MONEX

FX Forecasts

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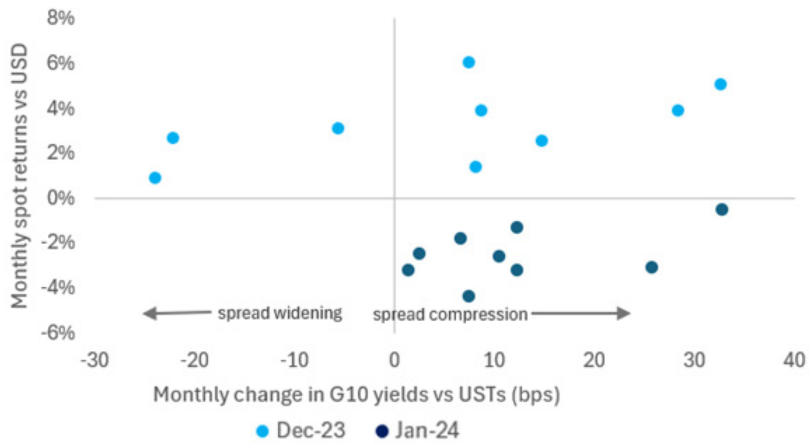
INTRODUCTION

Moving in the right direction

In our 2024 outlook, we argued that markets had gotten too excited over the prospect of Fed easing towards the end of 2023, leaving short dollar positioning stretched and many FX pairs unanchored from their economic fundamentals. With data throughout the first quarter likely to continue displaying weak cyclical conditions in Europe, Canada, and China, while simultaneously evidencing the US economy growing at an above-consensus rate, we expected a reality check to take place, fostering an environment of broad USD appreciation as a result. That said, we didn't expect the dollar to completely retrace its Q4 rout in the early part of Q1 as Treasury yields were unlikely to return to their 2023 peaks and multiple rounds of diverging data were likely required for markets to begin pricing more differentiated easing paths for major central banks; a dynamic that we viewed as crucial to unlocking a more substantial bout of USD strength. This is what ultimately occurred over the course of January, with the dollar DXY index retracing just 2.3%, half of its 2023 Q4 sell-off, as yield spreads continued to narrow even as the US exceptionalism narrative was maintained.

As mentioned, data out of the US over the past month have contrasted heavily with that from the rest of the world, sustaining the US exceptionalism narrative although at a lower level than in Q3 2023. Strength in the data have also led Fed officials to tone down their dovish rhetoric, evidenced by Governor Waller's caution that the easing cycle wouldn't be "rushed" and Chair Powell's direct pushback on pricing of a March cut. As we expected, this was insufficient to force markets to reassess the Fed's overall easing path for the year, with emphasis instead placed on progress in the core PCE measure and weaker details of the data, leaving markets to price around 140-150bps of easing this year. With other DM central bankers hesitant to discuss their upcoming easing paths and only a limited risk of rate cuts until March at the earliest, front-end G10 rate differentials with the US have generally continued to compress, even as the data remains divergent. However, in line with our view from the macro 2024 outlook, the move in rates is now playing a lesser role in driving spot returns relative to December across many pairs, with positioning, valuations, growth conditions, and risk conditions now having a larger impact. In fact, further compression in yield spreads has merely acted to contain further USD appreciation in January as opposed to driving sustained dollar depreciation, as was the case in December.

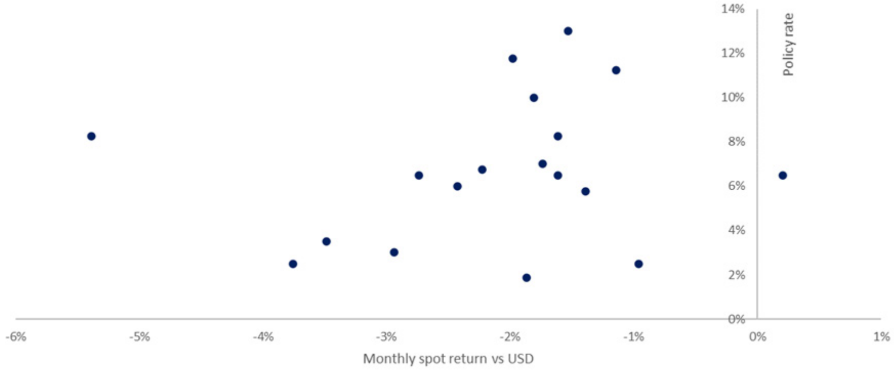
Although front-end rate spreads continued to compress, G10 currencies failed to replicate December's rally against the dollar



