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Global

FX Tech Flash

Room for FX Laggards to Play Catch Up

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Policy Normalisation Underway at Uneven Pace for Now

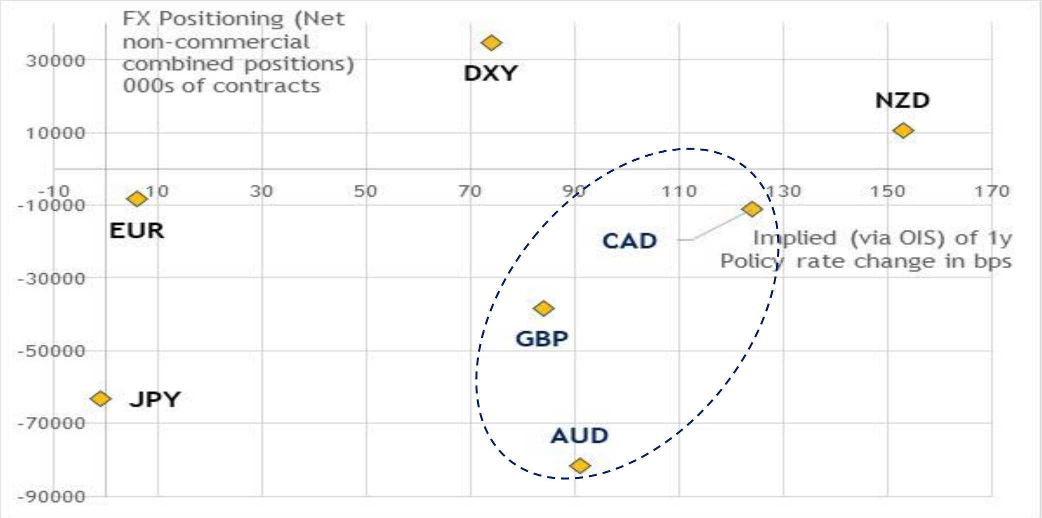
This week has seen a number of DM central banks' shifts. Fed double-down on taper and sets stage for faster pace of tightening in 2022; ECB embarked on cautious taper while the BoE surprised with a 15bps rate hike. Elevated price pressures lasting longer than being "transitory" is one of the catalysts (apart from labor market conditions, growth, etc.) pushing central banks to proceed with policy normalisation, albeit at different pace for now. Potentially the laggards - GBP, AUD and CAD could play catch-up (up to 3 months) while USD eases. We outlined some of the policy shifts in the following pages and look at FX positions vs. rates projection to look for short term relative value trades.

GBP, AUD and CAD Laggards are Potentially Under-Priced Relative to Rates Projection

From a markets-implied (via OIS) for rate expectation for 2022, markets are pricing in the most rate increases from RBNZ and BoC at +153bps and +124bps, respectively. For RBA and BoE, markets are looking for +91 and +84bps rate increases. For the Fed, markets are looking for about 74bps rate increase, in line with the latest FoMC dots plot guidance for 3 rate hikes in 2022.

Juxtaposing FX CFTC position against markets expectation for rate hikes next year, it appears that net shorts in GBP, AUD and CAD do not commensurate with expectations for policy normalisation at this point. Unwinding of stretched positions, in particular for AUD (shorts near all-time high) could see a sharp snapback. Elsewhere we also note that GBP shorts is at 2y high as well. With GBP and AUD nearing its 1y low (vs. USD), we do not rule out limited downside play and the chance for technical snapback.

CFTC FX Positions vs. Markets-implied Rate Hike in 1y



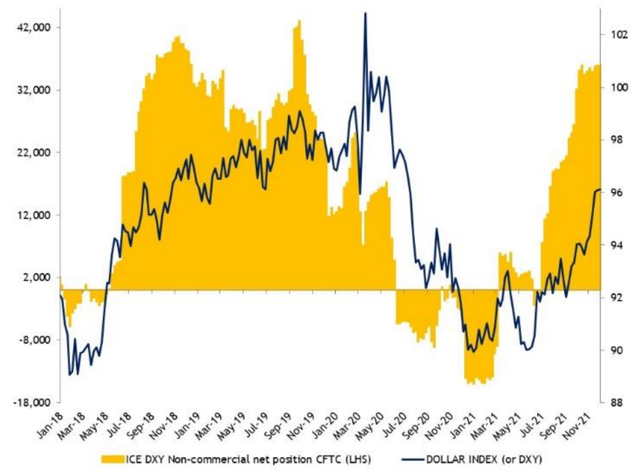
Note: CFTC position as of latest avail at 7 Dec 2021. Implied policy rate as of 16 Dec 2021
Source: Bloomberg, Maybank FX Research & Strategy

