CIBC

Economics and FICC Strategy

MONTHLY FX OUTLOOK

August 3, 2022

Global slowdown shaves C$ value

Currency	What's changed
USD	USD has one final leg stronger as economy skirts recession risks in the second half and the Fed delivers final hikes.
CAD	C$ to see modest weakening as slower global growth hits commodities, and the Fed slightly outguns the BoC.
EUR	Costly nat-gas prices and ongoing supply threats leave the eurozone facing elevated recession risks, which will weigh on the euro ahead.
GBP	Even though the BoE looks set to increase the pace of tightening, the backdrop for Sterling remains negative due to macro and political uncertainty.
JPY	The BoJ's outlier easy monetary policy stance will add pressure to the yen in the near term.
Commodity FX	Markets are trimming pricing for RBA and RBNZ rate hikes toward our expectations, which will continue to put pressure on the AUD and NZD ahead.
LATAM FX	USD/LATAM pairs have moved higher as the Fed's frontloaded tightening cycle continues and global growth concerns have increased.
FX Asia	We anticipate refreshed demand for Chinese assets and the yuan in the second half of the year, although concerns over the property sector are a headwind to domestic optimism, and to commodity demand and global economic activity.

Currency outlook

End of period:	August 3, 2022	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23
USD / CAD	1.28	1.29	1.31	1.33	1.33	1.31	1.31
EUR / USD	1.02	0.99	1.00	1.03	1.05	1.07	1.08
USD / JPY	134	135	132	127	126	125	122
GBP / USD	1.22	1.16	1.17	1.20	1.21	1.23	1.23
USD / CHF	0.96	0.96	0.97	0.97	0.97	0.96	0.97
USD / SEK	10.20	10.71	10.50	10.15	9.90	9.63	9.44
AUD / USD	0.69	0.68	0.67	0.68	0.69	0.70	0.71
NZD / USD	0.63	0.62	0.61	0.62	0.63	0.64	0.65
USD / NOK	9.69	9.90	9.75	9.44	9.24	8.97	8.80
USD / ZAR	16.84	16.85	16.50	16.35	16.20	15.95	15.75
USD / BRL	5.27	6.00	5.70	5.90	5.70	5.50	5.30
USD / MXN	20.7	21.0	21.5	21.0	21.5	21.3	21.5
USD / COP	4325	4500	4200	4000	4000	3900	3900
USD / CLP	903	920	900	880	880	840	820
USD / CNY	6.75	6.70	6.60	6.65	6.60	6.55	6.55
USD / KRW	1311	1295	1285	1280	1275	1275	1265
USD / INR	79.2	78.0	77.5	77.0	76.5	76.0	76.0
USD / SGD	1.38	1.39	1.38	1.38	1.37	1.37	1.37
USD / TWD	30.0	29.7	29.5	29.4	29.4	29.3	29.2
USD / MYR	4.46	4.40	4.35	4.30	4.25	4.25	4.20
USD / IDR	14913	14700	14600	14550	14500	14400	14300

Other crosses

End of period:	August 3, 2022	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23
CADJPY	104.1	104.7	100.8	95.5	94.7	95.4	93.1
AUDCAD	0.89	0.88	0.88	0.90	0.92	0.91	0.92
GBPCAD	1.56	1.50	1.53	1.60	1.61	1.61	1.61
EURCAD	1.31	1.28	1.31	1.37	1.40	1.40	1.41
EURJPY	136	134	132	131	132	134	132
EURGBP	0.84	0.85	0.85	0.86	0.87	0.87	0.88
EURCHF	0.98	0.95	0.97	1.00	1.02	1.03	1.05
EURSEK	10.39	10.60	10.50	10.45	10.40	10.30	10.20
EURNOK	9.87	9.80	9.75	9.72	9.70	9.60	9.50

