranted as the prospects for external demand are either already outright soft, or at very least challenging. Chinese export growth has slowed markedly over recent months, having been in contraction territory since October. A prospective weaker contribution to the current account from goods trade, at the same time as China borders reopen with potential greater net tourism outflow, both work in the same direction to erode one layer of yuan support.

The push and pull of domestic vs external demand can be counterbalancing for the currency, and feeds into our anticipation of more ranging rather than strong trending behaviour of the market over coming months. But in the near term the positives from reopening are holding sway, and thus we reiterate the view and recommendation to sell strength in USD/CNH.

CIBC Capital Markets

Comprehensive economic and cross-asset strategic coverage

FICC Strategy

cibcmacro.com

Canadian Government Credit

Tom Bognar, CFA
+1 416 956-6032
tom.bognar@cibc.com

Rates

Ian Pollick
+1 416 594-7057
ian.pollick@cibc.com

Foreign Exchange

Jeremy Stretch
+44 0 207 234-7232
jeremy.stretch@cibc.com

Bipan Rai
+1 416 594-7925
bipan.rai@cibc.com

Patrick Bennett
+852 3907-6351
patrick.bennett@cibc.com

Foreign Exchange & Rates

Sarah Ying
+1 416 594-8302
sarah.ying@cibc.com

Canadian Corporate IG Credit

Adam Bulley
+1 416 594-8510
adam.bulley@cibc.com

Growth Markets (LATAM & Caribbean)

Luis Hurtado
+1 416 594-8284
luis.hurtado@cibc.com

Economics

economics.cibccm.com

Avery Shenfeld
+1 416 594-7356
avery.shenfeld@cibc.com

Benjamin Tal
+1 416 956-3698
benjamin.tal@cibc.com

Andrew Grantham
+1 416 956-3219
andrew.grantham@cibc.com

Karyne Charbonneau

karyne.charbonneau@cibc.com

Katherine Judge
+1 416 956-6527
katherine.judge@cibc.com

Institutional Equity Research

Equity Portfolio Strategy

Ian de Verteuil
+1 416 594-7462
ian.deverteuil@cibc.com

Shaz Merwat
+1 416 956-6428
shaz.merwat@cibc.com

See separate disclaimer.

Disclaimer

FICC STRATEGY

This communication, including any attachment(s), is confidential and has been prepared by the FICC Strategy Team and may include contributions from CIBC Economics, CIBC Capital Markets Desk Strategists and the Research Department within the Global Markets Group at CIBC Capital Markets.

CIBC Capital Markets is a trademark brand name under which different legal entities provide different services. Products and/or services offered through CIBC Capital Markets include products and/or services offered by the Canadian Imperial Bank of Commerce and various of its subsidiaries. Services offered by the Canadian Imperial Bank of Commerce include corporate lending services, foreign exchange, money market instruments, structured notes, interest rate products and OTC derivatives. CIBC's Foreign Exchange Disclosure Statement relating to guidelines contained in the FX Global Code can be found at cibccm.com/fxdisclosure. Other products and services, such as exchange-traded equity and equity options, fixed income securities and futures execution of Canadian securities are offered through directly or indirectly held by CIBC World Markets Inc. or other CIBC subsidiaries as indicated below.

The contents of this communication are based on macro and issuer-specific analysis, issuer news, market events and general institutional desk discussion. The author(s) of this communication is not a Research Analyst and this communication is not the product of any CIBC World Markets Inc. Research Department nor should it be construed as a Research Report. The author(s) of this communication is not a person or company with actual, implied or apparent authority to act on behalf of any issuer mentioned in the communication. The commentary and any attachments (other than any attached CIBC World Markets Inc. branded Research Reports) and opinions expressed herein are solely those of the individual author(s), except where the author expressly states them to be the opinions of CIBC World Markets Inc. The author(s) may provide short-term trading views or ideas on issuers, securities, commodities, currencies or other financial instruments but investors should not expect continuing analysis, views or discussion relating to the securities, securities, commodities, currencies or other financial instruments discussed herein. Any information provided herein is not intended to represent an adequate basis for investors to make an informed investment decision and is subject to change without notice. CIBC World Markets Inc., Canadian Imperial Bank of Commerce or its affiliates may, currently or at any time in the future, engage in these trading strategies or hold positions in these issuers, securities, commodities, currencies or other financial instruments discussed in this communication and may abandon such trading strategies or unwind such positions at any time without notice.

