MONEX

FX Forecasts

April 2024

AUTHORS

SIMON HARVEY
Head of FX Analysis
+44 (0) 203 650 6472
Simon.Harvey@monexeurope.com

NICK REES
FX Market Analyst
+44 (0) 203 650 3736
Nicholas.Rees@monexeurope.com

MARÍA MARCOS
FX Market Analyst
+34 911 988 460
Maria.Marcos@monexeurope.com

CONTENTS

02
INTRODUCTION

04
FX VIEWS

07
US dollar
Move on up

07
Japanese yen & Chinese yuan
No change in management

08
Singapore dollar
Supported by its peers, for now...

09
Canadian dollar & euro
Postponing the pain

09
Swiss franc
Slow your horses

10
Scandi FX
Next steps hang on the currencies

11
LatAm FX
Keep cuts and carry on

13
FORECASTS

INTRODUCTION

Breaking new ground

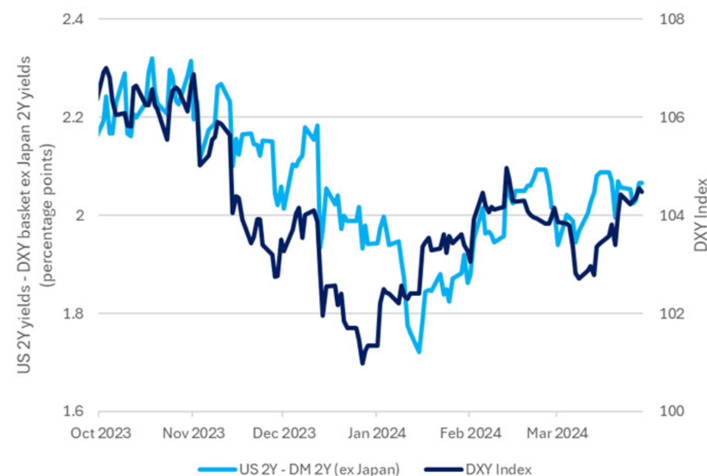
Last month we highlighted the risk that March would see implied and realised volatility in FX markets grind lower as G10 central banks delayed any decision to move on rates until Q2 while improving global growth indicators offset the corresponding recession risk this posed. That said, this wasn't our base case. While markets focused on the delayed and synchronised start date to easing to keep most major currencies range bound in February, a repeat was unlikely in March as some economies were already starting to show the effects of maintaining interest rates at their current peaks. We suspected that this would become even more visible in the economic data released and would ultimately erode the hawkish stance of some DM central banks, who were after all "data dependent". With the US economy continuing to exhibit strong levels of growth, we expected this would result in rate differentials widening once again in favour of the dollar. Nevertheless, we didn't expect the greenback to have a completely clear path higher as growth conditions were starting to converge, albeit only marginally, and the start of the Fed's easing cycle drew closer. As a result, we believed the dollar was "starting the hard yards" of its next leg higher.

In many ways this thesis played out. In the first part of the month, short vol structures dominated as the ECB and BoC delayed any decision to cut until late-Q2, while Chair Powell's projected confidence in his Congressional appearances kept the risk of a further delay in the Fed's easing cycle minimal. However, as the month wore on, markets began to price in greater divergence in DM monetary policy paths despite maintaining a synchronised start date. As we anticipated, this unlocked another round of dollar strength, leading the DXY index to close a third of a percent higher.

> "Stronger inflation pressures in the US saw markets adjust towards a shallower easing profile for the Fed, while weaker cyclical conditions either undermined hawkish guidance from policymakers or led central banks to outrightly pivot in a dovish direction."

In the case of the former, weaker Q4 wage data and another uninspiring round of PMIs suggested the ECB's decision to delay cuts until June would come at the cost of greater eventual easing, while the same outcome was derived for the Bank of Canada as core inflation softened once again in February. By comparison, the Bank of England, Reserve Bank of Australia, Norges Bank and Riksbank used their March meetings to lay the foundations for future easing, while the Swiss National Bank opened the DM easing cycle with a 25bp cut. Even the Bank of Japan, who hiked rates for the first time in 17 years to exit negative territory, sounded dovish as it stressed the need to "maintain accommodative financial conditions". As a result, yield spreads widened once again in favour of the dollar, even as US Treasury yields failed to close the month at year-to-date highs.

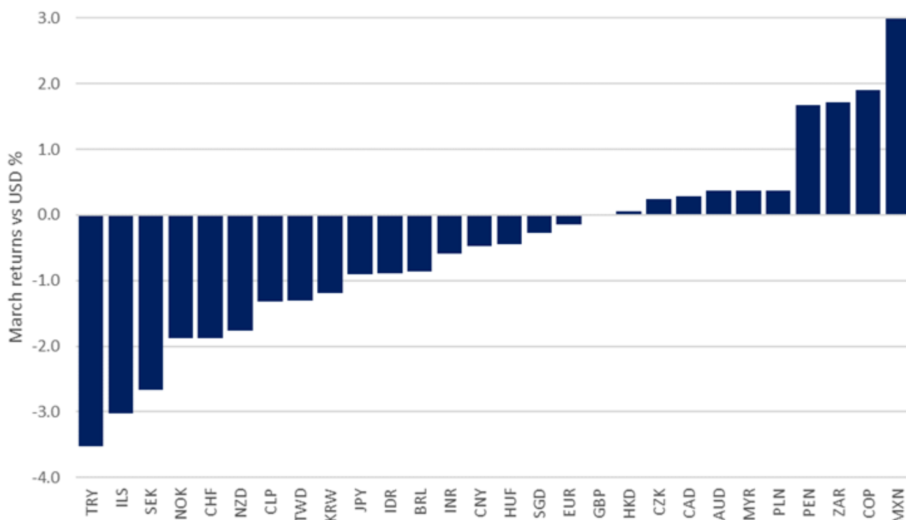
Diverging easing paths supported the dollar's rally in Q1 and should continue to do so in Q2



We suspect April will bring more of the same for markets. The bar to selling the dollar is likely to remain high as the greenback maintains its relative yield advantage, and although there is a risk that slower US growth at the start of the year begins to weigh on inflation and resurrect the prospect of a deeper Fed easing cycle this year, we think markets will be hesitant to jump to this conclusion having incorrectly done so three times now. Even if this is the case, we suspect the rate spreads are unlikely to considerably narrow against the dollar as the faster Fed easing will likely correspond with markets betting on more aggressive cutting cycles from peer central banks. Furthermore, impending election risk and noise around the reimplementation of tariffs is likely to support the dollar too.

