Monex January 2022 **FX Forecasts**

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Introduction

Our expectation of sustained USD strength throughout December proved correct as the arrival of Omicron and the risk it posed towards global growth conditions heading into 2022 kept risk conditions tentative. In addition, progress in the US labour market recovery and the more persistent inflationary backdrop resulted in a hawkish pivot from the Federal Reserve at December's meeting, with the US central bank doubling the pace of its QE taper and signalling three rate hikes in 2022. Outside of the US, events came thick and fast in December, but the idiosyncratic developments did little to derail our forecasts for the month within both G10 and EM spaces. The Bank of Canada was one of the more active central banks over the course of the last month as they not only released their latest policy decision, which was a status quo event in comparison to other G10 central bank releases, but also outlined the results of their monetary policy framework review. The latter announcement saw the central bank cast a dovish tone as they outlined a more flexible inflation mandate that would see the 1-3% CPI range used more actively in order to promote employment objectives. Despite the slight shock of the new mandate not following on from the previous one in its entirety, the loonie largely followed our expectations for December and closed out the year lower than the spot value at the end of November due to the arrival of the Omicron variant and the impact it had on oil markets. Next up was the National Bank of Poland who hiked rates by a further 50bps and set the tone for central banks in the coming days as they focused on the inflation backdrop as opposed to the growth risks posed by the Omicron variant.

> The pace of incoming news then picked up as a **string of central banks were announced in the same week** of the December Fed meeting.

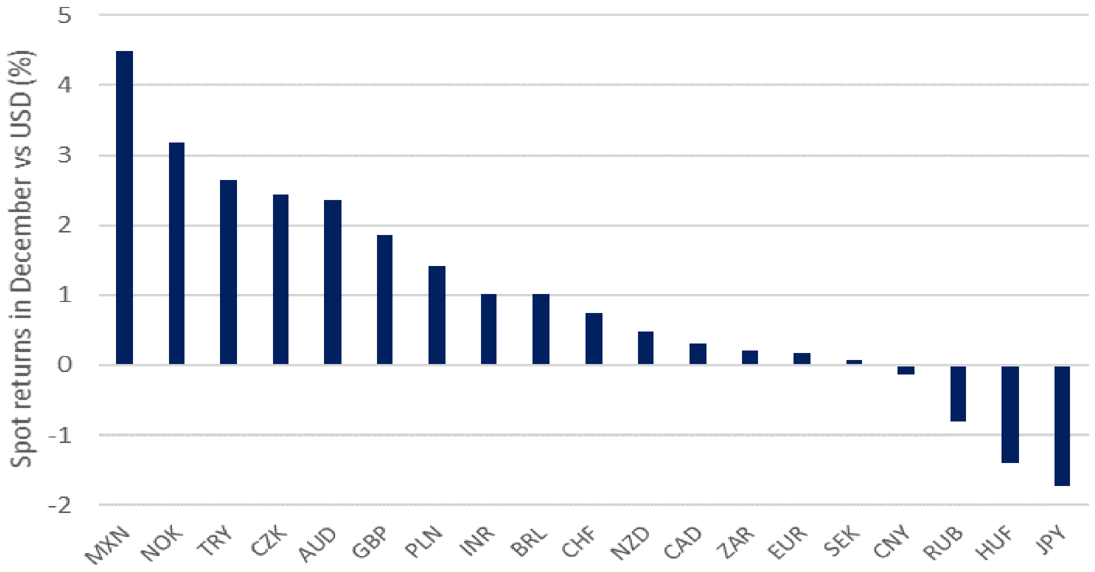
Firstly, the Norges Bank decided to continue with its tightening cycle by hiking rates by 25bps for the second time this year, while the Bank of England defied market pricing and conducted lift-off with a 15bps hike after data showed limited disruption to the labour market from the furlough scheme expiration. Following on from the Bank of England was the European Central Bank. Unlike the central banks before it, the ECB surprised market expectations but not by altering rates. Instead, the eurozone's central bank outlined what its post-pandemic QE programme would look like despite analysts expecting this to not be announced until Q1 before PEPP expired at the end of March in order to react to any developments in Omicron. Events in December can't be discussed without touching on the Turkish lira, however. On the same day as the Norges Bank, ECB and BoE, the Central Bank of the Republic of Turkey cut rates by a further 100bps but caveated the cut with a commitment to not touch rates throughout Q1 in order to assess the impact of the 500bps of easing conducted since August. We outlined that the CBRT's actions spelt troubled times for the lira, and in the following 48 hours this held true.