The contents of this message are tailored for particular client needs and accordingly, this message is intended for the specific recipient only. Any dissemination, re-distribution or other use of this message or the market commentary contained herein by any recipient is unauthorized. If you are not the intended recipient, please reply to this e-mail and delete this communication and any copies without forwarding them.

This report does not take into account the investment objectives, financial situation or specific needs of any particular client of CIBC. Before making an investment decision on the basis of any information contained in this report, the recipient should consider whether such information is appropriate given the recipient's particular investment needs, objectives and financial circumstances. CIBC suggests that, prior to acting on any information contained herein, you contact one of our client advisers in your jurisdiction to discuss your particular circumstances. Since the levels and bases of taxation can change, any reference in this report to the impact of taxation should not be construed as offering tax advice; as with any transaction having potential tax implications, clients should consult with their own tax advisors. Past performance is not a guarantee of future results. The information and any statistical data contained herein were obtained from sources that we believe to be reliable, but we do not represent that they are accurate or complete, and they should not be relied upon as such. All estimates and opinions expressed herein constitute judgments as of the date of this report and are subject to change without notice. This report may provide addresses of, or contain hyperlinks to, Internet web sites. CIBC has not reviewed the linked Internet web site of any third party and takes no responsibility for the contents thereof. Each such address or hyperlink is provided solely for the recipient's convenience and information, and the content of linked third-party web sites is not in any way incorporated into this document. Recipients who choose to access such third-party web sites or follow such hyperlinks do so at their own risk.

Distribution in Hong Kong: This communication has been approved and is issued in Hong Kong by Canadian Imperial Bank of Commerce, Hong Kong Branch, a registered institution under the Securities and Futures Ordinance (the "SFO") to "professional investors" as defined in clauses (a) to (h) of the definition thereof set out in Schedule 1 of the SFO. Any recipient in Hong Kong who has any questions or requires further information on any matter arising from or relating to this communication should contact Canadian Imperial Bank of Commerce, Hong Kong Branch at Suite 3602, Cheung Kong Centre, 2 Queen's Road Central, Hong Kong (telephone number: +852 2841 6111).

Distribution in Singapore: This communication is intended solely for distribution to accredited investors, expert investors and institutional investors (each, an "eligible recipients"). Eligible recipients should contact Danny Tan at Canadian Imperial Bank of Commerce, Singapore Branch at 16 Collyer Quay #04-02 Singapore 049318 (telephone number + 65-6423 3806) in respect of any matter arising from or in connection with this report.

Distribution in Japan: This communication is distributed in Japan by CIBC World Markets (Japan) Inc.

Distribution in Australia: Communications concerning derivatives and foreign exchange contracts are distributed in Australia to "professional investors" within the meaning of the Corporations Act 2001 by CIBC World Markets Inc. Communications concerning securities are distributed in Australia by CIBC Australia Ltd (License no. 240603; ACN 000 067 256) to CIBC Capital Markets clients.

CIBC World Markets Inc. is a member of the Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada. In the United States, CIBC World Markets Corp. is a member of the Financial Industry Regulatory Authority and the Securities Investor Protection Fund. CIBC World Markets plc is authorized by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and Prudential Regulation Authority. Canadian Imperial Bank of Commerce, Sydney Branch (ABN: 33 608 235 847), is an authorized foreign bank branch regulated by the Australian Prudential Regulation Authority (APRA). CIBC Australia Ltd (AFSL No: 240603) is regulated by the Australian Securities and Investment Commission ("ASIC"). CIBC World Markets (Japan) Inc. is a member of the Japanese Securities Dealer Association. Canadian Imperial Bank of Commerce, Hong Kong Branch, is a registered institution under the Securities and Futures Ordinance, Cap 571. Canadian Imperial Bank of Commerce, Singapore Branch, is an offshore bank licensed and regulated by the Monetary Authority of Singapore.

Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets Inc. is prohibited and may result in prosecution.

The CIBC logo and "CIBC Capital Markets" are trademarks of CIBC, used under license.