January has not spelt a good month for EM currencies

A slightly different story has been unravelling in the EM FX space. While a reset in valuations in accordance with other market variables has too been underway, emerging market currencies have also been under pressure from expectations of carry erosion and another downgrade in China's growth outlook. In terms of the former, although EM central banks outside of Hungary and Latin America held rates firm, or even hiked over the past month, a general repositioning out of carry trades has been underway on the expectation that the overall level of carry is set to decline. While the rotation out of popular carry trades should theoretically provide a boost to low yielding funding currencies, this hasn't been the case in January due to the deteriorating view on China's growth prospects, as displayed in local equities and China-linked commodities. As a result, nearly all major EM currencies depreciated over the course of the month, even as the rotation from carry-to-value has commenced.

High yield or not, it didn't really matter for EM currencies in January as the dollar firmed across the board on rate cuts and bearish China sentiment



Despite pushing back on expectations, some DM central banks tweaked language

While the majority of DM policymakers were actively trying to temper expectations of imminent rate cuts, it was notable that the official communications from those central banks that had rate decisions was generally tweaked in preparation of upcoming easing. This was most notable with the Bank of Canada, which removed its hiking bias from the rate statement and materially downgrading its growth and inflation forecasts. Although Governor Macklem highlighted that with inflation measures remaining elevated the BoC was unlikely to pull the trigger at its next meeting, the updated communications befit our view that the BoC is likely to be one of the first G10 central banks to cut. President Lagarde's acknowledgement of the slowing growth data and signs of easing domestic price pressures at January's press conference also confirmed our view that the ECB would join the BoC as an early easer, even as she maintained the view that rate cuts were unlikely until summer. This same communications challenge was navigated by the Fed, which also removed its hiking bias and noted the recent disinflationary progress, stating that the economy is now in better balance, but continued to push back on expectations of rate cuts as soon as March. The message from the North American central banks was deemed more credible by markets, as weak growth and softening inflation data continued to undermine the ECB's conservatism.

BoJ and SNB go their own way

That said, not all G10 central banks sought to mould market expectations in the direction of later rate cuts. In the case of the Swiss National Bank, President Jordan noted at the Davos economic forum that further appreciation in the franc risked undermining the SNB's inflation forecasts, even as inflation data for December marginally overshot expectations and the central bank's most recent projections.

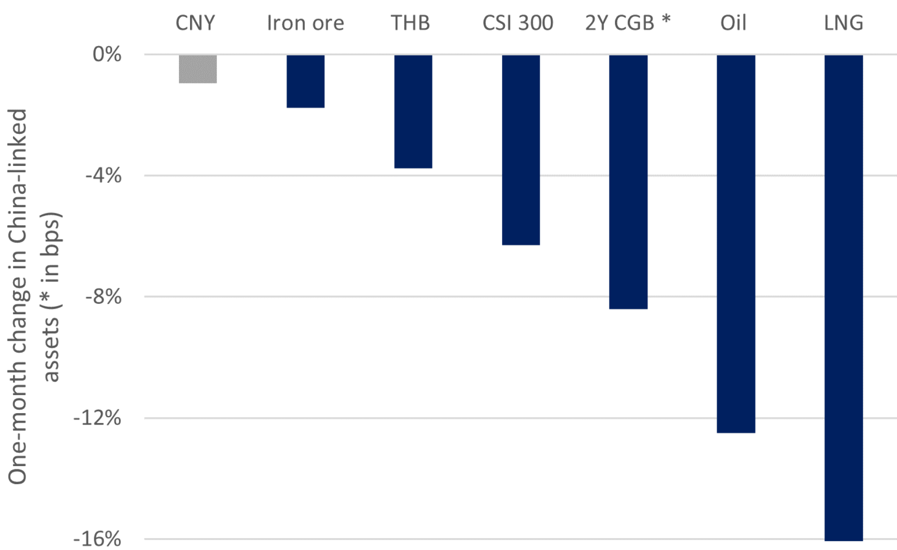
"This acted as confirmation of our view that December's meeting marked a regime change at the SNB, with further CHF appreciation now seen as increasing the risk of recession and deflation."