The currency slipped to as low as 18.44 per dollar before the government announced a new deposit protection scheme aimed at 3-to-12-month deposits. The scheme would top-up lira deposits should the currency depreciate further against other major hard currencies. This was effectively a stealth interest rate hike, but targeted at stemming domestic retail demand for foreign currencies as opposed to restricting domestic demand in order to tame inflation. The measures proved successful in driving the USDTRY rate back towards the 10 handle, however, the lira didn't fully recover the losses sustained since mid-November as questions over institutional credibility and the sustainability of such a policy remained.

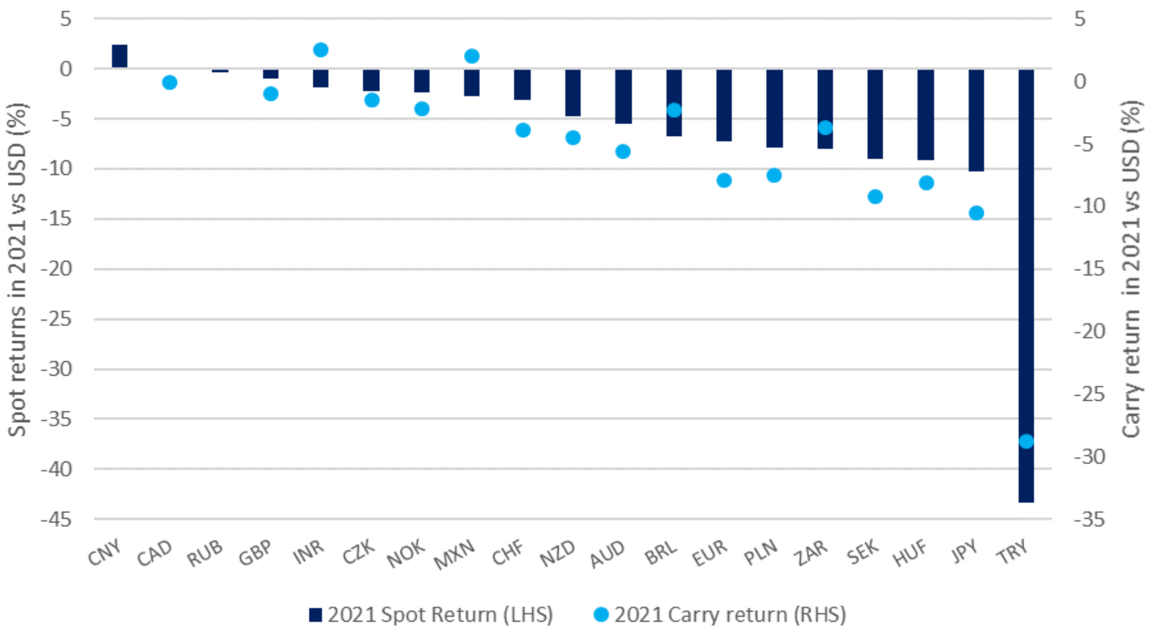
Looking ahead to 2022, our forecasts have been adjusted to take into account the new sensitivities of **central banks to inflation, continuing virus risks and the likely slowdown in growth in Q1.**

Risks over the 12-month horizon are plentiful, with the most notable ones outlined in our '2022 themes to watch out for' document released in January. These range from political and geopolitical risk to fiscal consolidation and terminal rates. In the short-term, Omicron risk continues to dominate as policymakers in major economies conduct a balancing act in order to mitigate the health and economic impacts. Regardless of further measures being imposed in January, a pullback in consumer spending in high contact services is likely.

