Turbulent Start to Year Pauses FX Moves

Currency	What's Changed
USD	USD climb versus majors since start of year to reverse as global economic recoveries progress.
CAD	CAD levels are stronger, less room for depreciation ahead vs. our prior call.
EUR	Euro trading in a higher range, reinforced by a dovish Fed, but it's not the strongest candidate for gains in majors vs. the greenback this year.
GBP	A challenging Q1 could pressure the BoE to consider a cut, weighing on Sterling in the short run.
JPY	Against a still structurally compromised USD, we expect continued JPY gains.
Commodity FX	Look for further strength in AUD & NZD, amidst a broadly weaker USD and economic recoveries.
LATAM FX	LATAM currencies appreciating in line with increasing commodity prices.
FX Asia	CNH and CNY appreciation expected to continue even with overall trade hawkishness under Biden.

Currency Outlook

End of Period:	Jan. 20/21	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
USD/CAD	1.26	1.30	1.32	1.33	1.33	1.34	1.35	1.35	1.34
EUR/USD	1.21	1.23	1.25	1.26	1.26	1.25	1.25	1.25	1.24
USD/JPY	104	102	100	100	99	99	99	99	99
GBP/USD	1.36	1.35	1.37	1.39	1.40	1.39	1.40	1.40	1.40
USD/CHF	0.89	0.88	0.87	0.87	0.87	0.88	0.88	0.88	0.88
USD/SEK	8.35	8.29	8.08	7.98	7.90	7.84	7.80	7.76	7.78
AUD/USD	0.77	0.79	0.80	0.82	0.83	0.84	0.85	0.86	0.87
NZD/USD	0.72	0.73	0.74	0.75	0.76	0.77	0.78	0.78	0.79
USD/NOK	8.50	8.25	7.96	7.82	7.74	7.72	7.64	7.56	7.58
USD/ZAR	14.90	15.15	14.90	14.50	14.40	14.20	14.00	13.90	13.80
USD/BRL	5.30	5.00	4.80	4.80	4.50	5.00	4.80	5.00	4.50
USD/MXN	19.6	19.5	20.0	20.0	19.0	19.5	19.8	20.0	20.5
USD/COP	3472	3500	3600	3600	3500	3400	3400	3300	3200
USD/CLP	722	760	780	780	720	750	740	720	680
USD/CNY	6.47	6.40	6.32	6.25	6.15	6.05	5.95	5.85	5.80
USD/KRW	1100	1095	1090	1080	1070	1065	1055	1050	1040
USD/INR	73.0	73.0	72.8	72.5	71.0	70.0	69.0	69.3	69.5
USD/SGD	1.33	1.33	1.32	1.32	1.31	1.31	1.30	1.30	1.29
USD/TWD	28.2	27.7	27.6	27.5	27.4	27.2	27.1	27.0	27.0
USD/MYR	4.04	4.00	3.95	3.90	3.85	3.80	3.75	3.70	3.65
USD/IDR	14035	14050	14000	13900	13800	13750	13700	13650	13600

Other Crosses

End of Period:	Jan. 20/21	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22
CADJPY	81.9	78.5	75.8	75.2	74.4	73.9	73.3	73.3	73.9
AUDCAD	0.98	1.02	1.06	1.08	1.10	1.13	1.15	1.16	1.17
GBPCAD	1.73	1.76	1.81	1.85	1.86	1.86	1.89	1.89	1.88
EURCAD	1.53	1.60	1.65	1.68	1.68	1.68	1.69	1.69	1.66
EURJPY	125	125	125	126	125	124	124	124	123
EURGBP	0.89	0.91	0.91	0.91	0.90	0.90	0.89	0.89	0.89
EURCHF	1.08	1.08	1.09	1.10	1.10	1.10	1.10	1.10	1.09
EURSEK	10.10	10.20	10.10	10.05	9.95	9.80	9.75	9.70	9.65
EURNOK	10.28	10.15	9.95	9.85	9.75	9.65	9.55	9.45	9.40

