Monex March 2022 **FX Forecasts**

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Introduction

February will be remembered in the history books for its geopolitical events and the predicament they, along with global inflation pressures, placed central banks in. Prior to Russia's invasion of Ukraine, shifting policy outlooks by G10 central banks was the main driver of FX price action. The double whammy of the Bank of England and the European Central Bank on February 3rd provided the first bout of FX volatility caused by central banks over the course of the month. Despite analyst expectations of the two meetings set to strike a stark contrast in monetary policy and likely further upside in GBPEUR, the decision by the ECB to relay more hawkish undertones proved seismic for financial markets and sent the currency cross over a percentage point lower despite the BoE's decision to raise rates by 25bps to 0.50%. This led us to revise up our near-term EUR forecasts as all indicators pointed towards the ECB announcing a faster pace of QE tapering at their March meeting and higher eurozone policy rates towards the end of the year. The entrenchment of more hawkish expectations wasn't just isolated to the ECB, however. Strong January Nonfarm payrolls data out of the US in spite of the Omicron wave emboldened expectations of the Fed's hiking cycle, not only in duration but also the probability of a 50bp hike in March. Meanwhile, a hot headline print in January's Canadian CPI data confirmed our expectation that the Bank of Canada will conduct lift-off in March, however, weaker domestic inflationary pressures suggested that rates would only be raised in 25bp increments. Despite the hawkish shift in G10 rate profiles, the Riksbank defied the general trend and continued to strike a dovish tone on rates despite the ECB providing the Swedish rates with a free pass to climb higher. The Riksbank's actions sent EURSEK flying higher as rate differentials narrowed in favour of the euro.

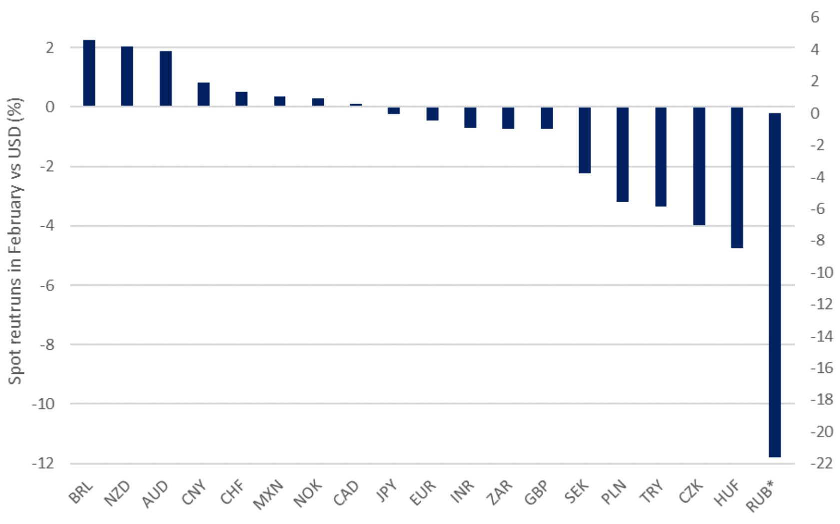
> However, the more hawkish **forward guidance by G10 central banks** in February proved to have a limited shelf life, especially in Europe, as **Russia's decision to invade Ukraine introduced new stagflationary risks**.

The series of geopolitical events took markets by surprise at each hurdle, not only due to the severity of the actions but also the pace at which they developed. Central banks in March will have to navigate the renewed risks to global growth and inflation, which may see the likes of the ECB cast a more neutral tone than previous communications suggest, while we expect North American banks to press ahead with raising rates. While initial policy decisions by G10 central banks are somewhat navigable, the market risk environment is more fluid. Given the fast pace of geopolitical events and the level of uncertainty in markets, our near-term forecasts remain under review following February's publication. Currently, our base case forecasts envisage a material deterioration in Europe's macroeconomic backdrop due to higher energy costs. This leaves EURUSD more vulnerable to the downside, and growth risks in the eurozone should support further appreciation in CHF, the regional safe haven, regardless of the overall market risk backdrop.

