

G5 FX Outlook



GLOBAL TRADING SOLUTIONS

Foreign Exchange Trading Strategy

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CS FX Trading Strategy

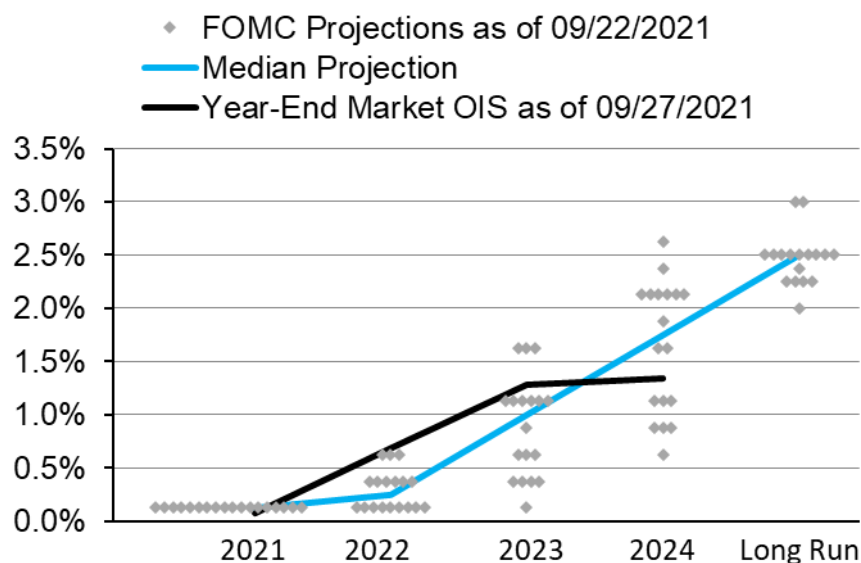
Core Views

- High energy prices and continued global supply chain problems pose major conundrums for central banks. Do they need to hike rates in order to repress inflation expectations? Or should they stay focused on growth as the recovery momentum slows and fiscal support in many countries starts to dwindle? Stagflation conditions are not comfortable for policymakers.
- The US economy is still in a relatively strong place compared to much of the rest of G10 - despite risks surrounding the possibility of debt default after 15 Dec, some signs of a loss of confidence among US consumers and possible watering down of fiscal stimulus hopes. This underpins what we see as a constructive USD picture, linked to a relatively hawkish Fed too. A committed dovish stance by major central banks like the ECB and BOJ also play well for the greenback.
- The ECB as an institution is sending a strong message of ongoing commitment to viewing high inflation as transitory – a position that has kept us committed EUR bears since Q1 2021. Together with previous suggestions that it actively welcomes wider rate differentials if US rates move higher as well as a weaker EUR, this is helping to define the EUR as a “funding currency of choice” for many investors.
- FX implied volatility is pushing higher towards / beyond earlier 2021 highs seen in Q1. Factors ranging from policy uncertainty / spillover from rates vol to year-end liquidity concerns for FX forward markets are contributing to this. Higher equity volatility remains a missing link.

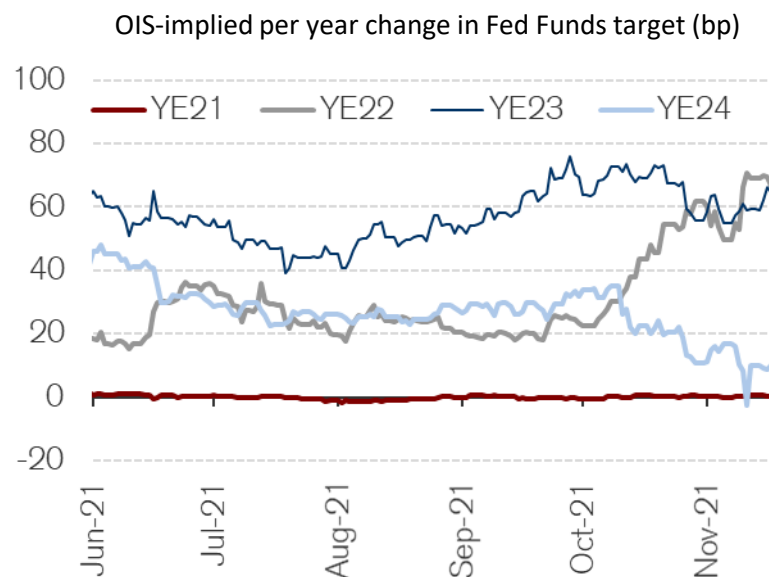
USD: Fed policy leaves scope for USD upside

- Strong US inflation and employment data, sustained asset prices, and tight credit spreads suggest market pricing for the Fed can prove stable at a time where pricing elsewhere comes into question.
- With real yields near YTD lows, a repricing of 2024 rate expectations could push yields and the USD higher. We have liked EDM2 vs EDM4 steepeners.
- The re-appointment of Jerome Powell as Fed chair eliminates one source of risk for the USD in terms of reducing the risk of a further structural dovish policy shift.