Key Indicators- Latest Data Point

	Quarterly Real GDP (y/y %)	CPI (y/y %)	Current Acct (% of GDP)	Central Bank Rate (%)
US	-2.9	1.4	-3.4	0.125
Canada	-5.2	0.7	-1.3	0.250
Eurozone	-4.3	-0.3	2.0	0.000
Japan	-5.7	-0.9	3.0	-0.100
UK	16.0	0.3	-2.1	0.100
Switzerland	-1.6	-0.8	7.6	-0.750
Sweden	8.7	0.5	5.2	0.000
Australia	-3.8	0.7	1.9	0.100
New Zealand	0.4	1.4	-2.2	0.250
Norway	-0.2	1.4	2.1	0.000
South Africa	-6.0	3.2	5.9	3.500
Brazil	-3.9	4.5	-1.6	2.000
Mexico	-8.6	3.2	1.5	4.250
Colombia	-9.0	1.6	-3.3	1.750
Chile	-9.1	3.0	0.0	0.500
China	4.9	0.2	1.5	3.850
South Korea	-1.1	0.5	3.8	0.500
India	-7.5	4.6	1.3	4.000
Singapore	-3.8	-0.1	16.3	n/a
Taiwan	3.9	0.1	12.7	1.125
Malaysia	-2.7	-1.7	3.5	1.750
Indonesia	-3.5	1.7	-1.3	3.750

CAD

Katherine Judge | Avery Shenfeld

Can the BoC Lean Against a Stronger C$?

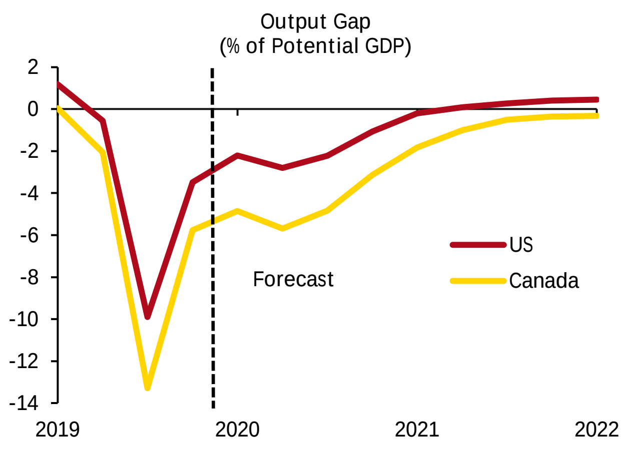
Q1 2021: 1.30 | Q2 2021: 1.32 (USDCAD)

The CAD is up slightly versus the USD so far this year, in contrast to most other majors, helped by a climb in crude prices alongside a less dovish BoC announcement than expected. But at 1.26, CAD is trading at a level that risks a headwind for the recovery in Canadian exports and business investment in export-oriented sectors, a view that the BoC shares.

Markets were mulling over the possibility that the BoC would undertake a micro-cut of 10-15 bps in January with an eye towards dampening enthusiasm for further C$ appreciation. Instead, as we expected, the Bank opted to keep rates on hold, but nudged up their estimate for the economy's non-inflationary potential output, so as to avoid having a stronger growth outlook accelerate the timetable for rate hikes. Even so, the market is still pricing in BoC hikes ahead of the Fed, a scenario that isn't likely to materialize. Note that our forecast has the US output gap closing earlier than Canada's reflecting the latter's greater retrenchment in 2020 (Chart 1).

At a future rate decision date, the BoC might try to reinforce its dovish stance, and signal it will hike later than the Fed, by announcing that it's adopting average inflation targeting for 2022 and beyond. That could see the C$ give back some of its recent gains, although given our revised forecast towards a bit more weakness for the greenback against other majors, our new targets show a smaller loonie depreciation ahead.

