FX Monthly Report

February 2022

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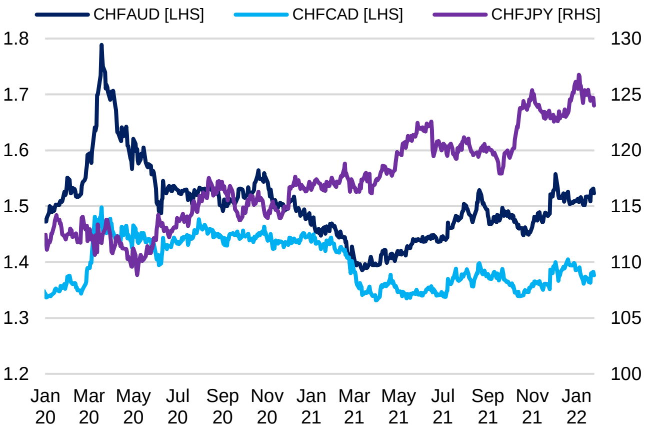
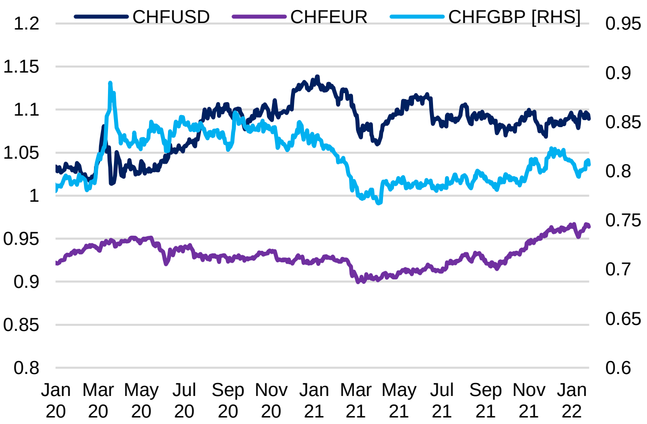
Swiss Franc

Swiss vs Major Currency Pairs

CHF has strengthened against a basket of currencies as macro jitters have dictated markets.



Source: Bloomberg



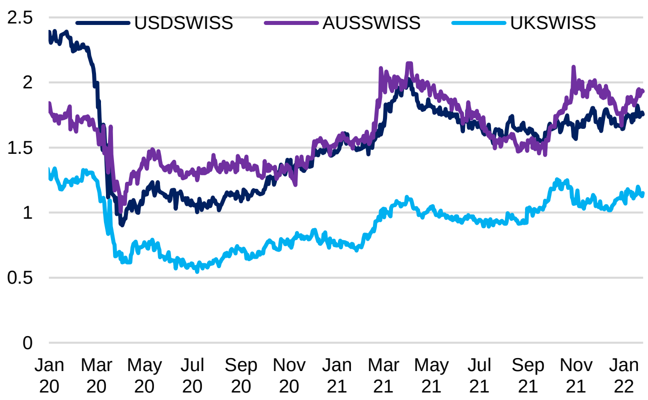
Source: Bloomberg

The Swiss economy is performing relatively well, all things considered. Manufacturing data is expansionary with January data at 63.8, up from 62.7 in December. Order books and production posted strong gains, we expect further expansionary readings in the near term but January data could be impacted by Omicron, although this would be a temporary dip. Unemployment data shows strong gains in the labour market, the unemployment rate stands at 2.6% as of January. Retail sales are robust with the November reading at 5.8%, up from 2.2% before. We expect the economy to post steady growth in 2022, real GDP is forecast at 3%. Following 3.5% in 2021, after Q3 growth surprised to the upside.

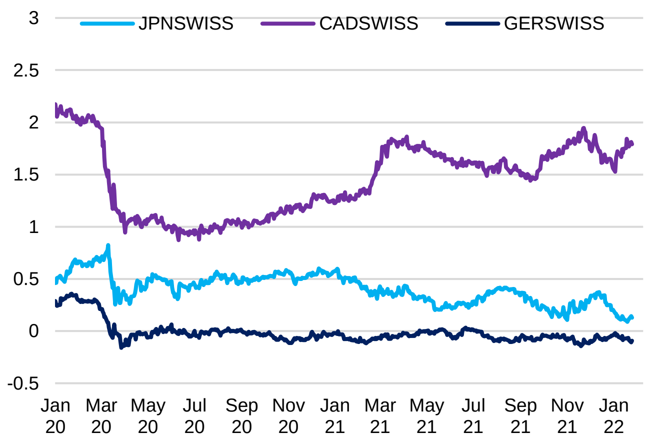
Switzerland is bucking inflation trend, CPI and Core CPI stand at 1.6% Y/Y and 0.2% Y/Y, respectively, in January. Price pressures in other countries are not being felt, but this could present weakness to the currency in 2022. However, producer & import prices are higher reaching 5.4% Y/Y in January. The inflationary environment through higher commodity prices is likely to see upside to this data in the near term, however the Swiss National Bank seem happy to have a stronger currency in the near term. Total sight deposits stand at CHF725bn as of February 4th, the trend continues to show growth, up from CHF704bn in January 2021, and significantly higher than the pre-pandemic level of CHF585bn as of January 2020. Sight deposits of domestic banks average week stand at CHF659.5bn, as of February 4th. The fundamentals of the Swiss economy continue to recover but we expect the currency to struggle against majors in 2022.