In fact, we think improving growth conditions outside of the US poses the largest risk to our moderately bullish dollar forecasts, as opposed to a more dovish trajectory for US rates. On this front, March saw constructive growth data out of China and the eurozone composite PMI suggests growth conditions have improved. That said, we think neither growth uplifts are significant enough to justify a considerable outflow of capital from the US. In Europe, despite the broad euro area PMI reflecting marginal growth as opposed to official forecasts of a stagnation, economic conditions in Germany and France remain concerning. With the ECB also looking to keep rates on hold until June, we remain cautious on the euro area's prospects in spite of the region's equities outperforming on the month. In contrast, data out of China suggests the economy has considerably accelerated from around 5.1% in December to 6.3% currently. Yet concerns around the property sector and authorities' ability to sustain the current growth rate have left investors cautious, as evidenced in the underperformance of Chinese stocks.

The dovish spectrometer is visible across FX returns in March (MTD returns vs USD)



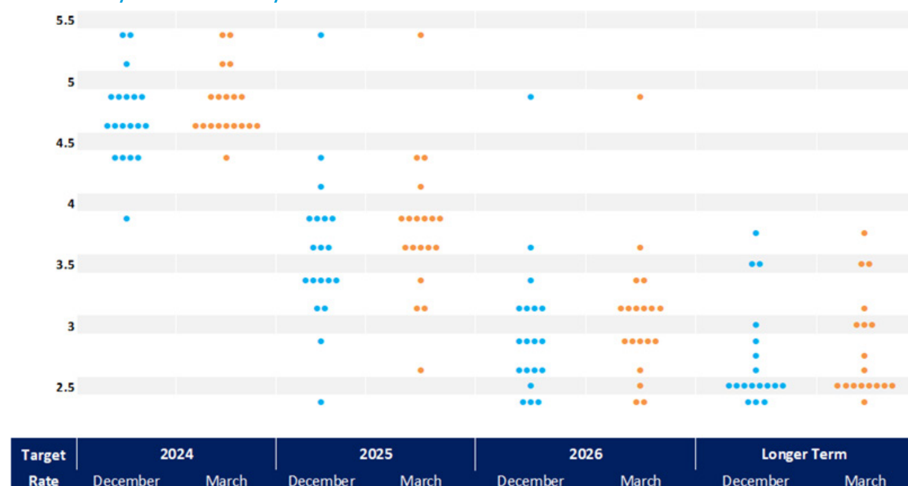
Despite displaying confidence over rate cuts this year, the Fed still stood out as hawkish

Admittedly, with all but one of the G10 central bank's set to deliver policy decisions in March, an expectation that monetary policy would be a focus for markets was hardly a stretch. Even so, we still saw a number of notable developments last month of relevance to FX markets. The most significant of those came from the Fed. The early part of the month saw Chair Powell giving his semi-annual testimony to congress, suggesting that confidence in US disinflation was building. For markets, this was widely seen as an endorsement of earlier policy easing, which triggered a reversal in February's price action and a notable selloff for the dollar. Data through the remainder of the month did little to validate this view, however. While strength in the prior round of releases had been treated with caution due to January effects, it was far harder for markets to ignore the strength seen across the labour market and inflation data for February.

"Even with signs of softening present at the margin, both sets of data suggested that US inflation is set to remain relatively sticky, with the hard yards for the Fed still to come."

This was reflected in the Fed's March meeting, where speculation emerged that the new Summary of Economic Projections could see the median 2024 dot revised up, in effect signalling just two rate cuts would be delivered this year. Ultimately, this did not materialise. The median dot remained in place, indicating three rate cuts expected, albeit only by the narrowest of margins. However, this wasn't as dovish as the market reaction initially suggested. While the 2024 dot remained intact, the updated economic projections saw the rate path upgraded from next year onwards and the skew of projections tilt to the upside, indicating that the neutral rate of interest in the US had structurally risen. Set against a backdrop of G10 central banks laying the groundwork for cuts, the Fed stood out as notably hawkish, an outcome that led the dollar to finish the month marginally higher.

While the median 2024 projection remained unmoved in March, the dots for future years saw upgrades, suggesting that the neutral rate of interest in the US had structurally risen in the eyes of Fed members



Most other DM central banks lent dovish

After three months of policy rates on hold in DM economies, March finally saw some movement with the SNB and BoJ adjusting their monetary stance. The former became the first G10 central bank to cut rates this cycle, delivering a 25bp cut in an attempt to stimulate exports and weaken the franc. In contrast, the BoJ exited yield curve control and hiked rates for the first time in 17 years. But despite pre-announcement optimism across markets that this would be the first rate increase of many, traders were ultimately left disappointed as the accompanying statement and commentary by officials presented dovish guidance, leading us to believe another hike won't be on the cards until Q4. Ultimately, this led both the franc and the yen to weaken last month, with building risks that both respective central banks may now need to intervene in markets to stem further depreciation.

Besides the BoJ and the SNB, all other G10 central banks kept policy unchanged in March, but that wasn't to say those meetings were uneventful. Broadly speaking, all of the remaining decisions leant dovish, albeit for different reasons. At the BoE, the vote split showed no MPC members favoured a rate rise for the first time since November 2021. Accompanied by Governor Bailey declaring every meeting from now on is "in play", this put a May rate cut back on the table, with this having been viewed only as an extreme tail risk prior to the meeting. Whilst the RBA was not quite so aggressive, policymakers still removed their hiking bias. Meanwhile, the Norges Bank, while not so dovish on the surface, still offered some interesting hints that policymakers are not quite as far from cutting rates as previously assumed. Specifically, the bank guided towards a possible September cut, with the prospect of NOK weakness preventing earlier action. Given our view that the krone should outperform the Bank's forecasts, this leaves risks skewed towards an earlier start to easing than traders have currently priced. Moreover, the strength of the currency was also a key consideration in neighbouring Sweden. Policymakers at the Riksbank indulged market speculation over the possibility of a May rate cut, overtly guiding towards a first rate cut taking place in either May or June, with the outcome depending on how the trade-weighted SEK evolves in the coming months.