Chart 1: US Output Gap to Close Ahead of Canada's, Allowing the Fed to Hike Rates Ahead of BoC



Source: BEA, CBO, StatCan, BoC, CIBC

USD

Bipan Rai

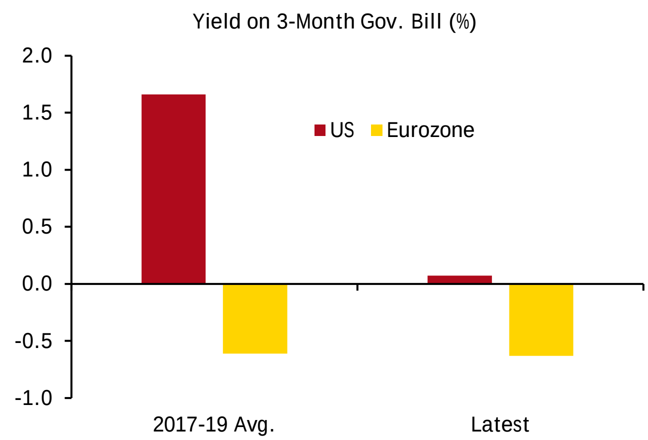
Adding a Bit More Room for USD Softness

Q1 2021: 89.7 | Q2 2021: 88.5 (DXY)

We judge the rally in the USD against overseas majors since the start of the year as unlikely to represent a protracted turn in that direction. As is the case for Canada, US trade fundamentals are a negative for the American dollar. The dollar has temporarily benefited from the attraction of higher real Treasury yields since the Georgia run-off elections, and the resulting rush to cover USD shorts. While there could be more to go on that front, our research suggests that such position squaring isn't a good predictor of currency directionality. Moreover, in the near term, we see longer US yields easing again in the wake of soft Q1 economic data.

With the Fed on hold for an extended period, sovereign front end spreads versus overseas rates will be nowhere near as generous as they were during the heady days of growth from 2017-19 (Chart 2). The impression that this will remain the case has been reinforced by very dovish talk from FOMC leaders, and the adoption of Average Inflation Targeting, which is viewed as extending the timeframe before the first hike. While long Treasury yields should look a bit more attractive later in the year, the Fed will be leaning with its QE program against a steeper climb that would give the USD any sustained momentum in 2021. Look for the USD to return to a weakening trend as we move through this year on a continuation of foreign portfolio diversification away from the greenback, at least until the market starts to price the Fed for the early 2023 hikes that we expect given our bullish 2022 growth forecast.

Chart 2: Yield Spread Compression Makes USD Less Attractive



Source: Bloomberg, CIBC

EUR

Jeremy Stretch

EUR Trading In Higher Range Through 2022

Q1 2021: 1.23 | Q2 2021: 1.25 (EURUSD)

The euro registered an annual gain of almost 9% versus the USD in calendar year 2020, representing only the second calendar year gain since 2014. The broad EUR/USD uptrend proved a function of both domestic and external factors. From a domestic perspective, a loosening of the Eurozone fiscal stance was significant. Previously, German fiscal prudence had proved a drag on broader euro activity. The toleration of increased deficit spending, including in the slower growing parts of the zone, will help drive a rebound in growth in 2021. We expect the pace of eurozone activity to be similar to that in the US. A second internal boost came via the agreement on the €750bn EU Recovery Fund. Expect the mixture of loans and grants to be front loaded across the seven year multi-annual financial framework. That some €390bn will be disbursed as grants is unprecedented and underlines part of the rationale for the EUR trading in a new, higher range.

While the EU agreement on the recovery fund was something of a game changer, the switch by the Fed to an average inflation targeting regime represented a significant US policy shift, undermining the USD in the process. In terms of the ECB, we expect a concentration on balance sheet expansion, via the recently announced expansion in its bond purchase programme.

Should the PEPP programme moderate in H2, as recovery dynamics become more entrenched, expect that to help encourage EUR/USD back towards 2018 cyclical highs. Although the ECB remains mindful of the disinflationary consequences of a stronger EUR, the rebound in underlying inflation expectations, up more than 20bp since November lows, suggests that the ECB can allow its current policy stance time to work, rather than be forced to act again in Q1.