Key indicators – Latest data point

End of period:	Quarterly real GDP (y/y %)	CPI (y/y %)	Current acct (% of GDP)	Central bank rate (%)
US	1.6	9.1	-4.8	2.375
Canada	2.9	8.1	0.7	2.500
Eurozone	4.0	8.9	1.7	0.000
Japan	0.4	2.4	2.3	-0.100
UK	8.7	9.4	-4.2	1.250
Switzerland	4.4	3.4	9.7	-0.250
Sweden	3.0	8.7	4.9	0.750
Australia	3.3	6.1	2.9	1.350
New Zealand	1.2	7.3	-6.5	2.500
Norway	4.8	6.3	19.1	1.250
South Africa	3.0	7.4	3.1	5.500
Brazil	1.7	11.9	-1.6	13.250
Mexico	1.8	8.0	-0.2	7.750
Colombia	8.5	9.7	-6.3	7.500
Chile	7.2	12.5	-7.3	9.750
China	0.4	2.5	1.8	2.100
South Korea	2.9	6.0	4.7	2.250
India	4.1	7.0	-1.2	4.900
Singapore	4.8	6.7	19.8	n/a
Taiwan	3.1	3.6	15.2	1.500
Malaysia	5.0	3.4	2.8	2.250
Indonesia	5.0	4.4	0.4	3.500

CAD

Katherine Judge and Avery Shenfeld

It's downhill for the loonie ahead as BoC approaches terminal

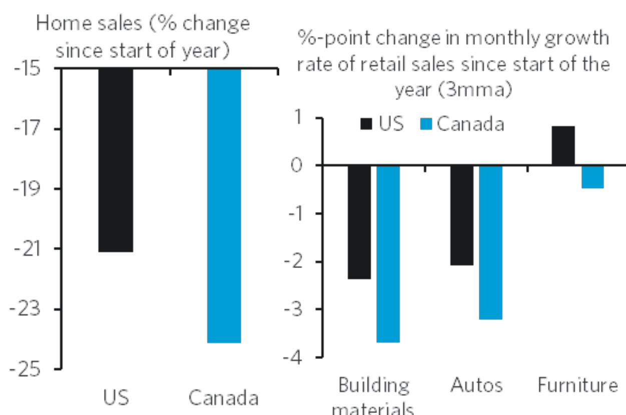
Q3 2022: 1.29 | Q4 2022: 1.31 (USDCAD)

The CAD continues to follow the pack in moves against the broad USD, which has eased off lately as risk appetite has improved. Any negative impact on the CAD from the ongoing retreat in oil and broader commodity prices has been offset by the Bank of Canada's frontloaded hiking cycle, highlighted by the supersized 100bp rate hike in July. While we expect another non-standard hike at the September meeting, if it's a 75bp move, that won't be bullish for the loonie if the market sees that as the end of the Bank's tightening cycle.

A terminal overnight rate of 3.25% for the Bank is slightly below what markets are pricing in and could add pressure to the loonie over the remainder of the year, particularly if the US sees a return to growth in Q3. With inflation higher in the US, the Fed will likely have to take the upper bound of the fed funds range up a quarter point above the Bank's terminal overnight rate, at 3.50%. A slightly more cautious BoC is necessary given Canada's debt-burdened households, which are already slowing spending in interest-sensitive areas at a faster pace than Americans (Chart 1), adding to the imminent impact of mortgage renewals at much higher rates. The cooling in Canada's housing market will be a key factor in getting inflation back to target in 2023, along with an easing in commodity prices as global growth slows.

We see USDCAD reaching 1.33 in early 2023, with a widening in the travel services trade deficit and a cooler path for commodities. But a broad softening in the USD that year as the Fed stays on hold suggests that the loonie won't weaken further over the balance of next year. Overall, CAD is still a rangebound currency.

Chart 1: Interest-sensitive areas slowing faster in Canada



Source: Haver Analytics, CIBC

USD

Bipan Rai

USD outperformance likely if US stays out of recession in H2

Q3 2022: 108.9 | Q4 2022: 113.1 (DXY)

The market took a bit of steam out of the US dollar of late, but we see some of what traders are looking for as a story that is more likely to play out in 2023 or later than in the latter half of this year, and judge this turn in DXY as similarly premature. The Fed's evident desire to put less emphasis on forward guidance on rates should not have been a surprise, given that rates are now in the neutral range, and the Fed's effort to steer to a soft landing implies it will have to watch incoming data to do that. The market put a lot of emphasis on Powell's hinting that the size of future moves might be smaller, while largely ignoring his willingness to repeat the hawkish prior "dot" forecast when pressured to comment on where the FOMC's thinking lies.

Moreover, while the contraction in Q2 GDP was well advertised going in, the imminent recession that those selling the USD might be looking for looks to be more of a risk for 2023 or later. An alternative measure of output, real GDI, still showed moderate growth in Q1, and the trends for other key recession indicators – employment, industrial production, and other monthly data – have all shown upward momentum through the first half. That said, given the slowing pace to growth and some signs of a peaking in inflation, we see the Fed's projections for further hikes in 2023 as unlikely to materialize, and don't see the funds rate getting through 3½%.

