AmBank Research

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Thematic

Foreign Exchange Strategy

Group Chief Economist/Head Research
Dr. Anthony Dass
anthony-dass@ambankgroup.com

Economist
Azri Azhar
azri.azhar@ambankgroup.com

Economist
Muhamad Farid Anas bin Johari
muhamad-farid-anas.j@ambankgroup.com

- 4Q22 remains a dollar play
- 1Q23 dollar is expected to peak
- 2Q22 major currencies expected to regain
- USDMYR to settle at 4.40 in 2023

A) US Dollar

Dollar is expected to overshoot in 4Q22

- Fed's aggressiveness plus the speed of rate hikes in 2022 with the aim to address inflation led to a strong bias towards the dollar. From the start of 2022, the cumulative rate hike by the Fed was 300 basis points (bps) to reach 3.00 – 3.25%. It saw the dollar appreciated by 15.3% as of 25 October 2022.

- The strong dollar momentum would remain in 4Q22. It will continue to be supported by the rate hikes. The Fed is poised to further hike the policy rate by 75bps in November and 75bps in December. This should see the policy rate settle at 4.50% - 4.75% by end 2022.

- Besides the aggressive rate hikes by the Fed, the real yields (UST10Y minus inflation) are deeply negative. It has been in the negative territory since November 2019. Hence, there are limited room for any immediate relief from the strengthening dollar.

- Furthermore, the dollar will remain as an attractive safe haven bids as we expect global recessionary fears to deepen in the coming months plus the heightening of the geopolitical tension.

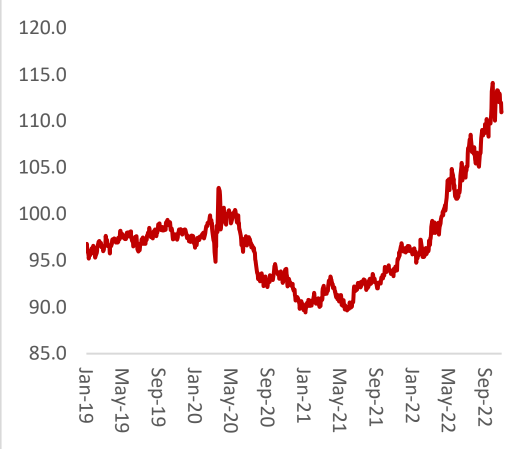
- Thus, we foresee the dollar to overshoot from its fair value in response to its monetary policy tightening. We expect the dollar to strengthen to 114 in the 4Q22.

Dollar momentum to lose steam early 2023

- As we enter the into year 2023, the dollar momentum is poised to lose steam. The narrative of "inflationary pressure" would shift towards "slower growth or recession". Inflation and rate hikes would have caught up with the economy.

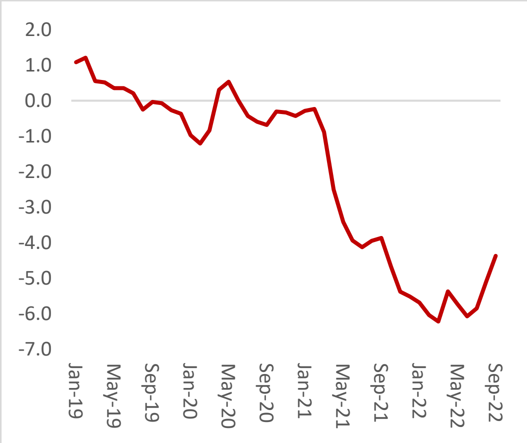
- Following more than a year of rising prices, wages are not keeping up. Consumers are dipping into their savings. The personal saving rate in August remained unchanged at only 3.5%, near its lowest rate since 2008. It is well below the pre-Covid level of around 9.0%.

Chart 1: Dollar Index



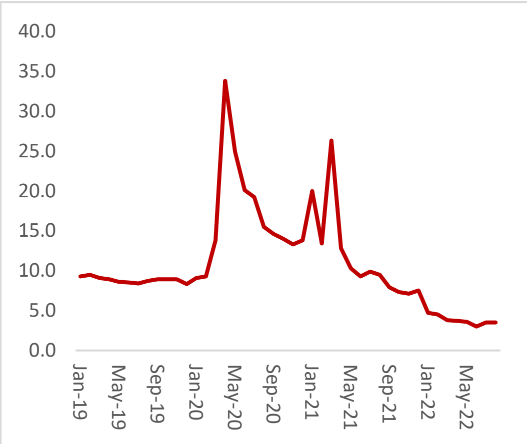
Source: Bloomberg/AmBank Research

Chart 2: Real Yields (%)



Source: CEIC/AmBank Research

Chart 3: Personal Savings (%)



Source: CEIC/AmBank Research

- Meanwhile, the recession risk has been ramped up since early July when the yields on 2-year US Treasury notes jumped above the yields 10-year Treasury notes, a phenomenon known as a yield curve inversion. Inverted yield curves have historically been a strong economic recession indicator. Two-thirds of the time, the economy has historically fallen into a recession within 18 months of a yield curve inversion. And the current yield curve inversion is the deepest since 2007, the year before the notorious global financial crisis.