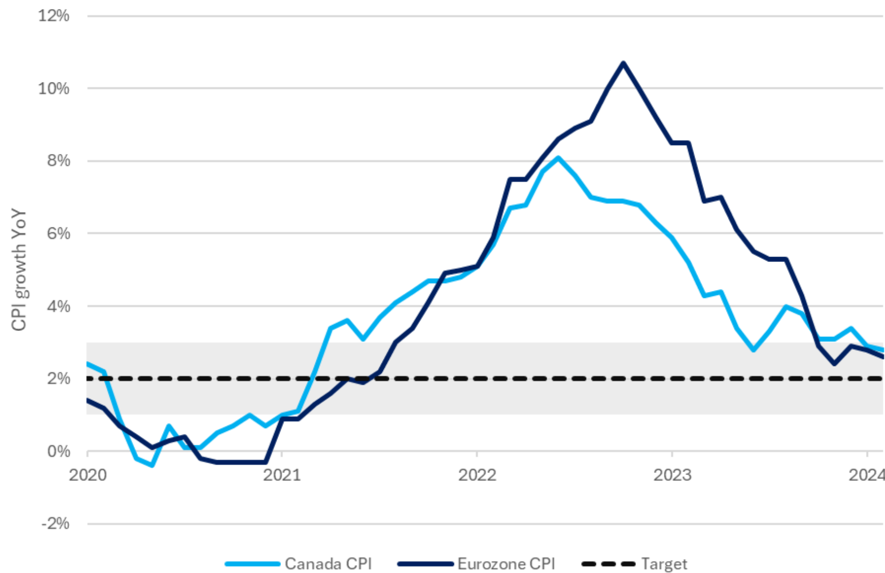
Some rate setters continue to defy the data

Meanwhile, in the eurozone and Canada, the data is beginning to offer a clearer readthrough, even as policymakers continue to pushback on earlier rate cuts. Admittedly, in Europe, inflation surprised marginally to the upside in the February print. But with headline at 2.6% YoY and core at 3.1%, and flash prints for March suggesting disinflation progress resumed, inflation is not at levels where the ECB should be overly concerned. In fact, the focus for policymakers remains on wage dynamics, and here there was some notable good news last month. Q4 labour costs dropped to 3.4% YoY, down from 5.2% in Q3. Whilst this remains above long run averages, we would note that the ECB struggled to achieve 2% inflation at those levels. The most recent reading is now broadly consistent with the ECB's inflation target and suggests that unit labour cost growth is likely to undershoot the ECB's 4.4% projection for 2024. Similarly, flash PMIs are also suggestive that risks to the eurozone economy remain skewed to the downside, with activity failing to expand and companies reporting that they are struggling to pass on higher wage costs to the consumer.

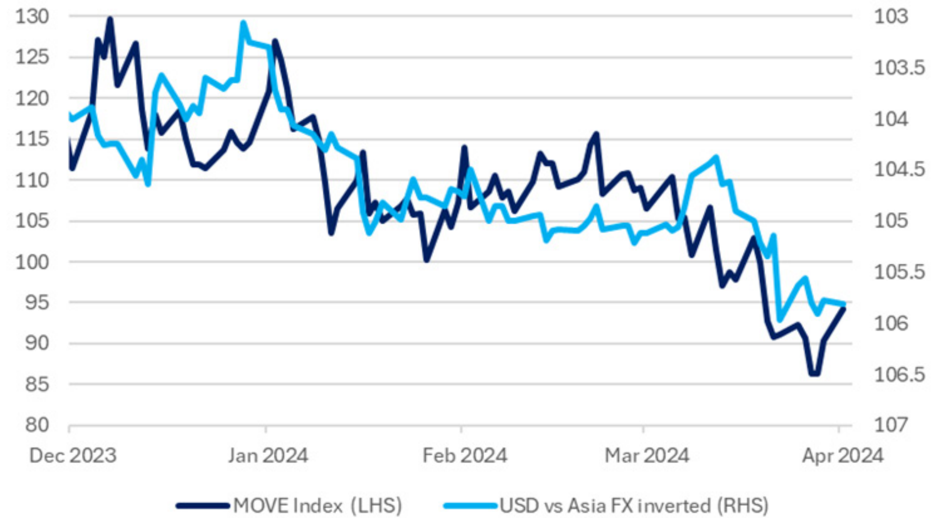
> "Despite this, policymakers continue to lean towards June to begin easing policy, indicating that not enough information will be available this month to be confident of hitting their inflation target. We disagree but expect that overly tight policy will necessitate back to back rate cuts at every subsequent meeting this year."

Perhaps more remarkably, the BoC appeared to move the goalposts in March. Having previously suggested that the direct impact of rate rises on inflation should be disregarded in assessing price pressures, they reversed course last month. We think they got it right the first time, a narrative reinforced by a soft inflation report for February. This delivered downside misses across all major CPI indicators, with headline inflation left tracking at 2.8% YoY. Similar to the ECB however, we now only expect a first rate cut in June in light of this shift. But we also expect that the Governing Council will find soft economic conditions warranting rate cuts at every meeting for the remainder of the year.

Inflation in both the eurozone and Canada is now almost back to target. Combined with indications that future price growth is set to soften further, the continued hawkishness of the ECB and BOC is even more puzzling



While rates volatility rose towards the end of March, this didn't disrupt carry trades, which continue to be funded in Asian currencies



Low yielding FX left under pressure

With the Fed's projected rate path for this year barely moving on the latest rounds of hot data, rates volatility continued to plummet, as measured by the MOVE index. This, alongside the market focusing firmly on the shallower overall profile of the Fed's easing cycle, meant conditions remained conducive for carry trades. March was therefore another painful month for the carry trade funders. This was particularly pronounced across Asian FX as speculation arose that quasi-pegs in the Japanese yen and the Chinese yuan could eventually break in favour of further depreciation. If this were to occur, it would likely result in broader weakness in Asian FX as policymakers across the region would be forced to allow greater FX depreciation to retain export competitiveness. While policymakers in China and Japan continued to defend their currencies into month-end, pricing in the options space show traders are beginning to brace for more volatility in the region in the months before the Fed's first rate cut – a scenario we warned of in mid-March (see here).

What about the receivers?

March was generally a constructive month for EM high yielders, even as markets fretted over a higher neutral rate in the US and, with Banxico's decision to cut, all central banks in Latin America are now easing policy. With the carry trade still in focus, MXN and COP ranked as the top two best performing currencies in March, driven in part by less dovish central bank decisions than initially feared. In the case of Banxico, while they cut rates against our expectations, policymakers gave little indication that this was the first cut in a series, leaving the outcome as hawkish for markets. While the same can be said for the Brazilian real too, with the central bank adjusting their guidance to suggest May's meeting may see rates cut by 50bps for the last time this cycle, the currency found itself in the middle of the expanded majors in March, down just over a percent against the dollar. This was primarily a result of fiscal policy, however. Concerns over the government's pledge to stimulate growth, potentially at the cost of its deficit rules or the central bank's autonomy, led the real to underperform its high yielding peers.

In contrast, inflation pressures continued to look soft in Eastern Europe, leading the region's currencies to trade under pressure. While in the case of CZK and HUF, rate cuts were the main anchor acting as a drag, the decisions by both respective central banks weren't as dovish as some had feared, rendering their currencies to trade flat. The NBP's decision to hold rates didn't necessarily strengthen the zloty by comparison, as rhetoric once again swung towards rate cuts this year. Although recent hostilities between the central bank and the government leave us cautious on the zloty against the euro and the dollar, higher relative rates should see PLN outperform its peers within the CE3 region.

