Monex November 2021 **FX Forecasts**

Authors

Simon Harvey
Senior FX Market Analyst
+44 (0)203 650 6472
Simon.Harvey@monexeurope.com

Ima Sammani
FX Market Analyst
+31 (0)20 808 3644
Ima.Sammani@monexeurope.com

www.monexeurope.com

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Introduction

Concerns over Europe's stagflationary environment in September reverberated through global markets last month, albeit on an inflationary front as opposed to stagnant growth. This resulted in money markets continually pushing back against G10 central bank communications to price in aggressive tightening cycles across the space as a whole, while bear flattening occurred in most sovereign yield curves. For the most part, this resulted in broad USD weakness, with the DXY index falling over a percentage point before losses were largely reversed on month-end flows. While overall DXY performance is a good barometer for broad FX developments, it is a limited measure as it predominantly tracks EURUSD and USDJPY, both of which weakened against the dollar over October and bucked the broad G10 move.

Over the past month, EURUSD touched a fresh 15-month low before retracing losses towards month-end, while the Japanese yen broke out of its recent range to trade at lows not seen since 2018. However, losses within the G10 space against the dollar stopped there. The reopening of the Australian and New Zealand economies resulted in AUD and NZD leading gains against the dollar, while commodity currencies that also benefited from more hawkish central banks such as CAD and NOK followed shortly behind. While the Norges Bank was known as a hawkish outlier coming into October, the Bank of Canada recently brought forward its assessment of when it will hike rates from H2 2022 to the "middle quarters of next year", following an adjustment to their output gap forecast and solid progress in the labour market. Central banks weren't just the focus of G10 FX markets, however, with the CBRT cutting rates by 200bps, which sent the lira to fresh historic lows, and the National Bank of Poland unexpectedly raising rates by 40bps.

> Looking ahead, the main thematic driver of FX price action in October, that is interest rate expectations and concerns over **persistent inflation**, is set to dominate again.

This is especially the case in the first week of November as key Reserve Bank of Australia, Federal Reserve, National Bank of Poland, and Bank of England announcements are pencilled in. Amid the environment of elevated inflation concerns and aggressive market pricing of policy tightening, we expect the dollar to sustain losses against the early rate movers. However, the DXY index is likely to remain propped up by incrementally hawkish commentary from the Fed keeping pressure on EURUSD and USDJPY. Over the medium-term, under our base case for Fed policy tightening, rate rises in H2 2022 following the completion of the QE tapering are likely to limit sustained USD downside. Upside risks to our DXY forecast are contingent on the Fed becoming less tolerant to above target inflation, resulting in the US central bank hiking rates more aggressively than we currently expect.

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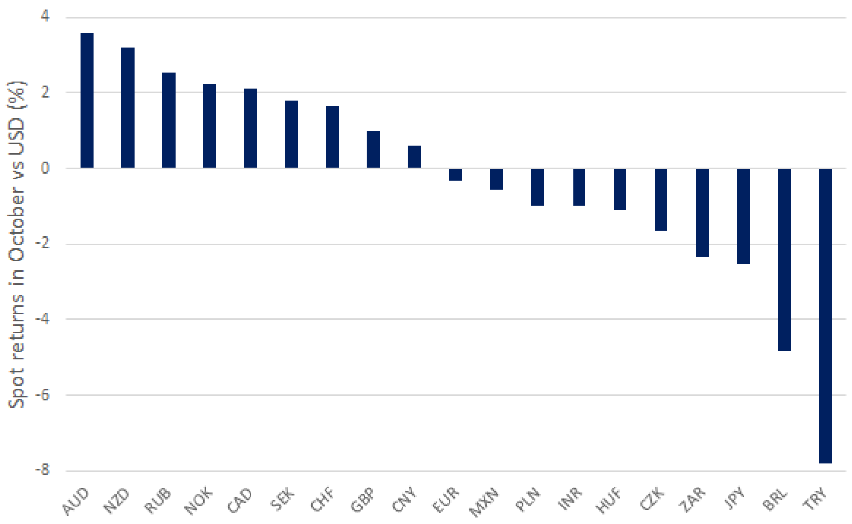
Chart: G10 and EM FX returns vs USD in October



Monex's key views on EUR, JPY, GBP, CAD, CHF, AUD, NZD & CE-3 currencies

EUR

We expect the Fed to show the first signs of becoming less tolerant to the current inflationary environment in November's meeting. The resulting impact on front-end Treasury yields is likely to keep pressure on EURUSD, especially as any contagion to front-end eurozone rates is likely to be offset by a temporary increase in pandemic purchases towards year-end given current macro conditions. Over the medium-term, a bridge from PEPP to APP will mean the ECB remains a dovish outlier, with the move pushing back interest rate expectations until 2023. At the same time, rate hikes will become a point of discussion for the Fed, supporting a case for a strong dollar over the same horizon. However, by the end of next year we expect tightening by the Fed to be factored into bond markets already, while the ECB is likely to start taking the first steps towards returning to post-pandemic policy.

> For this reason, while we have downgraded our 12-month EURUSD forecast from October's submission, **we still expect EURUSD to marginally strengthen a year from now.**

JPY

The impact of widening yield spreads has largely been priced into the USDJPY pair over the course of October.

Under our expectation of a marginally hawkish Federal Reserve this month, we think there is room for the pair to run higher in the near-term, however, USDJPY upside is limited by bear flattening in the Treasuries curve and thus limitations to back-end spreads. Over the medium-term, further flattening of the US yield curve and risks of monetary tightening being too aggressive within the G10 space is likely to filter into JPY strength at the margin. However, it must be noted that risks to our relatively flat USDJPY view are extensive, but broadly balanced.

