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Global Markets Research

Research Alert

FX Outlook: Managing Normalization

FX movements will likely depend on normalization in monetary policies, amid event risks

The global recovery is uneven and may meet further bumps, as inflationary pressures persist

We are more optimistic of the USD, MYR, SGD, compared to JPY and EUR weakness

Summary

We build on our views from our 4Q2021 quarterly outlook, where we last revised our forecasts. Major economies are at varying points of the economic recovery cycle, but are commonly experiencing inflationary pressures. This is caused by supply chain bottlenecks and high energy prices. In our view, the shortages caused by supply chains may take 3-6 months to resolve. However, inflationary pressures are here to stay, as global economies experience a rebound in demand, partly from a return to "normality".

Tighter central bank policies, although in varying timeframes will also likely shape FX movements in the coming year. If well-managed, financial conditions will remain accommodative for the global recovery, helping to moderate some USD strength in the coming year. Currently, we anticipate the US Federal Reserve to taper its quantitative easing programme by the end of 2021 and to hike policy rates by the end of 2022. Several other economies, like the Bank of England and Reserve Bank of New Zealand may start hiking before the Fed, while others like the European Central Bank and the Bank of Japan continue to drag their feet.

Over the coming year, we are slightly bullish towards a c.3% DXY (USD) strength in 2022. This will likely be against the EUR, JPY and other Asian currencies. Commodity-related currencies may soften as prices come off from heightened levels. Meanwhile, we are positive of MYR and SGD outperformance in the year ahead, as a recovery story. The CNY may remain relatively stable from the People Bank of China's preference against volatility

Figure 1: Dashboard of Market Movements

	Level	MTD (%)	YTD (%)
Equities			
MSCI World	3,167	5.3	17.7
S&P 500	4,575	6.2	21.8
China "H"	9,259	6.1	-13.8
Hang Seng Index	26,038	6.0	-4.4
Straits Times Index	3,205	4.1	13.0
Fixed Income			
US 3M LIBOR (%)*	0.13	*0.004*	*-0.104*
US 10 Year (%)*	1.62	*0.135*	*0.709*
SG 3M SIBOR (%)*	0.43	*0.006*	*0.029*
US Investment Grade		-0.4	-3.2
US High Yield		-0.5	-0.3
Asia Credit		-0.5	-0.4
FX			
DXY	93.95	-0.3	4.4
EUR/USD	1.16	0.2	-5.0
GBP/USD	1.38	2.2	0.7
USD/JPY	114.16	-2.5	-9.5
AUD/USD	0.75	4.2	-2.2
USD/CNH	6.38	1.1	2.0
USD/MYR	4.15	1.0	-3.0
USD/SGD	1.35	0.8	-1.8
Commodities			
WTI ($/bbl)	84.65	12.3	73.7
Brent ($/bbl)	86.40	9.6	66.1
Gold	1,792.91	2.0	-5.6

Updated on close of 26 Oct. Source: Bloomberg, HL Bank

USD vs. Other Major Currencies

Barring any event risks, we anticipate that a well-managed and coordinated tapering by the US Federal Reserve to consolidate rather than exacerbate excessive dollar strength. Expectations of further central bank tightening will likely be a factor towards USD movements compared to other major currencies. We anticipate only modest dollar strength over the year ahead, due to most major central banks either moving towards tighter monetary policy or at least staying pat on its stance.

Examining dollar movements between 2013 to 2017 (Figure 2), DXY strengthened around 20% before the its first rate hike in 2016. However, the effect was amplified by central bank divergence – the European Central Bank launched quantitative easing in March 2015, while the Bank of Japan provided a new framework (higher inflation target) on its qualitative and quantitative easing program in 2016.

At this stage, markets are already pricing in several central banks hiking policy rates before the Fed. These include the Bank of Canada and the Bank of England. With rising inflation expectations, the European Central Bank and the Reserve Bank of Australia may also have to consider some flexibility or adjustments to their respective bond buying programs. The ECB's pandemic emergency purchase program (PEPP) run out in March 2022. They had already slowed the pace of PEPP purchases in September.

Overall, the rest of world's catch-up to the economic recovery, positive market sentiments and some lingering inflationary risks (globally) will likely dampen against excessive dollar strength. We forecast DXY at 94.50 end-2021 and 97.50 end-2022. Correspondently, we forecast EUR/USD at 1.15 end-2021 and 1.12 end-2022. After near-term resilience, GBP/USD is also likely to end 2021 at 1.35 and 2022 at 1.32, in our view.

JPY

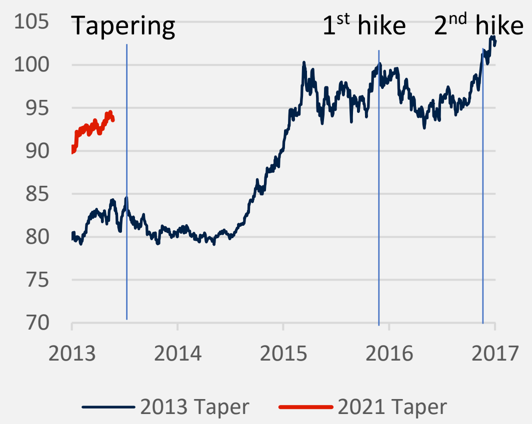
We single out the JPY for further underperformance ahead. Japan's inflationary expectations remains low and likely to still come in below the Bank of Japan's 2% inflation target on a medium-term basis. Japan's growth may also stay more subdued compared to other major economies, with China's slowdown an additional downside risk.

Bank of Japan is likely to keep its accommodative monetary policy in response, despite having one of the most extensive quantitative easing programs around.

Eventually, rising yield differentials between the US and Japan will limit yen weakness (Figure 3).

