FX Forecasts

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INTRODUCTION

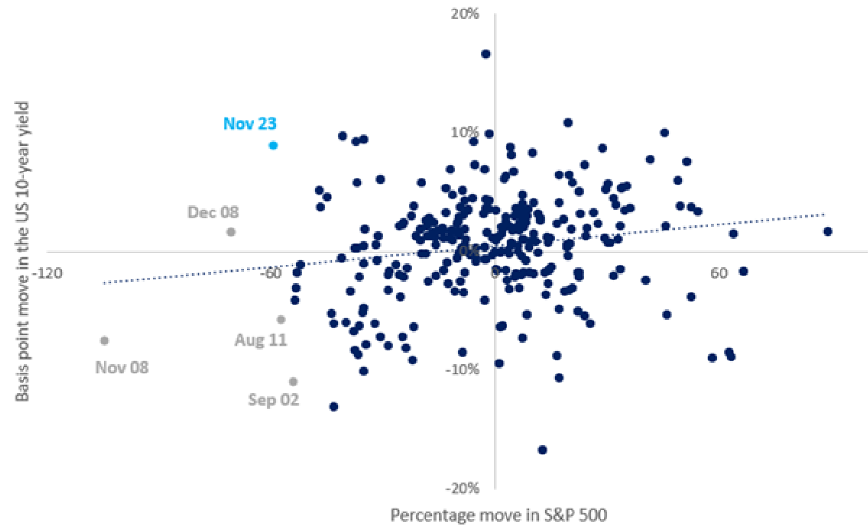
Data out of the US at the beginning of November provided the perfect mix for traders to begin significantly adding to Fed easing bets in 2024, leading markets to front-run what was seen as the main trend to trade in 2024 after tighter financial conditions sparked pushback from Fed officials in October, putting an end to the short duration trend of Q3. While the Fed cautioned against extrapolating too much from the latest round of data and flagged the risk looser financial conditions pose in reflating the US economy – Chair Powell even specifically warned against "head fakes" in the data – this did little to dampen the level of participation in taking Treasury yields lower.

In fact, the drop in 10-year yield over the past month was the third largest since the turn of the millennium, superseded only by the peak of the financial crisis and comparable only to September 2002 when deflation risk was prominent in the US and during the height of the 2011 eurozone bond crisis. However, unlike previous selloffs, the Goldilocks nature of the data meant that the decline in the 10-year yield last month didn't spell trouble for equities, with major indices recording near double-digit gains.

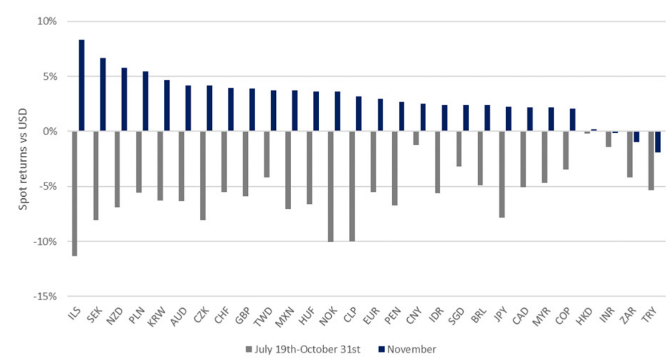
"This saw the decline in yields coincide with a broad rally in risk assets."

For FX markets, this spelt trouble for a greenback that had previously notched gains on the back of higher rates and exceptional data, which left prospective capital returns relatively benign outside of the US. The cracks in the foundations saw the dollar DXY index fall 3% in November, its worst month in a year. Across the expanded majors, currencies that felt the sharpest impact from the duration sell-off in the three months since mid-July generally posted the largest rallies in November, with pro-cyclical and rate-sensitive FX leading gains.

A unique month in markets as back-end yields drop in a non-recessionary manner



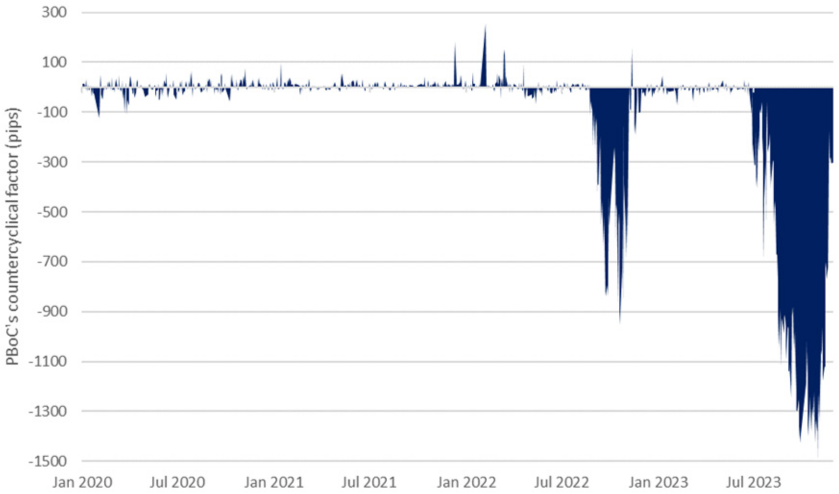
Currencies that were most affected by the duration sell-off tended to benefit the most from the introduction of Fed rate cuts