All told, the change in messaging from the Fed will likely see markets take profit on extant USD longs in the near-term, but it's too soon to establish short positions against other majors or the CAD. Indeed, we're sticking with our call that the USD should continue to perform into year end as the Fed likely ends up with a higher terminal rate relative to other central banks, and faces fewer imbalances, or risks on that path than what we see in Europe.

EUR

Jeremy Stretch

Recession risks to weigh on euro

Q3 2022: 0.99 | Q4 2022: 1.00 (EURUSD)

The ECB has finally moved on from policy pre-commitment. The 50bp hike, the first since 2011, has taken the deposit rate out of negative territory for the first time since mid-2014. Having junked forward guidance, we expect the bank to return to data-dependence. While the ECB is likely to tighten by an additional 50bps in September, its window to continue on that path is limited amidst rising recession risks.

Eurozone inflation remains well above that discounted in the June ECB staff forecast. Headline HICP came in at 8.6% in June, compared to the ECB's year-end forecast of 6.8%. Rising gas prices remain a residual threat to the CPI profile. The jump in gas prices, back towards Q1 highs, risks amplifying inflationary pressures.

Beyond price pressures, it's the security of gas supply that has become an existential eurozone threat. EU members have agreed on a voluntary deal to reduce gas consumption by 15%. However, the measures appear insufficient to preclude German winter gas rationing. Gas related concerns suggest Germany is on the cusp of a recession. And where Germany leads, the rest of the EU invariably follows.

The other eurozone risk criteria relates to fragmentation concerns. The resignation of Italian Prime Minister Draghi has resulted in fresh elections set for September 25th. The election risks undermining the passage of necessary structural reforms, including an overhaul of the tax system. Reform is necessary for continued eligibility of Next Generation EU funds; Italy is the largest recipient (€200bn) of the €750bn fund. Failure to pass the necessary legislation not only risks compromising necessary fiscal stimulus, but it also potentially undermines Italian access to the ECB's new anti-fragmentation tool, the Transmission Protection Instrument (TPI).

Costly natural gas prices and ongoing supply threats leave the eurozone facing elevated recession risks. A data dependent ECB may look to tighten again at its next meeting. However, recession concerns and fragmentation risks, due to rising credit concerns, point towards early December 2002 EUR/USD lows at 0.9863 remaining in view.

JPY

Jeremy Stretch

Extension of easy BoJ policy suggests modest yen depreciation

Q3 2022: 135 | Q4 2022: 132 (USDJPY)

To no surprise, the BoJ maintained its commitment to broad monetary policy easing at its recent meeting. We would expect that any change in the policy environment is set to be left to Kuroda's successor after Q1 2023.

The policy inertia, including in the YCC thresholds, comes despite the risks of BoJ dominance of the JGB market, with the latest data suggesting that BoJ holdings have exceeded 50% of the outstanding bonds in issue. The scale of holdings, amplified by recent measures to defend the 0.25% yield cap, may eventually prompt the BoJ to consider an adjustment in the YCC threshold. However, for now, we remain biased towards a perpetuation of easy policy, maintaining a broad defensive status for JPY.

BoJ policy inertia needs to be set against a downgrade in growth assumptions and an upgrade in the CPI profile. In terms of the former, the growth assumption for the current fiscal year was trimmed from 2.9% in April to 2.4% now. The Bank cited the resurgence of Covid-19, Ukraine-related issues, and the uptick in imported prices as justifying the downgrade. The latter was amplified by the weak JPY.

Headline consumer prices have been revised above the 2% target threshold, with the BoJ now assuming 2.3% versus 1.9% in April. Yet while inflationary pressures for the current year are revised up, core prices for fiscal year 2023 remain well below target at 1.4%, previously 1.2%. BoJ Governor Kuroda will likely see that tame underlying trend as justification for the BoJ to remain a broad central bank outlier, even if they face the inflation impetus of a modest further depreciation of the yen in the next few months. The lack of any further Fed tightening in 2023 should see the yen recover some lost ground next year.

