

FX Outlook: More Two-Way Movements Expected

We expect dollar strength to dissipate over the coming quarters

We think that the GBP and JPY will outperform the EUR over a 1-to-2-year period

The MYR, CNY and SGD will also likely be resilient to dollar volatility

Key Currency Themes

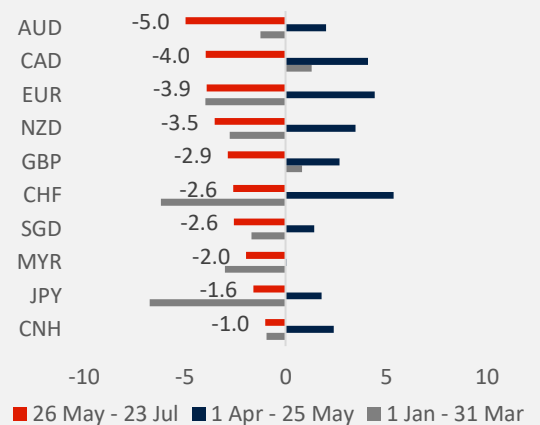
We hold the following convictions for the rest of 2021 and for 2022:

1. USD may experience sporadic bouts of strength, but we anticipate a general 90 to 93 range in the coming quarters. This comes as expectations on inflation and US monetary policy turns less hawkish, even as the Fed is on track to taper its quantitative program in 2022. Covid-19 will likely continue to trigger volatility in FX markets. Meanwhile, we see mixed employment conditions in the US, hindering progress towards a faster pace of tightening.
2. We expect GBP and JPY to outperform EUR. The Bank of England is likely to be more hawkish compared to the Bank of Japan and European Central Bank. Diverging core inflation trends in the US and Japan may continue to keep yield differentials wide.
3. For commodity related currencies, there are limited upsides from peaking factory input indices and stabilising crude prices. The Reserve Bank of New Zealand and Bank of Canada have been more hawkish compared to the Reserve Bank of Australia. Hence, after prior underperformance, AUD may only slightly catch up to NZD and CAD, unless fundamentals rebound significantly in the coming quarters.
4. In 2022, MYR, CNY and SGD may outperform as the Asia economy recovers, reversing the negativity clouding the region. Other Asian currencies may be vulnerable to tighter Fed policy, due to current account, fiscal account, and leverage risks.

Table 1: Revised FX Forecasts

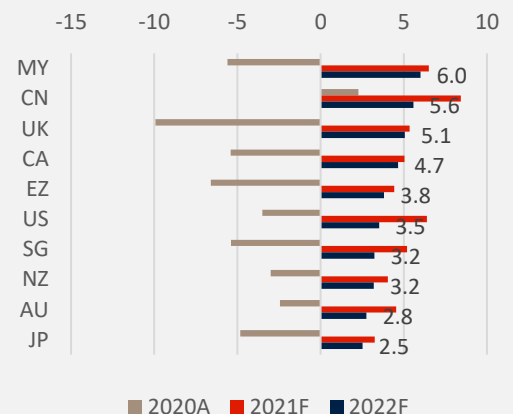
	3Q-21	4Q-21	1Q-22	2Q-22	4Q-22
DXY	92.00	91.50	90.00	89.00	90.00
EUR/USD	1.18	1.19	1.21	1.22	1.21
GBP/USD	1.40	1.41	1.43	1.45	1.44
AUD/USD	0.74	0.74	0.76	0.77	0.75
USD/JPY	109	108	107	105	106
USD/MYR	4.23	4.20	4.20	4.15	4.10
USD/SGD	1.35	1.35	1.34	1.33	1.34
USD/CNY	6.45	6.45	6.40	6.35	6.40

Figure 1: FX movements, %



Source: Bloomberg, HL Bank

Figure 2: IMF's GDP outlook (%), ranked by 2022 forecasts



Source: IMF, HL Bank

USD to Experience Cross Currents

In 2021, USD has strengthened in two waves: in the first quarter, and 26 May to 23 July (Figure 1). Dollar strength has been primarily brought about by rising yield curve and inflation rate expectations for the former, and potential tightening of monetary policy for the latter.

We believe that near-term inflation expectations have peaked. This comes as core inflationary pressures continues to rise (Figure 4), and core PCE numbers are showing signs of peaking around the 4% y/y mark.

Since the latest Federal Open Market Committee meeting on 27 to 28 July, fears of tighter Fed policy have also come off. This is despite the Fed previously projecting two rate hikes totalling 50bps in 2023. Employment conditions are mixed, tight in some segments. However, continuing jobless claims are nearly twice of pre-pandemic levels.

As a result, we see DXY around a range of 90 to 93 in the coming quarters, although we acknowledge the risks are biased towards USD strength. USD strength may come about from further US economic outperformance, a reduction of yield differentials (Figure 3), risk aversion, and rising inflation and rate expectations. However, the dollar may also be dragged down by recent repricing of the Covid-19 variants hindering the recent economic recovery.