While the past month will be broadly remembered for the price action in US rates and the ensuing cross-asset risk rally, November also saw the thawing of soft currency pegs in Asia after three months of relative stability. Although heavy management of CNY and JPY weren't necessarily restrictive factors during the early phases of the "higher for longer" period for US rates, they did become major impediments to the dollar's rally in October as valuations across other major currency pairs became stretched. Of the two, the most noteworthy move arguably occurred in the Chinese yuan, where stronger fixings, reduced levels of onshore liquidity, and quasi-intervention from state banks saw USDCNY pounce on the more accommodative rates backdrop to snap lower from the 7.3 midpoint it had traded around since mid-August to close out the month in the middle of our previous 3-and-6 month forecast at 7.13.

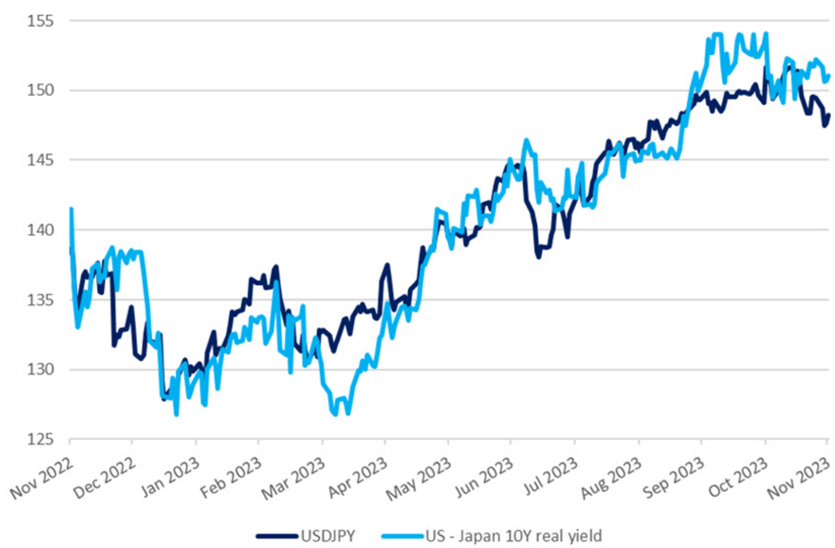
The Chinese yuan de-anchored from the 7.3 handle, with the PBoC supporting the move with stronger fixings

This comes after months of pushback from Chinese authorities through the reimplementation of its countercyclical factor in its daily fixing estimate



"Having withstood pressure from widening real rate differentials as the Fed's hawkish medium-term view contrasted with a consistently dovish Bank of Japan, the Japanese yen also benefited from the more accommodative backdrop in Treasuries, with USDJPY falling back below the considered intervention level of 150 having breached it earlier in November following another dovish BoJ decision at the end of October."

The Japanese yen also fell back below the 150 handle, supported by narrowing real rate spreads

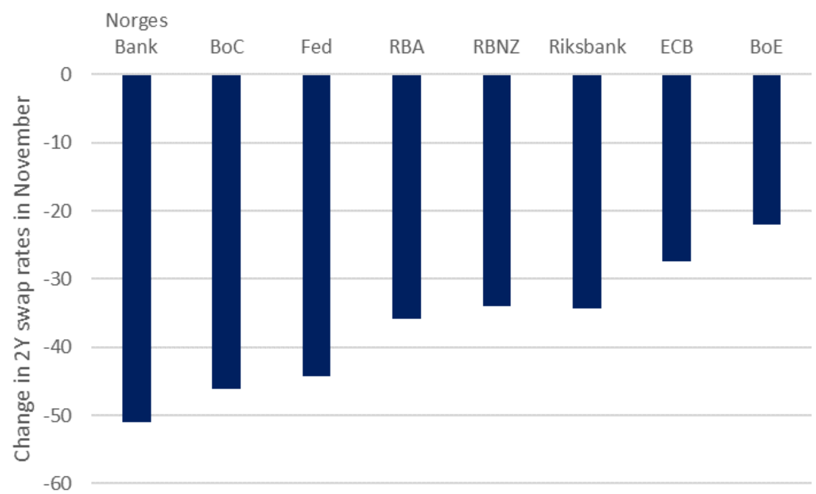


"Another notable feature of markets over the past month was the level of synchronisation in DM easing bets despite the discernible differences in the progression of underlying data."