JPY

Jeremy Stretch

Further Yen Strength in the Cards for 2021

Q1 2021: 102 | Q2 2021: 100 (USDJPY)

The second half of 2020 saw an underlying downward trend in USD/JPY. That reflected bouts of risk uncertainty combined with broad based USD negativity, reinforced by the Fed's dovish stance, which encouraged real money investors to increase JPY longs to levels not seen since late 2016. The early year push wider in UST-JGB spreads may have boosted the allure for US Treasuries, via widening nominal yield spreads. However, we remain wary of extrapolating the trend, as Japanese investors are likely to continue to look towards other liquid fixed income markets in the same time zone. Indeed, Japanese appetite for Australian bonds is part of the reason for ongoing AUD momentum.

The latest quarterly Tankan business survey, while taken before the full impact of the second wave, showed a modest improvement in sentiment, for the second consecutive quarter. However, big companies remain reluctant to increase capex, with the improvement in the headline index suggesting only incremental growth. While a third supplementary budget helped support near-term economic assessments, the outlook remains uncertain and the potential BoJ reaction function remains limited. Against a still structurally compromised USD, we expect cautious JPY gains. Expect the MoF to push back should the JPY advance too quickly. The Tankan survey revealed that large manufacturers forecast a budget rate of 106.70 for fiscal year 2020. As a consequence, it seems likely that exporter profits are likely to be compromised by the prospect of modest JPY gains.

GBP

Jeremy Stretch

Possibility of BoE Cut to Weigh on Sterling in Q1

Q1 2021: 1.35 | Q2 2021: 1.37 (GBPUSD)

The last month has seen Sterling move towards the top of the performance league table due to a combination of positive risk dynamics, global reflation impetus, and the avoidance of a no-deal Brexit. However, while we pushed up our medium-run GBP/USD forecast profile, we remain wary of extrapolating recent gains due to the possibility of a double-dip recession.

The UK economy snapped a run of six straight months of expansion in November. Although the 2.6% monthly contraction was almost half of what was feared, the quarter will struggle to beat the 2.0% decline implied within the BoE's November forecast. The February MPC meeting will see revised estimates which will reflect the impact of a third national lockdown. Although more parts of the UK economy remain open than in the first wave of restrictions, including manufacturing and construction, we expect the central bank's previous assumption of a near 2.5% Q1 quarterly GDP gain to be replaced by a retreat of between 1.5-2.0%. Back-to-back GDP declines underline that the UK economy is likely to take until early 2023 to retake lost economic ground.

Ahead of the February MPC decision, BoE Governor Bailey has acknowledged that activity will be weaker than anticipated in their previous Monetary Policy Report, which risks putting pressure on the BoE to act. The Bank appears minded to avoid negative rates, with the Governor citing "lots of issues" in this regard. With the Bank reluctant to go negative, expect pressure on the BoE to consider a 10bp micro cut in order to provide some stimulus ahead of a vaccine dependent recovery into H2. Expect the latter to encourage GBP/USD to return to levels not seen since early 2018.

CHF

Jeremy Stretch

CHF to Weaken Into H2 as Recovery Reduces Safe Haven Bid

Q1 2021: 1.08 | Q2 2021: 1.09 (EURCHF)

The SNB's primary policy tool remains FX intervention. The central bank views intervention and negative rates as essential for a small open economy which has a safe haven currency. We expect the central bank to remain vigilant as they continue to view the CHF as 'highly valued'. Having already taken rates to -0.75%, the SNB were likely relieved that the recent ECB policy recalibration focussed on expanding QE, rather than additional monetary easing, which the SNB would have found hard to ignore. We should not forget that the SNB cannot follow other global central banks in terms of bond purchases as the SNB have previously detailed that the scale and size of the domestic capital market remains too small to encourage meaningful QE.

Therefore, we expect the SNB to remain focussed on using intervention to maintain competitiveness and limit deflationary influences. Expect little change in their policy prescription despite the US Treasury declaring Switzerland a currency manipulator in the delayed semi-annual FX policy report. Despite the aggressive increase in the SNB's balance sheet, we expect them to remain poised to act, if necessary.