The Fed's guidance is more hawkish than market expectations at the 2024 point



Markets have brought forward rate hikes into 2022

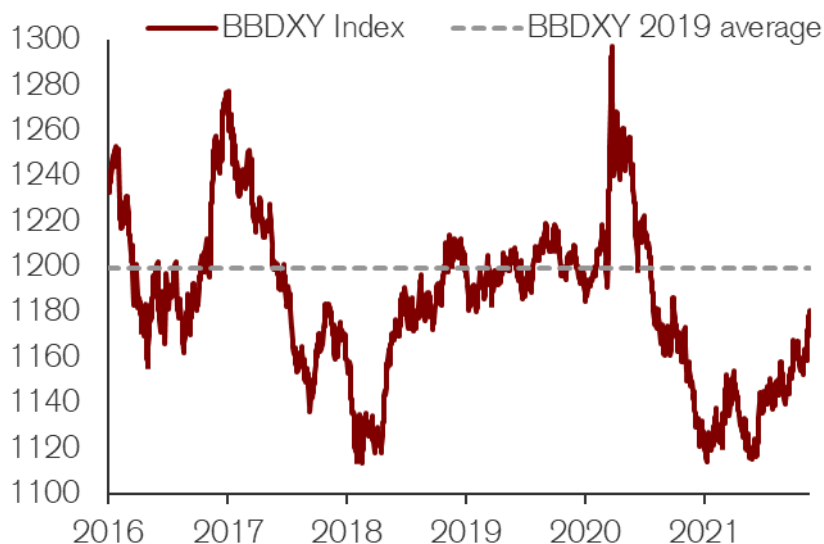


Sources: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, the US Federal Reserve

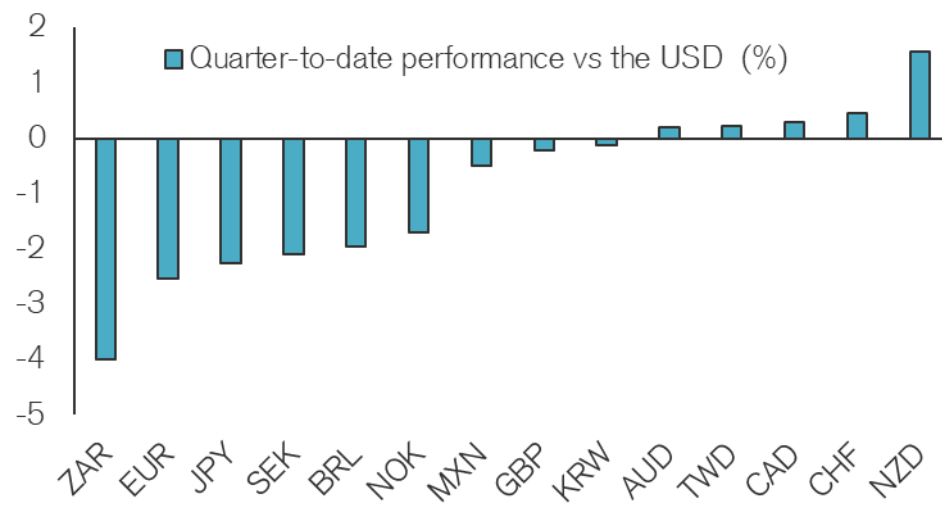
USD: The USD remains subdued by historical standards

- Even though the growth and rate differential outlook now looks more comparable to pre-pandemic times, the BBDXY remains nearly 2% off its 2019 average.
- The potential passage of the Build Back Better US fiscal stimulus bill is still riddled with uncertainties. If the bill is ratified, this would reinforce the outlook for the USD and Treasury yields.
- We retain a pro-USD bias against funding currencies but recognize there is space for idiosyncratic stories to play out in the EM and in the pro-cyclical FX space.

BBDXY still ways away from 2019 average



USD strength has realized most aggressively against low yielders, performance vs pro-cyclicals is more mixed