Geographical proximity did play a large role, with markets increasing bets on rate cuts from the Fed/BoC, RBA/RBNZ, and BoE/ECB over the next two years in almost lockstep, but that doesn't necessarily match the underlying economic data. In fact, out of the three sets of central banks, an argument can only be made for a similar change in the amount of easing from the RBNZ and RBA. In Europe, data out of the eurozone has been consistently more negative, reinforcing our view that the economy is currently undergoing a recession, which is reintroducing slack in the labour market and weighing more aggressively on core inflation pressures. This suggests that the ECB has overtightened policy and is likely to embark on a more aggressive easing cycle in 2024 compared with the Bank of England, which has viewed successive positive surprises in the incoming data and faces more structural inflation pressures that should restrict the pace of any easing. A similar dynamic is also visible in North America, with data out of Canada suggesting a monetary-induced recession is underway.

With the economic contraction now starting to materially weigh on core inflation pressures, as evidenced by the BoC's preferred inflation measures breaking back below 3% for the first time since March 2021, the Bank should be in a position to cut rates earlier than the Fed, where a slowdown in growth in Q4 has ushered in bets of similarly timed rate cuts, but this should be reversed somewhat by a reacceleration in growth in Q1. Looking ahead to the New Year, we expect varying growth rates and inflation outlooks to lead to a wider dispersion in central bank easing expectations next year. This should be a differentiating factor for markets to trade.

The synchronised easing cycle



All told, not many, including ourselves, foresaw the dollar rout that ensued in November as the incoming data stuck the right balance to induce confidence that inflation is on the trajectory to return back to the Fed's 2% target without the possibility of a recession increasing. In fact, our one-month DXY view in November remained constructive on the dollar, based on the view that Treasury yields would be supported in current ranges as any premature easing ran the risk of reflating the US economy.

At risk of compounding our forecast error, however, we don't think now is the time to structurally buy into the dollar's decline. Firstly, the slowdown in US growth conditions in Q4 is likely temporary, weighed down by transitory factors, peak transmission of Fed tightening, and constrained consumer finances after bumper consumption rates up until Q3.

"Looking into 2024, the fading impact of the Fed's tightening cycle, improving real wage growth, and recovering external growth rates should support a reacceleration in US growth, increasing the risk of inflation persistence at the margin."

Secondly, the latest leg lower in the dollar hasn't coincided with an improvement in growth conditions outside of the US, with activity levels in both China and the eurozone remaining tentative. Finally, we think that as markets approach the first DM rate cuts in Q2, we think the scope for incoming data to be supportive for risk assets will narrow, causing bouts of USD appreciation as recession risks rise on negative data surprises and rate cut expectations get pushed back on any signs of exceptional strength. While we have conviction in our view that the dollar will rebound over the medium-term due to these factors, we believe that over a tactical horizon that the dollar is likely to continue weakening as weak growth in Q4 manifests within the broader suit of US data, affirming the market's view of earlier rate cuts in 2024.

FX VIEWS

DXY

The path is too narrow

The broad dollar weakened close to 3% in November, driven primarily by the decline in US yields on softer inflation data and signs that the US economy was starting to slow. While two of the key components of the dollar's Q3 surge are now cast in doubt, we believe that the Goldilocks nature of US data is unlikely to persist over the coming months. Under our base case, the US economy will reaccelerate in Q1 as the drag from the Fed's tightening cycle fades and real income growth begins to support US consumption once again. Stronger growth should provide a floor under Treasury yields, especially the front-end with 4 rate cuts already priced in for 2024. If anything, we think this backdrop should see markets trim bets of earlier and more aggressive easing, aligning with our view that the Fed will commence policy easing in June at a rate of 25bps per quarter as stronger growth raises the risk of re-emerging inflation and a higher short-term neutral rate. Furthermore, stronger growth data in the US should keep global capital parked in US markets, especially as we expect the eurozone to experience a recession and China's economy to continue misfiring even as policymakers continue to offer support. All told, we expect this to provide some marginal upside for the dollar, especially against currencies with weak growth profiles (CAD, EUR).

Should the US economy not reaccelerate at the start of 2024, we see a narrow path for the data to continue fuelling Fed rate cuts whilst remaining positive for risk sentiment (i.e. the trough of the dollar smile is narrow). Any slight miss in growth and/or labour market data during this period is likely to materially raise the risk of recession, especially as the Fed is unlikely to have eased policy by this point. This should reignite the dollar's haven channel (the left-hand side of the smile), causing spurts of USD appreciation against high beta FX.

All told, we think markets have shown their hand by prematurely pricing an aggressive easing cycle from the Fed and are vulnerable to a shift in the underlying US data at the start of 2024. Surprises in either direction at this point are likely to be USD positive. Despite retaining a bullish USD view at the start of 2024, we still believe the dollar will struggle to return to its 2023 peak without a substantial deterioration in global risk sentiment as the inflation environment is now vastly different. Over the medium-term, we think the Fed will begin to ease policy towards the end of 1H24, ushering in another wave of structural USD depreciation as the global easing cycle begins to lift global growth. The main risk event over the medium-term view is the US election, with preliminary polls pointing towards a 2020 rematch between President Biden and former President Trump. Here, we think foreign policy is set to be the main battleground.