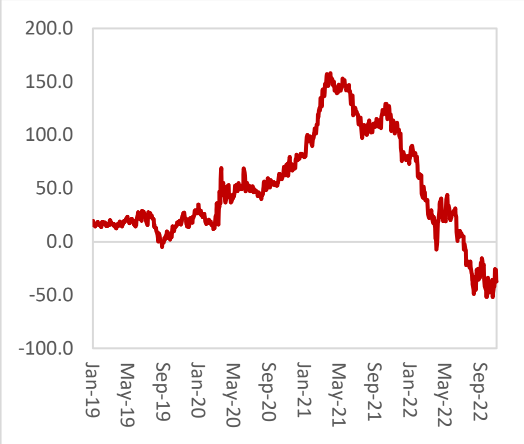
- But the sharp economic slowdown will prompt the Fed to slow down its tightening of monetary policy. This is likely to happen in early 2023. We expect a modest 25bps hike in January 2023 by the Fed. That should see the policy rate settle at 4.75% - 5.00% in 1Q23.

- Although the economy for the first two quarters of 2022 reported negative GDP growth based on preceding quarters, the overall full year GDP on annual basis is expected to grow by 2.3% in 2022. Looking into 2023, we project the GDP soften to a mere 0.5%, implying several quarters of negative GDP growth based on quarter-on-quarter. Hence, a stronger dollar should peak in 1Q23.

- Underpinned by a sharp slowdown or even likelihood of heading into a recession, can the Fed continue its rate hike policy even if inflation is high? We feel this will be rather unusual. Continued rate hikes in 2023 is not our cards. Such move risk hitting the economy even harder.

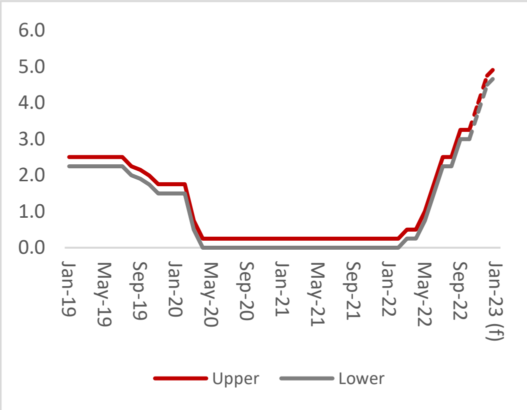
- Our strong dollar view is likely to peak at 116 in 1Q23. Thereafter, the dollar will start to give up its major gains in 2023 moving towards a "cyclical decline as the economy tips into a recession. This would open the door for the Fed to cut interest rates. We are expecting rate cuts to start in 2H23 by about 100bps. On that note, the dollar should start to slide to 112 in 2Q23 and ease all the way to 101 in 4Q23.

Chart 4: UST10/2Y Yield Differentials



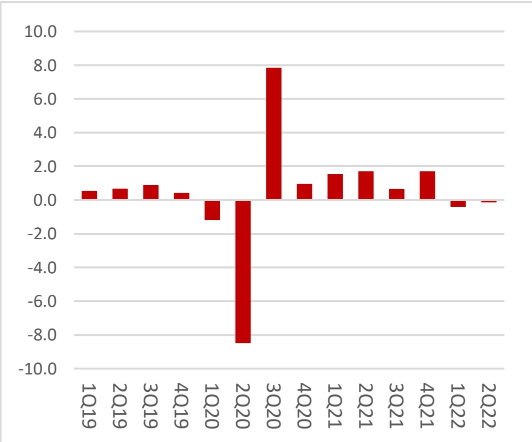
Source: CEIC/AmBank Research

Chart 5: Federal Funds Rate – FFR (%)



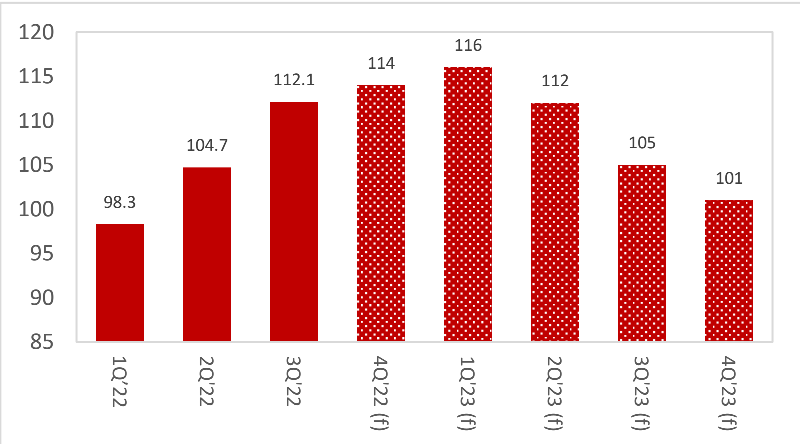
Source: CEIC/AmBank Research

Chart 6: Quarterly GDP s.a. (% q/q)



Source: AmBank Research

Chart 7: DXY Forecasts



Source: AmBank Research

B) Euro

Unlikely for the EURUSD to push above parity until end 1H23

- The ECB has thus far raised 125 bps to reach 1.25%. Expectations are for the ECB to raise another 75 bps to 2.00% in October and 75 bps to 2.75% in November. This would bring the policy rate to 2.75% by end of 2022. Despite their efforts to raise the policy rate, the Fed's fast and aggressive rate hikes in 2022 will continue to put pressure on EURUSD. The currency fell by 12.4% as of 25 October 2022.

