FX Forecasts

November 2023

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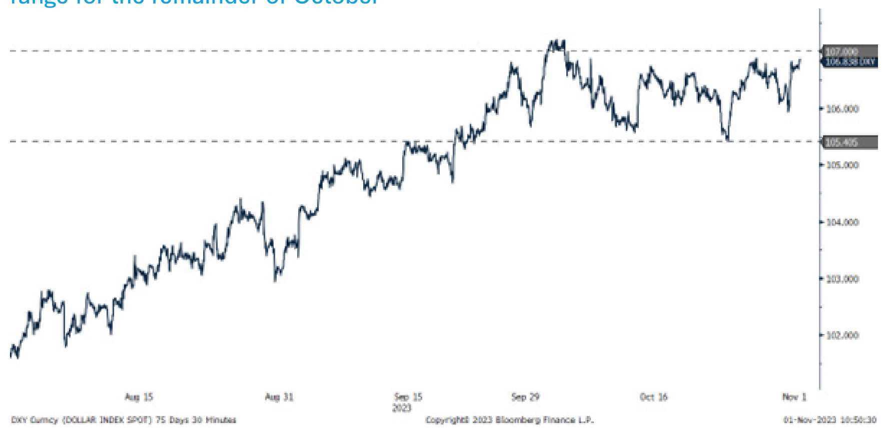
INTRODUCTION

Staying the course despite the bump

Last month we highlighted that the sources of dollar appreciation had broadened as the risk-off channel opened, with equities trading under substantial pressure from higher yields. While the outbreak of war within the Middle East merely exacerbated this and intensified the uptick in US yields, the dollar failed to continue appreciating after an initial surge at the beginning of the month which saw the DXY index break through 107 to hit fresh year-to-date highs. Despite the previous drivers of the dollar's rapid rally remaining in place, the greenback's inability to continue rallying seemed counterintuitive on a surface level. However, the range bound nature of the dollar can largely be explained by three factors.

After briefly breaking above 107, the DXY index settled to trade in a relatively tight range for the remainder of October

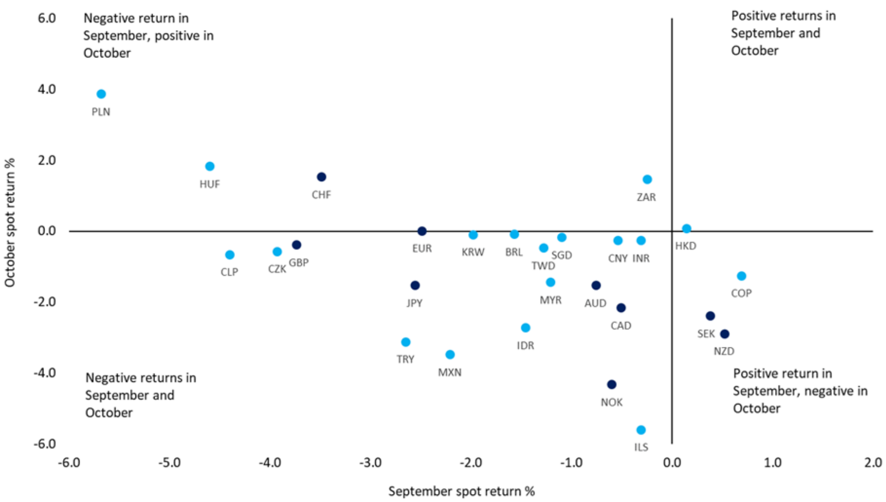


First, Fed officials were quite vocal at the start of the month on the interplay between financial conditions in the bond market and the prospect of further rate hikes. This not only created an implicit ceiling on nominal Treasury yields, but weighed heavily on US real rates. It is the latter which we believe to be instrumental in keeping USD appreciation contained, as it led to relative stability in most DM real rate spreads. Second, Asian central bank intervention has also been a restrictive factor. With actions by both the BoJ and PBoC effectively implementing soft dollar pegs for the yen and yuan at 150 and 7.30 against the dollar respectively, the ability of the greenback to climb higher has been mechanically limited. The final day of the month, however, brought a BoJ decision that ultimately saw markets test this policy, potentially creating conditions for the dollar to climb higher should there be a shift in appetite from policymakers. Third, signs that the US exceptionalism narrative may begin to wane are also helping to prevent a dollar breakout. Admittedly, US Q3 GDP numbers came in well above expectations at an annualised rate of 4.9%, but this only served to confirm to markets what was already known from more timely data prints. More importantly, a buildup in inventories that was supportive in Q3 is unlikely to be repeated in Q4, with a contraction in real discretionary income and the restart of student loan repayments also likely to weigh on future growth prints.