The most notable outlier was once again the Bank of Japan. Despite limited data since December's meeting, the Bank utilised qualitative information to project more confidence that its inflation target will be realised as it lifted its longer-term price outlook ahead of April's wage data. These developments also support our view that the Bank will likely update its assessment of inflation conditions again at April's MPM to the extent that it will have confidence to abandon its yield curve control policy. While we continue to think that the Bank will want to monitor bond market functionality and the second-round effects of the wage agreements on services inflation before raising rates in October, the Bank's newfound confidence raises the risk that the policy rate is also lifted by 10bps to exit negative territory at April's meeting.

China remains a drag

Even as 2023 GDP met consensus expectations at 5.2%, sentiment around China's growth prospects have continually been downgraded by markets at the start of the year. While this hasn't necessarily been reflected in USDCNY due to heavy management by the PBoC, China-exposed assets have generally moved to fresh cycle lows alongside local equities. This has taken place even as growth data hasn't necessarily disappointed. Nevertheless, the fact that previous stimulus is yet to materially improve conditions in the Chinese housing market and filter through into stronger levels of consumption has left many calling for further support. Granted, the PBoC has cut the Bank's RRR by 50bps, which is a credit stimulus in effect, and rumours have circulated about an offshore stabilisation fund of CNY2trn, the absence of broad-sweeping support has led investors to continually downgrade their expectations of Chinese growth.

Investors have downgraded China's growth prospects, although this hasn't been reflected in the yuan



As mentioned, depressed sentiment over China's growth prospects is effectively limiting the extent to which low-yielding currencies, specifically those within the APAC region, are able to benefit from lower engagement in carry trades. Not only that, weakness in Chinese equities and linked-commodities are also dampening cyclical sentiment, the uplift of which in December was one of the main drivers in weighing on the dollar. Given its wide-ranging implications, an improvement in the markets growth outlook in China is likely required for the dollar's fortunes to turn. However, due to the trade-off faced by Chinese policymakers, we expect the path to redemption to be much longer than in recent history as targeted stimulus measures are preferred over large-scale fiscal stimulus. Accordingly, China is likely to remain a drag on any risk rally until Q2 at the earliest, when policy easing by the Fed should make market conditions more accommodative for looser Chinese monetary policy and reduce concerns over debt sustainability.

FX VIEWS

USD

Coming into better balance

Positioning in the dollar at the start of the year scanned as inconsistent with our view that the US economy would continue to grow at an above consensus pace, while data would likely reflect weak growth conditions in the rest of the world. This quickly became the market consensus in early January, leading the dollar to correct from December's overly enthusiastic sell-off. The retracement in the dollar was supported by strong growth data, both in the form of January's PMIs and Q4 GDP, alongside another bumper payrolls print. This contrasted with signs of cyclical weakness, namely in Europe and China, and sparked a rotation in global capital flows back into US markets.

Yet, despite the continued divergence in growth data, market pricing of central bank easing remained relatively synchronised, in part due to data showing continued disinflation in the US, but also as a result of more conservative central bank commentary across the board. As a result, front-end rate differentials continued to compress in DM bond markets, inhibiting further USD appreciation.

"As outlined in our 2024 macro-outlook, we expect market pricing of DM easing cycles to begin differentiating towards the end of Q1 as disinflation progress in the US slows due to stronger growth and mean reversion in goods disinflation, while weak cyclical backdrops in the eurozone and Canada prompt earlier and more prolonged action from the ECB and BoC."

All else equal, the re-widening of front-end rates and weak investment conditions outside of the US should spur further dollar upside. The next round of monthly data should be sufficient to prompt this recalibration, especially as the underlying trend in the US data vs RoW is cutting in the right direction.