- The 2Q GDP reported a strong growth of 0.6% q/q. With energy prices unlikely to be resolved, we expect the GDP in the 3Q to most likely contract. This is further supported by the PMI of Eurozone which has been in the contraction since July 2022.

- And we foresee the euro's 4Q22 GDP to be in negative growth trajectory. How much it will shrink will depend on how best they can withstand the winter after Russia has halted the supply of natural gas through the main pipeline to Europe. The spiked energy prices to soaring levels and heightened fears about a supply crunch.

- We believe the hit to the euro zone economy and rising inflation driven by higher energy prices is so severe that more aggressive monetary tightening from the ECB will do little to stop the euro's slide. And it is unlikely to push the EURUSD above parity in 4Q22. The EURUSD is expected to stay below parity at 0.96 in 4Q22.

- Inflation stress should see the ECB raise rates by 50 bps to 3.25% in February 2023. This should see the policy rate settle at 3.25%. Despite the rate hike, it will do nothing to rescue the EURUSD. We expect the euro to weaken to 0.93 in 1Q23 due to demand destruction caused by the gas crisis that will lead to "a deeper and longer contraction."

- A recession added with geopolitical concerns remains uncontrollable. Also, the overnight interest rate differential between Europe and the US would remain significant at least until 1H23. Although the GDP outlook in 2022 is projected to grow by 2.0% y/y, our forecast for 2023 is contraction by -0.3% y/y, which means first three quarters of 2023 on q/q basis will still report negative growth.

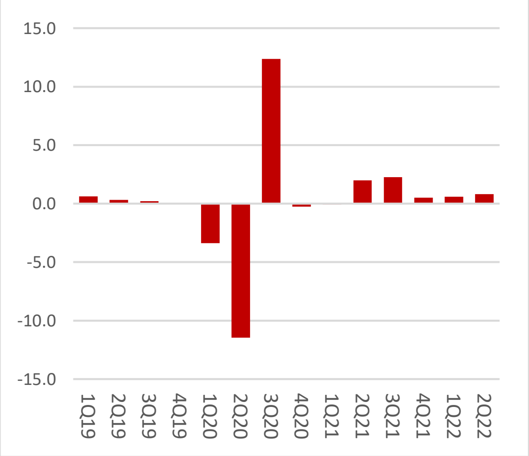
EURUSD to gain strength in 2H23

- But we expect the interest rate differential between Europe and the US to narrow in the 2H23. With sharp slowdown or recession risk in the US, we are of the view of potential rate pullbacks by the Fed in 2H23. With an estimated reduction of 100bps in 2H23, this would mean the interest rates differential would drop from a peak of 1.00 – 1.25% to 0.00 – 0.25%.

Chart 8: EURUSD

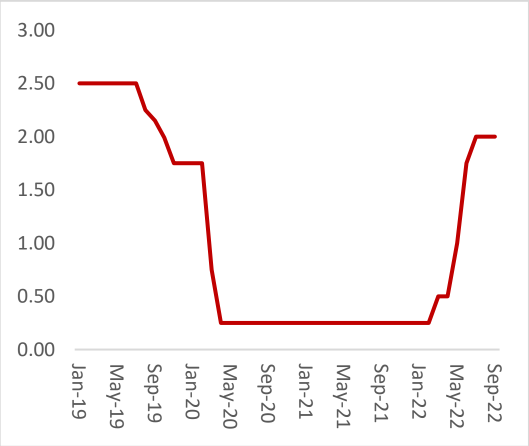
Source: Bloomberg/AmBank Research

Chart 9: Euro Area GDP Quarterly (% q/q)



Source: CEIC/AmBank Research

Chart 10: US Fed & ECB Rate Differentials* (%)

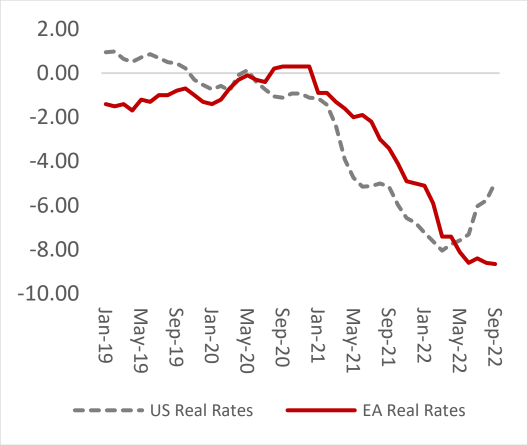


Source: CEIC/AmBank Research
**Note: Rate differentials refer to FFR minus ECB Main Financing Rate*

- Besides, with the help being offered to households in Europe, and rapid moves to diversify away from Russian gas, that should provide some comfort to the real-term interest rate differential. This could provide significant support to EURUSD through the 1H23, as long as we do not see a further material escalation by Russia. A rebound in activity growth from mid-2023 will add support to this trend.