Hedging the tail risks

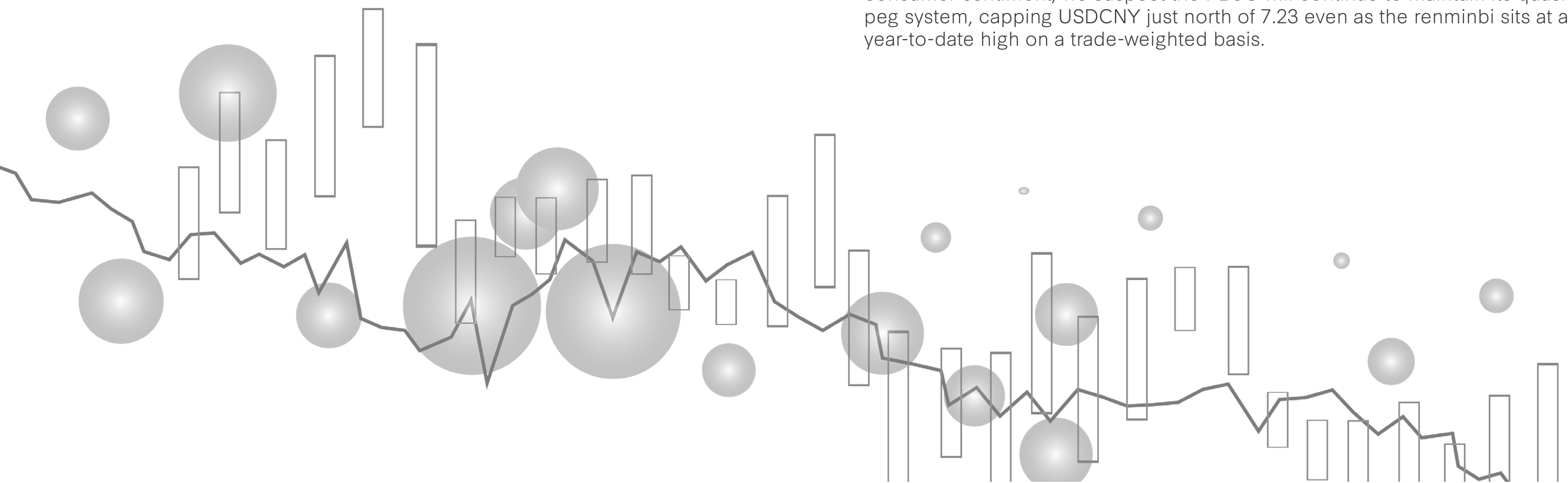
Looking ahead to Q2, we think some of the dominant themes of the past quarter are going to become more pertinent for markets, leading to an uptick in implied volatility and ranges across most dollar pairs to widen. Underpinning this should be data supporting increasingly divergent paths for monetary authorities, both on the timing and magnitude of policy easing. Traders will also have to contend with the increasing prominence of the November US election, the possibility of trade wars reigniting, and the decision by Asian central bankers to either shift their stance on currency depreciation or resume actively intervening. Moreover, the risk of recession should come back into scope concurrently with the risk of inflation persistence and higher for longer rates. Ultimately, we think the current low volatility environment is unsustainable given the aforementioned risks, but also one that offers a window to hedge the growing tail risks.

Picking up the pace of divergence

Whilst our prediction for policy divergence began to play out in the first quarter, we expect it will become more pronounced in Q2, fuelling further dollar appreciation. In particular, we think markets are grossly mispricing the easing paths for the BoC and the ECB as traders place too much value on the official forward guidance. As the data continues to show weak growth conditions filtering through into inflation measures, rates in these regions should begin to reflect the cyclical weaknesses we have long warned of. Against a backdrop that is supportive of a more cautious Fed, this should lead EUR and CAD to plumb fresh year-to-date lows against the dollar.

Meanwhile, markets are also likely to get a further steer on rate hikes from the BoJ, with the full outcome of the Shunto wage negotiations set to be published in April. Should the data show negotiated wages in the services sector match the preliminary readings thus far, we suspect the BoJ could begin to sound more hawkish, especially if policymakers choose to step up support for the yen. At present, we don't expect the BoJ to hike again until October such that they can assess the functionality of the bond market as well as the feedback of wage pressures into domestic inflation. However, this could be brought forward, depending on what transpires this month.

The tolerance of monetary authorities in Asia to further FX depreciation remains the biggest unknown for markets entering Q2. Similar to the BoJ, the People's Bank of China is also facing significant depreciation pressures after USDCNY broke through the 7.20 ceiling in late March. While an argument can be made in favour of PBoC shifting to a managed depreciation regime should the BoJ also relinquish control on the yen, we believe the risk of this is minimal given capital outflow pressures remain elevated. Thus, in order to support investor and consumer sentiment, we suspect the PBoC will continue to maintain its quasi-peg system, capping USDCNY just north of 7.23 even as the renminbi sits at a year-to-date high on a trade-weighted basis.



FX VIEWS

USD

Move on up

The dollar index rose 3% in the first quarter, with the rally driven primarily by markets pricing out rate cuts from the Fed this year, as we warned in our 2024 outlook. Nevertheless, the dollar's gains were restricted by two factors; currency management by Asian policymakers, and limited divergence in global rates as expectations of rate cuts from other DM central banks were also delayed until late-Q2. While we suspect policymakers in Asia are unlikely to allow further depreciation in their currencies due to the risk of amplifying capital outflow pressures, divergence in central bank easing paths should become more prominent in the second quarter. With US growth solid and inflation proving persistent in the 2-3% range, the Fed is in "no rush to adjust", as coined by Governor Waller. By comparison, disinflation outlooks in other G10 economies (ex Japan) are more supportive of successive rate cuts this year, with the case for cuts at each meeting in 2H24 the clearest in Canada and the eurozone in our view. However, as we highlighted in our March forecasts, we suspect the path higher for the dollar will be more challenging from here. Active currency management by Asian central banks and the hawkish impact further currency weakness will have on some European central banks (SNB, Norges Bank, Riksbank), suggests much of the dollar's upside will be channelled through EUR and CAD, but here, markets have already shown a reluctance to re-test year-to-date lows on the back of improving global growth data.

"Without the improvement in the global growth outlook stalling in Q2 or the risk of recession increasing outright in either the eurozone or Canada, we suspect upside in the dollar will be limited by the stable backdrop for risk."