Overall, we forecast DXY at 91.50 at the end of 2021, close to current levels. We also anticipate a weaker dollar in 1H-2022 to 89.00 at the end of June 2022 before rebounding to 90.00 at the end of 2022.

Expect GBP and JPY to Outperform the EUR

Over the next 12-18 months, we believe that GBP and JPY will register more currency strength compared to EUR. Yield differentials compared to the US are higher in Japan, compared to the Eurozone (Figure 3). The JPY is likely to play catch up after underperforming YTD. However, periods of risk aversion may strengthen the JPY.

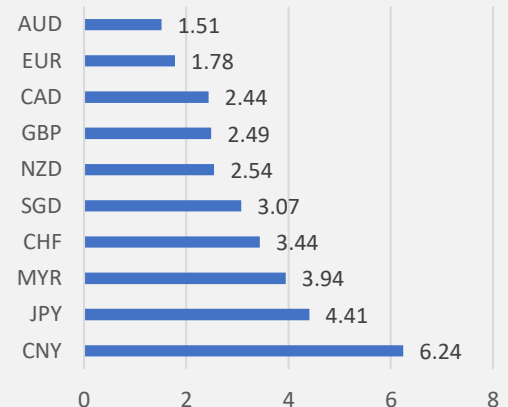
Central bank-wise, we see the European Central Bank and Bank of Japan lagging behind the Bank of England and Federal Reserve in tightening monetary policy. 2022 economic outlook is also relatively brighter in the UK, compared to Japan (Figure 2 shows IMF's GDP forecasts). This will imply at some relative EUR and JPY underperformance, compared to the USD and GBP. We expect dollar weakness to turn to some dollar strength in 2022.

We forecast EUR/USD, GBP/USD and USD/JPY at 1.19, 1.41, and 108 respectively at the end of the year. By the end of 2022, our respective forecasts are 1.21, 1.44, and 106.

AUD Playing Catch-Up to CAD & NZD

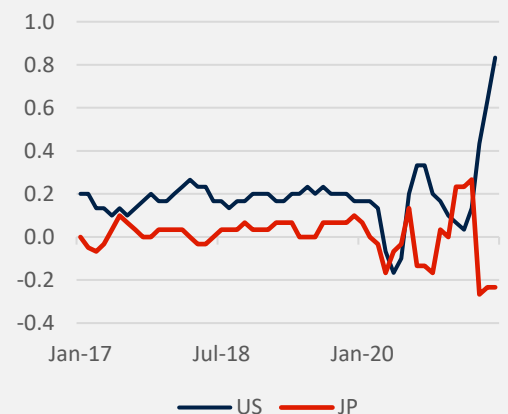
Near-term, AUD has underperformed compared to NZD and CAD (Figure 5). This is on the back of the domestic Covid-19 situation in Australia, and relatively more dovish central bank policy. We expect slight catch-ups for

Figure 3: Real yield differentials vs the USD (%)



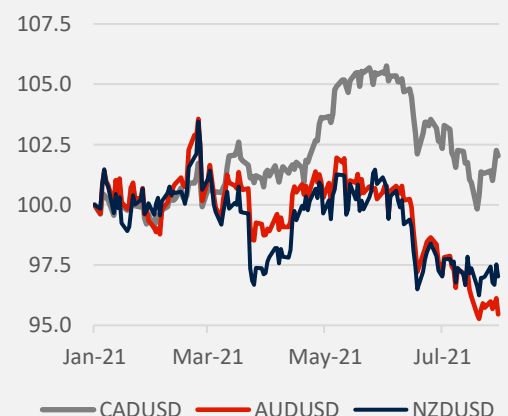
Source: Bloomberg, HL Bank

Figure 4: Core inflation differentials between US and Japan rising (% m/m, 3mma)



Source: Bloomberg, HL Bank

Figure 5: CAD and NZD doing better than the AUD this year (31-Dec=100)



Source: Bloomberg, HL Bank

AUD in the coming months. Producer price pressures looked to be peaking (Figure 6), coming off over the next year or so. This will provide less upsides for the commodity-related currencies going forward. Meanwhile, Australia's yield differentials compared to the US are the relatively lower, compared to Canada and New Zealand.

For AUD/USD, we forecast a relatively flat profile in 2021, ending the year at 0.74. For 2022, we expect the pair to peak at 0.77 by mid-2022 before coming off to 0.75 by the end of the year.

MYR

We expect MYR to regain some lost grounds as higher vaccination rates should help better contain the pandemic situation. This would allow Malaysia to move on to the next phase of its National Recovery Plan and most importantly, allow more economic sectors to reopen and/or operate at higher capacity. We are forecasting USD/MYR to trend back to the 4.20 levels in the months ahead once the situation stabilizes and some forms of calm return, paving the way for more meaningful reopening and recovery in the final quarter of the year. Expectations for some consolidation in the USD would be supportive of the MYR too.

SGD

We forecast SGD to outperform over a 12-to-18-month period. We forecast USD/SGD at 1.35 end-2021 and 1.34 end-2022. This is likely driven by a potential move by the Monetary Authority of Singapore to a "modest and gradual" appreciation stance of the Singapore Dollar Nominal Effective Exchange Rate (SGD NEER) in 2022 (Figure 7).