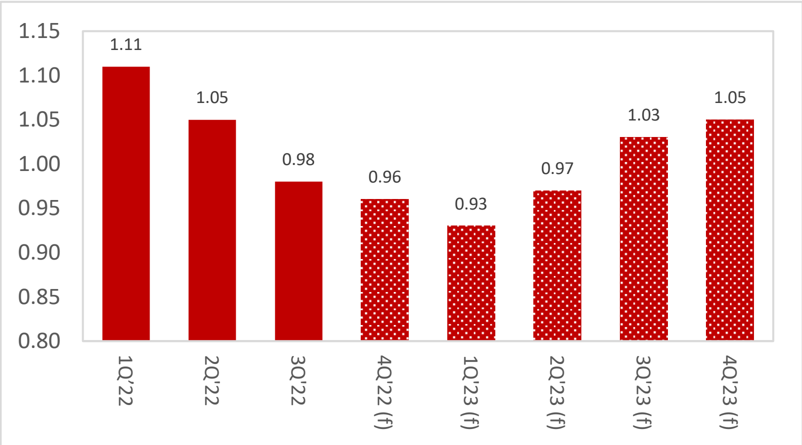
- With the greenback expected to enter into a period of cyclical decline from 2Q23, it would mean the EURUSD should start to strengthen from 2Q23 onwards. But is still expected to remain below parity. And it is only from 3Q23 we foresee the euro to push above the parity.

Chart 11: US & Euro Area Real Rates* (%)



Source: CEIC/AmBank Research
**Note: Real rates refer to key interest rates minus headline inflation y/y growth*

Chart 12: Euro Forecasts



Source: AmBank Research

C) British pound

Pound remains weak without positive news

- The pound fell by 14.9% as of 25 October 2022 against the strong dollar and a major political upheaval. Weakening trend on the pound remains without more positive news. It is despite the Bank of England (BoE) having raised rates by a cumulative 200 bps to reach 2.25% in 2022. The Fed's fast and aggressive rate hikes is putting pressure on GBPUSD.

- Also, the escalating inflation at 10.1% in September, the first double-digit reading in four decades, higher borrowing costs, crippling energy bills, high taxes and a likely recession with no strategy as to how to revive growth will continue hurting the pound.

- The new PM is likely to struggle to craft a plan to rescue the UK from the recession. The Europe's energy crisis will push both the eurozone and UK into recession while the US experiences a milder slowdown. UK may already be in its longer-term limits, no matter what are being said on the campaign trail. That sets up the pound to weaken further against the dollar. Pound could reach 1.08 against the dollar in 4Q22.

Pound could reach parity in 1H23

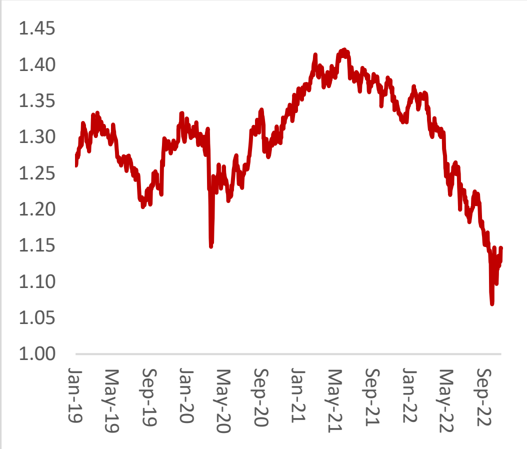
- Possibilities for the pound to get close to the parity in 1H23 is high on our cards. Two major factors that matters for the pound at present are the UK economic growth prospects and broader investor sentiment. For now, neither of these factors are looking supportive and we expect this scenario to likely remain over the coming months.

- We feel BoE's rate hikes will more likely weigh on the pound which is in contrast with the view that an acceleration in rate hikes is supportive of a currency. We believe the surging inflation will ultimately weigh on UK's growth prospects. And for international investors, this is a major concern and potential reason to avoid pound assets. Higher rates are no longer translating to stronger FX.

- In our view, hiking rates in a stagflation environment is not something to cheer for, especially for the currency. If anything, more rate hikes will only accelerate the growth slowdown, a scenario that does not bode well for the currency.