For NZD, JPY and EUR, their respective positioning are in part reflecting rates projection. For instance, markets are net short JPY, EUR and via OIS, there is no expectations for BoJ to normalise policies.

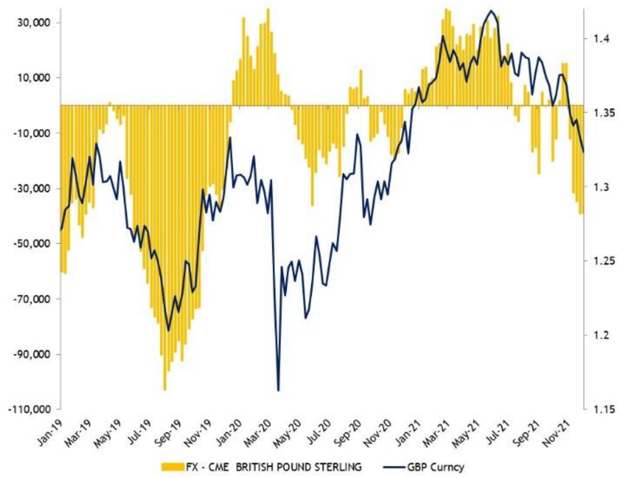
While the USD may still find some support amid policy divergence thematic (in its favour) and lingering risk aversion (omicron risks, China growth slowdown fears, etc.), we think the upside from current levels may somewhat be restrained. DXY positioning is at record 2-year high and to a large extent, rate hike expectations and strong US data may already be in the price. Hence we are more inclined to lean against strength.

On net, we see upside risks for GBP, AUD and CAD and potentially, for USD to correct lower.

DXY Long Positioning at 2y High



GBP Short Positioning at 2Y High



AUD Short Positions Near All-Time High

Unwinding of CAD Shorts Can Add to CAD Strength

Source: Bloomberg, Maybank FX Research & Strategy

Fed Quickened Pace of Taper and Looks for More Rate Hikes in 2022

In line with streets' wisdom, the Fed announced plans to double the pace of taper to $30bn (from $15bn currently) per month starting Jan-2022 and to end QE in Mar-2022 (earlier than Jun-2022 earlier anticipated) while dots plot reflected higher inflation and rate hikes projection. This did not come as a surprise as some Fed officials including Fed Chair Powell had told the senate banking panel (late last month) that "it is probably a good time to retire the word, transitory" and that Fed is prepared to quicken the pace of tapering.

Some points of interests from the 15-16 Dec FoMC include:

- 12 out of 18 FoMC members expect at least **<u>3 hikes in 2022</u>** while 5 look for 2 hikes and another member look for 1 hike in 2022. This is up from Sep's dot plot which indicated only 1 hike in 2022. Looking beyond, Fed looks for 3 hikes in 2023 and 2 hikes in 2024.

- Inflation forecast is raised to 5.3% for 2021 (up from 4.2% projected in Sep). For 2022 and 2023, inflation forecast is also raised for 2022 and 2023 to 2.6% and 2.3%, respectively (from 2.2%).