"The potential deterioration in US-China relations and the threat of new tariff implementation is likely to lead markets to position long dollar heading into the election cycle –a key upside risk to our bearish USD 12-month view.

EUR

Don't run before you can walk

The eurozone economy imported tighter financial conditions throughout the third quarter as longer-dated Treasuries sold off and dragged back-end eurozone bonds higher as a result. This proved particularly punitive for the euro area, where tighter monetary conditions were already being "forcefully" transmitted and external growth conditions in major trading partners showed no signs of vigour. With the US economy exhibiting stronger growth and higher yield pick-up, this macro backdrop saw EURUSD progressively weaken before settling just above the 1.05 handle.

The subsequent loosening in US financial conditions over the past month has therefore provided welcome relief, with the eurozone importing these looser financial conditions at a time when growth data already indicated a recession was ongoing.

As a result, sentiment around eurozone assets notably improved – cyclical equities have outperformed defensives with the spread back at the pre-SVB peak, non-commercial long positioning in EUR futures increased by 44k this month, and the ZEW measure of investor growth expectations increased to its highest level since February.

While a rebound in the euro makes sense as cyclical sentiment improved and rate differentials narrowed, the subsequent rally up to and partially through the 1.10 handle wasn't consistent with the underlying macro fundamentals, which showed little improvement in the eurozone. This was made apparent towards the end of the month, where a round of eurozone data proved a humbling experience for those holding long positions in the euro. In summary, the suite of macro data reflected a eurozone economy that remains in recession in the fourth quarter, with weak growth now starting to manifest in the labour market and inflation data. As the data landed, markets began to align with our view that the ECB will need to cut rates as early as April 2024, with risks tilted towards earlier easing should growth data deteriorate further from here. While the dovish reaction in rates markets brought EURUSD back down from its three-month high, the euro still scans as rich based upon the underlying fundamentals, primarily due to the fact that markets still expect similar easing paths from the ECB and Fed next year. This is inconsistent with our base case that the eurozone remains in recession at the start of 2024 while the US economy is set to reaccelerate. This not only means the Fed should begin easing later than the ECB – June under our base case – but the type of easing will also be different; non-recessionary rate cuts in the US should keep relative capital returns more attractive than in the eurozone, where monetary policy is being eased to mitigate a more severe economic downturn.

"We expect markets to further align with our views on central bank policy paths and relative growth differentials at the start of 2024 as the economic data begins to diverge once again on both sides of the Atlantic."

Reflecting this, we maintain our tactically short EURUSD view over this period. However, we are revising up our one-month forecast from 1.03 to 1.07 to account for both the adjustment in US rates and the higher starting point for the euro. Risks to our near-term views are broadly balanced. To the upside, faster non-recessionary rate cuts in the US or another round of Chinese stimulus will further boost risk sentiment and would likely result in EURUSD trading through 1.10. In the absence of another inflation shock, downside risks to the euro largely stem from the labour market. Should slack re-emerge much quicker than expected, threatening the income-led recovery in Q2 and extending the length of the recession, we expect the ECB to take contingent action, potentially lowering the deposit rate by 50bps as soon as March. In this scenario, we expect EURUSD to fall back to the 1.03-1.05 range.

Over the medium-term, our constructive view on the euro remains. As monetary policy is progressively eased globally throughout the year, growth conditions are likely to improve, benefitting the cyclically sensitive euro.

CHF

SNB inflation projections key for the Swissy

Whilst EURCHF traded above our short-term projection of 0.95 through much of November, the delivery of soft eurozone inflation figures towards month end saw the pair break back below 0.96 and towards levels that we think better reflects fair value for the cross. Indeed, we had been surprised to see the euro modestly appreciate against the franc for much of the month, even as growth indicators for the euro area pointed increasingly to recession, although we believe this was largely a product of improved cyclical sentiment on the softer yield backdrop. Nevertheless, the weaker eurozone fundamentals should have delivered some CHF strength as the franc picked up a regional haven bid. Admittedly, FX markets now appear to have converged on this view.

In contrast to events in the eurozone, Swiss data has largely delivered on expectations across recent releases. The big question now is to what extent a continued softening in external economic conditions will weigh on domestic growth conditions. A first indication of this is set to come in next week's inflation and unemployment. Whilst the latter is likely to remain around the current rate of 2.1%, risks are skewed to the upside given the slowing demand conditions. Similarly, the inflation outlook also appears weaker than previously expected. Despite headline inflation stabilising at 1.7% YoY in October and the SNB projecting this to rise back above 2% over coming months, slowing growth, a stronger exchange rate and lower oil prices all suggest that odds are tilted towards inflation undershooting these forecasts.

Risks to the franc moving forwards are therefore two sided in our view. On the one hand, a mild eurozone recession could both weigh on the euro and offer a modest boost to the franc in the short term, without spillover effects triggering rate cuts from the SNB earlier than June.

"A subsequent uptick in growth in the area as the impact of rate cuts takes effect would then likely see the pair retrace towards parity as both the SNB and ECB ease in tandem from mid-year 2024."

