

# FX Outlook: Possibilities of More Reversals

**We do not rule out further USD strength at some point in time, as it trends lower for 2021-2022**  
**Three factors shaping FX movements are: Covid-19, yield differentials, and commodity markets**  
**G10 currencies may fare better than some Asian counterparts**

### Key Currency Themes

In April, we observed broad dollar weakness after some strength in March. Markets were relatively buoyed by economic recoveries across major economies, as well as positive corporate earnings reports. The dollar was also pulled back as US yields retreated from end-March highs. This was in line with our views (a tad earlier than expected) that the dollar weakness will come when imbalances between expectations of growth and inflation correct.

**Our current view from May is centred on risks of some near-term dollar strength, and a weakening dollar outlook from 2H-2021 to 1H-2022.** Dollar weakness however is unlikely to be too sharp, given the US economy’s recent recovery and strong fundamentals. The USD is likely to only strengthen when markets start to price in the tighter US Federal Reserve policy – when it will be tapering its current quantitative easing programme and raising its policy rate.

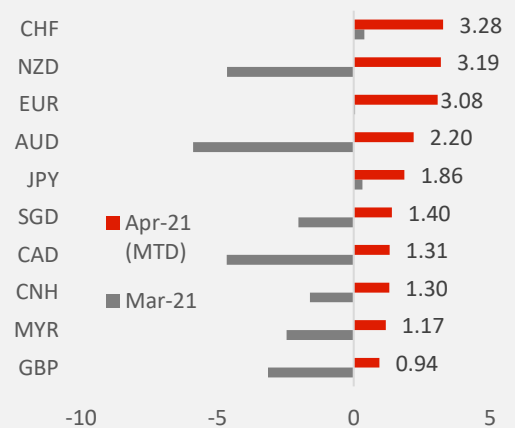
Three main factors will likely be the linchpin of currency moves over a 12-month period: (1) the Covid-19 pandemic, (2) yield differentials, and (3) commodity price movements. G10 currencies may also perform better than emerging market currencies over this period. Considering these factors, **we are comparatively more bullish on AUD, NZD, CAD, and SGD and relatively less optimistic on the EUR and CNY in an environment of dollar weakness.**

### Back-and-forth with Covid-19

Recent dollar weaknesses can potentially be derailed by the recent resurgence of Covid-19 cases (Figure 3). The latest wave appears to be centred from India, setting global records (349,691 on 25 April) for single day new infections for a few days from 21 April. Vaccinated individuals may possibly be less protected and immunised against new variants of the Covid-19 virus, which threatens to cause more lockdowns and activity shutdowns.

At the same time, the world is facing unevenness in its inoculation efforts. Many developed countries including the US are ahead in the inoculation

Figure 1: FX movements, %



Source: Bloomberg

Figure 2: FX Forecasts

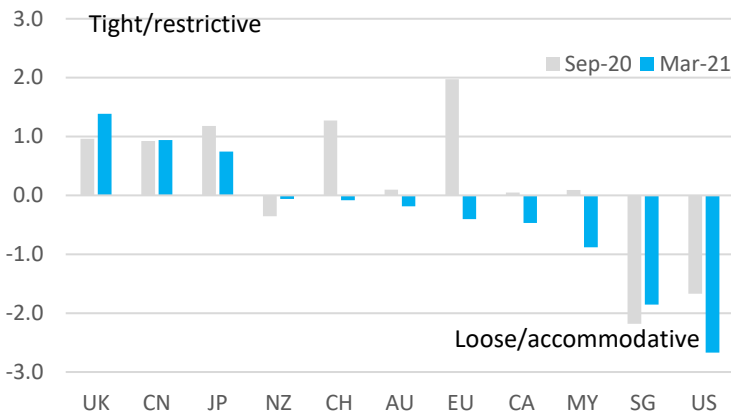
	27 Apr	4Q-21	2Q-22
DXY	90.901	91.50	90.00
USD/CAD	1.2399	1.24	1.22
EUR/USD	1.2091	1.20	1.22
GBP/USD	1.3913	1.40	1.42
USD/CHF	0.9136	0.93	0.91
AUD/USD	0.7765	0.78	0.80
NZD/USD	0.7208	0.72	0.74
USD/JPY	108.70	109.00	107.50
USD/MYR	4.097	4.08	4.00
USD/SGD	1.3262	1.33	1.31
USD/CNY	6.4804	6.45	6.35

Source: HLBB

drive, but the World Health Organisation is concerned about vaccine imbalance.