However, recent evidence from sight deposit data suggests that the central bank have been able to step back of late. The broad reflation environment and generally improved risk tone, helped by Covid vaccine progress, has seen EUR/CHF remain comfortably above the 1.07 area, a level that is perceived to be something of a threshold for the SNB. Sight deposits are back at levels not seen since August, and holdings have increased only once since the start of December, pointing towards SNB inactivity. On the proviso that Covid uncertainties continue to dissipate into H2, easing the CHF safe haven premium, we can expect the SNB to remain on the sidelines and EUR/CHF to grind higher, towards 1.10.

SEK

Jeremy Stretch

SEK Gains Tempered by Forthcoming Lockdown Measures, Riksbank Balance Sheet Expansion

Q1 2021: 10.20 | Q2 2021: 10.10 (EURSEK)

The SEK proved the strongest performing major versus both the EUR and the USD in 2020. A modest economic contraction, as Sweden eschewed lockdowns seen elsewhere, combined with a large current account surplus helped underpin SEK outperformance. Moreover, SEK gains proved a function of the rebound in the domestic economic surprise index. Real economy data in terms of industrial orders and production data proved to beat expectations while forward looking survey data, such as the manufacturing PMI, advanced to its highest reading seen since 1994 into year-end.

Although the avoidance of lockdowns in 2020 may have limited the immediate economic damage, the second wave looks set to test the government's policy stance. Lockdown restrictions are on the agenda, this comes as high frequency data implies activity levels, in particular in the service sector, look increasingly compromised. While the open and growth correlated Swedish economy should be a beneficiary of stronger global growth prospects in H2, we would not expect the SEK to be even the strongest currency in Scandinavia, let alone repeat its performance from last year.

The Riksbank remain intent in avoiding a return to negative rates, even should the economy slow. However, the bank are set to continue to expand their balance sheet, this comes as they have increased asset purchases from SEK500bn to SEK700bn, the programme being extended for six months to the end of 2021. The continued balance sheet expansion allied to the prospect of rising Covid restrictions suggests that while the SEK will extend modest gains versus majors in the year ahead it will struggle to outperform other pro-cyclical currencies.

Commodity FX

NOK

Jeremy Stretch

Norges Bank Set to Hike in 2022, Supporting NOK Momentum

Q1 2021: 10.15 | Q2 2021: 9.95 (EURNOK)

Resilient consumer spending points towards the Norwegian economy eking out a modest quarterly gain in Q4 despite mainland GDP declining by 0.9% in November. The monthly correction was around half of what was expected, with consumption proving to offset tightened lockdown restrictions. A rebound in annual credit growth, back to 4.7% yoy, underlines the potential to register back-to-back quarters of economic expansion for the first time since Q2/Q3 2019. Moreover, should the quarterly expansion equate to around 1.0%, this would leave the Norwegian economy barely smaller than pre-Covid levels. It is unsurprising that against such a background, the Norges Bank remains likely to be the first central bank to tighten monetary policy.

The central bank are currently biased towards tightening from the middle of next year, they currently assume 50bp of tightening in H2 2022. However, in a general reflationary backdrop, benefitting the oil sector, the risks of both an earlier and or a more aggressive rate cycle remain real. While the Bank looked towards a more aggressive rate profile in the December MPR, we remain mindful of the risks of rate hikes being brought forward, supporting NOK valuations as a consequence.

The continued uptick in house prices, with the four-quarter moving average gain in prices being the highest since Q1 2017, underlines ongoing central bank warnings regarding rising financial sector imbalances. A rebound in oil sector revenues, feeding through into employment gains and wage growth, risks further amplifying underlying structural concerns. With the daily inverse correlation between Brent crude and EUR/NOK extending back towards 2020 highs, broad reflationary trends, allied to the prospect of earlier central bank action, momentum in NOK is likely to continue.