GBP

Jeremy Stretch

BoE hiking impact offset by macro and political uncertainty

Q3 2022: 1.16 | Q4 2022: 1.17 (GBPUSD)

We head towards the August BoE against the backdrop of Governor Bailey detailing that the bank will bear down on inflation, ''no ifs or buts.'' Not only would that mark the sixth straight hike, but the Governor also detailed the

spectre of bigger hikes, as he underlined that "there are more options on the table than another 25 bps". Yet despite the aggressive move in rate assumptions, BoE Chief Economist Pill continues to underline the growth/inflation trade-off.

The BoE's primary problem is that the UK is set to face a higher and more protracted CPI spike than its G7 counterparts. June headline CPI reached 9.4%, its firmest since February 1982. Headline CPI will not peak until Q4, since the re-set of the energy price cap on 1 October could easily result in CPI extending towards 12%. Having never previously hiked by more than 25bps, the BoE looks set to consider 50bps.

That being said, we see little justification for the BoE to hike rates by nearly 150 bps by year-end. While the BoE could hike again in September, we expect the bank to pause into Q4 as the window for UK policy tightening is soon to close given the growth risks.

The UK macro outlook remains a function of aggregate consumption and within that, consumer confidence. Confidence is currently at all-time lows at -41. Macro headwinds will combine with ongoing political risk. The UK Conservative Party appears intent on installing Liz Truss as PM. Truss is campaigning on a platform of a substantial fiscal easing (£30-35bn), with the additional borrowing potentially compromising the international appetite for Gilts. The combination of political risk and macro uncertainty suggests that even though the BoE looks set to up the pace of tightening, we would not expect this to turn what remains a negative Sterling backdrop.

CHF

Jeremy Stretch

Outsized hikes from the SNB support CHF appreciation

Q3 2022: 0.95 | Q4 2022: 0.97 (EURCHF)

The unexpected 50bps hike from the SNB, which was matched by the ECB, suggested that the Swiss central bank was no longer materially concerned about the external valuation of the CHF. Indeed, the SNB rowed back from labelling the currency as being "highly valued".

The policy switch implied that the SNB had become increasingly mindful of financial sector imbalances. The Financial Stability Report shone a spotlight upon rising real estate prices, since a prolonged period of negative rates risked a real estate bubble. Moreover, the upshift in domestic inflation dynamics pointed toward the SNB moving away from attempting to cheapen the CHF via aggressive intervention.

As we move towards the 22 September policy update, the market is pricing in an additional 44bps of tightening. Such a move would result in Switzerland exiting negative rates for the first time since early 2015. The upgraded inflation profile that accompanied the June hike validates the presumption of another hike, most likely 50bps. A second outsized hike risks EUR/CHF testing towards fresh extremes towards 0.95.

The unexpected June rate hike suggested that the SNB was increasingly impervious to CHF gains. After all, a stronger CHF helps mitigate imported inflationary pressures. However, sight deposit data for the week ending 22 June reveals the fastest accumulation in more than two months. Such an acceleration suggests that despite ongoing tightening expectations, the bank appears intent on moderating, if not reversing, CHF gains via ongoing intervention.

SEK

Jeremy Stretch

SEK to underperform as global recession risks loom large

Q3 2022: 10.60 | Q4 2022: 10.50 (EURSEK)

The SEK remains a major underperformer in the year to date despite the fact that the currency has witnessed a strong rebound since the start of H2. The recent broad global risk recovery has resulted in EUR/SEK easing back to test the 200-day MAV at 10.40. Despite the recent rebound, we would expect many investors to continue to stand aside from a currency that remains highly cyclically correlated. The perpetuation of global recession concerns points towards the SEK continuing to struggle versus the USD over the next 3-6 months.

We remain wary of extrapolating recent SEK gains despite the fact that Riksbank has moved into an increasingly aggressive tightening cycle. Having hiked rates by 0.50% on 30 June, taking rates to 0.75%, the market is increasingly pricing in a further 0.75% hike at the next meeting on 19 September. The challenge for the central bank is balancing the rising inflation trend against weakening domestic fundamentals. Targeted inflation, CPIF, moved further away from the 2% target in June, and annual inflation registered an above expectations gain of 8.5% yoy. Yet as the bank attempts to moderate inflationary pressure by raising rates, consumer sentiment has plunged, falling below 2008 post-global financial lows.

Swedish households are at risk of being exposed by an aggressive tightening cycle. The European Systemic Risk Board recently warned of unsustainably high mortgage debt. Moreover, the percentage of outstanding residential loans to household disposable incomes is

around 177%, near the highest in the G20. Real estate vulnerability and sliding sentiment underline near-term challenges for the SEK.