Nevertheless, these factors merely prevented the dollar from appreciating further over a tactical horizon as opposed to creating fertile conditions for the dollar to begin sustainably depreciating, leaving intact our medium-term view that the dollar is unlikely to structurally depreciate until 2024 Q2 at the earliest. While the Fed's recent rhetoric has imposed a temporary cap on yields, we think the resiliency of growth data is likely to provide a high floor, meaning US yields are likely to settle into a new, higher range. The elevated level of nominal Treasury yields should maintain pressure on yield sensitive currencies, namely low-yielding Asian FX. This should mean any further depreciation will come through real yield spreads. With inflation expectations in the US likely to remain stable under slowing progress on disinflation and strong growth, movement in real yield spreads is likely to come from an increase in inflation expectations alongside dovish central bank guidance in Asia. In this scenario the dollar should make only incremental gains against Asian FX over the remainder of the year, especially as central banks remain vigilant to domestic currency depreciation.

We also think it is also premature to call the end of the US exceptionalism narrative, even as growth conditions in the US are set to cool and cyclical pessimism is close to troughing in Europe and China. October's flash PMIs exemplified this, with the US notably outperforming the eurozone, UK, and China across a variety of current and leading indicators. All told, we think the factors that prohibited the dollar from climbing higher in October are likely to loosen somewhat in the upcoming month, unlocking further USD appreciation before the next round of central bank decisions in December, which could hold significant dovish surprises.

October returns against the dollar saw a partial reverse of Septembers price action, with macro stories and idiosyncratic developments playing out on crosses



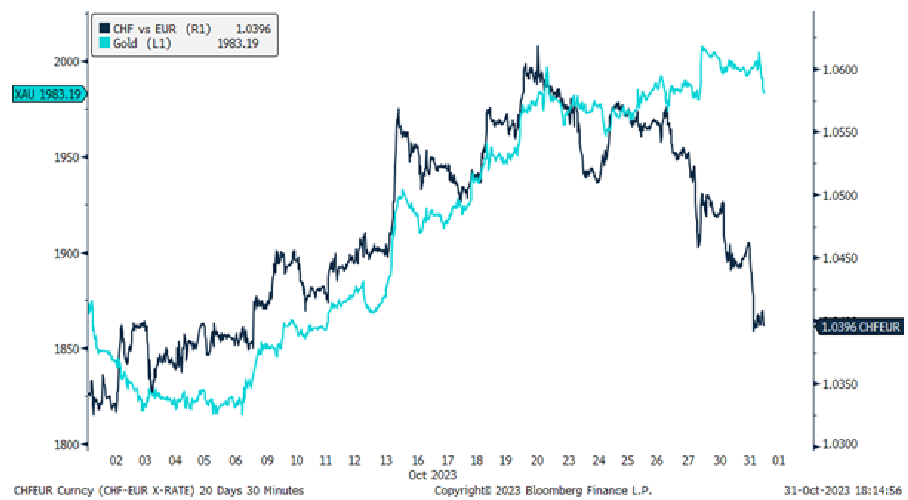
As the broad dollar traded within a tight range in October, the general trend across the expanded majors was a declining pace of depreciation against the greenback relative to September. Understandably, this was most visible in EM currencies where central bank policies actively dampened volatility and further depreciation (INR, HKD, CNY, SGD), but reduced downside pressure also became visible in European FX, with GBP and EUR both closing the month relatively flat and CE-3 currencies rallying on lower real Treasury yields, a more conventional approach to monetary policy by their respective central banks, and an election result in Poland which boosted investor sentiment within the region.