However, risks to this view have increased in the past week. Despite effectively ruling out a March rate cut at January's meeting, Chair Powell sounded a more confident on the disinflation progress achieved to date than we initially anticipated. Therefore, if this progress is sustained, it is highly likely that markets will continue to price around six rate cuts by the Fed this year, as opposed to our base case of five. With the Fed likely to begin easing in May, as per our base case, this would leave its easing cycle closely aligned with the likes of the ECB and BoC and would prevent the dollar from breaking significantly higher. Inflation data out of the US in February is key to determining the likelihood of this risk arising, especially as January's CPI report (released Feb 13th) is widely expected to show inflation pressures rising, while FOMC members have repeatedly pointed towards the 2023 benchmark revisions (released Feb 9th) as crucial in determining how confident they are in the disinflation trend. Should the data meet our expectations and show an uptick in inflation pressures, we expect markets to price out a rate cut from the Fed towards year-end, in line with our view of a quarterly pace of easing from Q4 onwards.

EUR

On track for an April cut

Coming into the new year, our 1.07 January end forecast for EURUSD was admittedly ambitious. Even so, for much of the month the pair made steady progress lower, as we anticipated. Monetary policy remained in the driving seat for the pair, with markets increasingly aligning with our base case for 6 rate cuts from the ECB, but expecting just 5 from the Fed. If this continues to play out in coming months as a result of weak growth conditions in the euro area, this should see EURUSD slide to 1.05 as a result. At the beginning of Q2, however, data supporting the start of Fed easing and a pick-up in growth conditions outside of the US should support a sharp retracement in the euro back to current levels.

While the evolution of Fed messaging has been notable this month (see USD), on the European side of things, the ECB also played its part, delivering a notable change of tone at its January policy meeting.This saw President Lagarde pass up the opportunity to highlight upside inflation risks, instead pointing towards ongoing disinflation and outturns that undershot projections, hinting that the ECB is increasingly confident of inflation returning sustainably to target. Lagarde also signalled that it is only services inflation that remains of concern, the most wage sensitive part of the CPI basket. It was also interesting that she accompanied this with an attempt to de-emphasise official labour market statistics, instead flagging more timely alternative labour market measures as indicative of falling wage and therefore inflation pressures. Whilst this was framed as justifying summer rate cut, we think ultimately the growth and inflation data will lead them to move earlier.

With broad consensus looking for services inflation to begin easing again in Q1 and headline inflation undershooting ECB forecasts too, the data is starting to erode the ECB's more conservative guidance. Moreover, with flatlining growth and signs of labour market softening, the risk of disinflation progress halting looks limited. That said, we think the March meeting comes a little too early, especially with services inflation remaining stubbornly at 4% in the January inflation figures. If policymakers are intent on cutting rates in April, then wage data will likely also be key. Given the lagged nature of official measures, which would only be available at the June meeting, the ECB is likely to shift their emphasis to alternative measures, which have been showing more consistent signs of weakness as President Lagarde highlighted. If we are correct, this keeps the ECB on track to ease six times this year. Initially this should see the current euro downside extend through Q1 as markets increasingly align with our view that the ECB should ease earlier and more rapidly than the Fed, widening rate differentials to the euro's detriment. From H2 onwards, however, improving growth should see the euro rebound. We continue to look for EURUSD reaching 1.14 at year-end.

CAD

Slowly sliding

The Canadian dollar has been a surprise outperformer so far this year, trailing only sterling as the best defensive G10 currency against the latest backdrop of dollar strength. Less dovish expectations for the BoC this year, in response to data showing greater persistence in core inflation and stronger growth than consensus, has been the main determinant of CAD outperformance on G10 crosses. Even so, whilst this left USDCAD more than 1% below our January forecast of 1.36, we think our underlying thesis for the pair remains intact as headline Canadian data continues to overstate the strength of the economy.

Indeed, the cornerstone of our CAD downside call was an expectation that the BoC would need to ease policy earlier than markets expect or that Governor Macklem has previously been willing to admit as Canadian economy proves to be considerably weaker than the headline data suggests. In fact, events in the past month have done much to validate this call. In particular, the January's BoC policy announcement all but confirmed that Canadian policymakers increasingly share our view. In particular, they made special note of the impact of housing costs on inflation in the monetary policy report. As we have previously noted, once stripping mortgage and rent from the CPI basket, it suggests that price growth has already returned to the BoC's 2% target. With the BoC similarly sharing this view, January's meeting marked a notable pivot in tone, one that saw the Bank drop its hiking bias and downgrade its forecasts, setting up policymakers to begin openly discussing policy easing in March before delivering their first rate cuts at the April meeting.