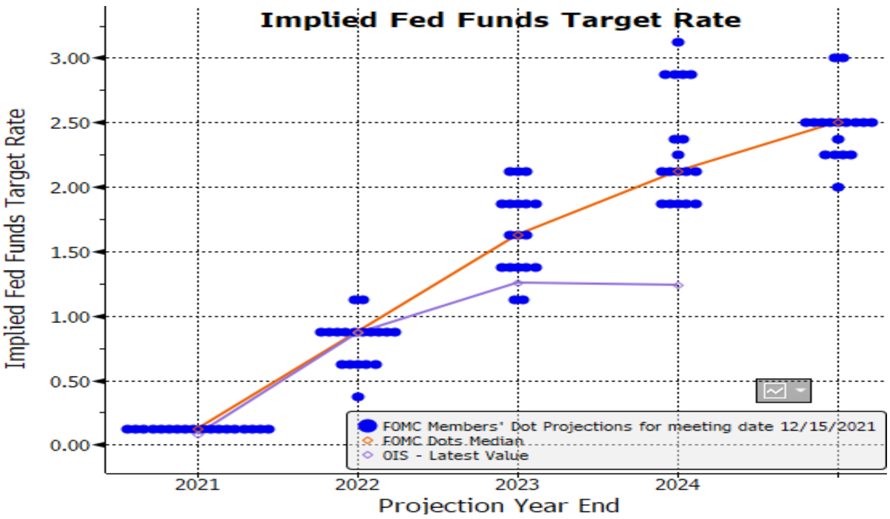
- Growth was forecasted to ease in 2021 to 5.5% (down from 5.9% earlier projected in Sep FoMC). But growth for 2022 was revised higher to 4% (up from 3.8%).

The accompanying statement noted that "supply and demand imbalances related to the pandemic and the reopening of the economy have continued to contribute to elevated levels of inflation" and that "job gains have been solid in recent months, and unemployment rate has declined substantially". We note that unemployment rate fell to 4-year low of 4.2% in Nov, down from 4.6%. Employment increased 1.1mio and labor force participation rate rose to 61.8% in Nov, up from 61.6%.

At the press conference, Fed Chair Powell said that "one of the two biggest threats to getting back to maximum employment is actually high inflation" (the other being pandemic). Indeed headline CPI rose to 39-year high of 6.8% in Nov. He also noted that Fed is keeping a close watch on wages "lest they begin rising so rapidly that they feed into already too high-inflation."

We opined that though markets have fully priced in 3 hikes and faster pace of taper, there is still risk of Fed tilting even more hawkish if inflation does show signs of running out of control. Also there is also risk of Fed tapering its balance sheet (not just bond purchases). Powell has indicated that debate on when to begin shrinking balance sheet is underway but no official decision on when the runoff would start. Play-up of these risk factors can add to USD strength and exert downward pressure on risk assets. But absence of that may see limited upside for USD.

<u>Dots Plot Projection Shows Fed's Hawkish Tilt from last FoMC in Sep</u>



Source: Bloomberg, Maybank FX Research & Strategy

ECB's Cautious Taper

In line with our expectations, the ECB confirmed that it would end its EUR1.85tn PEPP program, as scheduled in Mar-2022 and will expand its other bond purchase plan next year.

Currently, the present pace of bond purchases at EUR80-90bn/month (via PEPP at EUR60-70bn per month and APP at EUR20bn per month) will be slow to EUR40bn per month, starting Apr-2022 and will continue at least through Oct-2022. The ECB also stressed that during this period of bond purchases, the ECB will not increase its deposit rate (currently at -0.5%).

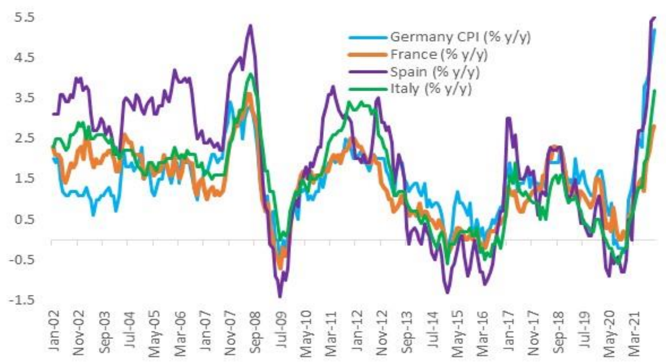
On macroeconomic update, ECB now projects inflation to average 3.2% in 2022, before easing to 1.8% for 2023 and 2024. ECB's Lagarde said that current surge due to high energy prices and constrained supply should pass eventually but later added that there is possible upside risks to inflation outlook as "numbers are not telling us that we are seeing second round effects".