G10 and EM returns vs USD in December



G10 and EM spot and carry returns over 2021



Monex's key views on DXY, EUR, GBP, CHF, CAD, RUB and TRY

DXY

The hawkish shift by the Federal Reserve in December to signal 3 rate hikes in 2022, along with looming growth risks and the possibility of a more inflationary global macroeconomic backdrop, has resulted in our DXY forecasts being raised for 2022. However, despite the expectation of a stronger dollar outlined by the DXY index, we think that USD price action will be more nuanced. Instead, we expect to see a two-speed dollar. Against high beta procyclical currencies, we expect to see sustained USD depreciation over the 12-month horizon as the global recovery matures and Fed rate hikes are offset by broadly rising G10 rates. Whereas against low yielding currencies, such as EUR and JPY, we anticipate that rising US yields will offset positive idiosyncratic developments and the improvement in global macroeconomic conditions , thus leading those pairs to trade in tight ranges around current spot levels. With regards to our 3-month forecasts, while we don't expect the Fed to hike rates at its March meeting given Powell's commitment to try and untangle the connection between QE tapering and rate hikes, we do think the Fed will use March's summary of economic projections to setup a rate hike for Q2 and a subsequent 25bps each quarter thereafter in 2022.

"The market reaction is therefore still likely to occur in March despite an actual hike unlikely to occur until May or June's meeting."

EUR

Our EURUSD forecasts were adjusted moderately to account for the Fed's review of its tapering timeline and the latest dot plot signalling three rate hikes in 2022. Under our expectation for the Fed, as outlined above in the DXY section, we have revised down our 3-month EURUSD forecast as the March meeting is likely to trigger a further widening of US and eurozone yield spreads.

We expect **the widening of spreads to largely offset the improvement in global and eurozone growth conditions**, which has resulted in our overall EURUSD forecasts being relatively flat.

However, despite the flat forecasts, we don't expect volatility in the currency pair to subside given how fluid the global macro backdrop is. Instead, our forecasts outline our expectations of the pair's mean value over the specified timeframes, with risks to these forecasts equally balanced. Downside risks include a greater impact of the Fed's hiking cycle and a return of carry flows into the euro, while upside risks include improving growth conditions over Q2/Q3 and a broader procyclical rally.

GBP

Our structural GBP view is little changed from December's submission, with just the 1-month forecast being upgraded to account for the more limited damage inflicted by the Omicron variant than initially thought. The muted reaction by authorities to contain the latest outbreak, coupled with early evidence that the new variant will result in less hospitalisations and deaths, means much of the downside risk has been removed from the pound, as visible with its recent rally up towards the 1.35 handle against the dollar.

Over the coming month, we expect the macro backdrop to continue supporting the idea of the **BoE raising rates up to 1% in 2022.**

The decision for a February rate hike will largely be dependent on incoming inflation and growth data. Expectations of BoE hiking should mitigate the impact of the Fed's hiking cycle on the pound over the course of the next twelve months, while a continued recovery in the global economy should support the procyclical pound rally back towards historic averages around the 1.40 region.

CHF

We remain mildly bullish on CHF over our entire forecast horizon, although the first few months into the New Year are expected to show less of the action. EURCHF broke through 1.04 for the first time in over five years in December and has been trading around that level ever since. The strength in CHF comes not only from the broader safe haven flows, but also from European Covid and inflation developments. The SNB previously intervened at the 1.05 level but Swiss sight deposits show that the central bank has been absent in FX markets this time around.

> **We think the SNB won't let the CHF strength get out of hand** and will want to guide markets towards a weaker franc should EURCHF look to sustainably break to the downside.

Deflation may be less of a concern now than when the SNB intervened previously as CPI currently sits within the 0-2% target band. This will likely only move the SNB's tolerance to a somewhat lower level in EURCHF but market participants will still be wary of the central bank's involvement if it continues to test their resolve. For this reason, we forecast only slight CHF appreciation against the euro over the course of January.

CAD

Our CAD forecasts remain on the bearish side over the 1-month horizon to reflect the likelihood that risk sentiment will remain tentative heading into Q1 2022, however, under our expectation of a pick-up in global growth momentum heading into Q2 we believe the loonie's procyclical nature will result in USDCAD heading back toward the mid-1.20 region towards the end of of Q1. Unlike some G10 pairs, we think the loonie is well shielded from the Fed's hiking cycle given the Bank of Canada's hawkish position. However, upside risks to our USDCAD forecasts are substantial should the Canadian central bank not keep apace with the Federal Reserve. This is especially the case given the Fed provides material forward guidance on its projected rate path whereas the Bank of Canada doesn't. This means that any minor delay in the BoC's hiking cycle relative to what markets have already interpreted will be viewed in a more dovish light as the decision will be priced into a longer time horizon. Upside risks in our USDCAD forecasts also centre around Covid risks and a more delayed uptick in global growth conditions.