All told, we think the BoC will ultimately deliver six rate cuts in 2024, a significant upgrade on the roughly four cuts currently priced in by markets. In contrast, we expect only five rate cuts from the Fed, close to a full cut less than swap pricing currently suggests. Continued softening in the data and what is likely to be a dovish tone from the BoC should see market pricing for rate cuts in Canada increasingly align with our base case over coming months. Contrasted against the modest hawkish shift in Fed expectations that we are looking for, this should see USDCAD rally strongly towards what we think is a ceiling of 1.40, over the next three months. Longer term, a pickup in global growth conditions should help support a loonie recovery, albeit we think this story will have to wait until after easing cycles are underway in both the US and Canada before this begins to play out.

Whilst monetary policy is likely to remain the key driving factor underpinning USDCAD price action this year, oil prices will also play a role. Specifically, escalating tensions in the Middle East could well see a spike in oil if they ultimately boil over into a broader conflict, although the corresponding deterioration in risk sentiment means the effect on the loonie remains ambiguous.

GBP

Further to run

Despite easing since the beginning of the year, GBPUSD modestly overshot our month end forecast of 1.26. GBPEUR in contrast, rallied to finish January almost in line with our call of 1.17. This means that both crosses have traded broadly in line with our base case so far this year, and we expect these trends to continue playing out looking forwards too. In particular, markets should continue moving towards our base case views for major central banks, anticipating six cuts this year from the ECB, five from the Fed and four from the BoE. With half a cut to be priced out for both the BoE and Fed under our base case, the move in rates would argue for cable to trade broadly sideways in the coming months. That said, whilst we think our core macro thesis remains intact, positioning in GBPUSD still feels a little stretched at present, especially with cyclical conditions remaining weak and our base case for greenback appreciation. Therefore, despite expecting markets to further trim easing bets for both the BoE and the Fed, we suspect a concurrent move in expectations could see modest GBPUSD softening in the very short term. Nevertheless, improving macro data and fewer priced rate cuts in the UK should sustain GBP appreciation on crosses against cyclically weaker currencies. Despite the 2% run-up in GBPEUR last month, we continue to favour upside, although we note that gains are likely to become limited.

> "Longer term, it is worth noting that the coming month should see confirmation that the UK economy fell into the shallowest of recessions at the back end of 2023, with activity contracting by 0.1% in both Q3 and Q4."

That said, this is unlikely to overly trouble FX markets. Not only is this old news, but forward looking growth indicators, in particular PMIs, suggest that UK growth has rebounded sharply in recent months. Better growth in 2024 should support the pound from Q2 onwards, particularly against the euro, comparing favourably with a eurozone slowdown and keeping the BoE on hold for longer than their European counterparts. Indeed, from a BoE perspective, a budget in early March and April's rise in the National Living Wage form the major UK specific risks for the next three months. Notably, whilst not our base case, both have the potential to stoke inflation, which could see an extension of the BoE's current hold, and consequently see sterling outperform our forecasts. Further out, policy easing and a general election remain the key dynamics for markets to monitor, with risks for sterling around these events, two-sided relative to our forecasts.