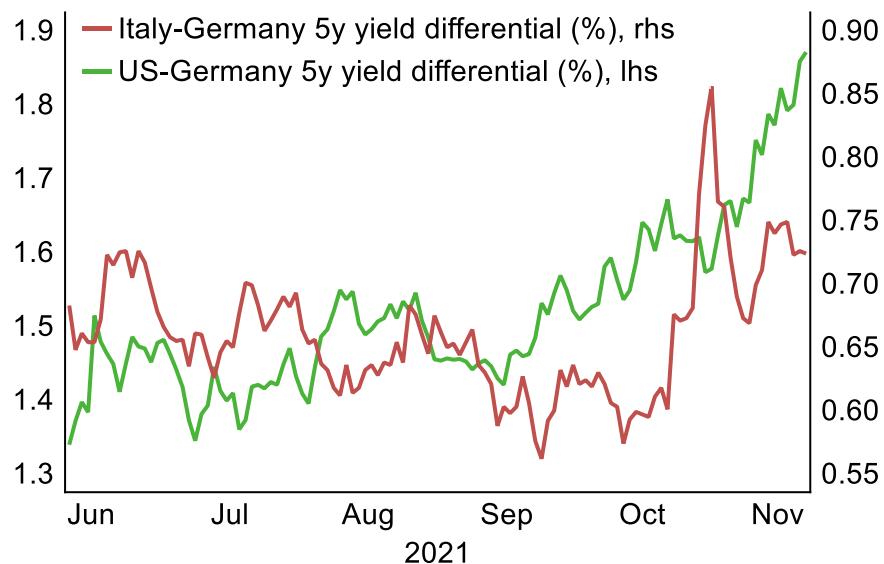


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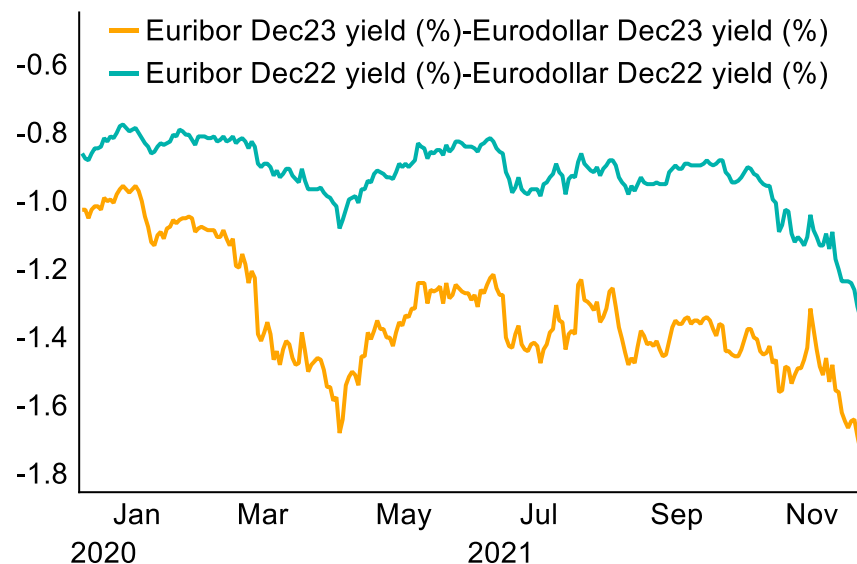
EUR: Yield differentials still a drag on the EUR

- Last week we lowered our target for EURUSD to 1.1150 from the 1.1400 level we had stated as our Q4 target at the end of Q3. We anticipate rallies to be capped around 1.1550.
- The ECB continues to push back against the market's expectations for rate hikes. Recent rhetoric suggests that the ECB also welcomes a weaker EUR as an additional easing factor.
- The recent widening in peripheral spreads creates further pressure for the ECB to replace PEPP purchases once these expire in March 2022, likely through enhanced APP purchases.

