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Global Markets Research

Research Alert

FX Outlook: Implications from US & China

Managed expectations regarding tighter US monetary policy is likely to be a slight negative for USD

However, a China slowdown can swing USD higher, with downside risks to global fundamentals

FX markets will likely be shaped by central bank divergences and Covid-19 strategies

Actionables from Tighter US Monetary Policy and Slowdown in China

We anticipate that the USD remains on track in its consolidation phase, after prior rallies. We expect the USD to start on a strengthening path only around mid-2022, although near-term/transitory spikes cannot be discounted.

Two drivers of global fundamentals over the next 6 months are:

1. **US Federal Reserve tapering of the quantitative easing program around end-2021, and expected policy rate hikes in 2023.** This comes as a broad and uneven US economic recovery gets hit with downside risks from Covid-19 variants. Barring unexpected shocks (after expectations being managed by Federal Reserve Chairman Jerome Powell in his Jackson Hole speech), this is likely to be slightly dollar-negative.
2. **China's economic slowdown.** We currently forecast China growth at 8.5% in 2021 and 5.7% in 2022. However, August PMIs are showing some downside risks to growth. This can impact global and Asia fundamentals. Although Asia has built up its external resilience since the 2008 Global Financial Crisis, they are behind the US in its economic recovery cycle, and are vulnerable to a China slowdown **and** tighter US monetary policy.

In the meantime, FX markets are likely to be shaped by divergences in central bank policies, Covid-19 outbreaks and strategies (with Covid-zero strategies a negative for some Asian FX). Reduced upsides in commodity prices are also unfavourable for the CAD, AUD and NZD.

Trend-wise, we continue to expect GBP and JPY outperformance against the EUR. Commodity-related currencies will likely see limited upsides against the USD. We are optimistic on MYR, CNY and SGD over a 12- to 18-month period.

US Monetary Tapering and Tightening

US economic indicators show a broad but uneven recovery, presenting the case for a gradual tightening of US monetary policy. This continued to be flagged by Powell in his Jackson Hole speech. For instance, US consumers

Figure 1: Dashboard of Market Movements

	Level	MTD (%)	YTD (%)
Equities			
MSCI World	3,134	2.1	16.5
S&P 500	4,509	2.6	20.1
China "H"	8,958	-2.7	-16.3
Hang Seng Index	25,408	-1.7	-6.3
Straits Times Index	3,081	-2.0	9.1
Fixed Income			
US 3M LIBOR (%)*	0.12	*0.002*	*-0.119*
US 10 Year (%)*	1.30	*0.080*	*0.389*
SG 3M SIBOR (%)*	0.43	*-0.001*	*0.023*
US Investment Grade		-0.3	-1.8
US High Yield		0.1	0.8
Asia Credit		0.4	1.2
FX			
DXY	92.69	0.5	3.0
EUR/USD	1.18	-0.6	-3.4
GBP/USD	1.38	-1.0	0.7
USD/JPY	109.84	0.0	-5.9
AUD/USD	0.73	-0.6	-5.1
USD/CNH	6.46	0.0	0.6
USD/MYR	4.19	1.2	-3.6
USD/SGD	1.35	0.6	-1.8
Commodities			
WTI ($/bbl)	68.74	-7.3	41.3
Brent ($/bbl)	72.70	-4.5	40.7
Gold	1,817.57	0.2	-4.2

Updated on 30 Aug. Source: Bloomberg, HLBB pivoted to durable goods and away from services. Services spending is still 7.0% below trend, although GDP and consumption spending is above pre-pandemic levels. In our view, the trend is quite global across the board.

Non-farm payrolls displayed that it is catching up at a pace faster than trend. However, there remains still a relatively large gap below trend (Figure 2). This is despite a tight employment market for skilled labour, amid some structural employment issues. Powell views that prospects are good for continued progress to maximum employment, despite the near-term risk from Covid-19 variants.

In the meantime, Powell's view of inflation remains tilted towards "transitory", although he remained open on reviewing it. This is due to relatively narrow inflation pressures in durable goods and energy prices, compared to other items. Figure 3 shows that transport, food/beverage, recreation and communications items are the current drivers for US inflation. In contrast, housing, apparel, medical care, and education inflation stayed below or in line with trend growth.

Current market views are for the Fed to start to taper around the end of 2021 and to hike its policy rates in 2023. Market reactions to Fed tapering are relatively benign at this stage, with a softer USD and relatively stable US yields.

China (& Other Majors) Slowdown

China's August PMIs present a red flag for concern. Manufacturing PMI slowed to 50.1, the lowest since February 2020 (Covid-19 outbreak period). New orders turned negative, amid high input and output prices.

In addition, non-manufacturing PMI unexpectedly fell to negative territory, at 47.5, dampened by the recent Covid-19 outbreak in China. This was dragged by new orders (42.2) and selling prices (49.3).

These continued a trend of slowing China growth (Figure 4 shows the annualised growth numbers from 2019, removing base effects from 2020). Other major economies are also seeing a slowdown, albeit less pronounced, evidenced by the peaking PMIs among the larger economies.