While our mildly bullish dollar view is conditioned on the Fed's relative hawkishness, it isn't necessarily dependent on the Fed delaying any decision to cut until Q3. Should it do so in June, as per our base case, it will likely be delivered in a distinctly hawkish manner, leaving the bar for further rate cuts elevated, supporting wider rate differentials and providing a floor under the dollar. In fact, improving growth conditions outside of the US pose the largest risk to our bullish dollar call. March saw growth conditions marginally improve in China and the eurozone, with equity performance in the latter beating that of US indices. If sustained, portfolio allocation out of the US could trigger sustained USD depreciation. However, for this to trigger meaningful downside in the dollar, the improvement in growth conditions would need to coincide with narrowing rate differentials in order to prompt a rotation from yield to relative value. At present, this remains a nascent risk.

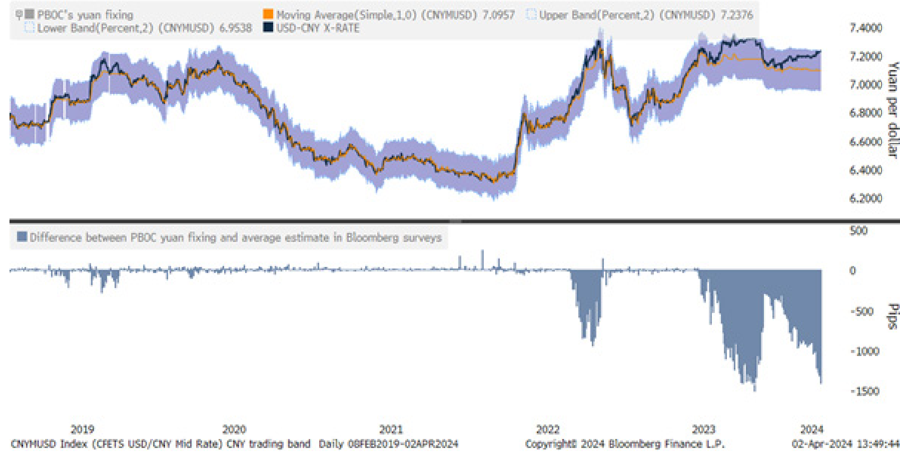
JPY and CNY

No change in management

The Japanese yen and Chinese yuan have been under heavy management year-to-date, and while there are reasons to suggest policymakers may soon pivot away from hard caps on the currency pairs towards a regime of managed depreciation, we remain sceptical of such action due to the risks it poses on inflating capital outflow pressures. Turning first to the yen, while the pace of depreciation is significantly slower than previous periods that triggered the threat of intervention, officials seem acutely aware of benefit of "topping up" previous intervention efforts and the risk that failing to do so could spark a rapid 2% sell-off in the yen, taking USDJPY up to 155. As a result, officials have been aggressive with their verbal interventions when USDJPY trades shy of 152, with the intention of changing the calculus for JPY shorts. Thus far, the rhetoric has proven successful, although we think there remains plenty of fundamental challenges in the coming months under an outlook for higher for longer US rates. More likely than not, to prevent USDJPY from jumping up to 155, officials will need to directly intervene in the coming months, and with liquid dollar reserves of around $175bn, there is capacity to conduct similar interventions to that seen in late-2022 (~$40bn). However, we doubt this will be sufficient to turn the tide for USDJPY in Q2, especially as we don't expect the BoJ to raise rates until early Q4, and for the Fed to have only conducted minimal rate cuts by that point. Accordingly, we expect USDJPY trading in tight ranges over the coming 3-months and have raised our forecast slightly to 152 to reflect this.

On the contrary, with the trade-weighted renminbi tracking at fresh one-year highs on a nominal basis just as domestic growth conditions begin to improve, there is a stronger rationale for the central bank to allow USDCNY to track back to the 7.30 handle, which was an anchor point for the pair from mid-August to mid-November last year. While managed depreciation of the yuan would assist China's exports and support growth, we think the central bank is unlikely to change tack due to the damaging impact this could have on sentiment around Chinese assets at a time when capital outflow pressures remain elevated, exports are cost competitive on a real basis, and concerns are emerging over the potential amplification of Sino-American tensions. Accordingly, we expect the PBoC to continue buffering depreciation pressures from higher US rates, prioritising stability in the yuan to support investor and consumer confidence. This has become increasingly visible since USDCNY broke above 7.20, with the PBoC widening the countercylical factor to fresh year-to-date highs. With the root cause of yuan's decline unlikely to be addressed until Q3 at the earliest, we expect volatility in USDCNY to flatline once again as it trades at the upper end of its daily range. We have raised our one-month and three-month forecast to 7.2 to reflect this.

The PBoC's increasing use of the countercylical factor suggests they aren't moving towards managed depreciation any time soon



The trade-weighted yuan sits close to a year-to-date high, an outcome that could cause the PBoC to rethink its yuan policy if the trend higher continues

That said, risks remain tilted towards further depreciation in the region, most likely triggered by a change in tolerance from Japanese policymakers. By our estimates, with inflation steady in the 2-3% range, a rally in US 10-year yields above 4.5% should be enough to widen real rate differentials to the extent that markets test the resolve of Japanese policymakers, especially if this coincides with stronger inflation pressures in Japan. While not our base case, there is a risk that officials at the Ministry of Finance and the Bank of Japan concede to this pressure having stressed the importance of the pace of depreciation as opposed to the level of the yen. Should USDJPY climb to 155, peer Asian currencies are likely to appreciate on a trade-weighted basis. With this undermining the competitiveness of exports, it will likely lead policymakers in the region to allow further depreciation of their own currencies, with this most likely if the move higher in USDJPY prompts the PBoC to gradually set the daily USDCNY fixing higher over the course of Q2.

SGD

Supported by its peers, for now...

The environment of higher for longer US rates has exerted renewed pressure on USDSGD, which towards the end of Q1 broke through the 1.35 handle that we deemed a near-term top in the pair, after USDCNY broke fresh year-to-date highs. While our expectation of rangebound trading in USDJPY and USDCNY over the course of Q2 suggests upside in USDSGD should remain limited from here, especially as MAS are likely to retain their tightening bias in Q2 following an uptick in inflation in February, risks are increasingly tilted towards a continuation in the USDSGD rally given that the possibility of synchronised depreciation in EUR, JPY, and CNY has meaningfully risen. With those three currencies alone accounting for roughly 50% of the S$NEER basket, there is potential for USDSGD to rally back to 1.37, with the MAS maintaining a

restrictive policy stance. However, under our base case of rangebound trading in USDJPY and USDCNY, only moderate depreciation in EURUSD, and the MAS maintaining its appreciation bias of around 2% per annum, we expect trading in USDSGD to be constrained to a small range around the 1.35 handle over the course of Q2.