Dollar had spiked up sharply in March 2020 from the first wave of Covid-19 spread. In this instance, major central banks' accommodative monetary policy stances are likely to insulate against any significant USD spikes. We note that monetary conditions remain accommodative in the US, Eurozone, Singapore and Malaysia, as compared to relatively tighter conditions in the UK, China, and Japan. This may mean that the GBP, JPY and CNY be comparatively more vulnerable against a Covid-19 resurgence.

**Monetary Conditions (real interest rates & real effective exchange rates)**

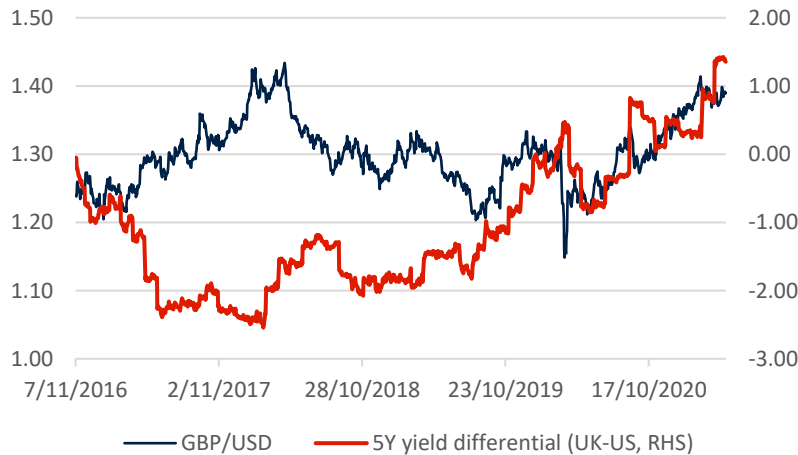


Estimated by HL Bank, in standard deviations compared to the past 3 years

**Yield Differentials with the US**

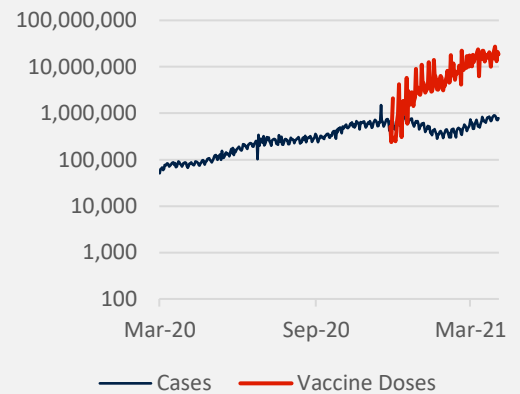
Due to comparatively higher inflation rates in the US compared to the rest of the world, we continue to see positive yield differential gaps compared to the US (see Figure 4 and GBP/USD example). This is likely to remain a driving force for dollar weakness against various G10 and Asian currencies. The JPY, AUD and GBP may be more fundamentally supported than the CAD and EUR, in this regard. We see this gap partially narrowing in 2022, limiting dollar weaknesses at that point in time.