JPY

Patiently waiting for the BoJ

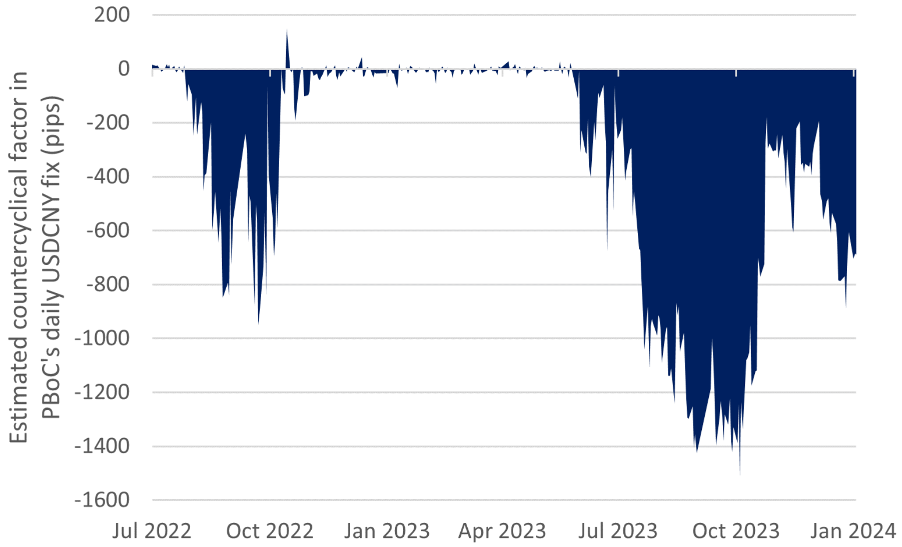
In a low vol environment, the Japanese yen continues to stand out. After benefiting considerably from the euphoria over Fed easing towards the back-end of 2023, and expectations of further normalisation from the BoJ, the yen started the new year by declining over 4% against the dollar as speculative long positioning was trimmed, spreads in real rates widened, and the equity environment stabilised. The combination of the aforementioned factors led USDJPY to overshoot our one-month and Q1 forecast of 145, however, price action towards the end of the month suggested the pair was set to return to our forecasted rate. This was primarily a result of developments in bond markets, with Treasury yields falling on reduced issuance and a somewhat dovish Fed over the medium-term, while January's Bank of Japan meeting also supported the view that rates would be allowed to freely rise from April's meeting onwards. All told, despite yielding a significant forecast error in January, our view on USDJPY remains unchanged over the course of the first quarter. That is, a lower range in Treasury yields and a view that the BoJ will adjust policy further in April, should see USDJPY avoid re-testing highs of 150. A break back towards the 140 handle is also unlikely seeing as the Fed looks reticent to move on policy until Q2 and risk sentiment in equities is unlikely to sour outside of China given the recent stabilisation in growth data. Therefore, despite USDJPY recording significant moves over recent months, we don't expect the pair to provide any more fireworks this quarter. Instead, we expect it to fluctuate around 145, the mid-point of its recent range, until the second quarter when central banks begin to adjust policy.

CNY

The PBoC put

While January has been a torrid month for China-linked assets, this hasn't been reflected in the performance of the yuan, which has weakened just under a percent even amidst an environment of broader US dollar strength. The outperformance of the yuan relative to other local assets and regional currencies reflects the PBoC's efforts to deter further depreciation. Similar to the mid-September to mid-December period, the Chinese central bank has utilised the countercyclical factor of its daily fixing, alongside quasi-intervention through state banks over the past month, to limit a retracement in USDCNY to last year's peak of 7.3.

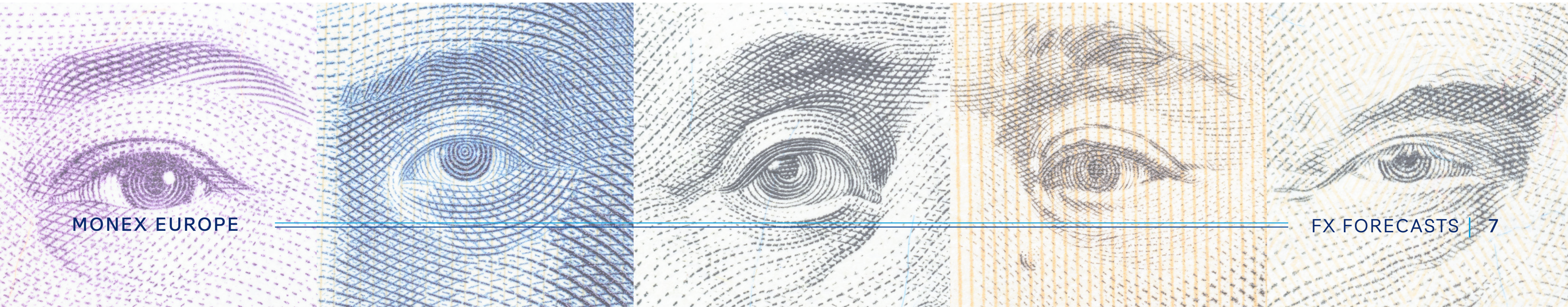
The PBoC's heavy use of the countercyclical factor once again stemmed CNY depreciation in January