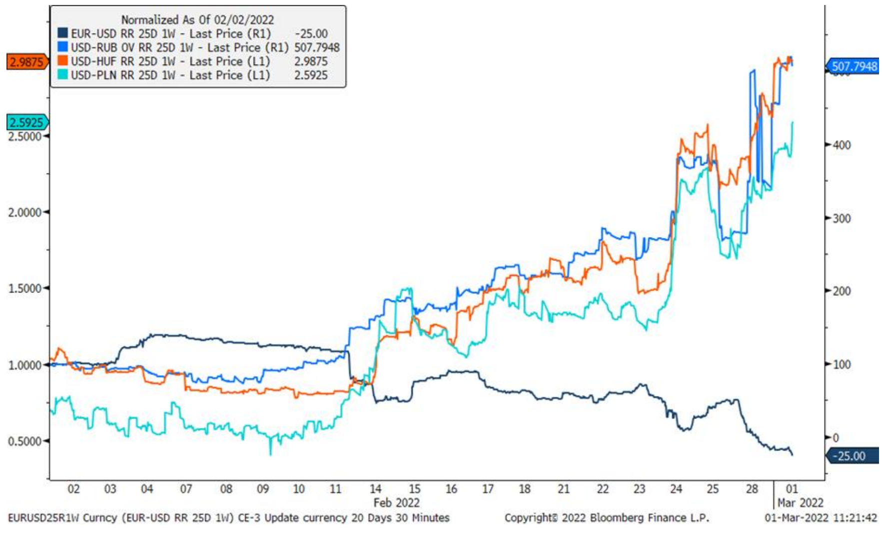
In the rest of the G10 space, commodity currencies like AUD and CAD are likely to buffer any further risk-off bouts due to the offsetting impact of higher commodity prices while any stabilisation in broad risk conditions will likely see these currencies lead gains in the G10 complex. Over the medium-term, we are more confident that risk conditions will be more stable, although recent events may result in some major economies slipping into recession in Q1. This will limit the downside in the broad dollar despite the more stable risk environment unwinding haven demand. Over the longer-term, our forecasts remain fairly stable relative to February's submission, owing to the expected improvement in global macroeconomic conditions. We still expect to see a limited decline in the broad dollar over this period, however, as yield differentials should still favour the greenback.

G10 and EM returns vs USD in February

**RUB returns are portrayed on the right-hand axis*



EURUSD risk reversals show demand for EURUSD put options is larger than call options, but moves are a long way off the moves seen in CE-4 currencies against the dollar



EUR

In our latest EUR update, we revised up our short-term euro forecasts to account for the recent shift in ECB communication visible at the February meeting, where ECB President Lagarde highlighted the upside risks to inflation and refused to rule out a rate hike in 2022. This led us to believe a hawkish communicational pivot at the March meeting was incoming, especially as eurozone inflation continued to shoot higher. In comparison, the well-signalled intentions of the Federal Reserve and the overtly hawkish market pricing suggested the Fed was likely to under deliver on expectations. While this initially led to us revising up our short-term EURUSD calls, one of the more prominent downside risks to our outlook materialised in the subsequent weeks. Russia's invasion of Ukraine not only weighed on regional risk sentiment but also struck concerns over higher energy prices and risks of stagflation in Europe. This leaves the ECB in a more precarious position in March, at a time when the Fed is likely to start raising rates due to geopolitical events having less of a growth impact on the US economy. We expect the re-widening of rate differentials to weigh on the euro in the near-term along with ongoing geopolitics. While risks over the medium-term are still plentiful, we expect the pace of the downturn in risk sentiment to slow and result in a mild retracement in assets directly impacted by recent events (EUR, SEK, and CE-3 currencies). However, as military posturing continues, downside risks of an extended period of war and elevated commodity prices remain a downside risk to our euro forecasts. To the upside, an earlier resolution to the current conflict and a de-escalation in economic sanctions will support the euro on multiple fronts as the risk profile improves, fears around stagflation decrease and the ECB can continue a more hawkish trend.

RUB

The Russian ruble sank to a record-low on Monday after the West imposed another tranche of sanctions, including measures targeted towards the CBR's FX reserves - a first for an economy the size of Russia's - and restricted access to SWIFT for a selection of Russian financial institutions. The CBR responded to this by imposing capital controls and hiking the interest rate from 9.5% to 20% as the currency crumbled. While the currency has stabilised somewhat, offshore liquidity is non-existent, making the quoted pricing unobtainable. A reduction in sanctions and increased Russian access to global markets will be required for liquidity to re-emerge in offshore markets, but the timing of such a scenario is highly uncertain as things stand.

> Given the fluid nature of the situation, we have based our forecasts on current spot prices at present, **with a gradual retracement in USDRUB over the medium-term** under our base case assumption of a moderation in geopolitical tensions.

CHF

Ongoing geopolitical developments have resulted in increased flows into the regional safe haven that is the Swiss franc as of late, however the extent of this was more limited compared to flows into the USD. After repeated attempts to break below the 1.03 level over the past week, the inability of EURCHF to close at fresh lows fuelled speculation around potential FX intervention by the Swiss National Bank. Sight deposit data for the final week of February suggested that the SNB didn't actually intervene, but instead market psychology prevented further CHF appreciation. Given limited signs of SNB intervention, we expect further CHF appreciation due to increased regional risk and concerns over eurozone growth conditions. We estimate the SNB's new tolerance level is around the 1.0250 mark, past which, we think commentary by Governor Jordan regarding how "highly valued" the franc is will begin. This is usually a precursor for currency intervention by the SNB.

G10 commodity currencies

Despite G10 commodity currencies tending to have a high sensitivity to global risk conditions, the nature of the recent downturn and the corresponding impact on commodity markets suggests that commodity currencies within the G10 space are likely to be more resistant to any further deterioration in risk conditions. This is especially the case for commodity currencies outside of Europe (CAD, AUD, and to a lesser extent NZD).

> "Given this dynamic, we anticipate a slight strengthening in these currencies over the near-term due to an improvement in their terms of trade, with further gains driven by an improvement in global risk and growth conditions over the medium-term."

