Sucden Financial

FX Monthly Report

December 2021

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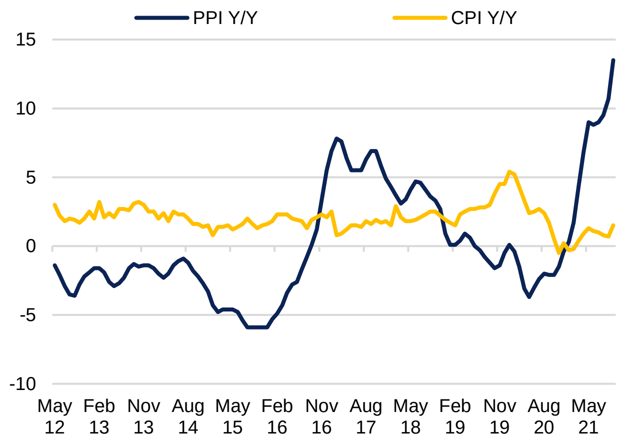
China in Focus

China PPI vs CPI Y/Y

Inflationary pressures have particularly impacted PPI.

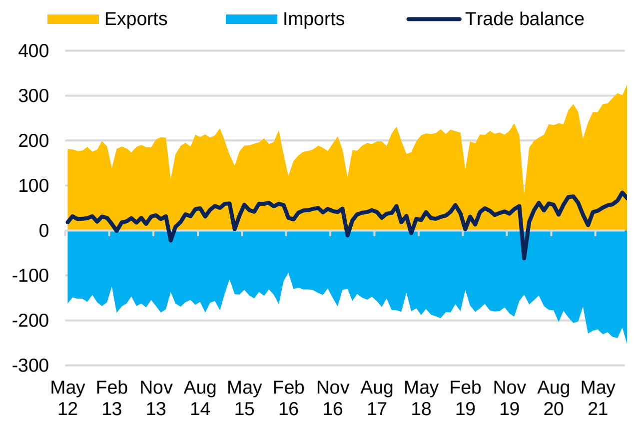


Source: National Bureau of Statistics

The Chinese On and Offshore currency has consolidated gains made in H2 2020 in 2021. The original strength was highlighted by China recovering from the pandemic before other major economies. The strong recovery was built on the back of strong demand for raw materials and stimulus from the Chinese government, strong demand for consumer electronics and materials from the rest of the world. At the same time, they were locked down, preventing these countries domestic manufacturing and industrial industries from fulfilling those orders. This led to a shift to the traditional economic growth metrics from China. This year, the currency strength has continued despite the weaker fundamentals for the Chinese economy and the strengthening dollar because of the hawkish Fed. Which, following comments by the Fed today (30/11/2021), will become more hawkish as Jerome Powell has finally admitted that inflation is not transitionary. Therefore, we expect to see rates rise and asset purchases decline slightly faster than previously expected. The U.S. yield curve has flattened somewhat off the back of this news.

China Trade Balance

The trade Balance continues to be strong.



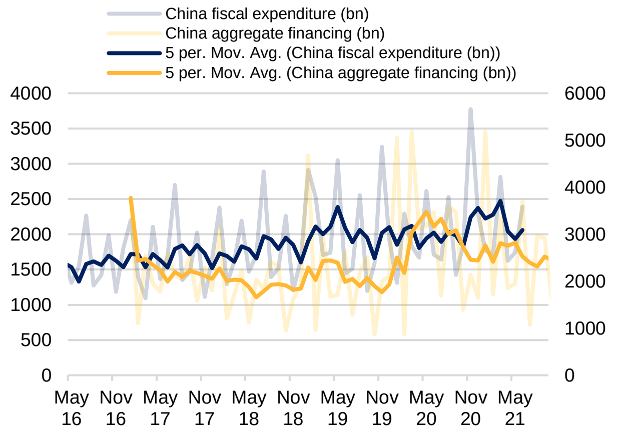
Source: Customs General Administration

CNY and CNH have remained strong even with the energy crisis in China, causing factory prices to rise, industrial output to decline due to high energy prices. The currency also stayed firm throughout the Evergrande fall-out. We now expect that the financial restrictions on the property market will loosen, increasing demand for raw materials. Chinese New Year falls at the beginning of February in 2022, and activity in the first 6 weeks of the year will be limited. However, we expect stimulus to increase at the end of Q1, and a rise in all system financing will evidence this. We continue to look at the net weekly injections from the PBOC, risk reserve requirements.

The Chinese economy continues to transition into a consumer-led economy. Economic growth will moderate over the long run as they transition, and external investors may see this as a weakness. The 20th Party Congress is next year, and this will likely consolidate Xi Jinping's power. The disconnect between the ideologies of the West and China are starting to appear. Even though China was looking to open its market to the outside world, we expect a solid crackdown for western companies from China. The private sector in China is subject to increased regulations, and western companies could be next. This will no doubt impact the currency and more likely affect the offshore currency. Pan Gongsheng's speech at the Financial Street Forum Annual Meeting said that they expect cross-border capital to flow in both directions and that the RMB will remain stable. They state that the economy is in a better cyclical position, even though indicators are weakening.