Commodity FX

NOK

Jeremy Stretch

NOK supported versus euro by continued tightening and higher gas prices

Q3 2022: 9.80 | Q4 2022: 9.75 (EURNOK)

The Norges Bank, like most central banks, has accelerated the pace of policy tightening. After hiking rates by 50bps at the most recent policy meeting, the market was expecting 25bps, we have seen the Norges Bank adopt a more aggressive policy profile. We now anticipate that the central bank is intent on rates reaching 3.00% in the next 12 months. Due to a relative dearth of spare capacity, notably in the labour market, we expect the Norges Bank to take rates well into restrictive territory. The bank currently considers 1.75% to be neutral.

However, despite upping the pace of tightening, investors are uncertain whether the August meeting will result in another 50bps. Part of the reticence comes as the meeting is not accompanied by a Monetary Policy Report, which has some thinking that will hold the central bank to a 25bp adjustment. That seems less likely than a larger move. We are in an environment of central bank frontloading, making it probable that the Norges bank will look for at least one more supersized hike.

As we move towards Q4, we expect the central bank to face an increasing policy challenge. Elevated price pressures and an unemployment rate at a cyclical low of 1.6% warrant additional tightening. Conversely, the prospect of higher rates risks undermining real estate prices, while monthly retail spending has retreated in three of the last four months. While that raises some uncertainties surrounding how far the Norges Bank can hike rates, for the currency, it's worth remembering that Norway is a net beneficiary of the aggressive uptick in European gas prices. That should still provide a constructive NOK backdrop against the euro.

AUD

Patrick Bennett

AUD: Tests of support not yet complete

Q3 2022: 0.68 | Q4 2022: 0.67 (AUDUSD)

We have previously highlighted the growing headwinds to domestic and global activity through inflation and hawkish central bank responses that have pressured the AUD to lower levels. We see scope for further underperformance ahead, underscored by the procyclical and high-beta nature of the currency.

A prominent illustration of the pro-cyclical exposure of the AUD is now developing via the path of weaker commodity prices. Commodities are being pressured as a result of building concerns over global growth and demand. Correlations between AUD and global commodities including copper and iron ore remain significant. The correlation between the AUD and commodity and equity indices is similarly noteworthy.

Australia has benefitted from strong terms-of-trade gains over recent years, and the RBA has recently heralded that the terms, at a record, are able to provide a counter to the negative impact on domestic activity that will result from higher policy rates. Though we identify a very strong historical correlation between Australia's terms-of-trade and the value of the AUD, the influence in recent years has waned. Given the prospects of both softer commodity demand and lower prices, we do not share the same confidence as the central bank that activity will be sufficiently compensated by the terms-of-trade.

China is Australia's largest trading partner and is critical to the demand for its largest export, iron ore. Chinese iron ore imports have softened modestly this year, down 5% year-to-date from previous levels. Australia's share of those imports has remained steady at around 60-65% of the total. But recent reports introduce risk of not maintaining that share, as China is said to be moving to establish a centralised purchasing plan, both to counter Australia's dominance, and to secure lower prices.

The balance of current risks still points to further AUD weakness. We expect a re-test of spot toward lows of around 0.6600-0.6700 will be seen before a major low is recorded.

NZD

Patrick Bennett

Further weakness before a low is established

Q3 2022: 0.62 | Q4 2022: 0.61 (NZDUSD)

As is evident across most major markets, it is headwinds to New Zealand domestic and global activity from tighter monetary policy that is playing more strongly to currency movements than are simple movements or references to

interest rate differentials. The RBNZ was early to begin its normalisation cycle and we see another 150bps of hikes before year-end, taking the OCR to 3.50%.

New Zealand's procyclical relationship to global activity and its exposure to commodity demand and prices, leave economic activity and the currency, as in Australia, particularly exposed. That exposure comes on top of already slowing domestic activity, that again is very much like the situation in neighbouring Australia, and is showing up in weak consumer and business confidence, and in softness in the housing market.

The NZD has already depreciated swiftly as a result of mounting global activity concerns. It is near the weakest of major currencies against the USD over the last three months. We do not see a particularly strong case to make a long-term bearish case for the currency at present levels. But we do remain inclined from a tactical perspective to be a seller of near-term strength, believing that while bearish global views and talk of recessions will ebb and flow, we are not yet at the peak of those concerns.