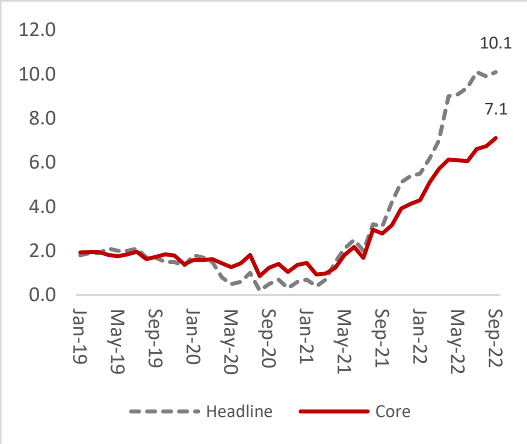
- So, a continued deterioration in the economic growth outlook should keep pound weak. Hence, it could reach parity by 1H2023. If that happens, it would be even lower than levels reached before the Plaza Accord in 1985, when one pound traded at 1.09. That agreement saw France, West Germany, Japan, the UK and US agree to let the dollar depreciate.

Chart 13: GBPUSD



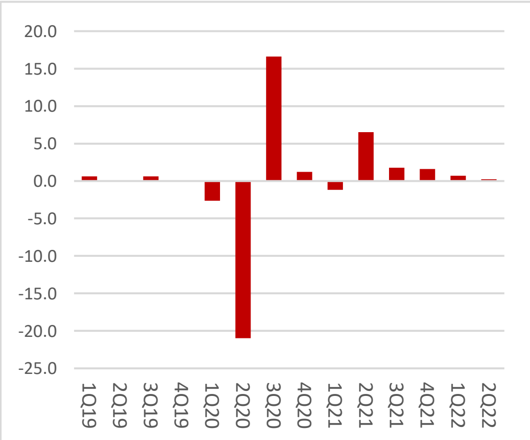
Source: Bloomberg/AmBank Research

Chart 14: UK Inflation (% y/y)



Source: CEIC/AmBank Research

Chart 15: UK GDP Quarterly (% q/q)

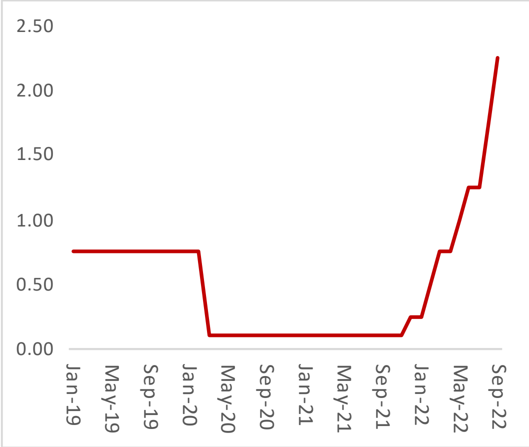


Source: CEIC/AmBank Research

Expect pound to improve in 2H23

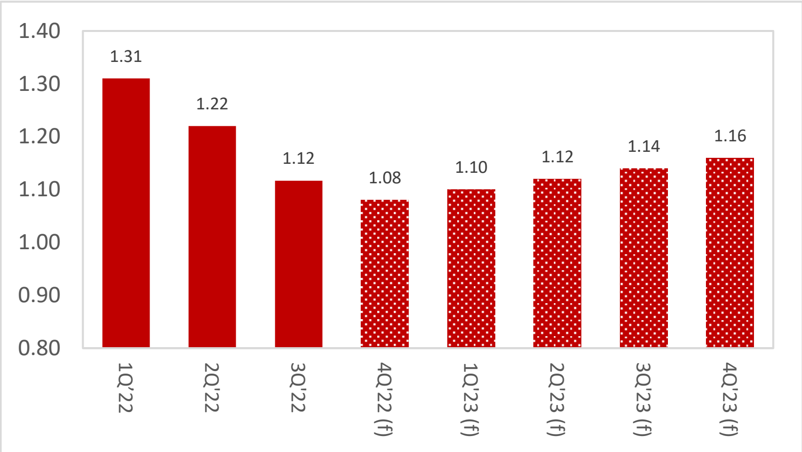
- The current poor economic growth outlook would drive pound to underperform relative to its risk-sensitive peers. Still, we believe there would not be a significant selloff in the pound.
- The new PM will be desperate to revive the economy, especially with a general election likely to be held in less than two years. And should the global market sentiment and UK's economic growth prospects improve over coming months, it would provide a rosier outlook for pound added with the view of dollar weakening in 2023.

Chart 16: BoE's Policy Rate (%)



Source: CEIC/AmBank Research

Chart 17: Pound Forecasts



Source: AmBank Research

D) Malaysian ringgit

USDMYR to remain weak in 4Q22

- Fed's aggressive rate hikes in 2022 with the aim to cool inflation led to a strong upwards bias on ringgit. The currency fell by 13.5% as of 25th October 2022. This is despite BNM raised its policy rates by a cumulative 75 bps to reach 2.50% until October 2022. Expectations are for BNM to raise another 25 bps in November 2022 and another 25bps in January 2023. This will bring the policy rate back to pre-Covid level of 3.00%.

- Ringgit remained weak despite the efforts of stabilising the currency by utilising around US$9.5bn of BNM's reserve.