Overall, the ECB meeting can be interpreted as slightly hawkish and may have caught some economists off-guard. Nevertheless, ECB's hawkish tilt still lags behind other DM central banks including Fed, BoE, RBNZ. We still expect ECB to stick to their dovish rhetoric but reiterate our caution that the ECB may be underestimating the persistence of price pressures and that it may need to walk back on its words and normalise policies earlier. If this happens, it would be a positive turnaround for EUR.

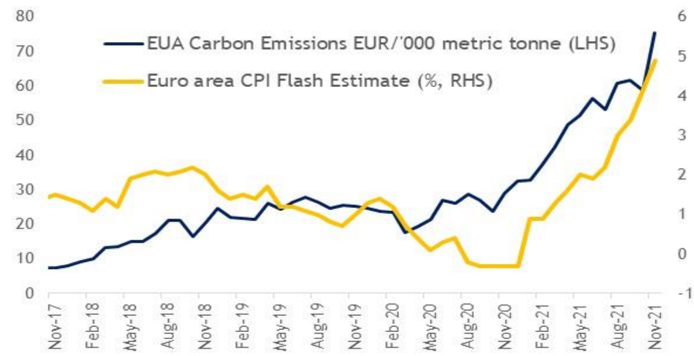
Acceleration of Climate Change Policies Add to Inflationary Pressures

The shift towards net-zero GHG emission reduction target is accelerating. In Jul, Europe announced ambitious climate goals to increase its emissions reduction targets to 55%, from 40% (dubbed the Fit-for-55). To meet these targets, corporates need to demand for carbon credits in the interim. EU carbon prices rose sharply this year (+100% at one point) as power generators needed to buy more carbon allowances after exceeding emission levels amid the switch to coal-fired power due to natural gas shortages. The purchase of carbon credits or offsets is needed as coal emits twice as much carbon as natural gas per megawatt of power produced. To add the rise in carbon prices was also due to measures aimed at progressively reducing carbon allowances to emitters (via the compliance markets). Persistent rise in energy prices amid bitter winter ahead, gas supply issues as well as acceleration in climate change policies can derail ECB's inflation forecasts and policymakers could be forced to normalise earlier than expected.

Headline Inflation Surging to Multi-Year High in Europe



Acceleration of Climate Change Adds to Inflation



Source: Bloomberg, Maybank FX Research & Strategy

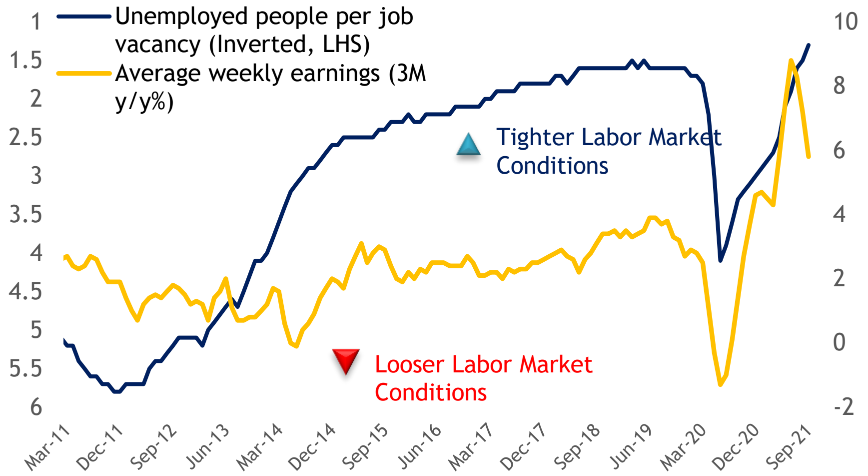
BoE's Surprise Hike

The BoE voted 8-1 to raise policy rate from record low of 0.1% to 0.25%. The timing of hike was earlier than unexpected as previous expectations for a Nov hike was disappointingly pushed back.