The MAS's tightening stance should support USDSGD from breaking above 1.35 unless there is synchronised depreciation in Singapore's major trading partners

EUR & CAD

Postponing the pain

As noted prior, both the BoC and ECB stood out amongst G10 central banks last month. Despite data suggesting that policy easing should be imminent in the eurozone and Canada, policymakers instead used their respective March meetings to steer towards a later start to rate cuts. This led us to push back our expectations for the start of policy easing to June for both Banks, leaving both the euro and the loonie to outperform our near-term forecasts last month. That said, our underlying thesis for growing rate differentials to weigh on both currencies remains intact, suggesting that this is likely a story of delayed rather than avoided pain for both currencies.

The extent to which this downside plays out in April hangs in part on another round of central bank meetings. Given that there remains a residual risk that one or both the BoC and ECB cut rates this month, simply maintaining rates at current levels would offer a small upside boost to the respective currencies when taken in isolation. However, we doubt this will result in either currency appreciating in a meaningful and durable manner, as both decisions to hold will likely be accompanied with dovish forward guidance, which in turn will be validated by data showing continued cyclical weakness. A recognition from policymakers this month that inflation has largely disappeared, growth is non-existent, and slack continues to grow in both economies should prompt markets to accelerate easing bets post-June. With the Fed moving in the opposite direction in light of US economic resilience, rate differentials should widen further despite the decisions to hold in April, weighing on the loonie and the euro as a result.That said, if both the ECB and the BoC do steer hawkish and choose to ignore the broad economic softening to date, this could offer temporary support for both currencies, as was the case in Q1. Nevertheless, this path is narrowing as further weak data prints raises the risk markets start to second guess policymakers and de-anchor the implied easing paths for the ECB and BoC from the Fed's, meaning rate spreads are likely to widen irrespective of policymakers' guidance.

"All told, while we see risks this month as skewed towards further downside for both the loonie and the euro, this is not a certainty."

Where we are more confident is that this will have to play out over Q2 at some point, with both currencies and central banks unable to defy the laws of economic gravity forever. Depending on the extent to which the data deteriorates beneath the central banks' feet, we estimate USDCAD could rise as high as 1.38-1.40, while EURUSD could similarly drop to the 1.05s.

CHF

Slow your horses

While the SNB became the first G10 central bank to cut rates in this cycle, lowering the policy rate 25bps last month, we think EURCHF price action following the March meeting is instructive for the franc's prospects. Despite selling off sharply, and threatening to break above 0.98 in the aftermath of last month's meeting, EURCHF ended March trading just above the 0.97 handle, in line with our March forecasts. To us this reflects the likely range for the franc over the short term. As we noted following the March policy meeting, the franc should continue to underperform given lower rates and the SNB's revealed intolerance towards further CHF appreciation. That said, with the SNB having cut rates early, inflation readings for Q2 are now more likely to overshoot the Bank's projections than undershoot them. This makes future decisions to ease less clear cut than for central banks elsewhere. It also means that further CHF depreciation from this point is likely capped by a prospect that it results in the SNB holding rates. All told, we expect this dynamic to see EURCHF trade in a tight range through the next quarter, with a price target of 0.98 for the end of Q2.

"Longer term, however, we suspect that last month's decision removes some downside risks for the franc."

The pragmatic approach taken by policymakers in moving early also suggests that the SNB's terminal rate is likely to be higher than anticipated. This should further stymy CHF weakness as the eurozone economy recovers in the second half of the year, as should the SNB's slower pace of easing. As such, while we still look for a slow grind higher towards EURCHF parity by the end of 2024 as Switzerland's haven bid fades, risks of a substantial break higher for the cross now scan as increasingly unlikely.

Scandi FX

Next steps hang on the currencies

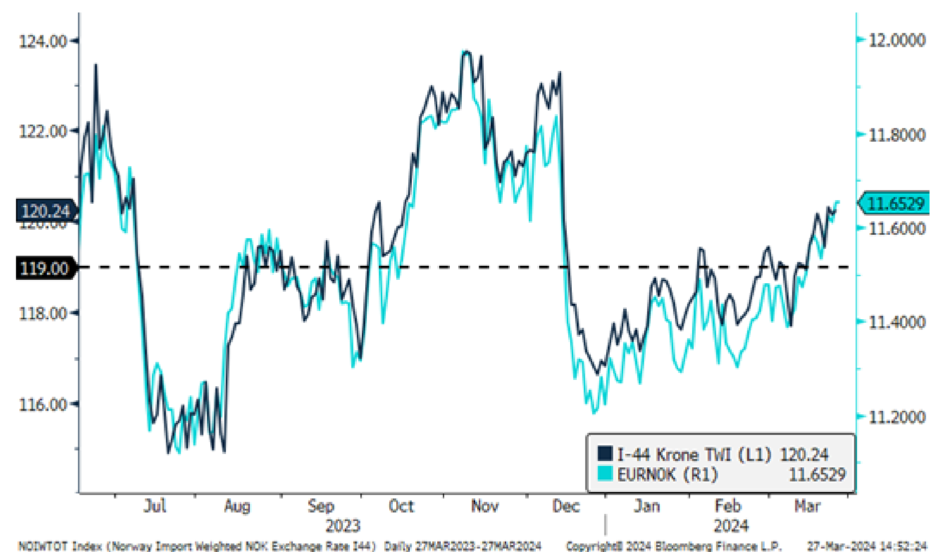
Last month saw both the Norges Bank and Riksbank pin their easing paths to the strength of their respective currencies. In the case of the former, this saw Norwegian policymakers steer hawkish on an assumption that the current bout of krone weakness persists. The Riksbank meanwhile sounded dovish, suggesting that SEK appreciation could see them ease as soon as May. We think both Banks are likely to find that currency developments do not quite meet their expectations, and will likely result in earlier cuts in Norway and a delay in easing in Sweden. That said, only the second of these is likely to be of concern for markets this month, which we suspect will prevent SEK from appreciating to the same degree as NOK as traders begin to factor in a deeper ECB easing cycle. All told, we expect EURSEK to stabilise around the 11.4 level by the end of April, while NOK should reverse last month's sell-off in light of valuations that continue to scan as cheap. Further out, improving growth conditions should prove supportive for Scandi FX as rates ease, meaning that long run appreciation for both NOK and SEK remains our base case against the euro over a twelve month horizon.

"Admittedly, the krone did underperform our expectations in March, with EURNOK finishing 2.6% above our one-month forecast."

This, however, fails to reflect the solid fundamentals underpinning the Norwegian economy. Both headline and core inflation undershot expectations and are now running at 4.5% and 4.9% YoY respectively. Yet despite this, the Norges Bank continues to sound hawkish, and is likely to be amongst the last G10 central banks to begin easing policy. Moreover, growth continues to hold up in contrast to elsewhere in Europe, as does the labour market, pointing to an environment that should have been NOK supportive. We expect NOK to strengthen to better reflect these fundamentals, starting this month. While this would imply a stronger currency than the Norges Bank expects, ultimately prompting a rate cut in August, this is unlikely to weigh on the krone in the short term, a fact that we expect to leave NOK free to appreciate unimpeded in April.