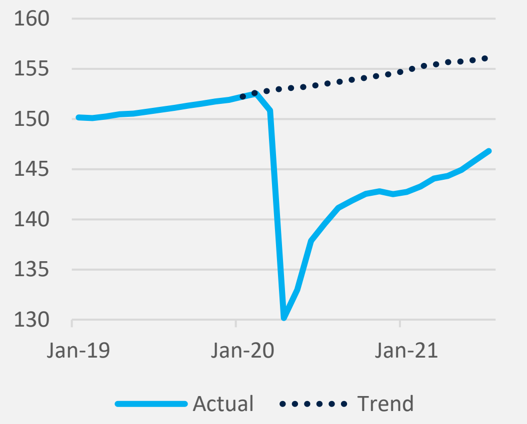
The spotlight is now on China's authorities, whether there will be any policy support. At this stage, we neither expect broad-based fiscal stimulus nor monetary policy loosening. China's 2021 GDP growth target is 6.0% and above, which should be surpassed, following the 12.7% y/y growth in 1H-2021. M2 money supply growth has been just above 8% y/y in recent months, after peaking around 10-11% for the most of 2020.

We only anticipate likelihood of some targeted spending, and reserve requirement ratio cuts for the coming months. The official focus in China may remain on structural reforms, like in the technology and education sector.

Implications on FX

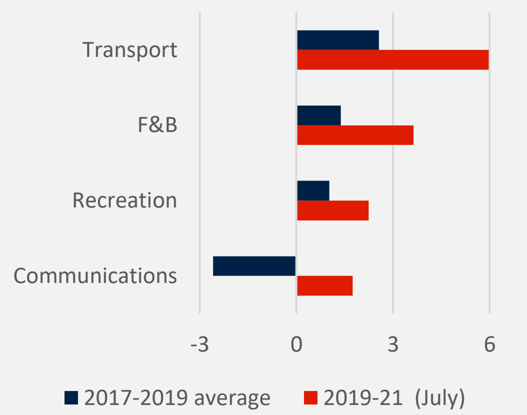
We maintain our view and forecasts that were revised on 2 August. Over the past month, the USD has slightly strengthened against most G10 FX, but some Asian FX rebounded after previous lows. The USD is likely to stay in

Figure 2: US non-farm payrolls, compared to projected trend growth without pandemic (mn)



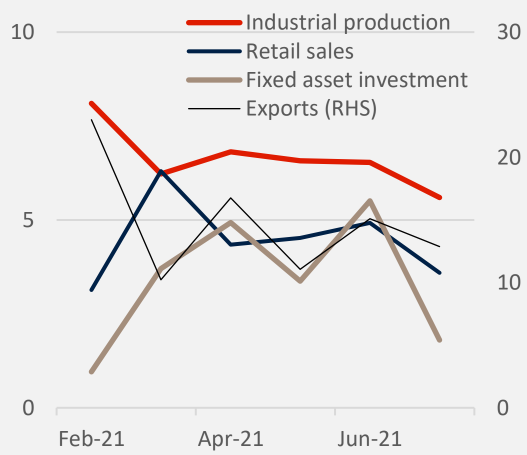
Source: CEIC

Figure 3: Current drivers of US inflation (annualised monthly, in %)



Source: Bloomberg

Figure 4: China's key monthly data (2019-2021 annualised, in %)



Source: Bloomberg, HL Bank

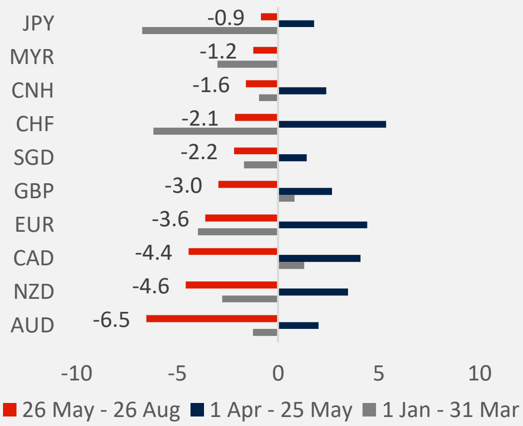
consolidation mode after its previous rallies (Figure 5). However, we do not rule out any short-term/temporary USD strength in 2021-2022, particularly during periods of volatility.

Trend-wise, we continue to expect GBP and JPY outperformance against the EUR. Commodity-related currencies will likely see limited upsides against the USD. We are optimistic on MYR, CNY and SGD over a 12- to 18-month period.

A moderated and well-managed Fed tapering is likely dollar-negative, until markets' pricing of Fed policy rate hikes comes in. Currencies whose central banks are relatively hawkish will likely display more resilience, particularly if the fundamentals are strengthening, compared to others that are more accommodative (Figure 6). We see the European Central Bank (ECB) and Bank of Japan (BOJ) lagging behind in tightening, in contrast.

A sharper deterioration in China growth (from current trends) will likely be dollar-positive, particularly on Asian currencies (excluding the CNY). This will likely weigh on the current accounts of trade-open Asian economies (such as Singapore, South Korea, Taiwan, Malaysia). At the same time, the recovery of Asian economies may be delayed. Although Asia has built up its external resilience since the 2008 Global Financial Crisis, they are behind the US in its economic recovery cycle, and are vulnerable to a China slowdown **and** tighter US monetary policy.

Figure 5: FX movements, %



Source: Bloomberg

Figure 6: Our View of Central Bank Policy Stance

Hawkish	BOC, RBNZ, BOK
Neutral with a slight hawkish tilt	Fed, RBA
Neutral (cautious optimism)	BOE
Neutral	PBOC
Accommodative	ECB, BOJ, BNM, BOT, BI

Source: HLBB

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	1.75	1.75	1.75	1.75
MAS	-	Hold	-	Tighten
PBOC	Hold	Hold	Hold	Hold

Source: HLBB

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

Source: HLBB

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