BoE Governor Bailey said that evidence of a **very tight labor market** and **more persistent price pressures** were the push factors for BoE to act. He also said that "we're concerned about inflation in the medium term and we're seeing things now that can threaten that". Recall that BoE previously said that price pressures are transitory and CPI will return to 2% in medium term. Governor Bailey is now saying that inflation could top 6% in coming months. Nov headline CPI surged to decade high of 5.1% y/y.

Markets are now pricing in 3 hikes for 2022 with the next 25bps hike coming in as early as around the 3 Feb or 17 Mar MPC. There is little forward guidance from BoE's statement except for the line, "modest tightening is likely to be necessary".

Tighter Labor Market Conditions Can Stoke Wage Inflation and Add to Tightening Bias



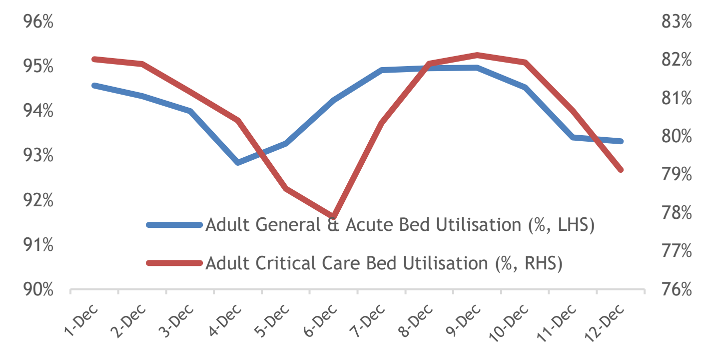
Source: Bloomberg, Maybank FX Research & Strategy

Looking on, omicron development in UK matters. Concerns are rising over risk of further lockdown amid omicron's rampant spread in UK and especially after PM Bojo imposed plan B ((8 Dec), ordering people to WFH, wear masks in public places and use vaccine passports for entry into large indoor venues in attempt to slow the spread of omicron spread.

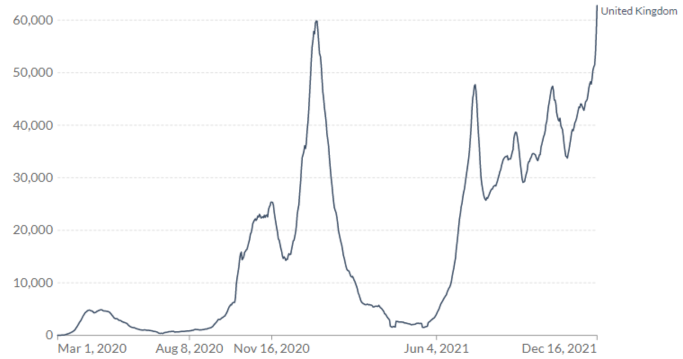
Subsequently on 12 Dec, PM Bojo warned of "tidal wave" of omicron infections as UK raised alert level to 4, from 3. Omicron cases are doubling every 1.5 days in London (>75% of cases are now expected to be omicron). England's chief medical officer warned that omicron infections could lead to daily hospitalisation from covid exceeding the peak of last Winter (when more than 4500 people in UK was admitted on a single day - alpha variant). Bear in mind that hospitals in England area already 94% full with 4 out of 5 critical care beds occupied even before the spread of omicron.

It remains unclear if UK will further tighten restrictions. Another lockdown could dent growth recovery momentum and temporarily weigh on GBP.

High Bed Utilization in UK



Surge in Covid Infections in UK (7d rolling average)



Source: Bloomberg, NHS, Ourworoldindata Maybank FX Research & Strategy

DXY - Bearish Divergence in the Making

DXY was last at 96 levels. Bullish momentum on weekly chart intact but shows tentative signs of waning while RSI is showing signs of turning lower from overbought conditions. Despite the rise in DXY in recent months, recent moves on the weekly chart has produced spinning tops for nearly 4 consecutive weeks. This represents indecision of the uptrend thus far. We see potential signs of exhaustion. Bias to lean against strength. Support at 95 (50DMA – not shown in chart), 94.50 levels (38.2% fibo retracement of 2020 high to 2021 low). Resistance at 96.90 levels (2021 high), 97.7 (61.8% fibo).

DXY (Weekly): Spinning Top a Sign of Indecision

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