On the other hand, a sharp downturn in European growth would also see Swiss inflation easing significantly faster than anticipated, which would only be amplified by any adverse strength in the franc. The risk of deflation would likely spark SNB intervention, first through FX markets directly and then potentially through earlier rate cuts.

How exactly these risks are viewed by the SNB will be key for the franc's short-term prospects. It is fortunate then that the next policy meeting is due to take place on 14th of December. Whilst we think policymakers will be cognizant of the risks of a nasty eurozone recession, we do not think this is likely to form the SNB's base case at present. Therefore, whilst the inflation forecasts that accompany the forthcoming decision will likely see a modest downgrade in light of deterioration in the economic outlook, there is little to read into this from an FX perspective at present. As such, we continue to see EURCHF being range bound over coming months, before seeing modest appreciation in the cross as eurozone growth picks up in H2 2024 supporting the euro, and the franc gains less benefit from its haven characteristics.

GBP

High for longer gives sterling a boost

November finally saw our longstanding call for GBPEUR upside finally begin to play out, with increasing signs of divergent growth prospects between the UK and the rest of Europe seeing the pound significantly outperform over the month. Whilst we had expected this to take place, our view had been that markets would need to see another round of data before taking the plunge. Instead, this shift has begun to emerge earlier and more aggressively than we expected. Indeed, whilst we have been big advocates for the idea that the pound was undervalued, even we were taken by surprise at the recent move higher for sterling, resulting in markets significantly overshooting our short-term GBP forecasts.

On the UK side of developments, last month's moves were fuelled by a market realisation that the Bank of England will likely keep rates high for longer due to structural supply constraints, even as other central banks begin to ease policy in the first half of next year. With growth holding up in the UK, especially relative to the euro area, this boosted sentiment around UK assets and the pound. This divergence was most notably highlighted in the flash PMI data, with the UK's composite reading for November returning to expansion with a print of 50.1, whilst its eurozone counterpart failed to show signs of a sustained improvement. This arguably sparked the increasing divergence between pricing for ECB and BoE easing cycles, which has since been further aided by signs of continued inflation persistence in the UK and accelerated disinflation in the eurozone. In the UK, wage growth remains elevated at 7.9% 3m/YoY, unemployment remains below the BoE's estimate of neutral and more anecdotal evidence suggests a pickup in the passthrough from wage costs to sales prices, a dynamic that had appeared to ease over the summer. Comparatively, eurozone inflation undershot the market and ECB expectations, suggesting policy is now overly restrictive.

> "All told, the BoE now looks likely to hold rates well into 2024, a view we expect to be confirmed when the MPC delivers a final rate decision of the year on the 14th. Unlike the Fed and the ECB, both of which we see cutting in H1 next year, the question for the BoE is whether policy easing comes in Q3 or Q4."

Significant for sterling though, is that this is now being priced by markets. With central bank policy expectations having largely traded in lockstep in recent months, the growing divergence between swap pricing for Bank Rate when compared to other DM central banks creates a strong appreciative dynamic in early-2024, provided the UK growth data avoids negative territory. Therefore, whilst we anticipate cable retracing modestly over a one-month time horizon, this comes as a function of a stronger dollar rather than sterling weakness, with GBP still set to outperform on crosses where cyclical dynamics are weaker. Further out, there is a risk that a more severe downturn in one or both US and Europe could spill over into UK growth. But absent that, a resilient economy combined with a high for longer policy stance should see GBP rally into the middle of next year against the euro whilst holding ground on the dollar. That said, heading into the second half of 2024 we expect growth conditions in economies where policy rates have been cut to outstrip the stagnant UK, with the cyclical outperformance dominating capital flows. Furthermore, heading into year-end, election jitters will likely also weigh on the pound, as will rate cuts when they ultimately materialise. As such, whilst we continue to look for GBPEUR appreciation from current levels, given the risks that are increasingly coming into scope we expect the pound to give back some of these gains at the back end of the 12-month forecast horizon.

CNY

Moving the fix

After months of relative stability around the 7.3 handle, the soft yuan peg broke to the downside in November as rate differentials between the US and China compressed. The move lower in USDCNY mid-month was supported by the People's Bank of China, which set the daily fixing rate lower, temporarily removed liquidity from the onshore market, and instructed state banks to sell dollars. Furthermore, sentiment around the yuan was bolstered by a constructive meeting between President Xi and Biden at the APAC Summit and the announcement of further measures to support the ailing property market. However, similar to the euro, the strengthening of the yuan hasn't corresponded with a pick-up in China's growth rate, with October's activity data printing mixed and the official manufacturing and non-manufacturing PMI measures undershooting expectations again for November.