There were exceptions to this rule, however. The pace of ILS depreciation understandably accelerated over recent weeks given the onset of war, although this has been somewhat contained by BoI measures to backstop liquidity, preventing a sudden stop in the currency. Furthermore, the Mexican peso and Norwegian krone saw their pace of depreciation accelerate on the month due to idiosyncratic factors. In the case of MXN, rising long-term Treasury yields still made market conditions unfavourable for carry positions, leading to a sharp reduction in long MXN positioning. Meanwhile, moderating oil prices, weaker growth data out of the eurozone, and crucially a large drop in domestic inflation saw NOK underperform against the dollar in the G10 space.

> "While some idiosyncratic factors such as positioning and varying risk premia were at play in October, generally speaking most currencies traded within quite tight ranges against the dollar."

These low levels of volatility were surprising given the deluge of economic data, shifting market conditions, and the increase in geopolitical risk. However, that's not to say that currency markets in this bemusing low vol environment weren't sensitive to these developments either. Instead their effects were visible on crosses rather than against the dollar. For example, building expectations of further hikes from the RBA and news of China's 1trn yuan stimulus package remained supportive of AUD against NZD, NOK, and CAD, where monetary policy is now seen on hold and their terms-of-trade is less orientated towards Chinese infrastructure spending. This took place even as the Australian dollar fell against the greenback on deteriorating risk sentiment. Furthermore, the uptick in geopolitical risk saw CHF rally against the EUR on the month, even as both central banks remained on pause and are subject to similarly weak growth profiles. This was best represented at the beginning of the month when stagflationary concerns were the most pronounced, leading EURCHF to drop to lows last seen during the peak of last year's energy crisis as other inflation and risk hedges, i.e. gold, also saw risk-off inflows.

CHF appreciated against the euro during periods of pronounced geopolitical risk alongside other inflation and risk hedges



Risks remain tilted towards a stronger dollar into year-end

At first glance, November looks like it could bring much of the same for FX markets, with the dollar's path higher set to remain stymied at least in part by rate dynamics and a PBoC intent on staving off further currency depreciation. Moreover, with DM inflation unlikely to return to central bank targets until mid-2024 and most hiking cycles on hold for an extended period, there is a risk that volatility subsides further as markets assess incoming data against the respective monetary policy stances. Ultimately this should leave FX markets trading in tight ranges over a tactical horizon once again, with idiosyncratic developments largely playing out on crosses as they did last month. Nevertheless, despite some of these prohibitive factors remaining in place, we still see further, albeit marginal, appreciation for the dollar in the next month. This is primarily motivated by macro conditions outside of the US, which we think are likely to show a greater risk that central banks have overtightened policy, increasing recession risks and bringing forward expectations of policy easing in swap markets. This is especially prevalent in Canada, the eurozone, and to a lesser extent the UK, where data already shows weak consumption and investment outlooks which are beginning to influence labour market conditions. If sustained, there is a risk that these dynamics could create a virtuous loop, creating a much faster disinflation path. Furthermore, events towards the end of October showed that the anchors within the Asian FX space are beginning to loosen, with Japanese policymakers potentially becoming more tolerant to JPY depreciation. This should clear the near-term path higher for the dollar.

"Even though the dollar undershot our expectations in October, we still see short term risks to our DXY forecasts as tilted to the upside, mainly on a more pronounced recession in the eurozone, a higher tolerance for currency depreciation by Asian central banks, and the risk that with stalling progress on inflation the Fed delivers on its Q4 rate hike in December."

In particular, USDJPY could now be a joker in the pack, with the BoJ's latest YCC adjustment seeing a renewed sell off in the yen. Whether or not the BoJ chooses to push back on JPY depreciation, and how, is likely to be key. A failure to do so could see USDJPY run significantly higher, especially if it looks like the Fed will hike once again despite tighter effective financial conditions.