- The 2Q22 GDP reported a strong growth of 8.9% y/y. And expectations are for the 3Q22 GDP to perform better than 2Q22 GDP, projected to hover around 9% - 10% - supported by strong exports and domestic activities. However, the GDP is projected to grow at slower pace in 4Q22, to around 5.0%. Despite a strong full year GDP of around 7.5% - 8.5%, the ringgit is poised to stay weak due to the "dollar play".

- External headwinds plus domestic noises remain major drawback to the ringgit. Also, the interest rates differentials remain wide, favouring the dollar. We project the USDMYR in 4Q22 would be at 4.70 against the dollar.

USDMYR to peak in 1Q23

- The ringgit has seen its weakest valuation against the dollar i.e., 4.88 on 31st March 1998. Upside pressure on the currency remains which will be coming from both external headwinds and domestic noises. We expect the ringgit to weaken further in 1Q23 to 4.80 against the dollar.

- Going forward, we foresee the interest rate differential between Malaysia and the US to narrow in 2H23. With sharp slowdown or recession risk in the US, we are of the view of potential rate pullbacks by the Fed in 2H23. With an estimated reduction of 100bps in 2H23, this would mean the interest rates differential would drop from a peak of 1.25-1.50% to 0.25-0.50%.

- Besides, the domestic economy would be much settled post GE15. This would mean the positive impacts from the 12th Malaysia Plan, FDIs, DDIs, domestic activities, exports and better management of inflation and Budget 2023 should provide the necessary comfort for the economy to expand around 4.5% in 2023.

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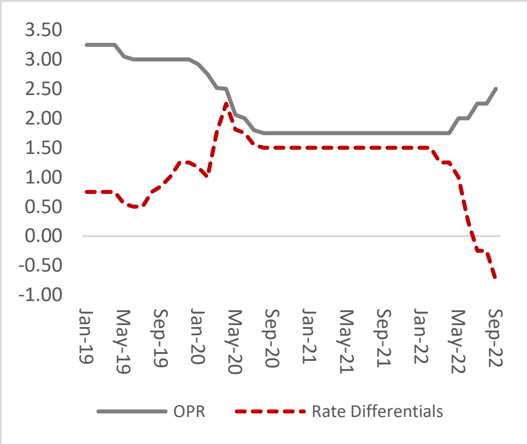
Chart 18: USDMYR

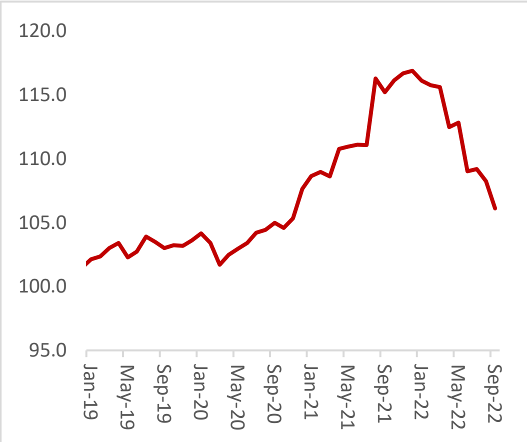
Source: Bloomberg/AmBank Research

Chart 19: BNM OPR & Rate Differentials (%)



Source: CEIC/AmBank Research
**Note: Rate differentials refer to OPR – FFR Upper Bound*

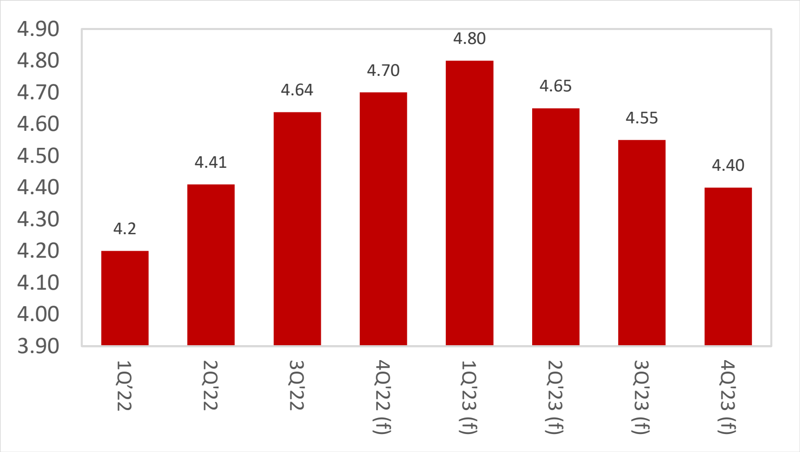
Chart 20: BNM International Reserve (USD'bn)



Source: CEIC/AmBank Research

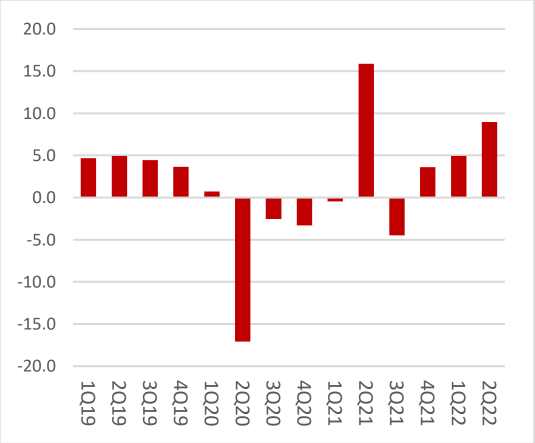
- And with the greenback expected to enter a period of cyclical decline, it would mean the USDMYR should start to strengthen from 2Q23 onwards and settle at 4.40 levels in 4Q23.