While continued deflation and underwhelming manufacturing growth argues against this regime, our view that the central bank sees CNY weakness as a threat to consumer and investor confidence during the economic transition leads us to believe that the PBoC will effectively peg the currency until domestic growth conditions or external market conditions become more accommodative. Our conviction in this view was boosted over recent weeks as the PBoC met our off-consensus call and held the one-year MLF rate at 2.5%, noting that a rate cut remains too broad of a stimulus measure and risks adding downside pressure on the currency. While rumours of a CNY2trn offshore stabilisation fund presents a downside risk to our 3-month USDCNY forecast, we believe this risk is limited. Firstly, the size of the stabilisation fund in terms of liquid offshore funds and average foreign equity inflows is questionable and thus raises doubts over the likelihood of the initiative, even at a reduced scale. Secondly, given the PBoC's preference for CNY stability and the need to keep financial conditions loose throughout this transition period, we expect the central bank to be as averse to near-term yuan appreciation as they are to deprecation.

"As DM central banks begin to ease policy in the second quarter, we believe external market conditions will reduce concerns over China's debt trajectory and provide a more sympathetic environment for the PBoC to cut rates to support the economy."

An improvement in domestic banks' net interest margins following measures to reduce their liabilities, such as cuts to reserve ratios and deposit rates, should also support such actions after Bank profitability reached a record low in Q1. With looser monetary policy stimulating growth conditions domestically and externally heading into the second half of the year, we expect the PBoC to loosen its grip on the yuan, enabling it to rally gradually in line with the improved cyclical backdrop.

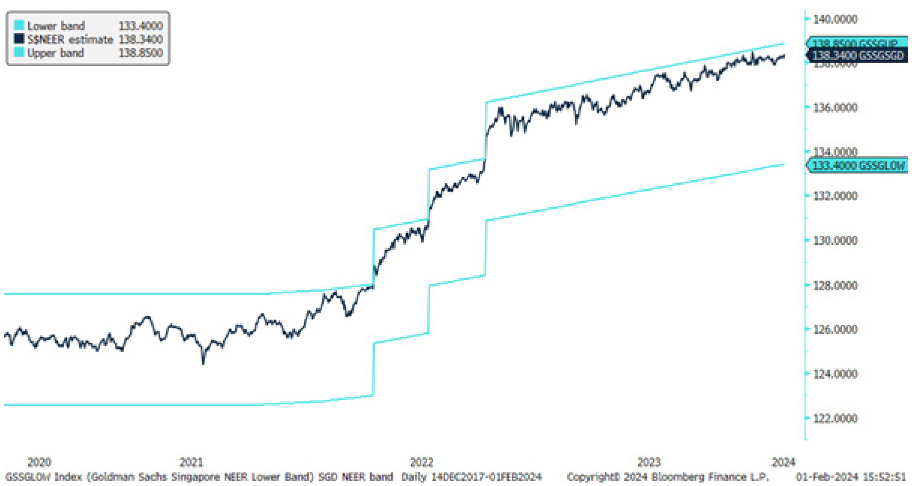


SGD

Protected by MAS

At its first quarterly meeting, the Monetary Authority of Singapore maintained all its policy parameters (mid-point, slope, and width) of the SGD NEER (S$NEER) policy band, a decision that was widely expected seeing as disinflation progress in core CPI has recently stalled. With the MAS maintaining its tightening bias, which we estimate at around 1.5% S$NEER appreciation annually, and a shift to a more neutral stance unlikely before 24H2 based upon its updated core inflation forecasts, we think upside in USDSGD should be limited throughout Q1 despite our view of continued broad USD appreciation. This is because policy intervention to stem further depreciation in CNY and JPY (see above) reduces the extent to which USDSGD can rise while the S$NEER basket continues to appreciate in line with MAS's stance given both currencies account for roughly a third of the S$NEER, with that rising to two thirds once factoring in the dollar. That isn't to say that a top in USDSGD has necessarily formed as continued weakness in EUR and MYR under our base case can offset any impact of further USDSGD upside on the S$NEER, but we do think upside potential is limited at around 1.35 over a tactical horizon.