European yields have not rered higher in line with US rates in recent weeks



Yield differentials increasingly support further EURUSD downside

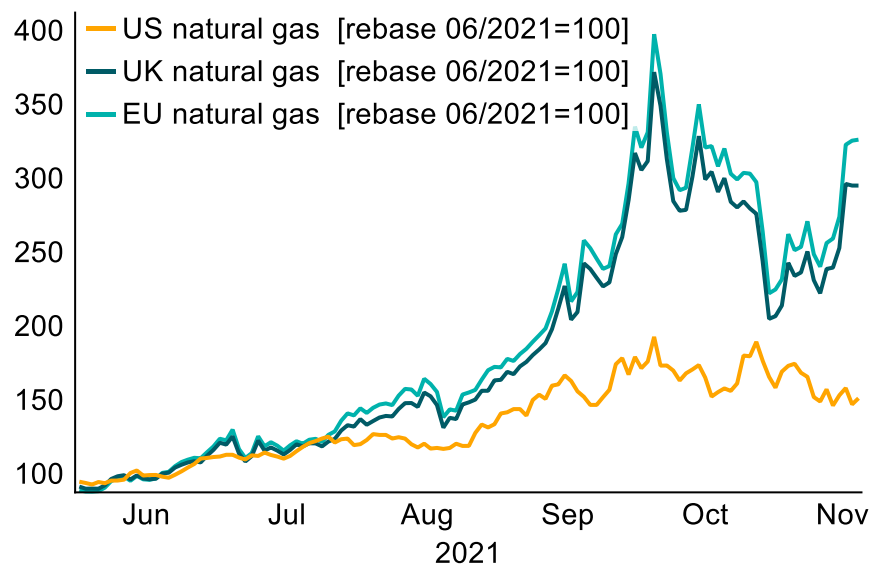


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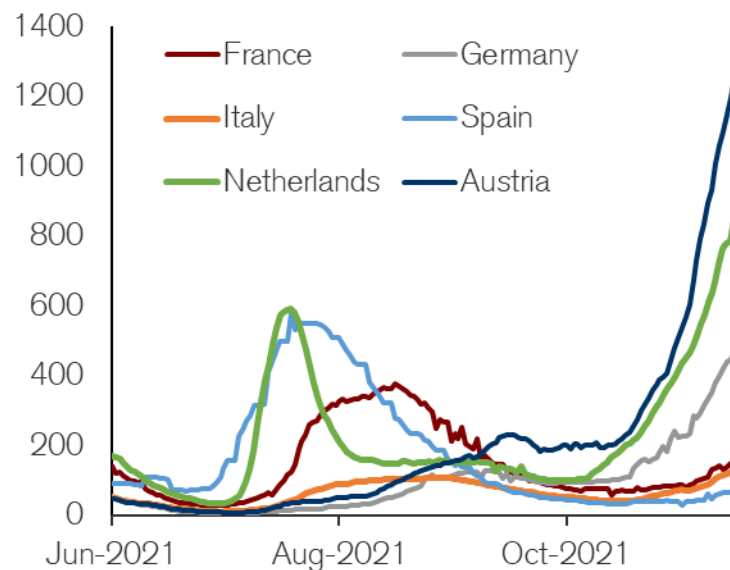
EUR: Affected by idiosyncratic growth risks

- The euro area is more vulnerable to sustained strength in energy prices. Geopolitical tensions with Russia further complicate this matter.
- The resurgence of Covid cases is an idiosyncratic risk for Europe's outlook. The tolerance for lockdowns and other growth-suppressing Covid remedies is higher in Europe than in the US.
- Risks surrounding the French election in Q2 2022 have so far not had a large role in EUR sentiment. A strong showing for far-right candidates in polls would likely be a negative factor.

Idiosyncratic energy dynamics threaten to stall growth prospects



Covid cases are spiking in the euro area

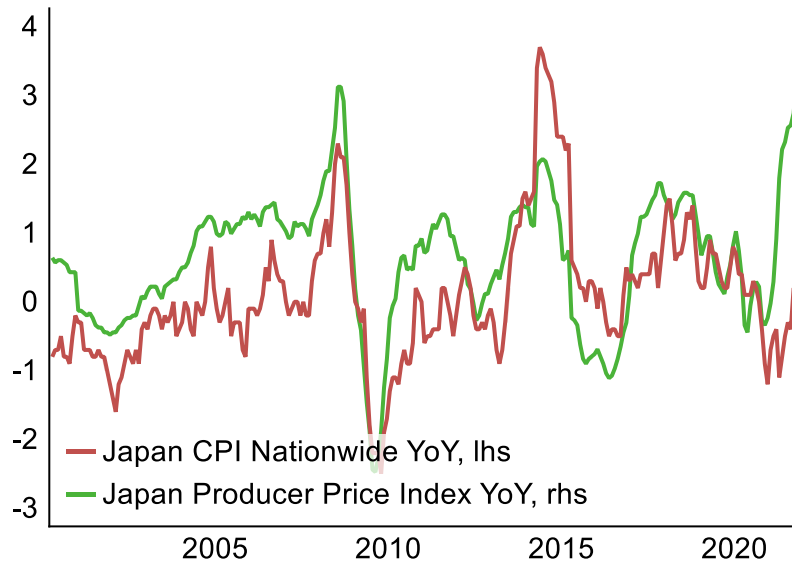


Sources: Credit Suisse, the BLOOMBERG PROFESSIONAL™ service, ICE exchange, New York Mercantile Exchange, Our World In Data