In contrast, we expect the Swedish krona to remain rangebound over the short term. Significantly, accelerating market bets on a May rate cut, which currently stand at roughly 70%, saw a notable weakening in the krona through March. But given that Riksbank inflation forecasts are based on the krona strengthening, the latest price action in the krona weighs strongly against easing policy next month. We expect this to be progressively reflected in market pricing in April, which should guide EURSEK back down towards the 11.4 level. We do not, however, expect a sustained break to the downside for the cross given that such a reaction would reignite the risk of the Riksbank cutting in May, a dynamic that would subsequently weaken the currency. This self-fulfilling dynamic should keep EURSEK contained in the short-term, before the Riksbank ultimately gets the green light from the ECB to cut rates without triggering an undue response in FX markets.

Norges Bank staff project the I-44 index between 118.8-119.0 through the remainder of 2024. We expect the krone to perform better than this, supporting an earlier start to rate cuts than the MPC currently envisages



LatAm FX

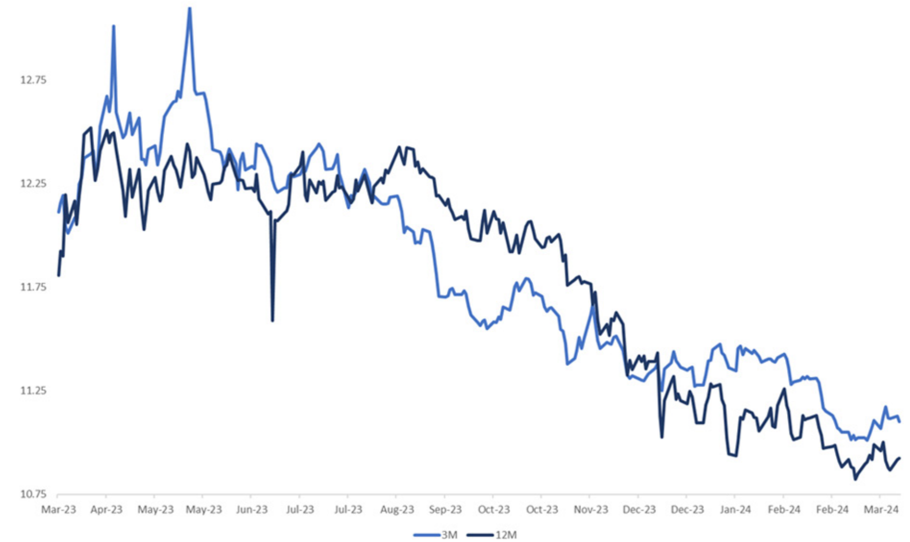
Keep cuts and carry on

Banxico joined the BCB in easing its policy rate in March, but despite both central banks now cutting, this wasn't too disruptive for their respective currencies and the overall carry trade, largely because both central banks had delivered them in a hawkish manner. In the case of Banxico, by changing its forward guidance in the statement to a more general stance of data dependency, policymakers relayed that they aren't yet comfortable in starting a period of sustained easing. This message was reiterated through the voting split, which no longer showed unanimity within the Board of Governors for the first time in twelve months. At the last meeting, Deputy Governor Irene Espinosa voted to keep the interest rate at 11.25%. In our view, this is primarily because some upside risks still prevail, such as the lack of progress on core inflation or even the risk that markets interpreted the decision to cut as the start of a sustained easing cycle, risking an overeasing in financial conditions. In the case of the BCB, its more hawkish stance has come from a shift in forward guidance from anticipating cuts of the same magnitude, plural, to anticipating "a reduction of the same magnitude at the next meeting", singular. Moreover, the tone throughout the statement was consistently tightened with respect to the February meeting, removing any mention of headline inflation being close to the inflation target and emphasising that several measures of core inflation are still above target.

"Taken together, the tone from March's meetings were suggestive that the current pace of monetary easing is not ensured."

In Mexico, we doubt Banxico will be able to continuously cut rates until the second half of the year due to upside inflation pressures, something that was evident in its revision of the inflation outlook for the end of the year from 3.5% to 3.6%. In addition, successive rate cuts would run the risk of financial conditions materially loosening, leading to a reacceleration of the economy at a time when services inflation remains high and the labour market is tight. Meanwhile in Brazil, while the BCB has maintained the pace of its easing cycle in the first quarter of 2024, the risks of a tight labour market, persistent services inflation, expansionary fiscal policy, and the limited scope to lower rates before they hit estimates of neutral validate the BCB's "calls for caution". In fact, we think there is a tail risk that the central bank reneges on its forward guidance and cuts by 25bps in May, should the government ease fiscal policy considerably in the interim.

More stable implied yields in MXN suggests Banxico isn't about to conduct an aggressive easing cycle



As a result, carry levels for both currencies appear to have remained broadly intact after both meetings. While carry positioning is unlikely to increase as easing cycles are underway, we believe that low market volatility should keep attention firmly on receiving yield from these popular carry trades. This should support both USDMXN and USDBRL around current levels.

That said, the degree to which this will be positive for both currencies will depend largely on some idiosyncratic risks, such as fiscal developments in the case of Brazil and the outcome of the presidential elections in Mexico. As for the former, now that the Lula government is trying to boost growth through expansionary spending measures, there is a credible risk that the more hawkish BCB stance will provoke a new public confrontation with government officials which, as 2023 demonstrated, is viewed negatively among currency markets.

Although the latest tax revenue data showed the largest windfall at BRL280bn in January since records began in 1995, the prospect that expansionary fiscal policy may not result in the zero primary deficit rule being breached may not be enough to calm markets. First, it should not be forgotten that part of this

improved fiscal performance in Brazil is cyclical and supplemented by the nonrecurring income tax resulting from the measures approved last year. Second, there is a risk that the latest revenue windfall leads to increased spending, which in the current environment could prove highly inflationary. Additionally, there is the possibility that President Lula da Silva's plans may go further. In particular, investors are increasingly concerned about indications that Lula wants more state-controlled companies to help boost economic growth which, given the recent experiences of Petrobras and Vale SA, may weigh heavily on the BRL.

As for Mexico's election, while it seems that the start of the election campaign is not generating enough political noise to deter traders from picking up MXN's higher carry, the decisive moment will probably come after the elections. With the consensus pointing towards a likely continuation of Andrés Manuel López Obrador's legacy for the next six years, with Claudia Sheinbaum as President, we believe that one of the great challenges for the next administration will undoubtedly be the composition of Congress, not just to ensure the majority required for any fiscal reform proposal, but also to ensure the correct counterbalancing mechanisms in the lower house at the same time.