AUD

Patrick Bennett

Further Gains for AUD in 2021

Q1 2021: 0.79 | Q2 2021: 0.80 (AUDUSD)

The Australian dollar (AUD) was amongst the strongest major currencies in the last quarter of 2020 and has begun 2021 in similar fashion. From present levels, we target further gains in AUD/USD, to 0.7850 in Q1.

A rebound in domestic economic activity, underpinned by accommodative monetary policy, was a strong driver of AUD strength to date. We anticipate that support to continue. External trade has also held up well and has done better than was feared through the middle period of last year. Those fears were prompted by threats to global activity as a result of the virus, and on increasing tensions with China.

The apparent shrugging off of trade tensions between the two countries is notable, as there remains a clear sense of market caution over a situation that generates plenty of headlines. The significance being, that should some resolution be found, or tension itself calm, we would anticipate a positive response in AUD.

Significant to our view of AUD being able to sustain further gains has been Australia's improved trade performance over the last few years. Australia has swung from a trade deficit in 2016 and a current account deficit as recently as 2019, to now surpluses in both.

RBA has often spoken of the terms-of-trade and the level of AUD, desiring a more competitive currency as a support to the external sector. The reality is that while the rebound off lows of last year was sharp; the AUD is still no firmer than around the middle of multi-year ranges against the USD and on trade-weighted measures. The currency also still shows at a discount to the terms-of-trade, though the gap is closing. On trade, the contribution of iron ore cannot be dismissed, any talk of that market between Australia and China would be concerning. Unless that is the case, we remain bullish and buyers of AUD weakness.

NZD

Patrick Bennett

NZD Tracking to Stronger Levels

Q1 2021: 0.73 | Q2 2021: 0.74 (NZDUSD)

After consolidation through mid-2020, much of it related to caution over impacts of containing the virus, NZD/USD performed strongly in the last two months of the year. We see NZD continuing to track to stronger levels as the economy rebounds.

One point of caution is regarding the RBNZ's attitude towards the stronger currency. The bank has previously raised the notion of using tools to slow the currency's ascent. Having walked the market back from expectations of negative cash rates through comments at their November meeting, we expect we may hear the topic raised again at the first RBNZ meeting of the year in late February.

Global reflation confidence is buoyant, but on that which is related to vaccines, we note that New Zealand is adopting a 'wait-and-see' approach, i.e. not beginning vaccinations for some time. The success of that approach is uncertain. The economy has weathered the virus challenges well and recovery is underway, though a continued shut-off from the rest of the world may be a future challenge. We forecast gains for the NZD against the USD, but anticipate some underperformance against the AUD.

ZAR

Jeremy Stretch

Second Wave to Limit ZAR Gains in H1

Q1 2021: 15.15 | Q2 2021: 14.90 (USDZAR)

We underlined in our most recent publication that higher yielding currencies which benefitted from the global reflation trend would prove the top performers. These characteristics certainly reflected the ZAR. It's therefore unsurprising that the currency proved to be the top performing major currency versus the USD in Q4, with the spot return equating to almost 14%. On a total return basis, including rates, the gain was in excess of 15%.

Speculative ZAR buying interest, predicated upon a reflationary bias and supportive rate spreads, accelerated rapidly through the bulk of the quarter. However, overseas appetite for local bonds proved to dissipate into year-end as did real money ZAR flows. The retreat in investor appetite coincides with the country witnessing a significant Covid second wave. Moreover, the strain has proved far more aggressive than in phase one. After witnessing an above expectations 14.6% quarterly gain in Q3 GDP, almost matching the retreat in Q2, investors had hoped for further positive macro surprises. However, a slow political response to the new strain, allied to the realisation that the country was well down the list for vaccine rollout, has resulted in a reversal in investor sentiment and flows.

Tightening economic restrictions will further undermine Q1 macro momentum, opening up debate as regards the possibility of additional monetary easing. After witnessing consumption growth decline by 7.0% across the first three quarters of 2020, the near-term outlook remains challenged, as demonstrated by recent new car sales data. Therefore, despite us continuing to favour growth orientated and reflation stimulated currencies versus the low yielders, such as the USD, those expecting an early return to the late 2020 USD/ZAR lows are likely to require a degree of patience. While we expect a stronger medium to long run ZAR trajectory, reflecting underlying reflationary tendencies, near-term Covid risks look set to contain the ZAR in H1.