**GBP/USD Yield Differentials (%)**



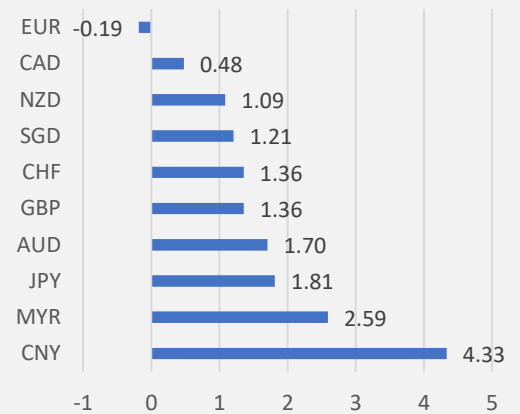
Estimated by HL Bank, in standard deviations compared to the past 3 years

**Figure 3: Net changes in Covid-19 worldwide**



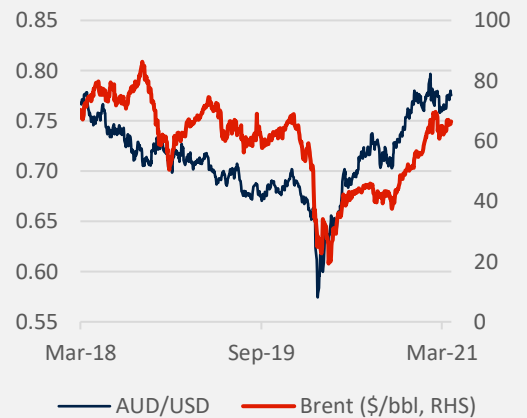
Note: Exponential chart. Source: Bloomberg

**Figure 4: Real yield differentials vs the USD (%)**



Source: Bloomberg, HLBB

**Figure 5: Commodity-related currencies outperformed as crude prices climbed more**



Source: Bloomberg

### Improving Commodity Market Outlook

Commodity prices have been fairly supported by the economic recovery. This will likely hint at continued support for commodity related currencies like the AUD, CAD and NZD (Figure 5). Global PMIs (particularly manufacturing) stayed in the highly positive territories.

In China, the economy remains fairly supported by strong demand for its exports and industrial goods, which has boosted commodity prices like in copper and aluminium (up by around 20% YTD). Besides, consumer sentiments and spending looks to be improving, which can also be a boost to commodities.

Inflation concerns have faded slightly in April. Producer prices continued to surge (Figure 6), but inflation has been fairly limited to energy (Figure 7). However, should energy inflation broaden to higher core inflation, this may bring about more volatility and dollar strength.

### Asia Currencies May Underperform

The shift in market focus towards US growth, compared to Asia growth, is likely to imply better USD performances against Asian currencies like the CNY, SGD and MYR. Still, the CNY has weathered recent volatility fairly well (Figure 8). We expect some resilience from the SGD, as markets expect the Monetary Authority of Singapore to tighten its exchange rate policy earlier than other major central banks (that are using more conventional interest rate policies and targets).

### What do These Mean in Terms of Forecasts?

We believe that dollar may strengthen near-term sometime in 2Q. With markets already back and forth umpteen times over the past year from fluctuations in risk appetites, renewed concerns on Covid-19 can strengthen the dollar. At the same time, US yields have pulled back but will still likely rebound again, owing to economic outperformance in the US. As a result, we maintain our DXY and EUR/USD view of 92.50 and 1.1850 respectively in end-June (27 April: 90.91 and 1.2082). On USD/SGD and USD/MYR, this may hint at some pullbacks closer to 1.36 and 4.15 respectively (27 April: 1.3271 and 4.0970).

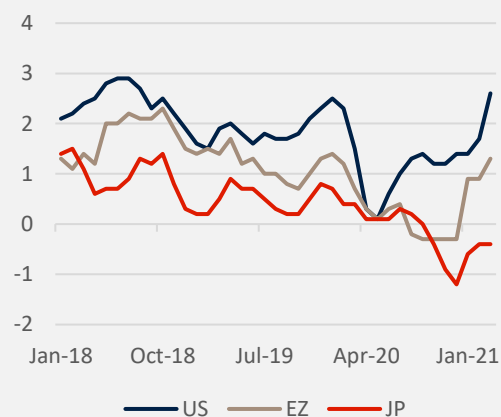
Over a longer horizon, we still expect dollar weakness to prevail, from pandemic containment, yield differentials and commodity price increases. Hence, we maintain our DXY and EUR/USD view of 90.00 and 1.22 respectively in end-2Q-2022. On USD/SGD and USD/MYR, this will mean a move down to 1.31 and 4.00 respectively at the end of 2Q-2022.