Spread Between 10yr Yields

The spread between CHF and other major 10yr yields is widening, as CBs except for BOJ, SNB, ECB become hawkish.



Source: Bloomberg



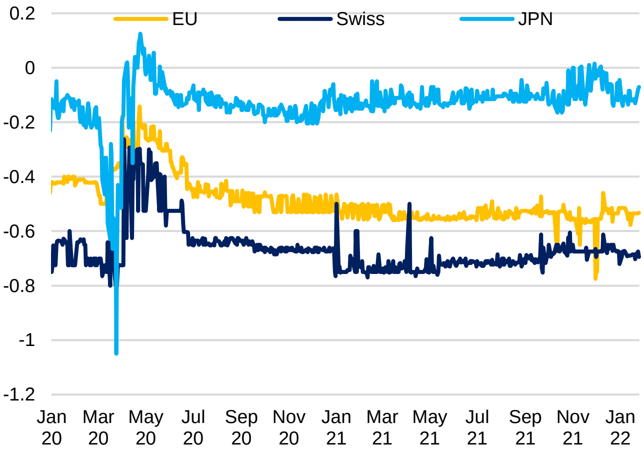
Source: Bloomberg

The SNB will not raise rates in the immediate term, as they have less of an inflation issue than other economies, however the change in rhetoric from CBs has caused yields to rally. Swiss yields have remained low with the 10yr yield stands at 0.3% and spreads other major currency 10yr yields have widened in recent weeks, except for the Japanese Yen and Germany. The widening of spreads between Switzerland and other economies such as the U.S., Australia, U.K., and Canada. The divergence in yields and borrowing costs will likely fuel the carry trade, prompting traders to short CHF and the JPY, indeed, **buying AUD, CAD, and selling CHF, and JPY, this trade yielded an average annual return 9.95%. Similarly, G10 carry of long NZD, NOK, CAD, and selling EUR, DKK, CHF, has an annual average return of 10.45%.**

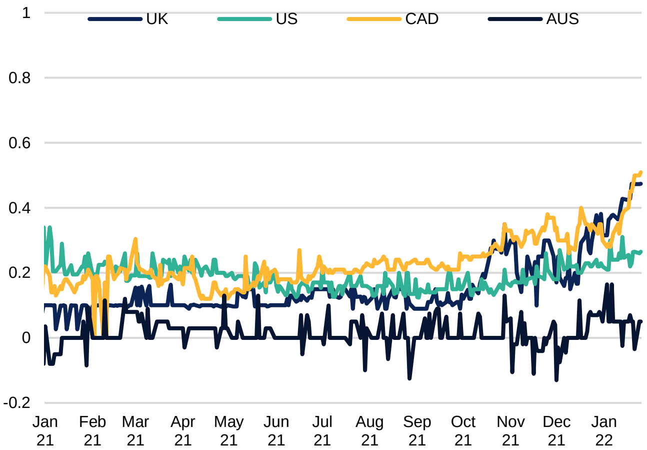
Higher yields provided strength to the USD in H2 2021, but the dollar has consolidated in recent weeks as this trade ran out of steam. Inflation continues to rise, and the Fed have been slow to react. The clarification from the Fed of when interest rates will rise, which will be March, but also clarification of asset purchases and balance sheet run off. The ECB has indicated they may increase rates in Q4 2022 in response to higher inflation, we expect the ECB to taper asset purchases first but yields have rallied and all mahor 10yr yields are positive once again. German and Swiss yields are comparatively low. Euro has weakened against CHF, politics in Italy has not been priced in and this could present downside to EURCHF in the immediate term and expect the recent rally to be sold and the pair to creep lower towards 1.02.