Prices for dairy products, New Zealand's most significant export, and agricultural prices in general, have been falling of late. While that may be good news down the line for inflation, export receipts are set to remain pressured. We caution however, that the weakness already priced in the NZD/USD is already somewhat ahead of levels that correlate with previous relationships to relevant commodity prices.

Weakness in NZD/USD has eroded a number of key technical support levels, and we see risk of a move back toward 0.6000 before a major low is established.

ZAR

Jeremy Stretch

ZAR under pressure as recession fears dominate

Q3 2022: 16.85 | Q4 2022: 16.50 (USDZAR)

The ZAR is currently the worst performing major since the start of Q2, as it has depreciated by nearly 12% versus the US dollar in the last four months. The high beta status of the ZAR has left the currency under pressure as external investors have generally preferred the safety and liquidity of the USD. Foreign investors have been major sellers of domestic bonds over the last month, while speculative ZAR longs have been aggressively pared over the last couple of positioning snapshots.

Investor unwinds have come despite the South African Reserve Bank aggressively ramping up policy tightening. Although an unexpected 75bp hike in July tempered ZAR weakness, investors remain wary as real rates remain negative. The SARB policy rate is currently 5.5% versus headline CPI at 7.4%; the differential underlines ongoing external investor reticence. Beyond external risks, the currency has also been negatively impacted by several specific domestic factors. Broad investor sentiment has been compromised by the country facing its longest run of rolling blackouts, while falling commodity revenues drag on external trade.

The cheapening up in the ZAR should over time provide a more constructive trade backdrop. However, until global recession fears materially correct we would be wary of anticipating a durable ZAR rebound.

LATAM FX
MXN

Luis Hurtado

Banxico set to increase overnight by 75bps in August

Q3 2022: 21.0 | Q4 2022: 21.5 (USDMXN)

Since early June, USD/MXN has moved higher. This has been driven by the USD leg as levels reacted to the rout in equity markets, and the aggressive Fed tightening cycle. On the MXN leg, despite the increased hawkishness in the most recent Banxico rate announcement, board members differed on how long to continue this stance. Moreover, on the trade front, the US and Canada have sent a formal complaint (under the USMCA trade agreement) about Mexico's energy policies, increasing headline risks for the rest of the year. Although we recognize that the MXN carry is likely to push USD/MXN lower in the near term as equity markets trade sideways, or absent significant news on the external front, we like using such MXN strength to buy USD/MXN at 20.20 with a 21.00 target and a 19.82 stop loss.

Based on the June hawkish/cautious statement, and a continued increase in inflation expectations, we have revised our terminal rate forecast from 9.00% to 9.25%. In terms of the magnitude of the coming rate increases, we foresee Banxico increasing the overnight rate by 75bps, 50bps and 25bps in August, September, and November, respectively, but remaining below the 9.75%-10.00% terminal overnight rate currently priced by the market.

Further, we stress that meeting market expectations will (assuming a peak in inflation expectations in Q3) put Banxico's real-ex ante policy rate above the higher end of its neutral real rate range (1.8%-3.4%), implying an even more restrictive monetary policy than in 2018-2019. Nevertheless, from current levels, we see risks skewed towards Banxico decoupling from the Fed (slowing the pace of rate increases vs. Fed), a situation that could, and should, play against the MXN into the end of 2022.

BRL

Luis Hurtado

BCB plays it safe

Q3 2022: 6.00 | Q4 2022: 5.70 (USDBRL)

Although most of the recent BRL depreciation is explained by the downward trend in commodity prices as global growth concerns increase, and fiscal concerns, it is important to note that, different to developed markets, the tightening cycle in the country is well underway and close to an end. We expect the BCB to increase the SELIC rate by 25bps on Wednesday and, perhaps, leave the door open for a final 25bp rate increase in September as concerns with regards to the future of the spending cap increase.

On the political front, we expect government measures to reduce inflation and provide assistance to the poorest sectors of the population to remain in place and increase as we approach the October presidential election. Hence, although we could find some BRL support driven by a hawkish BCB and the real's attractive carry, we expect USD/BRL to retest the 5.50 mark and maintain its upward path 5.70 as we approach elections.