CNY

Despite the downturn in global risk appetite, ongoing financial stability concerns, and a domestic backdrop of slowing growth momentum, the Chinese yuan has continued to strengthen both against the dollar and in trade weighted terms over the course of December. In light of its recent performance, we have adjusted our near-term expectation of CNY to factor in continued yuan appreciation, albeit only slightly. Over the medium-term, our expectation of narrowing yield differentials and the pressure that will place on capital flows remains, hence our expectation of CNY depreciation from the end of Q1 onwards. In fact, the PBOC's recent decision to cut the 1-year loan prime rate reinforces our expectation of narrowing yield differentials in 2022 as G10 core rates are set to rise further while domestic growth conditions place easing pressure on the Chinese central bank.

RUB

While our forecasts for the ruble have remained unchanged, this isn't due to a lack of developments around the currency. Elevated crude prices and record-high European energy prices would usually support ruble appreciation, but this wasn't visible in FX markets recently as investors remain unwilling to bolster exposure to Russian assets. This is due to continuous streams of headlines around the Russia - Ukraine situation and lingering sanctions from the EU, UK and US, which has capped FX gains that would normally result from improving current account developments. We expect the current trends to continue until a breakthrough in geopolitical tensions arises, while risks from the inflation outlook are arguably more limited for the ruble compared to other Central Eastern European currencies due to the CBR's responsiveness and credibility.

TRY

We have reviewed our TRY forecasts to adjust for the latest developments on the monetary and fiscal front. As has been the case over the past few months, the latest CBRT policy decision pushed the lira down further as concerns over a limited pause to the easing cycle rose, while rising inflation in Q1 may only embolden President Erdogan's views on interest rates. The latest news on the fiscal front was well received by markets and saw dramatic intraday moves in the lira, but since then, the currency retraced gains somewhat as questions remain as to how credible and sustainable Erdogan's emergency plan to curb the lira's depreciation is.

> Over the more medium-term, lower pressure on inflation through energy prices should help stabilise the lira, but risks around the outlook are plentiful given the currencies sensitivity to political events.

FX Forecasts

January 2022

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Forecasts

Currency Pair	1-month (31st Jan 2022)	3-month (31st Mar 2022)	6-month (30th Jun 2022)	12-month (31st Dec 2022)
G10				
EUR/USD	1.13	1.12	1.13	1.14
USD/JPY	115	116	115	115
GBP/USD	1.3550	1.36	1.38	1.39
USD/CHF	0.916	0.929	0.929	0.939
USD/CAD	1.27	1.25	1.24	1.23
AUD/USD	0.72	0.74	0.74	0.75
NZD/USD	0.69	0.71	0.72	0.72
USD/SEK	9.16	9.06	8.94	8.82
USD/NOK	9.03	8.84	8.67	8.60
DXY	96.09	96.52	95.62	94.97
Emerging Markets				
USD/CNY	6.35	6.40	6.42	6.50
USD/INR	75	75	74	73
USD/ZAR	15.5	15.8	15	15.5
USD/TRY	14.5	13	12.5	12.5
USD/RUB	74	71	68	70
USD/PLN	4.07	4.06	3.98	3.91
USD/HUF	327	326	323	316
USD/CZK	22.12	21.43	21.68	21.93
USD/BRL	5.7	5.8	5.85	5.7
USD/MXN	21	21.5	21	20.5
Euro Crosses				
EUR/GBP	0.834	0.824	0.819	0.820
EUR/CHF	1.035	1.04	1.05	1.07
EUR/CAD	1.44	1.40	1.40	1.40
EUR/SEK	10.35	10.15	10.10	10.05
EUR/NOK	10.2	9.9	9.8	9.8
EUR/TRY	16.39	14.56	14.13	14.25
EUR/RUB	83.62	79.52	76.84	79.80
EUR/PLN	4.60	4.55	4.50	4.46
EUR/HUF	370	365	365	360
EUR/CZK	25	24	24.5	25
EUR/BRL	7.24	7.25	7.25	7.01
EUR/MXN	21.21	21.82	21.42	20.92

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