For CAD specifically, the incoming hiking cycle from the Bank of Canada will provide another backstop for the loonie in the near-term, while an increasingly more hawkish Reserve Bank of Australia may offer more limited support for AUD. New Zealand's rate profile will be a more prominent source of support for NZD given the economy's smaller commodity profile.

Scandies

While both the Norwegian krone and the Swedish krona usually move in tandem in broader risk-off conditions, the Russia-Ukraine crisis has mostly had a negative impact on SEK due to Sweden's exposure to eurozone growth and inflation conditions, while NOK was better supported through higher crude oil prices - a by-product of the Russia-Ukraine conflict as fears around disrupted commodity supplies dominate markets. This meant that losses in the Norwegian krone were more limited, with EURNOK even hitting November lows while EURSEK was trading close to May highs.

On top of that, the hawkish Norges Bank serves as a backstop for NOK while the Swedish krona sees no support from the slow-to-move Riksbank, which recently stated its more dovish stance on inflation. In terms of risks to the outlooks, the most severe risk would be sanctions on Russia's energy companies, which would hammer the Swedish krona as inflation fears in Europe rise while the Riksbank may be unable to respond with tighter policy: after having only moved to positive rates late 2019, the last thing the Riksbank wants to do is tighten policy too quickly. As the euro weakens significantly in such a scenario as well, the weaker krona would be mostly visible in USDSEK. For NOK, on the other hand, such a move would only extend and exacerbate the current rally as Norway then becomes a more critical supplier of energy to Europe, which would be supportive for NOK. In such a scenario, the risks would be more centred around EURNOK than USDNOK.

BRL

Rate differentials are likely to continue driving BRL gains over the near-term as markets price out the probability of a steeper US rate path due to global geopolitical risks and rising global inflation pressures are likely to keep the BCB committed to raising rates. On top of this, the increasingly bullish commodity backdrop will provide another tailwind for the drive lower in USDBRL over the one-month horizon. Further out in the forecast horizon, we continue to expect a period of BRL depreciation in the run-up to October's elections, as has been standard in previous pre-election periods. Risks to our BRL forecasts are roughly balanced. Further upside in global commodity prices poses downside risks to our USDBRL forecasts, while a more substantive risk-off environment is the largest upside risk to our one-month forecast.

CNY

The yuan remained stable during the early parts of February where global currencies were placed under pressure by rising expectations of G10 policy rates, while the currency rallied as global geopolitical tensions ramped up in the latter parts of the month. The stability in CNY was highlighted further by the drop in the currency's correlation to global volatility to a three-year low during the last week of February as markets anticipated rising CNY demand from Russia as the economy is frozen off from Western capital markets. While we still expect sustained CNY depreciation over the course of the next twelve months, largely due to slower growth conditions in China and diverging monetary policy stances between China and G10 economies, further CNY appreciation is likely in the near-term as geopolitical risks remain prominent.

There is a risk that PBOC officials intervene to offset sustained CNY appreciation, but this is unlikely at our projected one-month spot levels.

Forecasts

Currency Pair	1-month (31st Mar 2022)	3-month (31st May 2022)	6-month (31st Aug 2022)	12-month (28th Feb 2023)
G10				
EUR/USD	1.10	1.12	1.13	1.14
USD/JPY	115	116	115	115
GBP/USD	1.34	1.36	1.38	1.39
USD/CHF	0.932	0.924	0.929	0.939
USD/CAD	1.26	1.25	1.24	1.23
AUD/USD	0.73	0.74	0.75	0.76
NZD/USD	0.68	0.71	0.72	0.72
USD/SEK	9.77	9.29	9.03	8.86
USD/NOK	8.82	8.57	8.50	8.34
DXY	97.97	96.60	95.66	94.99
Emerging Markets				
USD/CNY	6.3	6.35	6.4	6.45
USD/INR	75	75	74	73
USD/ZAR	15.5	15.4	15	14.8
USD/TRY	14.2	13.6	12.5	12.5
USD/RUB	100	95	90	85
USD/PLN	4.32	4.11	3.98	3.90
USD/HUF	343	326	323	316
USD/CZK	23.00	22.14	21.68	21.93
USD/BRL	5.2	5.3	5.5	5.4
USD/MXN	20.75	21	20.5	20
Euro Crosses				
EUR/GBP	0.821	0.824	0.819	0.820
EUR/CHF	1.025	1.035	1.05	1.07
EUR/CAD	1.39	1.40	1.40	1.40
EUR/SEK	10.75	10.4	10.2	10.1
EUR/NOK	9.7	9.6	9.6	9.5
EUR/TRY	15.62	15.23	14.13	14.25
EUR/RUB	110	106.4	101.7	96.9
EUR/PLN	4.75	4.6	4.5	4.45
EUR/HUF	378	365	365	360
EUR/CZK	25.3	24.8	24.5	25
EUR/BRL	5.72	5.94	6.22	6.16
EUR/MXN	22.83	23.52	23.17	22.80

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