With the economy seemingly in need of further policy support to achieve sustained growth in the region of 5% next year, we think there are limitations to the current CNY rally. However, a retracement is unlikely as long as US data continues to point towards a soft landing, keeping risk assets supported and US rates capped. As a result, we have marked our 1-to-3-month forecasts down to the current market level of 7.15 while maintaining a structurally bullish view on CNY over the medium-term. While not our base case, any retracement back to the 7.3 handle in the near-term will likely be heavily managed given the PBoC's revealed preference for CNY stability and now strength in order to support consumer and investor sentiment. There is a risk that the yuan continues to appreciate around the turn of the year without growth conditions improving, however. Chinese exporters are reported to have accumulated $150bn in foreign currency since the DM hiking cycle began in mid-2022.

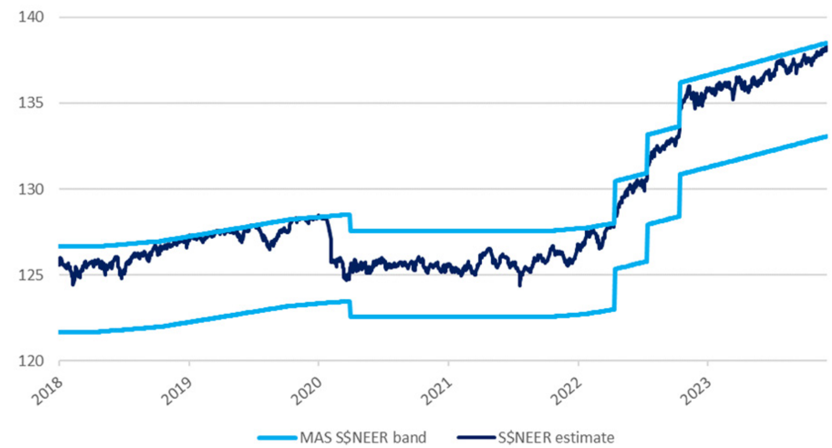
"While we would expect conversion rates to remain low until the DM easing cycle begins and narrows rate spreads further, there is a risk that exporters drawdown on FX reserves, which could take USDCNY back to 7.00 in Q1."

SGD

Lagging the rally

The decline in US rates in November brought relief for the low-yielding Asian FX complex. This saw the Singapore dollar appreciate 2.5%, making its gains relatively aligned with those of the Japanese yen and the Chinese yuan. The stability in the SGDCNY and SGDJPY exchange rates, alongside SGD's underperformance against more cyclically sensitive currencies within the S$NEER basket, meant a slight buffer between the S$NEER rate and the perceived ceiling of the MAS's monetary policy framework was maintained, even as the S$NEER rate continued to appreciate over the course of the month. The development of the exchange rate is in line with the progression in Singapore's macro fundamentals, with October's CPI report once again underscoring concerns over core inflation persistence. Looking ahead, our view that USDCNY is likely to remain stable at 7.15 into Q1, and USDJPY will continue to hover around 150 over the next three months leads us to believe that the USDSGD rate will also stabilise at around the 1.34 level as further appreciation against the dollar would risk the S$NEER rate breaking the MAS's tolerance band to the upside. Over the medium-term, as looser monetary policy from the Fed sparks a more sustained rally in Asian FX, we expect a sustained break lower in USDSGD, with the Sing dollar likely to lag the risk rally against the dollar as monetary policy turns more neutral. Risks to our USDSGD view are tilted to the upside in the near-term, primarily on the risk that the current Goldilocks trend of US data is derailed, leading to a renewed sell-off in Asian FX versus the US dollar.

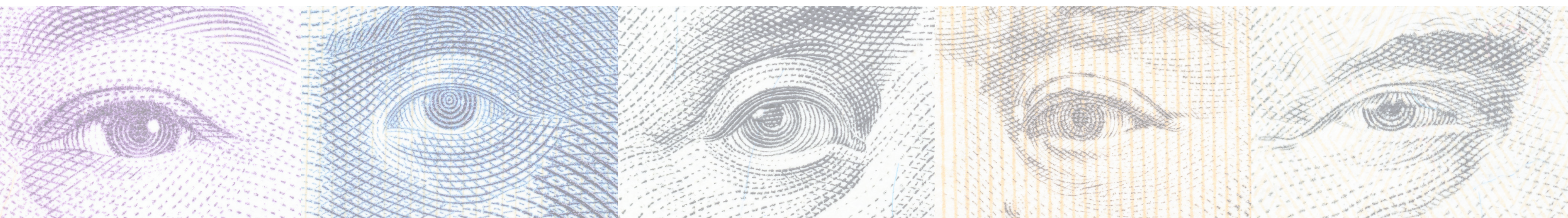
The drop in USDSGD in November has pushed the S$NEER rate towards the upper end of the MAS tolerance band



Scandi FX

NOK to catch up with the pack

November proved a strong month for Scandi FX, with both NOK and SEK posting gains against the euro as an easing DM rates backdrop lifted sentiment in Europe on the whole. The Swedish krona's performance was particularly notable, coming despite the Riksbank leaving policy on hold, and despite consensus expectations that looked for a final rate hike from Swedish policymakers. All told, this meant that SEK undershot our one-month projections, posting gains of 6.6% to finish as the G10 top performer against the dollar. In contrast, EURNOK overshot our short-term forecasts despite notching a 1% loss this month, as falling oil prices continued to be a headwind to the krone. That said, even following November's positive performance, in both cases we still see the two currencies as undervalued on a fundamental basis.