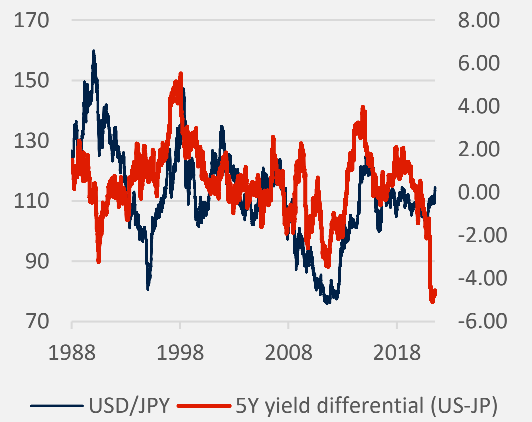
We forecast USD/JPY at 112 at end-2021 (with upside risks now given that the pair hovered around 111-114 in Oct), and 117 at end-2022.

Figure 2: Federal Reserve Policy and DXY movements



Source: Bloomberg, HL Bank

Figure 3: Yield differentials between the US and Japan (%)



Source: Bloomberg, HL Bank

Near-term Support for Commodity-related Currencies

Commodity-related currencies (AUD, NZD and CAD) are likely to be supported until the start of 2022, assuming current global supply chain bottlenecks and elevated commodity prices. They have seen some near-term weaknesses on dollar strength, despite a sustained rally in the World Commodity Price index (Figure 4). Hence, there is scope for some rallies. This is dependent on risk sentiments, with reversions likely to drag. We see a range of 0.73-0.77 range holding pre-Fed tapering (sometime Nov/Dec).

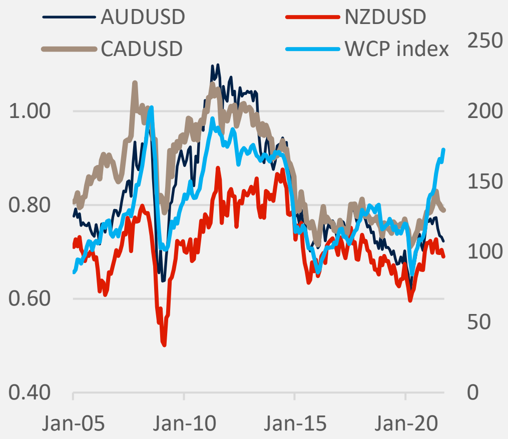
Our views of the Reserve Bank of New Zealand tightening in 2021 and no more hikes in 2022, alongside less pronounced tapering from the Reserve Bank of Australia is likely to pull AUD and NZD downwards in 2022. This comes as bottlenecks start to resolve and help moderate input prices downwards. We forecast AUD/USD at 0.72 (with upside risks) end-2021 and 0.70 end-2022.

MYR

We would also like to highlight our view for MYR resiliency, contrary to the overall mild bearishness expected in other Asian currencies. We project MYR to stay well-supported around 4.15 through the most part of 2022 before strengthening to 4.10 against the USD by end-2022. Recovery in the Malaysian economy, delayed by two separate lockdowns in early and mid-2021, is expected to pick up in 2022, expanding 5.6% after the dismal 2.7% growth in 2021. Upside to 2021 growth following the almost full reopening in economic activities in October shall set the stage for firmer recovery going into 2022.

While our base case call for rate normalization by BNM in early 2023, we do not discount the possibility of an earlier move in the 2H of 2022 if the recovery pens out better than expected, giving another positive boost to the MYR. In addition, the resumption of tourism receipts as the borders reopen is also expected to be positive for the MYR.

Figure 4: World Commodity Price (WCP) index compared to AUD, NZD and CAD



Source: Bloomberg, HL Bank

FX Forecasts

FX	1Q-22	2Q-22	3Q-22	4Q-22
DXY	95.00	95.50	96.50	97.50
USD/CAD	1.24	1.23	1.24	1.25
EUR/USD	1.14	1.14	1.13	1.12
GBP/USD	1.35	1.34	1.33	1.32
USD/CHF	0.94	0.95	0.95	0.96
AUD/USD	0.71	0.71	0.70	0.70
NZD/USD	0.69	0.68	0.68	0.68
USD/JPY	113	114	115	117
USD/MYR	4.15	4.15	4.15	4.10
USD/SGD	1.34	1.33	1.34	1.34
USD/CNH	6.45	6.45	6.50	6.50

Policy Rate (%)	1Q-22	2Q-22	3Q-22	4Q-22
Fed	0.00-0.25	0.00-0.25	0.00-0.25	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	0.25	0.25
SNB	-0.75	-0.75	-0.75	-0.75
RBA	0.10	0.10	0.10	0.10
RBNZ	0.75	0.75	0.75	0.75
BOJ	-0.10	-0.10	-0.10	-0.10
BNM	1.75	1.75	1.75	1.75
MAS	-	Tighten	-	Hold
PBOC	Hold	Hold	Hold	Hold

FX Crosses Forecasts

MYR	1Q-22	2Q-22	3Q-22	4Q-22
EUR/MYR	4.73	4.73	4.69	4.59
GBP/MYR	5.60	5.56	5.52	5.41
AUD/MYR	2.95	2.95	2.91	2.87
SGD/MYR	3.10	3.12	3.10	3.06
MYR/CNH	1.55	1.55	1.57	1.59

SGD	1Q-22	2Q-22	3Q-22	4Q-22
EUR/SGD	1.53	1.52	1.51	1.50
GBP/SGD	1.81	1.78	1.78	1.77
AUD/SGD	0.95	0.94	0.94	0.94
SGD/JPY	84.33	85.71	85.82	87.31
SGD/CNH	4.81	4.85	4.85	4.85

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