CLP

Luis Hurtado

BCCh Announces FX intervention program

Q3 2022: 920 | Q4 2022: 900 (USDCLP)

As we anticipated in our note following the Banco Central de Chile (BCCh) rate announcement on July 13th, the central bank stepped in to control the volatility and sharp depreciation of the CLP on July 14th. The program announced by the CB is similar to that announced at the of 2019, consisting of spot dollar sales of up to 10bln and FX hedge sales of up to USD10bln. In light of the extension of the tightening cycle and the FX intervention program announcement, we maintain our preference for long CLP, but favour reflecting such views against other commodity currencies such as the COP.

Strictly looking at USD/CLP, there is scope for the pair to test the 890-900 as carry plays return to the front following the Fed rate announcement. Nevertheless, the reduction of the size of the BCCh daily FX intervention remains the main risk to such a downward trend. Note that we expect to see sudden but temporary spikes in USD/CLP following the central bank FX intervention schedule release on Friday afternoons, as our base case is to see the BCCh slowly reducing its daily FX intervention size as volatility diminishes.

COP

Luis Hurtado

COP to remain under pressure as market assess checks and balances in congress

Q3 2022: 4500 | Q4 2022: 4200 (USDCOP)

It has been an ugly month for the COP, as concerns regarding the new government, and the recent decline of oil prices made the peso the underperformer in the region. On the monetary policy front, despite Banrep revising its growth forecast significantly higher for 2022, and the government's announcement to lower fuel subsidies in the short term, we do not expect much support for the COP coming from Banrep's hawkish stance as the market processes the victory of Gustavo Petro in the recent presidential elections.

Going forward, we expect the market to focus on the Ministry of Finance plans for the 2023 Budget (i.e. ambitious tax reform and aggressive spending), and carefully analyze the checks and balances in place in congress as investors assess how feasible Petro's radical ideas are in the short term. Hence, although we see space for a tactical rebound on the COP driven by a hawkish central bank, we maintain our preference for buying USD/COP dips with a 4500 target in line with our revised forecast for the end of Q3

Asia FX
CNY

Patrick Bennett

A shift toward cautious appreciation

Q3 2022: 6.70 | Q4 2022: 6.60 (USDCNY)

As global markets focus on the economic influence of aggressive monetary tightening from a wide range of central banks, China policy levers are still in full forward, and forecasters and commentators, rather than speculate about a recession, are talking potentially about the low point for growth having been seen. We agree, and given prospects for outperformance of the Chinese economy in 2H relative to major peers, we have formed a tactical bias to seek opportunity for CNH longs.

China's 2Q GDP missed expectations in expanding just 0.4% y/y vs the expected 1.2%, though we note that this period was already expected to mark the low point of activity, and that some of the components paint an improving picture. Most notably, coming out of the widespread COVID lockdowns was a recovery in retail sales to 3.1% y/y in June vs a 6.7% contraction the previous month. The property sector, however, is a concern, with a larger-than-expected 5.4% contraction in investment ytd y/y, highlighting it as an area to watch.

Recent reports of mortgage boycotts over delayed apartment projects have prompted a support package of lending to developers to be announced. The situation remains fluid, and while there is confidence it will be resolved, the work-out will take some time. We do not consider this to be a systemic risk at this point.

Strong portfolio inflow has previously been a cornerstone of CNH outperformance. We now believe that as other major economies slow under the influence of higher policy rates, at the same time as China recovers, we can see inflow pickup. Recent data bear this out with evidence of slowing bond outflows and a return of equity purchases.

On interest rate support and influence, China's nominal interest rate differential advantage was eroded over the last 18 months. But we now see signs of stability, with a trend of steady and potentially rising Chinese bond yields, partly as issuance increases, to cover infrastructure stimulus, at the same time as global term yields look to be capped and global centrals banks shift closer to terminal rates. The result will dampen the influence of one factor to drive USD/CNH higher on a medium-term basis.

China's current effective 7-day repurchase rate is around 1.7%, while the PBoC policy rate is currently 2.1%. The policy support has been required, though policymakers are now signalling that easing is now likely complete.

New lending data has been strong, and we see rates on-hold from this point forward through the end of the year. Comments from policymakers regarding the threat of capital outflow on widening interest rate differentials, also point to a reluctance to ease further.

Ongoing risk around the zero-COVID policy is an unknown, particularly as related to getting the economy working again. Though trade and retail data for June, including showing a strong export performance, should alleviate some of the more immediate worries.

We are watching a range in USD/CNH of 6.7870-6.8380 with potential for that to cap the upside and for the market to then develop toward cautious CNH appreciation. We expect that will be confirmed should market confidence build more toward our view of a 2H recovery in Chinese activity.

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