[Economic fundamentals](#) are likely to improve as Singapore gradually removes Covid-19 restrictions. An Asia rebound story in 2022 is also beneficial for the SGD. Besides, underlying inflation is progressively recovering, albeit at a slow pace.

CNY & CNH

We expect USD/CNY to be relatively stable over the coming quarters, and forecast 6.45 end-2021 and 6.40 end-2022 (Figure 8). China's focus on minimising idiosyncratic risks and on quality growth will likely anchor currency expectations around current levels. Its [retail sector has shown signs of recovery in recent months](#), even as the outlook for industrial production, fixed asset investments and the banking sector is more mixed. China is also aiming to reduce inequality in the economic recovery, which hints at broader growth.

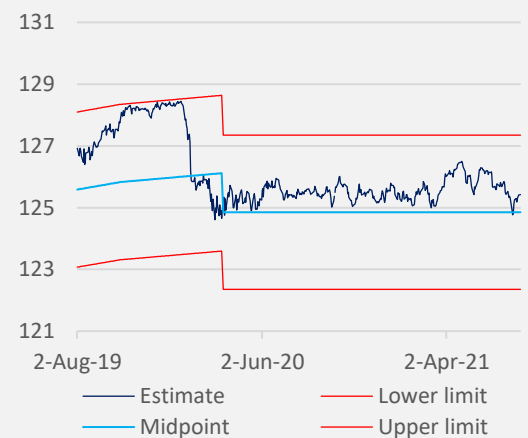
Although China has recently cut the reserve requirement ratio, we do not expect further measures on its various monetary policy instruments at the moment, apart from liquidity injections if necessary. For the yuan, market confidence and US-China relations pose as downside risks.

Figure 6: Producer prices are possibly peaking (% y/y)



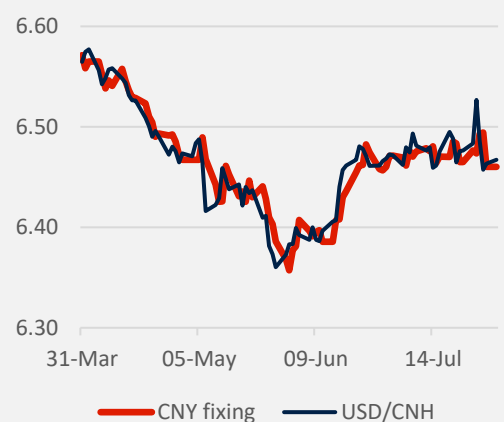
Source: Bloomberg, HL Bank

Figure 7: HL Bank's estimate of the SGD NEER



Source: Bloomberg, HL Bank

Figure 8: Expect relatively stable USD/CNH movements



Source: Bloomberg, HL Bank

FX Forecasts

FX	3Q-21	4Q-21	1Q-22	2Q-22
DXY	92.00	91.50	90.00	89.00
USD/CAD	1.25	1.25	1.24	1.23
EUR/USD	1.18	1.19	1.21	1.22
GBP/USD	1.40	1.41	1.43	1.45
USD/CHF	0.91	0.90	0.89	0.88
AUD/USD	0.74	0.74	0.76	0.77
NZD/USD	0.70	0.70	0.71	0.72
USD/JPY	109	108	107	105
USD/MYR	4.23	4.20	4.20	4.15
USD/SGD	1.35	1.35	1.34	1.33
USD/CNH	6.45	6.45	6.40	6.35

Policy Rate (%)	3Q-21	4Q-21	1Q-22	2Q-22
Fed	0.25-0.50	0.25-0.50	0.25-0.50	0.25-0.50
BOC	0.25	0.25	0.25	0.25
ECB	-0.50	-0.50	-0.50	-0.50
BOE	0.10	0.10	0.10	0.10
SNB	-0.75	-0.75	-0.75	-0.75
RBA	0.10	0.10	0.10	0.10
RBNZ	0.25	0.25	0.25	0.25
BOJ	-0.10	-0.10	-0.10	-0.10
BNM	1.50	1.50	1.50	1.50
MAS	-	Hold	-	Tighten
PBOC	Hold	Hold	Hold	Hold

FX Crosses Forecasts

MYR	3Q-21	4Q-21	1Q-22	2Q-22
EUR/MYR	4.99	5.00	5.08	5.06
GBP/MYR	5.92	5.92	6.01	6.02
AUD/MYR	3.13	3.11	3.19	3.20
SGD/MYR	3.13	3.11	3.13	3.12
MYR/CNH	1.52	1.54	1.52	1.53

SGD	3Q-21	4Q-21	1Q-22	2Q-22
EUR/SGD	1.59	1.61	1.62	1.62
GBP/SGD	1.89	1.90	1.92	1.93
AUD/SGD	1.00	1.00	1.02	1.02
SGD/JPY	80.74	80.00	79.85	78.95
SGD/CNH	4.78	4.78	4.78	4.77

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