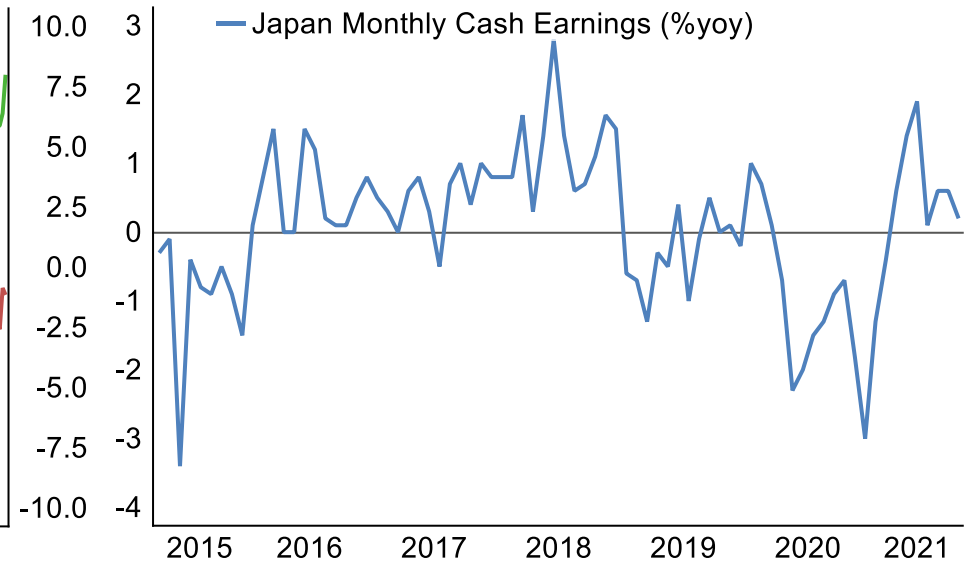
JPY: New fiscal measures are in focus

- We continue to target USDJPY 118.00, as we have done since early October.
- Prime Minister Kishida is set to announce a JPY79tn fiscal package. Recent price action does not suggest that markets see the new fiscal measures as meaningfully improving Japan's growth hopes.
- Global inflationary pressures have failed to feed into Japan CPI, due partly to downward pressures on mobile phone charges. Markets are likely to remain skeptical of faster inflation prospects as long as wage inflation also remains slow.

No signs of inflation yet, while soaring PPI threatens to cut into profit margins



Japan's wage growth remains sluggish

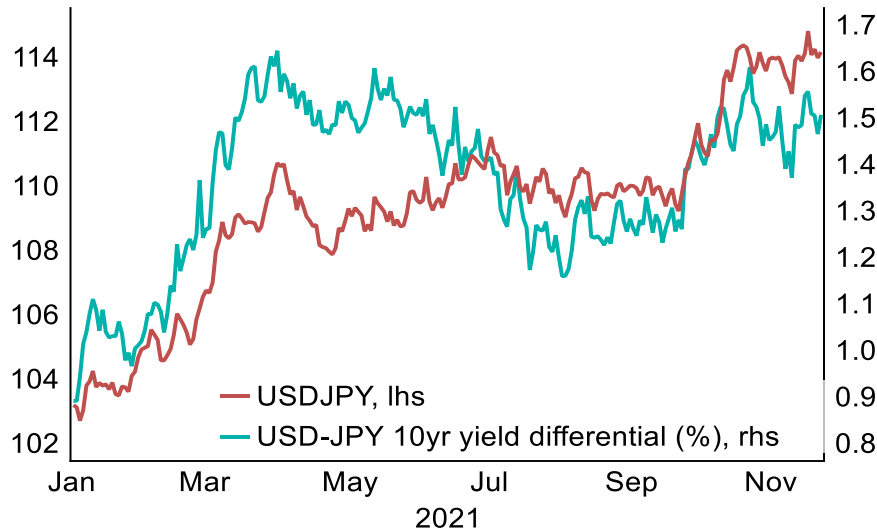


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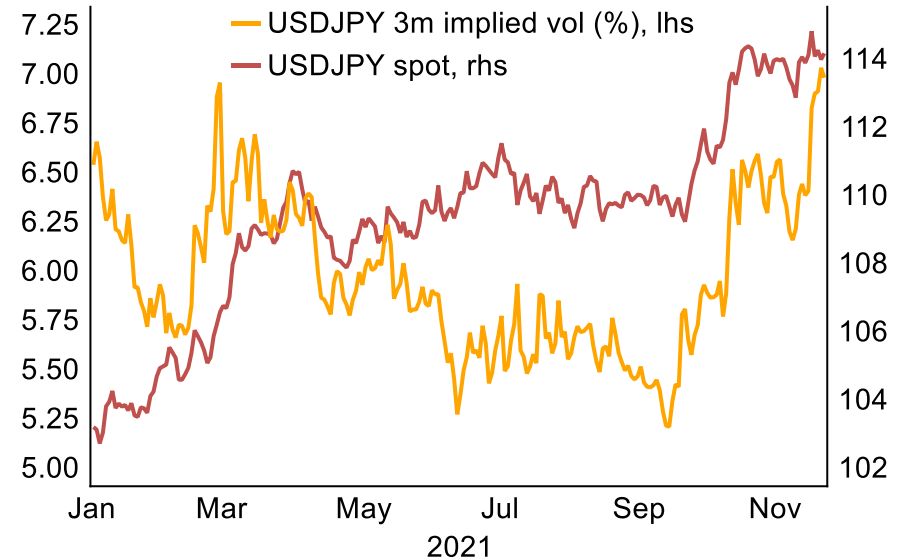
JPY: Yield differentials still in the driver seat

- The government said it does not plan to fund its new fiscal plan through taxes, which suggests that the BOJ could contribute to funding these measures. For some, this represents a further step in the direction of a permanent “helicopter money” policy, especially if there is a UBI component.
- In the meantime, Fed tightening expectations combined with YCC in Japan continue to drive wider US-Japan differentials. We continue to expect USDJPY to trade in line with these differentials.
- A prolonged period of risk-off price action remains a risk to view, but JPY has been relatively agnostic to the recent spike in G10 vols.