GBP

Regardless of whether the Bank of England hikes rates at November and/or December's meeting is largely irrelevant in our view, with the manner in which the rate decision is delivered being more deterministic for FX markets than the physical act of altering rates.

> "Under our current base case, we expect the Bank of England to push back on expectations of a rate hike in November, instead opting to view the impact of the furlough expiry at December's meeting."

However, while this may be seen as dovish on the surface, we expect the Bank to signal a modicum of content with the market implied rate path for the coming three quarters, which should be supportive of a continued GBP rally. Concerns over the sustainability of the BoE's tightening cycle should limit gains above the 1.40 handle over the medium-term, however. Risks to this view are largely tilted to the downside, with GBP underperformance likely to be driven by a less hawkish Bank of England and an unwind in current positioning.

CAD

Higher oil prices and a sustained hawkish outlook from the Bank of Canada should maintain the bearish USDCAD trend that has been in place since the beginning of October. We now expect the Bank to hike rates by 25bp at April's meeting, and to continue hiking in 2022 at a pace that is defined by both inflation readings and housing market developments.

> "With oil prices expected to moderate in the middle of next year and the Federal Reserve to begin hiking rates, **we expect a mild retracement in the CAD rally over the 12-month horizon,** however."

CHF

Stagflation concerns and regional risk from Turkey has been driving the franc down towards levels associated with FX intervention.

We expect the latest EURCHF downtrend to continue as the macro backdrop remains supportive of franc appreciation, however, we expect the SNB to begin intervening around the 1.05 level again. While rising inflation in Europe should mitigate the deflationary impact CHF appreciation has on the Swiss economy, the rate of change in the currency cross will remain a concern for the central bank after a staunch defence back in 2020.

AUD & NZD

The room for further AUD strength in the near term is likely to be limited by the RBA failing to live up to the markets' expectations despite its hawkish pivot, especially after the latest breach of its yield curve control policy following the return of core inflation to the Bank's 2-3% target. Despite the hawkish shift from the RBA, we still expect the central bank to lag in the normalisation race, which should see a medium-term retracement in AUD over the near-term. An improvement in economic fundamentals and a stabilisation in the core CPI rate within the Bank's target range should facilitate a return in AUD back towards current spot levels over the 12-month horizon.

> "For the kiwi dollar, near-term interest rate hikes will likely offset the Fed's reaction function, **building out further NZD strength over the short-term**."

As we enter into the 6-12 month period, however, the RBNZ hiking cycle is set to slow as housing market dynamics cool. The contrasting pace for normalisation between the RBNZ and the Fed is then set to weigh on NZD, which we have factored into our 12-month projection.

CE-3

PLN, CZK and HUF were of the few currencies that weakened against the euro over the last month, despite all three central banks having embarked on a tightening cycle to combat inflationary pressures - including the NBP who were the latest to join. While the Russian ruble was being supported by higher energy and oil prices throughout October, PLN, CZK and HUF were hit by the increase in energy prices as the CE-3 is a net importer, while inflation continued to overshoot expectations. Beyond this, rising Covid-19 cases in their domestic economies called for warnings of drastic steps to limit the daily infections. We have downgraded the CE-3 forecasts to account for this, although renewed Covid measures would mean additional downside pressure on these currencies. Our 12-month forecasts envisage modest weakening against the euro relative to our 1-to-6-month projections due to the expectation of the European Central Bank playing catch-up with other DM central banks by then.

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Currency Pair	1-month (30th Nov 2021)	3-month (31st Jan 2022)	6-month (30th April 2022)	12-month (31st Oct 2022)
G10				
EUR/USD	1.15	1.16	1.16	1.17
USD/JPY	114.5	114	113	113
GBP/USD	1.38	1.38	1.40	1.41
USD/CHF	0.92	0.905	0.92	0.93
USD/CAD	1.23	1.22	1.20	1.23
AUD/USD	0.74	0.74	0.73	0.75
NZD/USD	0.72	0.73	0.73	0.72
USD/SEK	8.52	8.41	8.53	8.63
USD/NOK	8.39	8.28	8.41	8.46
DXY	94.32	93.61	93.32	93.07
Emerging Markets				
USD/CNY	6.40	6.45	6.48	6.50
USD/INR	74	74	73	73
USD/ZAR	15.1	15	14.5	14.3
USD/TRY	9.6	9.7	9.8	10
USD/RUB	69	67	66	68
USD/PLN	4	3.92	3.88	3.81
USD/HUF	313	312	303	303
USD/CZK	22.39	21.94	21.81	21.71
USD/BRL	5.7	5.7	5.8	5.8
USD/MXN	21	21	21.5	21
Euro Crosses				
EUR/GBP	0.833	0.841	0.829	0.830
EUR/CHF	1.06	1.05	1.07	1.09
EUR/CAD	1.41	1.42	1.39	1.44
EUR/SEK	9.8	9.75	9.9	10.1
EUR/NOK	9.65	9.6	9.75	9.9
EUR/TRY	11.04	11.25	11.37	11.70
EUR/RUB	79.35	77.72	76.56	79.56
EUR/PLN	4.6	4.55	4.5	4.46
EUR/HUF	362	360	352	355
EUR/CZK	25.75	24.45	25.3	25.4
EUR/BRL	6.555	6.612	6.728	6.786
EUR/MXN	24.15	24.36	24.94	24.57

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