**Figure 6: Surging input prices, observed from PPI (% y/y)**



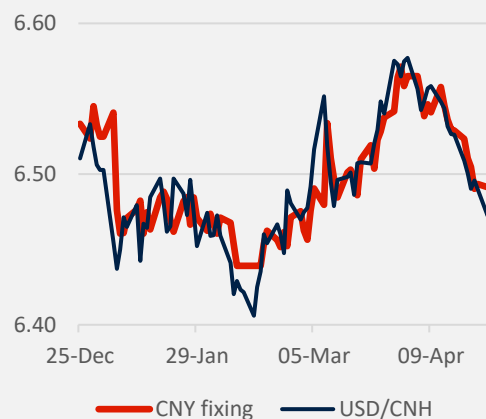
Source: Bloomberg

**Figure 7: Energy inflation still the main driver (% y/y)**



Source: Bloomberg

**Figure 8: CNH has recently corrected but is poised to move lower again**



Source: Bloomberg

## FX Forecasts

FX	2Q-21	3Q-21	4Q-21	1Q-22
DXY	92.50	92.00	91.50	90.75
USD/CAD	1.26	1.25	1.24	1.23
EUR/USD	1.1850	1.1900	1.2000	1.2100
GBP/USD	1.3850	1.3950	1.4000	1.4100
USD/CHF	0.95	0.94	0.93	0.92
AUD/USD	0.76	0.77	0.78	0.79
NZD/USD	0.70	0.71	0.72	0.73
USD/JPY	111.00	110.00	109.00	108.00
USD/MYR	4.15	4.10	4.08	4.05
USD/SGD	1.36	1.35	1.33	1.32
USD/CNH	6.60	6.55	6.45	6.40

Policy Rate (%)	2Q-21	3Q-21	4Q-21	1Q-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	-	Hold	-
PBOC	Hold	Hold	Hold	Hold

## FX Crosses Forecasts

MYR	2Q-21	3Q-21	4Q-21	1Q-22
EUR/MYR	4.92	4.88	4.90	4.90
GBP/MYR	5.75	5.72	5.71	5.71
AUD/MYR	3.15	3.16	3.18	3.20
SGD/MYR	3.05	3.04	3.07	3.07
MYR/CNH	1.59	1.60	1.58	1.58

SGD	2Q-21	3Q-21	4Q-21	1Q-22
EUR/SGD	1.61	1.61	1.60	1.60
GBP/SGD	1.88	1.88	1.86	1.86
AUD/SGD	1.03	1.04	1.04	1.04
SGD/JPY	81.62	81.48	81.95	81.82
SGD/CNH	4.85	4.85	4.85	4.85

## 2021 Central Bank Meetings/Announcements

Central Bank	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Federal Reserve (FOMC)	27		17	28		16	28		22		3	15
Bank of Canada (BOC)	20		10	21		9	14		8	27		8
European Central Bank (ECB)	21		11	22		10	22		9	28		16
Bank of England (BOE)		4	18		6	24		5	23		4	16
Swiss National Bank (SNB)			25			17			23			16
Reserve Bank of Australia (RBA)		2	2	6	4	1	6	3	7	5	2	7
Reserve Bank of New Zealand (RBNZ)		24		14	26		14	18		6	24	
Bank of Japan (BOJ)	21		19	27		18	16		22	28		17
Bank Negara Malaysia (BNM)	20		4		6		8		9		3	
Monetary Authority of Singapore (MAS)				Apr						Oct		

Note: Updated FX forecasts from 7 January 2020. Source: Bloomberg, HLBB

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