USDJPY continues to trade in line with yield differentials



... as suggested by the relative stability in USDJPY despite the spike in vols

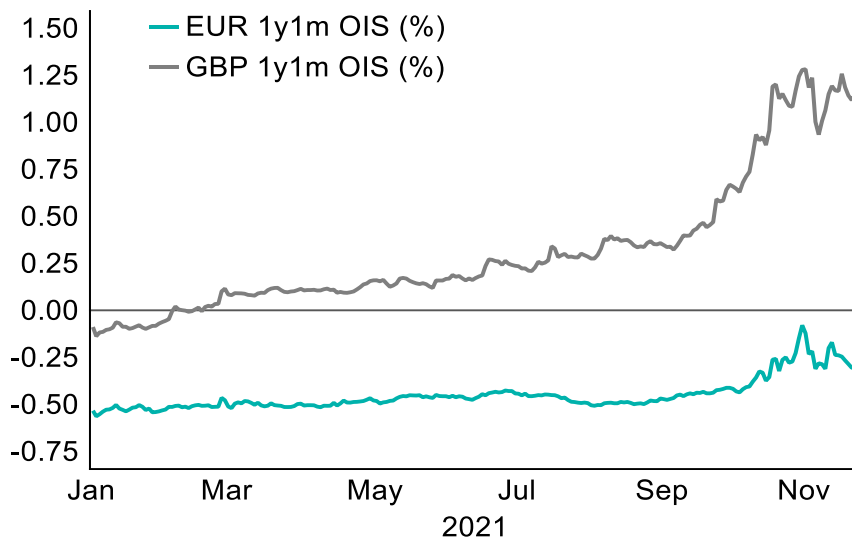


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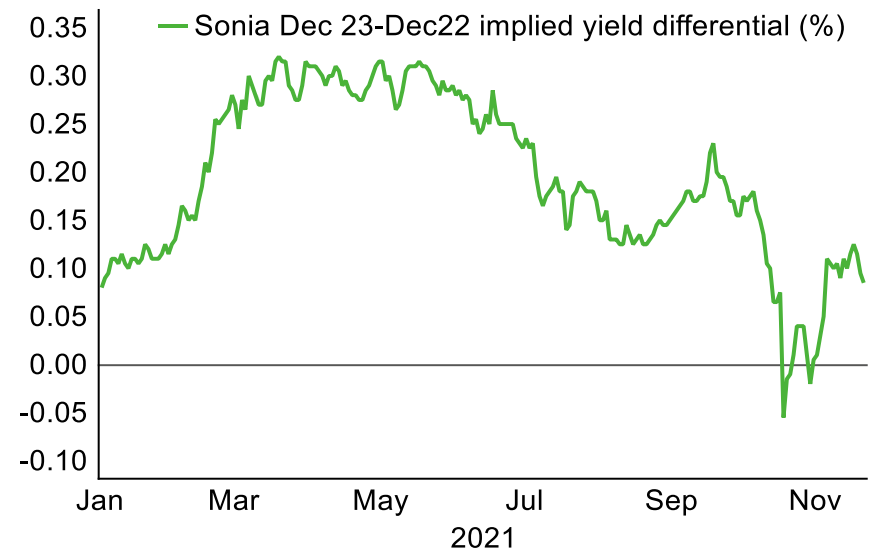
GBP: Backdrop now consistent with a Dec BOE hike

- Recent strong employment and CPI reports reinforce expectations of a 15bp hike in December. With the BOE still focused on the state of post-furlough labour markets, employment data for Oct scheduled on 14 Dec represents the next litmus test for the economy.
- The SONIA curve is no longer inverted between December 2022 and December 2023. Markets are no longer concerned with the prospects of a tightening policy error.

Policy expectations for the UK have regained lost ground and have stabilized



Markets no longer pricing in a “policy error”