China Government Financing

Financing levels have dipped but we expect a strong recovery in Q1 2022.



Source: Ministry of Finance of the People's Republic of China, The People's Bank of China

The trade surplus and portfolio flows suggest that there are strong fundamentals for the economy and outline a reduced appetite for a weak currency, especially when you factor in the spread between PPI and CPI. Interbank trade volumes have remained relatively subdued so far. New lending facilities will support the base money in the coming year, the PBOC injection remains a key feature, and we continue to watch liquidity in the near term. Starting from mid-December, China stated it will cut the reserve requirement ratio by 0.5pps, releasing more liquidity into the financial system to support economic growth. The fundamentals for the economy, while weakening, is still robust, and while we expect data to be weaker in the near term until after the Chinese New Year, China will likely find support then. Political tensions have eased in recent years, but there remains substantial disagreement on specific issues. However, proceedings are more diplomatic, meaning disputes are unlikely to be posted on social media.

CNY/CNH Spread

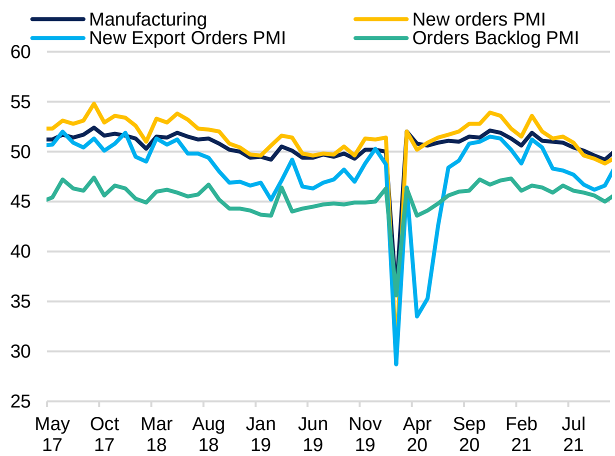
Analysis of the spread between the Onshore and Offshore going back to 2010 shows 48.8% of the time USDCNY>USDCNH, compared to 50.75% for USDCNY<USDCNH. The standard deviation for the spread between 2010 is 0.0219. When we look at the spread and how many times USDCNY > 0.02 over USDCNH, this happened 8.16% of the time when USDCNY>USDCNH. The widest spread for USDCNY>USDCNH was 0.1712; the spread between USDCNY and USDCNH was only ever >0.1 0.41% of the time. Interestingly, every time the spread is >0.05 it reached 0.07, this happened 2.1% of the time. We can deduce from this that the range of spread between USDCNY and USDCNH is predominately between 0.02 and -0.02. However, if USDCNY > USDCNH and reaches 0.05, it will more than likely widen further, which is something to keep in mind for those wanting to hedge or even arbitrage the two, noting that the PDF spread is expected to be narrower, and you have to account for the time delay.

Currency View

We hold a constructive view on CNY and CNH vs the USD as China will strengthen in 2022 and volumes until then will be weak. The Party Congress will provide insight into the next years under Xi Jinping. As mentioned, we are bullish the dollar in 2022 as the Fed become hawkish and increase interest rates. However, we expect China's trade surplus against the U.S. and in our view CNY & CNY will remain strong against the dollar, the options data suggests consolidation in the near term for USDCNY. After December we will not get data from China until February/March and after Chinese New Year. We expect the economy to really strengthen after Chinese New Year and industrial practices to increase after the Winter Olympics. The all-systems financing data, trade surplus, PBOC net injections, and PBOC Repo rates will give us an indication of stimulus levels and financial easing. The property sectors is a headwind to the economy but developers will continue to expand as regulations are eased, which in turn will support industrial production and Chinese steel production. Chinese stocks in the US are declining sharply as investors expect that relations between China and the US will worsen in 2022. This involved China's to ban companies from going public on foreign stock markets. Indices of Chinese stocks have declined heavily, with Baidu and Alibaba falling sharpy.

EM Currencies Indexed to January 2018

TRY and BRL are the worst performing EM currencies in the index.



Source: China Federation of Logistics

Desk Comments

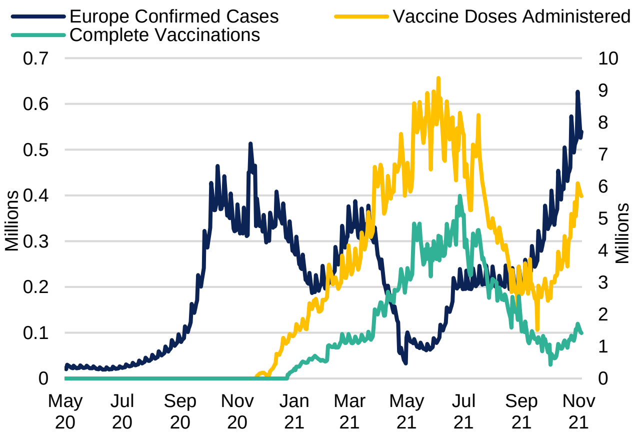
Euro Desk Comments

Euro suffered during 2021 and we expect this trend to continue during the first half of 2022. ECB remains dovish and behind the curve compared to other majors and we expect the euro will continue to be used as a funding currency for high yield plays. Lagarde during last month's conference once again pushed back on market expectations for a rate hike in 2022. it remains to be seen how long she can push back for after November's inflation came in above expectations again with CPI YoY core now @ 2.6%, which will have to be addressed by ECB. However, Eurozone remains plagued with rising covid cases bringing fresh lockdowns and tighter restrictions further denting hopes of a rate hike in 2022.