"While we remain bullish on LatAm high yielders into Q2, despite noting the pronounced downside risks, we expect this strength to wane throughout the year."

Increased market volatility from adjusting policy rates, coupled with concerns over the US election and the reimplementation of trade barriers, should impact the attractiveness of carry trades as a whole. Furthermore, rate differentials between the US and Latin America should compress further, with the Fed having acknowledged in the latest update of its dot plot that risks to rates over the medium-term are tilted to the upside.

Forecasts

Currency Pair	1-month (30th April 2024)	3-month (30th June 2024)	6-month (30th September 2024)	12-month (31st March 2025)
G10				
EUR/USD	1.07	1.05	1.08	1.12
USD/JPY	152	152	145	138
GBP/USD	1.25	1.25	1.28	1.32
USD/CHF	0.91	0.93	0.91	0.89
USD/CAD	1.37	1.38	1.36	1.32
AUD/USD	0.66	0.66	0.68	0.70
NZD/USD	0.61	0.61	0.62	0.64
USD/SEK	10.7	10.9	10.2	9.6
USD/NOK	10.7	10.7	9.9	9.5
DXY	105.35	106.75	103.54	99.79
Emerging Markets				
USD/CNY	7.2	7.2	7.0	6.8
USD/INR	83	83	82	80
USD/SGD	1.35	1.35	1.30	1.28
USD/ZAR	19	19	18	17
USD/TRY	33.0	34.0	33.0	30.0
USD/PLN	4.02	4.10	3.89	3.75
USD/HUF	374	381	352	321
USD/CZK	24.1	24.8	23.3	22.0
USD/BRL	5.0	5.0	5.1	5.2
USD/MXN	16.5	17.0	17.1	17.0
Euro Crosses				
EUR/GBP	0.86	0.84	0.84	0.85
GBP/EUR	1.17	1.19	1.19	1.18
EUR/CHF	0.975	0.98	0.98	1.00
EUR/CAD	1.47	1.45	1.47	1.48
EUR/SEK	11.4	11.4	11.0	10.8
EUR/NOK	11.4	11.2	10.7	10.6
EUR/TRY	35.3	35.7	35.6	33.6
EUR/PLN	4.3	4.3	4.2	4.2
EUR/HUF	400	400	380	360
EUR/CZK	25.75	26	25.2	24.6
EUR/BRL	5.35	5.25	5.51	5.82
EUR/MXN	17.7	17.9	18.5	19.0

General disclosure

This material, including, any statistical information, is provided for informational purposes only. It does not constitute advice and you should seek independent advice if necessary.

The material is based upon information which we consider reliable, but may not be accurate or complete, and therefore should not be relied upon. Any estimates and forward-looking statements, or forecasts do not represent a guarantee of future performance. Reliance upon information in this material is at the sole discretion of the reader. No permission is granted to reprint, sell, copy, distribute, or modify this material, in any form or by any means except with the written permission of Monex Europe Holdings Limited.

Monex Europe Holdings Limited ("MEHL") is part of the wider financial services group, Monex S.A.P.I. de C.V. ("Monex"), an investment grade institution. The group's principal activity is the provision of foreign exchange services to corporate and institutional clients.

MEHL operates various subsidiaries in the FX industry, comprising of Monex Europe Limited, Monex Europe Markets Limited, Monex Europe S.A., Monex Canada Inc., MonFX Pte Ltd.; with offices in the UK, Spain, the Netherlands, Luxembourg, Toronto and Singapore.

All entities under MEHL are regulated for different products and services within the jurisdictions in which they operate. Details of the different entities can be found at www.monexeurope.com/contact-us. Details of the respective entities' regulatory status and available products and services can then be found on the relevant links to the individual jurisdictions' website.

Market specific disclosures

United Kingdom: This document is distributed in the UK by Monex Europe Limited ("Monex Europe") and Monex Europe Markets Limited ("Monex Europe Markets"). Monex Europe Limited is authorised and regulated by the Financial Conduct Authority (FCA) as an Authorised Electronic Money Institution, with permission to issue electronic money (e-money) and provide payment services - firm registration number 998114. Monex Europe Markets Limited is an authorised and regulated investment firm, FCA reference number 596146. Monex Europe Markets only transacts business with clients who have been categorised as Professional or Eligible Counterparties. Foreign exchange options and other derivative products are not suitable for everyone and may present a high level of risk to your capital. You should seek independent advice if necessary. This communication has not been reviewed by the Financial Conduct Authority. It is for information only and does not constitute investment advice, or an offer to sell, or a solicitation of an offer to buy any investment product or service.

European Economic Area (EEA): This document is distributed in the EEA by Monex Europe S.A., a company registered in Luxembourg with registration number B230160 and has its registered office at 35 Avenue Monterey, L-2163 Luxembourg. Monex Europe S.A. is authorised and regulated by the Commission de Surveillance du Secteur Financier as a payment institution. Licence number 16/20 and regulatory identification number Z00000023. The entity delivers services to clients across Europe. This communication has not been reviewed by the CSSF. It is for information only and does not constitute investment advice, or an offer to sell, or a solicitation of an offer to buy any investment product or service.

Canada: This document is distributed in Canada by Monex Canada Inc. ("Monex Canada"). Monex Canada Inc. is a registered extra-provincial company under the Canada Business Corporations Act. Corporation number: 884479-8. Registered address: 199 Bay Street, Suite 4000, Toronto, Ontario, M5L 1A9. Monex Canada is registered with both the Financial Transactions and Reports Analysis Centre of Canada ("FINTRAC") and the Revenu Quebec. In Toronto, Ontario, Monex Canada is registered as an MSB with FINTRAC and holds registration number M17698932. Additionally, Monex Canada holds a license from Revenu Quebec with license number 11642.The entity delivers services to clients across Canada. This communication has not been reviewed by FINTRAC. It is for information only and does not constitute investment advice, or an offer to sell, or a solicitation of an offer to buy any investment product or service.

Singapore: This document is distributed in Singapore by MonFX Pte Ltd ("MonFX"). MonFX Pte Ltd is licensed and regulated by the Monetary Authority of Singapore as a Major Payment Institution under the Payment Services Act 2019 and as a Capital Markets Services Licence holder under the Securities and Futures Act 2001. MonFX Pte Ltd is a company registered in Singapore with registration number 201611101E and has its trading address as 5 Shenton Way, UIC Building, #10-01, Singapore 068808. The entity delivers services to clients across Singapore and other APAC countries. This communication has not been reviewed by the Monetary Authority of Singapore. It is for information only and does not constitute investment advice, or an offer to sell, or a solicitation of an offer to buy any investment product or service.

Copyright © 2024 Monex Europe Holdings Limited/or its affiliates. All rights reserved.