Chart 22: Ringgit Forecasts



Source: AmBank Research

Chart 21: Malaysia GDP Quarterly (% y/y)



Source: CEIC/AmBank Research

E) Japanese yen

USDJPY remains top-heavy in near term

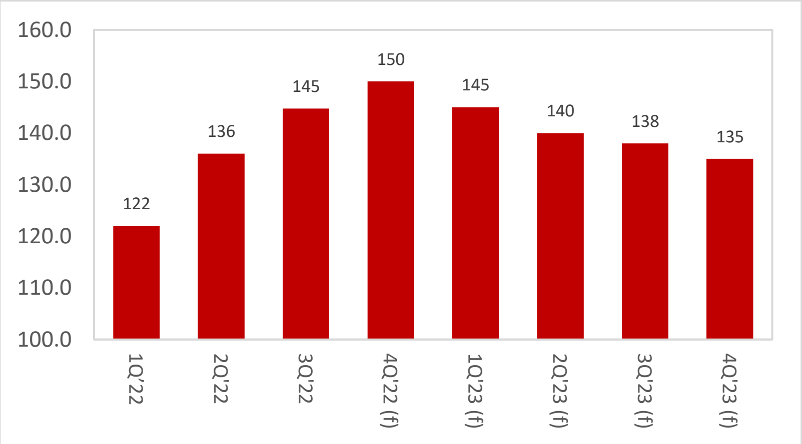
- The yen still has potential to weaken against the dollar in 4Q22. The increasing divergence in monetary policy between a hawkish Fed and dovish BoJ paves way for a still weak yen. This is despite the authorities intervene in FX markets to support the currency.

- Although the Fed and global central banks have more tightening to do while the BoJ does nothing but ease, we suspect such policy divergence will potentially cool off. The Fed should be able to pause after January 2023 rate hike. And the terms of trade shock for Japan should subside in 2023. That should see the yen to start recovering somewhat as the year progresses in 2023.

Chart 23: USDJPY

Source: Bloomberg/AmBank Research

Chart 24: Yen Forecasts



Source: AmBank Research

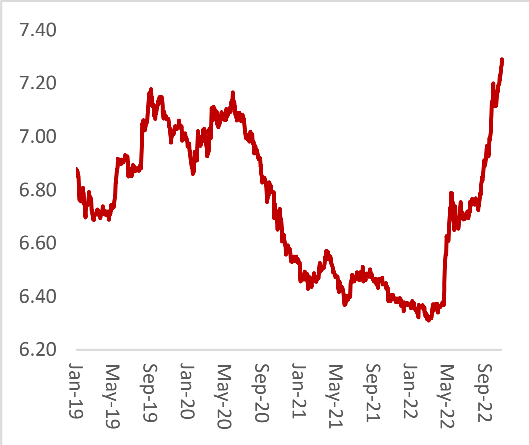
F) Chinese yuan

USDCNY to peak in 1Q23

- The yuan has seen its weakest valuation against the dollar since 2008. Upside pressure on the currency remains. We expect the yuan to remain vulnerable in the short term amid the hiking of Fed interest rates. Suppressed demand from the West will put further pressure on China's export growth engine and the zero-Covid policy plus property crisis will weigh on the economy. The pair should be at 7.30 in 4Q22 and reach a high of 7.35 in 1Q23.

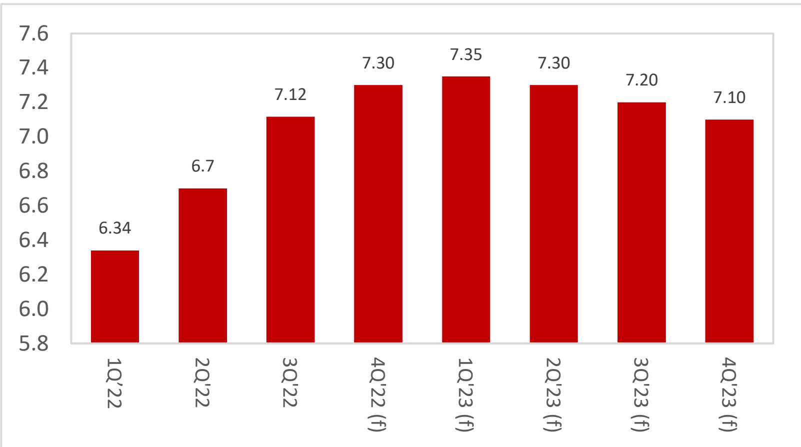
- However, a lot of bad news is already priced in. And therefore, we see limited further upward potential for USD/CNY. Going forward into 2023, with a scope of limited recovery and relief from the Fed's aggressive rate hike policies, the yuan should start to gain momentum. We expect the USDCNY to gain momentum in 2Q23 and appreciate to 7.10 in 4Q23.