Turning first to the Swedish krona, with inflation cooling more rapidly than expected and growth conditions remaining weak, the necessity of further policy tightening in Sweden now looks dubious, evidenced by the Riksbank's decision to pass up their last good opportunity to add a layer of carry protection to a krona, leaving it vulnerable to a sell-off should risk conditions shift. Given this, we suspect that markets are unlikely to take EURSEK much lower from current levels, with eurozone recession risks or a blowup in the Swedish property market weighing against the currency's cheap valuations. Even so, as these risks fade over the course of next year and the ECB begins to cut rates, we continue to see the cross declining in line with our longer-term forecasts.

"Given this, we are revising our one month call for EURSEK to reflect the better-than-expected starting point, whilst rolling forward the projections for longer time horizons."

In contrast to the Swedish krona's remarkable recent turnaround, NOK has found itself under significant pressure over recent months. In part this is a function of the continued slide in oil and gas prices, a move that continued through November. That said, a cold snap in Europe expected for early December, and an OPEC+ decision to continue restricting supply, should offer some support for oil prices moving forward. Whether similar support for the currency is forthcoming from the Norges Bank, however, remains an open question. On the one hand, policymakers gave a strong steer towards no additional rate hikes at the November policy meeting. On the other hand, October inflation significantly overshot expectations, with headline price growth reaccelerating to 4.0% YoY and underlying inflation to 6.0% in the latest October release, up from 3.3% and 5.7% respectively. Given the central bank's prior track record of reacting strongly to inflation overshoots, we think on balance they will deliver a final rate hike on November 14th. This should see the krone appreciate strongly in the next month if delivered, with any Norges Bank hawkishness standing in contrast to policy rates set to remain on hold across other DM central banks this month. Given this, we remain bullish on NOK into year-end, though note that a failure by the Norges Bank to deliver a final rate hike, or a further slip in oil, could well trigger another bout of NOK weakness.

LatAm FX

The carry awakens

In general, November has been a month largely marked by the fall of the US dollar and the effects this has had on asset valuations, especially on pro-cyclical and interest rate sensitive currencies. This supported a retracement in LatAm FX after a generalised sell-off in September and October.

Not only did the region's major currencies close out November in positive territory against the dollar, COP, and to a lesser extent MXN and BRL, came close to the highest levels of the year. This occurred despite the fact that the latest leg lower in the dollar has not coincided with an improvement in growth conditions outside the US that would favour an improvement in the global risk environment. The evolution of commodity prices during November has also not been a particularly supportive factor for LatAm. With oil futures prices falling below $80 per barrel in November, only the appreciation of copper has brought good news for the region's exports. However, as we warned a month ago, these external headwinds appear to have generally moderated in November as a result of a combination of factors. The tendency of DM central banks to keep monetary policy intact while waiting for indications to assess whether the current degree of tightening is too restrictive or not has led to a general decrease in market volatility levels which, together with solid economic fundamentals and clear forward guidance from some of the major central banks in the region, has allowed markets to return to good carry positions. So too has the reduction in term premia across DM bonds, which during its accumulation acted as a severe impediment to carry currencies. Despite the improved carry conditions, we note that the long LatAm trade is much more limited than it was earlier in the year due to the recent erosion of total returns, domestic political risk, and the fact that global growth remains tenuous.

Easing external headwinds led LatAm currencies to overcome the massive sell-off of the last two months to trade in the upper end of their 2023 range heading into year-end

For the MXN, this has undoubtedly been the year of the “super peso”. This concept began to be coined in early 2023 when the Mexican currency experienced a substantial and consistent strengthening that would lead it to reach its highest levels since 2015 against the US dollar. While most of the factors that have catapulted the peso to these heights have remained present in November (and we believe will continue to be evident in December), they will likely begin to subside in early 2024. Carry is perhaps the most obvious. The peso’s yield spread is set to compress early in the year when Banxico likely begins its monetary easing cycle ahead of the Federal Reserve. In any case, this does not mean that there will be an abrupt change in the valuation of Latin American carry and especially MXN and BRL, whose yields are still projected to remain in double digits in 2024, but rather marks a transition towards more moderate yields throughout the year. However, heading into late 2023, we believe that the high carry offered by the MXN and the currency’s stronger economic fundamentals set the stage for the MXN to at least slightly outperform the BRL in the short-run. Another risk factor for long LatAm positions over a tactical horizon is the risk that markets struggle to distinguish between a soft and a hard landing in the US as Fed rate cuts draw closer.

“With carry positioning likely to remain heavy, any sharp misses in US economic data could spark pronounced selloffs in LatAm currencies, likely in early 2024.”