3-month Deposit Rates

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



Source: ECB, SNB, BOJ



Source: BOE, Federal Reserve, BOC, RBA

The two charts above show 3-month deposit rates for the countries analysed. Higher borrowing costs are evident in the second chart with chart 1 showing little change at all over the last 14 months. While it is worth remembering monetary policy is still extremely accommodative, and what we have seen in recent months is a robust increase in the capital in the financial system. Financial conditions in the U.S. have tightened significant in recent weeks, and rising yields in have prompted change in strategy on the stock market with less appetite for speculative stocks. The rising deposit rates exemplifies hawkish central banks, and the divergence in monetary policy across the globe. We expect a normalization of interest rates with the Fed targeting at least 1% at the end of 2022. However, with debt levels high across the globe due to the pandemic, central banks will have to find a balance of increasing rates too high and as a result struggle to pay interest on debt. This is especially important for Brazil who hold a large proportion of U.S. treasuries. The largest holder of U.S. treasuries as of November 2021 was Japan, with China second, before the UK.

Rate hikes for the USD are priced in and this gives downside risk to the currency. While the tightening path has been set by the Fed, the speed is still up for debate, and as data weakens, we have seen financial markets become volatile and choppy. This has given JPY a bid as traders have looked for safety and holding U.S. assets became unattractive. GDP growth across companies analysed will be robust but as mentioned we expect weak data, with retail sales falling, inflation high, falling real earnings, amid a tight labour market. The Tsunami of consumer demand during the pandemic is subsiding but this has blocked supply-chains. Demand is weakening, and we expect these backlogs to be cleared in H2 2022. Helping to ease inflationary pressures, but commodity prices are high. If we hit 3 or 4% inflation in December this will still represent an increase of 9/10% over the course of 2 years. While the consumer has a buffer due to savings from lockdowns, this will slowly diminish.

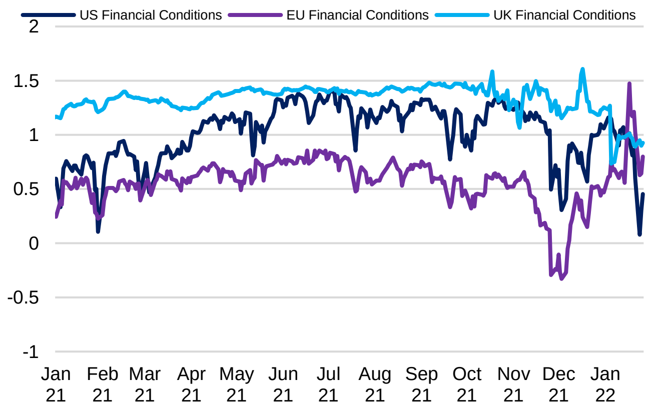
Currency View

As mentioned, we expect the divergence in rates to drive flows in currencies. In our opinion, higher rates in US, UK, AUS, and CAD. The probability of rate hikes for these economies are high and this presents downside to the economy, currently. To ease pressure on CBs we need to see inflationary pressures ease, we do not see this as likely. Therefore, the carry trades owning AUD, CAD, USD or even NZD, who will look to raise rates is a trade we like this year, selling the JPY, CHF, and EUR. However, we see upside to the EUR so in H2 2022.

CHF and JPY are expected to benefit from an increase in macro jitters, and lack of clarity from the Fed. We have seen CHF and JPY firm in the first weeks of 2022, but as CBs become more transparent and rates rise, CHF and JPY may be left behind on a carry trade and rates basis.

U.S., Europe, and UK Financial Conditions

Financial Conditions in all countries have shown tightness in the first month of 2022.