Further USDSGD upside is inconsistent with the MAS's preference for a strong S$NEER



CHF

That's enough now

Whilst the franc was one of the best performing currencies of 2023, we came into the new year expecting that December would mark a top for the Swiss currency. Notably, a change in language from the SNB suggested that policymakers were running out of patience with the franc's strong run having previously utilised it to supplement their efforts to tame inflation, especially considering the broad disinflation playing out domestically. Our call for CHF depreciation partly played out over the past month, though a haven fuelled rally at the back end meant that we undershot our 0.94 EURCHF projection for January. Looking forward, however, we continue to expect the franc to weaken, with a dovish SNB likely to see EURCHF back to 0.94-0.95 range in coming weeks.

Admittedly, with a reading of 1.7%, December's inflation data slightly overshot SNB inflation of 1.6% projections for the fourth quarter. Still, we don't think this will concern policymakers too much as inflation remains within the Bank's tolerance band and upside pressures are largely the result of idiosyncratic factors. President Jordan's recent statements appeared to confirm this view, saying that: "our expectation is that inflation will rise due to the VAT increase and electricity prices [...] but it should not exceed 2%." Indeed, stagnant growth, cooling external inflationary pressures and rising domestic deflation risks are likely to see the SNB stay cautious of downside risks in the short term, intervening verbally to weaken the franc if necessary, and likely cutting rates from June.

> "Even weaker growth coupled with inflation that is rapidly approaching target means the ECB should start its easing cycle in April, meaning EURCHF is likely to remain at the lower end of its recent ranges."

On a tactical horizon, risks to our franc call are generally skewed to the upside. Continued weakening in eurozone activity, or a possible escalation of tensions in the Red Sea, could push EURCHF lower as the franc picks up a haven bid. We expect that such an outcome would trigger pushback by the SNB given the deflationary risks, first verbally and then through direct interventions in FX markets to weaken the franc, capping the scope for significant further appreciation. Not only that, but this could also lead the SNB to initiate monetary easing earlier than we anticipate, especially if incoming inflation rates continue to move away from the upper end of the bank's 2% tolerance range. As a result, we see limited risks of EURCHF breaking back below 0.93 on a sustained basis.

In the medium term, we expect that both the ECB and SNB should be easing in the second half of the year. However, considering the lower terminal rate in Switzerland, and with only four meetings per year, the SNB's rate of cuts is unlikely to keep pace. Consequently, SNB policy easing is likely to focus on the franc level too, with the potential for active currency devaluation by the SNB to ease monetary conditions at the margin, especially if outright deflation looks to be a risk. In combination with improving growth conditions in Europe, could lead to a rapid weakening of the franc in 2H2024 although we continue to maintain that a break of parity in EURCHF is unlikely.

Forecasts

Currency Pair	1-month (29th February 2024)	3-month (30th April 2024)	6-month (31st July 2024)	12-month (31st January 2025)
G10				
EUR/USD	1.07	1.07	1.10	1.14
USD/JPY	145	140	138	130
GBP/USD	1.26	1.26	1.28	1.32
USD/CHF	0.88	0.88	0.89	0.86
USD/CAD	1.36	1.37	1.36	1.32
AUD/USD	0.66	0.67	0.70	0.74
NZD/USD	0.61	0.62	0.65	0.69
USD/SEK	10.7	10.9	10.2	9.5
USD/NOK	10.65	10.67	9.73	9.30
DXY	104.42	103.96	101.70	97.77
Emerging Markets				
USD/CNY	7.15	7.15	7.0	6.8
USD/INR	83	83	82	80
USD/SGD	1.34	1.34	1.30	1.28
USD/ZAR	19.0	18.0	17.5	17.0
USD/TRY	30	31	33	28
USD/PLN	4.11	4.19	3.91	3.68
USD/HUF	364	381	345	316
USD/CZK	231	23.6	22.9	21.6
USD/BRL	4.9	4.9	5.0	5.2
USD/MXN	17.2	17.1	17.1	17.0
Euro Crosses				
EUR/GBP	0.85	0.84	0.86	0.86
GBP/EUR	1.17	1.19	1.16	1.16
EUR/CHF	0.94	0.945	0.98	0.98
EUR/CAD	1.46	1.45	1.50	1.50
EUR/SEK	11.4	11.4	11.2	10.8
EUR/NOK	11.4	11.2	10.7	10.6
EUR/TRY	32.1	32.6	36.3	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	5.24	5.15	5.50	5.93
EUR/MXN	18.4	18.1	18.8	19.4

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