Chart 25: USDCNY



Source: Bloomberg/AmBank Research

Chart 26: Yuan Forecasts



Source: AmBank Research

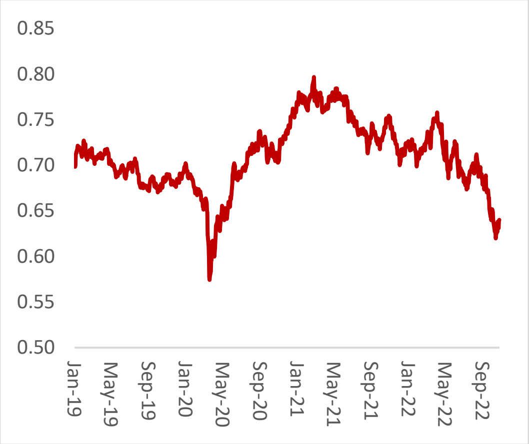
G) Australian dollar

It will take some time for AUDUSD to bounce back

- The AUD is "catching its breath" before it pushes higher. The economy is currently facing headwinds and should improve in 2023 and 2024. But we feel it will take some time for the AUDUSD to bounce back given domestic economic headwinds.

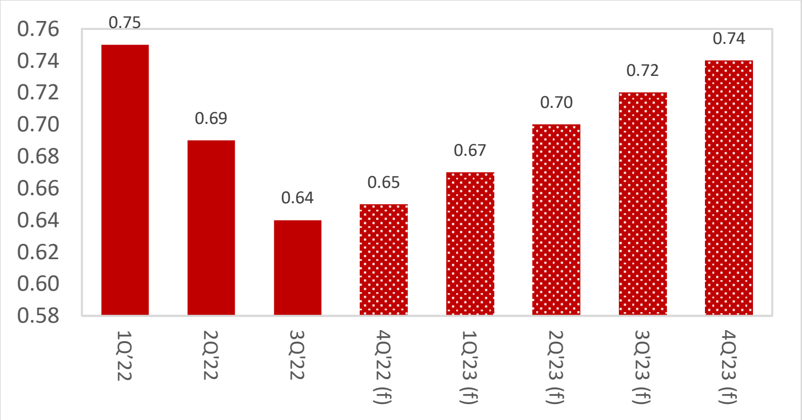
- The economy has faced setbacks from the poor PMI and employment data. Besides, ongoing signs of a Chinese economic slowdown will weigh on the Australian economy. And headwinds should be increasing, as firms and households are having to content with 175 bps of rate hikes from the RBA over just four months and a slower backdrop of global growth.

Chart 27: AUDUSD



Source: Bloomberg/AmBank Research

Chart 28: Australian dollar Forecasts



Source: AmBank Research

Table 1: FX Forecast Table

		1Q'22	2Q'22	3Q'22	4Q'22 (f)	1Q'23 (f)	2Q'23 (f)	3Q'23 (f)	4Q'23 (f)
Against USD	DXY	98.3	104.7	112.1	114	116	112	105	101
	EURUSD	1.11	1.05	0.98	0.96	0.93	0.97	1.03	1.05
	GBPUSD	1.31	1.22	1.12	1.08	1.10	1.12	1.14	1.16
	USDJPY	122	136	145	150	145	140	138	135
	AUDUSD	0.75	0.69	0.64	0.65	0.67	0.70	0.72	0.74
	USDCNY	6.34	6.70	7.12	7.30	7.35	7.30	7.20	7.10
	USDSGD	1.35	1.39	1.44	1.43	1.42	1.41	1.40	1.39
	USDMYR	4.2	4.41	4.64	4.70	4.80	4.65	4.55	4.40
Against MYR	EURMYR	4.67	4.60	4.54	4.51	4.46	4.51	4.69	4.62
	GBPMYR	5.52	5.35	5.20	5.08	5.28	5.21	5.19	5.10
	AUDMYR	3.15	3.04	3.01	3.06	3.22	3.26	3.28	3.26
	JPYMYR	3.45	3.25	3.20	3.13	3.31	3.32	3.30	3.26
	SGDMYR	3.11	3.17	3.24	3.29	3.38	3.30	3.25	3.17
	MYRCNY	1.51	1.52	1.53	1.55	1.53	1.57	1.58	1.61

Source: AmBank Research

AmBank Group

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Group Treasury & Markets

Corporate Client Group (CCG)	**+603-2059 8700/8600**
Institutional Client Group (ICG)	**+603-2059 8690**
Azli Bin Abdul Jamil	azli-abd-jamil@ambankgroup.com
Jacqueline E. Rodrigues	jacqueline-r@ambankgroup.com
Ho Su Farn	ho-su-farn@ambankgroup.com
Melisa Lim Giok Ling	melisa-lim@ambankgroup.com
Roger Yee Chan Chung	

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