Source: Bloomberg

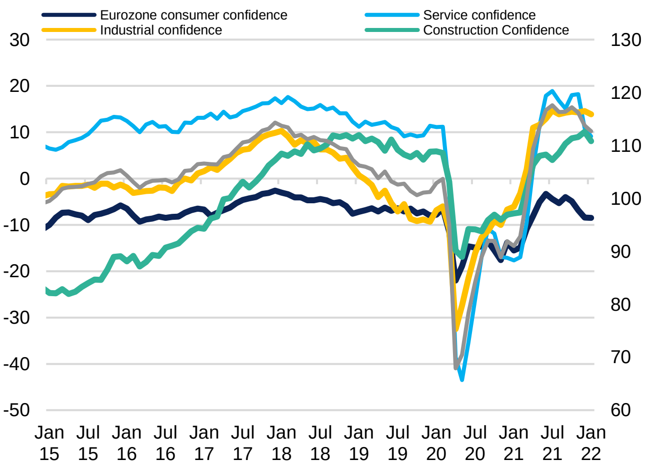
Desk Comments

Euro

EUR started the year on the backfoot as the differential in CB policies widened. However, the downward pressure on the EUR was short lived as President Christine Lagarde recognised the risks to rising inflation, surprising the market with a hawkish outlook although a hike in 2022 remains unlikely. Currently inflation has largely been kept in line but Q3 2.9% and Q4 4.7% has seen inflation begin to tick above the 2% target. This will put pressure on the ECB to act. However, the ECB will first want to see an increase in earnings growth in addition to the recent fall in unemployment figures. An escalation between Russia and Ukraine could add to inflationary pressures sending European energy prices back to last year's high.

European Industry Confidence

Confidence across all industries has started to weaken



Source: European Commission

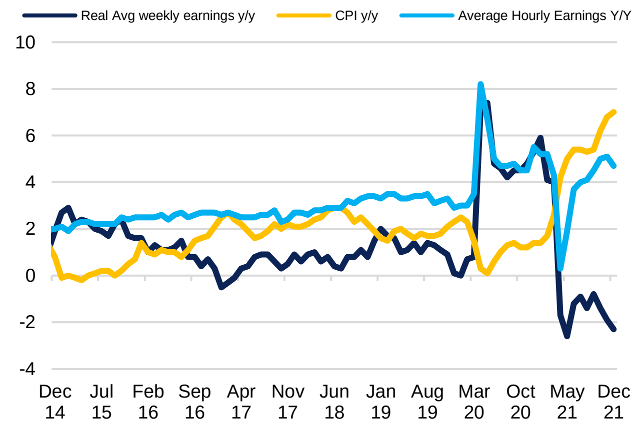
USD

The USD got off to a strong start in 2022 after the Fed's Powell delivered his most hawkish delivery yet, in line with our expectations, but surprising the consensus. There was a sense from Powell's tone when answering questions, that controlling inflation was a matter of urgency now. Powell indicated that every meeting will be live, hinted QT is likely to start in June and did not rule out 50 basis point hikes. We believe that a 50-basis point hike is a very likely scenario in March, the market is now pricing 5 rates hikes of 25 basis points now, compared to 3 - 4 prior to the meeting. Many of the key macro data numbers will be closely watched over the next weeks starting with NF pay roles and will add volatility to these FX markets as markets try to gauge the magnitude of march's rate hike. We expect the USD to remain strong over the next few months, before some of the other major Central Banks hit their hawkish tipping point as inflation remains a global issue. At that point USD likely to just plateau out the rest of the year.

There is the uncertainty of a potential war between Russia and Ukraine which could also see USD appreciate short term especially against high beta currency amid large scale risk aversion and supply shocks in energy markets fuelling further inflationary pressure globally.

Real Weekly Earnings vs Average Hourly Earnings vs CPI

CPI growth is outpacing wages presenting headwinds to consumers.



Source: Bureau of Labour Statistics

GBP

GBP is the best performing G10 currency excluding the USD this year. The BOE continued tightening of monetary policy this month with back-to-back rate hikes for the first time in 17 years. Additional hikes are priced in this year to help combat rising inflation and we revise our forecast for implied rates to exceed 1%. UK gilts have surged to the highest level since 2019 as the economic recovery gathers pace. However, GBP strength may be curbed in Q2 as businesses will be faced with rising cost pressures post Brexit and an increase in cost of living will hit households hard notably from rising energy bills and NI tax increase. Therefore, BOE face some challenging times ahead to manage inflation whilst ensuring rates don't exceed too much when households are facing their lowest disposable income in decades.

Technical Analysis

GBPUSD

GBPUSD bounced after testing support @ 1.3165 (38% Fib) but failed to test level @ 1.3834. We now expect the market to consolidate between downtrend and support @ 1.3165(38.2% fib)/1.3135. On the upside, a break above trendline could see market test resistance @ 1.3835 also 38% Fib of recent move; with a break above there leading to retest of 1.40 psychological mark. On the downside, a close below 1.3135 would open the door to a deeper correction down to 1.2830.

EURUSD

EURUSD after making fresh lows end of January has bounced back very strongly and breaking above and testing 1.1500 again. We should now see a period of consolidation between 1.15 and 1.1040. On the upside, a break above 1.15 and top of the broadening triangle is needed indicate a change in direction for the EURUSD and would lead to deeper pull back towards 1.19/1.20 broadening triangle target. On downside, a sustained close below 1.1040 could lead to a deeper correction down to 1.0723 and 1.0636 (lows from March 2020).

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