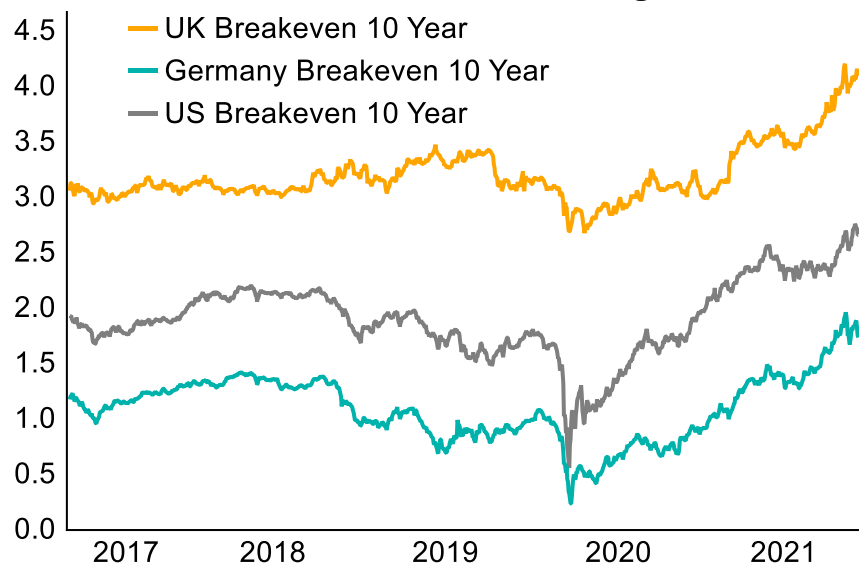


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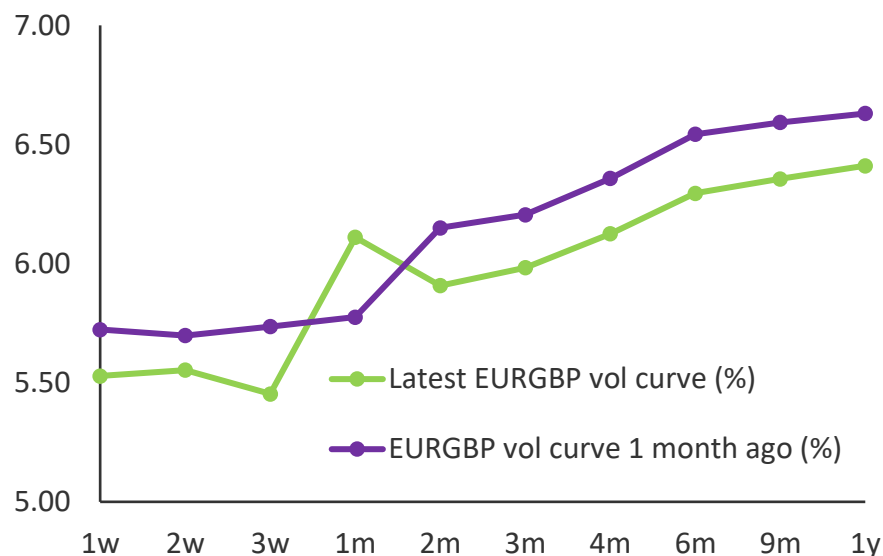
GBP: Risks remain, but are appropriately priced in

- While inflation validates a GBP-supportive BOE tightening cycle, it also highlights supply constraints that could be detrimental to the UK growth story. Elevated gas prices are a risk to the UK too.
- The political outlook remains a wildcard. Risks of triggering Article 16 remain, but recent news suggests the UK may be reluctant to push this ahead of the all-important Christmas period.
- We recently lowered our EURGBP target from the long-held 0.8450 previously to 0.8300. We would now look to sell into rallies to 0.8520.

The UK's historical experience with inflation suggests the BOE will be diligent



The vol curve suggests that markets remain more concerned with the MPC meeting mid-Dec

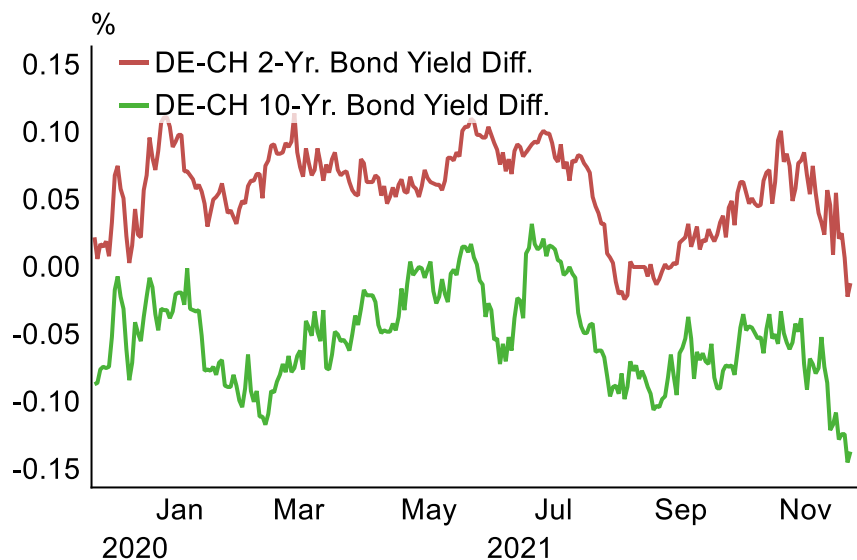


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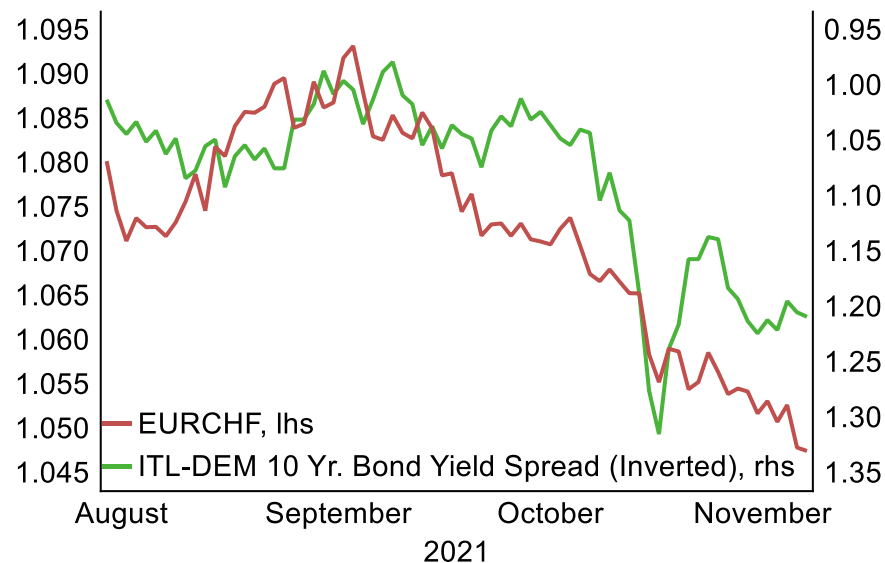
CHF: We revise our EURCHF forecast lower