We are likely to see rallies over the next few weeks during periods of risk aversion and equity markets sell-offs brought on by uncertainty surrounding Omicron and could provide good opportunities to sell EURUSD at favourable rates.

European COVID Cases vs Vaccinations

Vaccines have increased along with cases in recent weeks.



Source: Bloomberg and John Hopkins

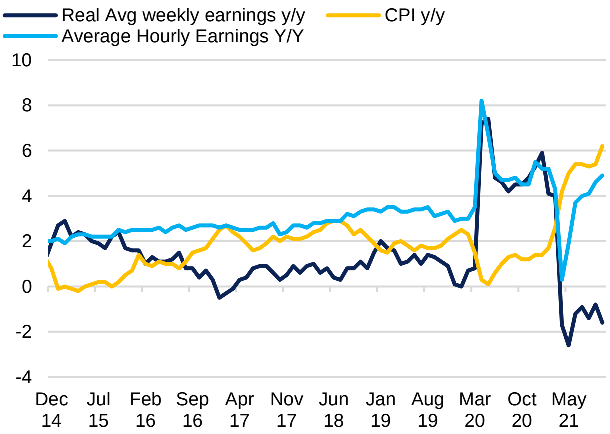
However, any moves on the back of data could be short-lived for the reminder of the year as covid is once again likely to take centre stage, as market participants await more information/data on the impact of omicron and as delta variant numbers continue to rise across the globe.

Predicting timings of rate hikes and unwinding of QE on the back of data whilst overlaying risks to growth poised by COVID, rising commodity prices and supply disruptions have brought increased volatility to markets, creating a great environment for short term traders, but is a huge problem for corporates budgeting for 2022.

Assuming risk associated with covid dissipates early next year we expect USD to have a strong year in 2022. We believe Fed will unwind tapering and raise rates more aggressively than general market censuses amid a strong macro backdrop and believe volatility over the next 2 months will provide a good opportunity to get USD hedges on at favourable rates. Our view was reaffirmed at the end of last month after Powel provided his clearest indications yet, the Feds chair believes it's time to retire the word transitory. These comments to us, indicates the FED will look to prioritise getting inflation under control rather than supporting growth. Getting long USDs against EM and EUR could be the best play for the first half of next year.

Real Weekly Earnings vs Average Hourly Earnings vs CPI

CPI growth is outpacing wages presenting headwinds to consumers.



Source: Source: Bureau of Labour Statistics

USD Desk Comments

USD has had a very strong quarter and a 2021, although last few days it has pared some gains as fears over covid variant omicron brought risk aversion to the forefront. FX markets over the last few months for the first time in 4/5years has become increasingly data-driven. This month's non-farms and CPI data are likely to be closely watched once again as market participants try to gauge the intensity of feds taper withdrawal and reprice rate expectations.

GBP Desk Comments

GBP was a top to mid-table performer in 2021 after what was meant to be a good year for GBP post Brexit. We expect more of the same in 2022 with GBPUSD to remain at similar levels but sterling to strengthen against most majors by end of next year.

First half of the year is likely to be turbulent as stagflation concerns are amongst the worst out of the majors, after large downgrade in growth expectation and upgrades to inflation amid tensions with Europe and supply chain disruptions.

The BOE is expected to raise rates this month by 0.15%, but with uncertainty around covid and with the recent drop in commodities prices, they could be tempted to swerve market expectations again and leave rates unchanged. If they fail to raise rates expect more pressure on GBP into year end. Any Rate hike cycle in UK is not likely to be aggressive and we would not expect rates to exceed 1% next year.

Technical Analysis

GBPUSD

GBPUSD has continued to trade lower after breaking and closing below 1.35 and could now test support @ 1.3165(38.2% fib)/1.3135. We expect the market to consolidate between the down trend from April 2022 and 1.3135, with a breakout indicating next move. On the Upside, a break above trend line could lead to a retest of 1.40 and then highs from April 2022. A close below 1.3135 would open the door to a deeper correction down to 1.2830.

EURUSD

EURUSD has continued to trend lower after breaking 50% fib. On downside, while downtrend remains intact we expect market to test recent lows and the area around 1.104 (76%fib)/1.10. A sustained close below 1.10 would lead to a deeper correction down to lows from March 2020. On the upside a break above trend line could see market consolidate between 1.15/1.10. A break above 1.15, could lead to a pull back to 1.1695.

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