CE3 FX

Divergent easing remains a theme

Common themes saw CE3 FX outperform our forecasts over the past month, with falling US rates, easing external monetary policy expectations and a continued slide in oil prices combining to propel outperformance across the bloc. That said, whilst CE3 FX outperformed alongside other carry currencies in November, we do not expect this to be repeated next month. Whilst easing prospects at the ECB in particular may continue to creep forward, this is increasingly the result of a recession outlook that will weigh on euro-fringe economies. November’s fall in yields also seems to have run its course, with risks that a hawkish Fed next month could see a partial retracement in the recent bond market rally. Similarly, OPEC, having watched oil price ease, now look poised to extend oil production cuts with the intent of stabilising oil at around $80 per barrel. All told, this should at a minimum see the rally in CE3 FX stall out, but the prospect of yield erosion as domestic central banks cut policy rates could well send this move into reverse.

This looks least likely in Poland, where the NBP has seemingly called a halt to policy easing with rates at 5.75%, at least for the time being. Indeed, whilst the central bank’s reaction function has proven hard to predict over recent meetings, recent signalling that no rate cuts will be delivered until policymakers have assessed the incoming government’s fiscal plans appear credible to us.

With this unlikely to happen until next year at the earliest, and headline inflation stabilising at 6.5% in the most recent November reading, we suspect the central bank will remain on hold until at least Q2. Combined with political risk having eased since last month, we therefore see the zloty largely holding its ground at current levels in the short term, before EURPLN eases back towards our 12-month target of 4.2 as cyclical conditions globally improve.

At the other extreme is the NBH in Hungary, where having already delivered back-to-back 75bp rate cuts, we expect policymakers to continue with this pace of easing over coming meetings. Notably, year-on-year price growth fell into single digits in October, which at 9.9% landed someway below an NBH forecast of 10.5% for the month. With it looking like price growth could be sub-7% by year-end, we would be surprised if the NBH failed to deliver 75bp cuts in both December and January, moves that together take the main policy rate to 10%. While the pace of easing may slow from here, we expect the continued carry erosion to weigh on the forint moving forwards. Therefore, whilst the forint has slightly outperformed our expectations for this month, we are rolling forwards our forecasts given we still expect our underlying macro thesis to play out.

Finally, turning to the Czech Republic, where we expect that the one CE3 country yet to ease policy rates is due to start this month. Admittedly the rebound in the October inflation figures would at first glance be cause for concern, it is worth noting this comes as a sharp fall in price growth from October 2022 drops out of the annual calculation. Indeed, despite CNB forecasts suggesting that inflation would stabilise in Q4 this year at just north of 8%, the current run rate instead now suggests it will undershoot these projections by some margin. Not to mention, the economy is broadly expected to have contracted in Q3, underperforming neighbouring economies where policy easing is already in full swing. That said, this outlook is broadly in line with our prior expectations for the Czech economy, where we expect that once the beginning of policy easing is confirmed the koruna will ease to our prior one-month target of 24.75.

“With a slow and steady series of rate cuts subsequently set to keep CZK softening at the margin moving forwards, we will also hold our current EURCZK forecasts at their current targets for another month.”

Forecasts

Currency Pair	1-month (31st December 2023)	3-month (29th February 2024)	6-month (31st May 2024)	12-month (30th November 2024)
G10				
EUR/USD	1.07	1.05	1.07	1.14
USD/JPY	150	150	140	130
GBP/USD	1.255	1.245	1.26	1.30
USD/CHF	0.89	0.91	0.92	0.86
USD/CAD	1.37	1.40	1.38	1.34
AUD/USD	0.66	0.67	0.70	0.72
NZD/USD	0.61	0.61	0.64	0.67
USD/SEK	10.7	11.0	10.5	9.6
USD/NOK	10.65	10.67	10.00	9.21
DXY	105.0	106.0	104.1	98.2
Emerging Markets				
USD/CNY	7.15	7.15	7	6.8
USD/INR	83.4	83.4	82	80
USD/SGD	1.34	1.34	1.32	1.30
USD/ZAR	19.00	19.00	18.25	17.00
USD/TRY	29.15	31	30	28
USD/PLN	4.11	4.19	4.02	3.68
USD/HUF	364	381	355	316
USD/CZK	23.1	23.6	23.6	21.6
USD/BRL	4.8	4.9	5	5.2
USD/MXN	17.3	17.2	17.2	17.0
Euro Crosses				
EUR/GBP	0.85	0.84	0.85	0.88
GBP/EUR	1.17	1.19	1.18	1.14
EUR/CHF	0.95	0.95	0.98	0.98
EUR/CAD	1.47	1.47	1.48	1.53
EUR/SEK	11.5	11.5	11.2	11.0
EUR/NOK	11.4	11.2	10.7	10.5
EUR/TRY	31.2	32.6	32.1	31.9
EUR/PLN	4.4	4.4	4.3	4.2
EUR/HUF	390	400	380	360
EUR/CZK	24.75	24.80	25.20	24.60
EUR/BRL	5.14	5.15	5.35	5.93
EUR/MXN	18.51	18.06	18.40	19.38

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