- Monetary policy divergence between the euro area and Switzerland should guide EURCHF lower. Wider European peripheral spreads provide further impetus.
- SNB FX interventions appear to be modest so far and won't derail the downward EURCHF trend in our view.
- We revise our target from 1.0500 to 1.0250. We would consider ourselves wrong at 1.0720.

Nominal interest rate differentials moving in the franc's favour



Peripheral spread widening is a warning signal for the ECB

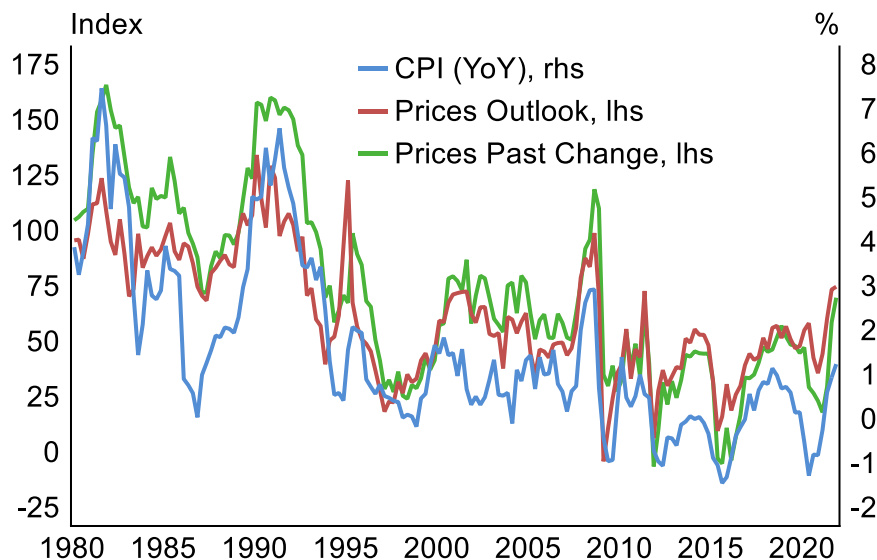


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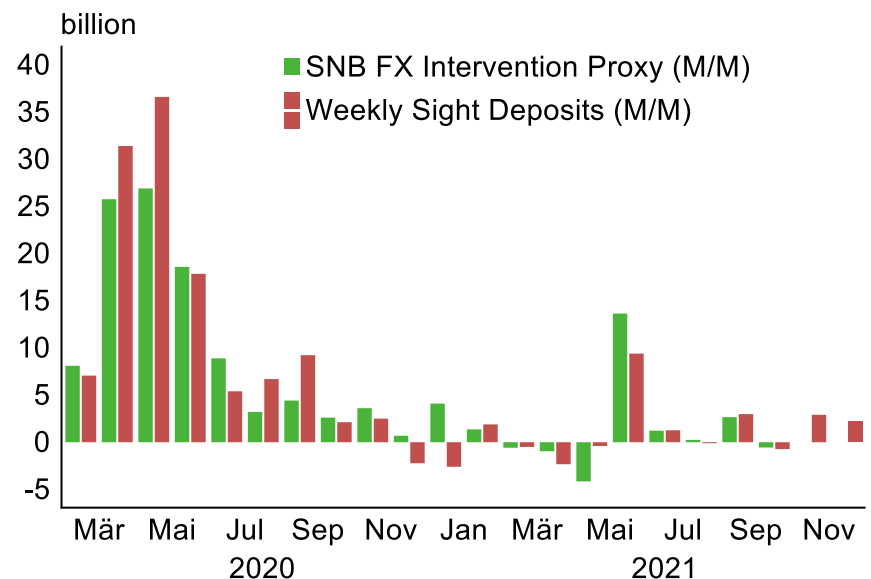
CHF: SNB might be willing to tolerate a stronger franc

- SNB might be more tolerant of a firmer franc as Swiss inflation expectations are also rising.
- Although sight deposits have increased of late, hinting at some FX intervention, the increase has been on average a modest CHF 1bn per week over the last five weeks.
- We also note that USDCHF has stopped declining for now. This gives the central bank some relief as it considers the overall currency situation when deciding on monetary policy.

Swiss consumer price inflation expectations are rising



SNB FX intervention has been modest so far



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