LATAM FX

MXN

Luis Hurtado

Dovish Tilt in Banxico's Board of Directors Points to 25bps Cut in February

Q1 2021: 19.5 | Q2 2021: 20.0 (USDMXN)

Mexico has the highest overnight rate in the region, while Banxico does not tend to intervene directly in the FX market during appreciation cycles. Thus, we expect any concerns on a rapid appreciation of the MXN to be reflected via more aggressive/frequent rate cuts hints by the CB this year as inflation drops closer to the CB target. This responds to the dissipation of inflation pass-through risks in a still ample and negative output gap scenario.

On this note, December inflation came in at 3.15% y/y in line with consensus estimates and dropping from the 3.33% recorded in November, while core prices jumped to 3.80% y/y from the 3.66% y/y posted in November. This supports our expectations for a 25 bps rate cut at the February meeting. The latest rate decision vote showed less opposition to a new rate cut, while Galia Borja (nominated by AMLO) replaced Javier Guzman (known hawk). Therefore, we expect a transition to more dovish statements as we move into Q2.

Regarding recent USD/MXN action, we maintain our downward bias towards the 19.50 level in Q1. Nevertheless, we recognize that the continuation of MXN appreciation back to the levels seen in January 2020 looks difficult to attain in the short term given Mexico's low growth, limited fiscal room, and the July mid-term election.

BRL

Luis Hurtado

BRL Still Faces Fiscal and Political Headwinds

Q1 2021: 5.00 | Q2 2021: 4.80 (USDBRL)

Brazil is highly unlikely to implement any measures to prevent an appreciation of its currency in the short term. It has been a rough start to 2021 for the BRL. Volatility has surged, in line with our expectations for a rocky road towards our 5.0 USD/BRL forecast by the end of Q1. Risk-off moves continue to be amplified by the uncertainties surrounding the Lower House Speakership election and the future of import reforms in congress. Spending cap concerns have been a constant factor preventing the BRL from following the appreciating trend seen in its regional peers.

On the monetary policy front, in line with the BCB's change in tone in December, we expect the Brazilian central bank to start hinting about a SELIC rate increase at its January meeting, and to implement a 25 bps hike before the end of Q1 (we were guiding to Q2 previously). This expectation is backed by the recent increase in inflation beyond the central bank's 4.0% target in December. Moreover, we expect the central bank to restate its concerns with respect to the precarious fiscal situation and to re-emphasize the possibility of more aggressive rate hikes this year.

Regarding our USD/BRL outlook, recent FX interventions (USD buying), hawkish comments from the central bank, and Arthur Lira (Bolsonaro's candidate) advantage in the Lower House Speakership race support our view that there is sufficient room for a strategic USD/BRL move lower towards 4.80 by the end of H1 2021 and to 4.50 by the end of the year, contingent on the speed of the discussions and approval of reforms.

CLP

Luis Hurtado

Replenishing International Reserves

Q1 2021: 760 | Q2 2021: 780 (USDCLP)

Among the usual motives to intervene against currency appreciation, perhaps the least controversial is the need to accumulate reserves for precautionary reasons. In this context, the central bank builds up foreign currency reserves for use during adverse market conditions. Hence, such action can help attenuate an overshooting of the local currency in the short-term. This was certainly the initial impact of the BCCH announcement (January 13) to increase international reserves to 18% of GDP by buying USD40mln daily in the stock market up to a total of USD12bln.Nevertheless, subsequent communication by the CB and the small size of the daily intervention, compare to the overall size of daily transactions in the FX market (USD 1.0-1.5bln), reversed such reaction by of the second week of January.

On the monetary policy front, the Banco Central of Chile did not provide anything of note in its latest rate decision. As expected, the central bank kept the overnight rate at 0.5% while liquidity measures were reiterated. Furthermore, the central bank mentioned that it expects the impact of the recently approved pension withdrawal bill on inflation to be temporary. In line with these comments, we expect the BCCh to keep the current 0.5% rate until at least Q4 2021, but to start removing some of the measures that provided liquidity and freed USD during the pandemic.

Regarding the recent USD/CLP break below 745, the positive news on vaccines, and fiscal expansion in advanced economies, and the overall rally seen in risk assets, could push USD/CLP closer to 720 once again in the short term. Nevertheless, we expect the CLP to have limited room for further gains as a prolonged electoral cycle remains the main risk into 2021, while we expect the BCCh to scale back some of the liquidity measures implemented last year.

COP

Luis Hurtado

Lower than Anticipated Inflation Opens Debate on Final 25bps Rate Cut

Q1 2021: 3500 | Q2 2021: 3600 (USDCOP)

Banrep maintained the overnight rate at 1.75% in December. However, two out of the seven board members voted in favour of a 25bps rate cut, opening the door for a final 25bps rate cut as inflation drops below initial expectations. The statement highlighted anchored inflation expectations and that recent economic indicators showed signs of recovery. In line with the slightly dovish tilt in the latest central bank announcement, we now see space for a final 25bps cut in Q1 2021 (contrary to our initial expectations of an hold CB), while we push our expectations for the start of the hiking cycle back to the last quarter of 2021 (previously Q3).

With regards to recent USD/COP action, the Colombian peso benefited from a large inflow of USD in Q4 in line with substantial financing needs to battle the COVID-19 crisis and the overall reach for yield across the world. This, is turn, improved recent external account indicators, however, we do not expect this trend to be sustained as imports rebound, and fiscal risks remain a concern.

Asia FX

CNY

Patrick Bennett

CNY CNH: Yuan Gains to Continue

Q1 2021: 6.40 | Q2 2021: 6.32 (USDCNY)

We forecast USD/China to reach 6.15 by Q4 this year and to be trading on a 5-handle by mid-2022. Support for Chinese currency gains will be a combination of ongoing strong economic performance, both outright and relative to major peers, and the related demand for Chinese assets, both portfolio and FDI. A softer US dollar will be a significant influence on USD/China, although we also see gains for the yuan on a trade-weighted basis.

Following consolidation in the last weeks of December, USD/CNH resumed its downside recently, making a new cycle low at 6.4120 on January 5th. Recent trading has seen near-term enthusiasm for CNH (and CNY) gains tempered. That has been on USD consolidation, but more prominently on reports of official USD/China support (buying by state banks) and on promotion of policies to encourage two-way flow.

Chinese authorities are usually expected to discourage a swift pace of appreciation. So too to speak more of opening avenues for outflow and encouraging two-way flow. But at present levels, we don't see those factors weakening CNH to a degree that counters strong growth and yield support. On overall intervention risks, so long as the pace of currency appreciation remains moderate, we consider the once strong interventionist mode of the PBoC is unlikely to be revived. Key to watch will be how the CNH tracks against other major currencies – neither too hot or cold.

To our view, China policy is aimed for the currency to ultimately reflect a balance of supply and demand. Supply is from domestic investors wishing to buy foreign assets – which remains largely controlled, but is expanding through programs such as QDII. Demand is from foreign investors looking for portfolio and direct investment into the economy.

Demand was strong for CNH when the currency was around 7 vs USD. We expect stronger supply and/or a tempering of demand to show toward the 2018 lows around 6.25, and build as spot reaches a 5 handle.

Inflow to Chinese portfolio assets has been strong and was particularly so in 2020, correlating with CNH gains. Foreign direct investment has also increased as a result of China proceeding with opening its economy – still in piecemeal fashion, but progressing nonetheless.

The next leg to opening of the economy and capital account, and the internationalization of the currency, involves encouraging greater use of the yuan in trade settlement, permitting domestic investors to buy more foreign assets, and for foreign investors to easily repatriate funds. All support two-way flow.

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