Other risks for our macro outlook appear skewed towards dollar upside too. Notably, financial stability could start to come back into scope for markets. While we previously alluded to this taking place in the eurozone given elevated recession risks and fiscal trajectories posed the risk of bond market fragmentation, indicators of financial stability risks have broadened in the past month. Housing market risks in Sweden have increased, US credit spreads have widened to levels last seen during the March regional banking crisis, meanwhile the proportion of banks tightening rather than loosening standards for commercial loans has now almost hit 50% - a level only exceeded during the worst periods of the financial crisis and the pandemic, and headlines around China's property developers have yet to improve. If these risks ultimately materialise, raising the risk of recession and aggressive central bank easing, we would expect the dollar to catch a haven bid. That is unless the stability risks remain isolated to the US economy, similar to events in early March.

Similarly, though not our base case, events in the Middle East also hold the potential to trigger a dollar haven bid too. Whilst hostilities between Israel and Hamas remain contained for now, risks for a broader escalation have not disappeared. Admittedly, a more cautious than anticipated approach by Israel in the Gaza strip weighs against this risk. But even so, continued shelling across the Israel-Lebanon border risks escalation. The big concern for markets, however, are developments that draw in Iran and perhaps the US, broadening the scope of the conflict and ultimately leading to a significant jump in oil prices alongside possible renewed disruption to global supply chains.

This isn't to say downside risks to our dollar view aren't absent. We note that although growth data in Europe and China has yet to show sustained improvement, it has exceeded expectations on some measures. Should recession risks in the eurozone recede into Q4, we expect EURUSD to find support around the 1.05 level, capping the extent to which the dollar can appreciate. Furthermore, increased stimulus measures out of China have the potential to boost cyclical assets, especially if they aren't seen precluding negative growth or industry headlines. Finally, there is a risk that the US economy enters a more durable slowdown as opposed to a temporary blip. While leading indicators at the start of Q4 suggest this is unlikely, if it were to occur then it would likely bring forward expectations of Fed easing, and with it the start of the structural downturn in the dollar which we don't currently see taking place until Q2 2024 at the earliest.

FX VIEWS

DXY

Staying long dollar despite October's misfire

The broad dollar climbed just 0.5% in October after spending most of the month in a relatively tight range. Stability in real rate spreads following commentary from Fed officials that higher bond yields could substitute for further rate hikes can largely explain the more placid DXY price action compared to our one-month forecast, which foresaw a 1.35% rally. Further prohibiting broad dollar gains was the inability of EURUSD to plumb below 1.05 despite data suggesting that the eurozone economy is likely to contract in the fourth quarter if current momentum is sustained, undershooting the ECB's forecast for a slight 0.1% QoQ expansion. The final factor weighing on the dollar was efforts by Asian central banks to offset depreciation pressures on their respective currencies. While the PBoC's fixings and the BoJ's previous stealth intervention measures saw USDJPY and USDCNY imitate pegged currencies for much of the month at 150 and 7.30 respectively, the Bank of Indonesia and the central bank of Philippines also hiked interest rates with the sole intention of supporting their currencies.

While the dollar's inability to climb higher in October suggests that the rally since mid-July has now run out of steam, we are hesitant to turn neutral on the greenback just yet. Instead, we are rolling a large proportion of our 1-month forecasts from October based upon the view that markets are currently underpricing the risk of earlier monetary easing in Canada, the eurozone, and to a lesser extent the UK and that continued weak data releases should lead this to change. In contrast, slower but still resilient growth data in the US should keep markets from pre-emptively pricing Fed rate cuts.

> "Out of the major DXY components, the main adjustment in our near-term forecasts has been USDJPY, where we think price action after October's BoJ meeting could be symbolic of a regime change by Japanese policymakers."

As opposed to topping up the psychological impact of previous stealth intervention efforts, which we believed to be the case previously, we now think policymakers will be more tolerant to JPY depreciation as long as it takes place at a steady pace. This should see one of the main Asian FX anchors start to move, easing the path for the dollar to climb back to levels last seen in November 2022.

Risks to our near-term dollar view are largely tilted to the upside, mainly on a more pronounced recession in the eurozone, a higher tolerance for FX depreciation by Asian central banks, and the risk that stalling progress on inflation leads the Fed to deliver on its guidance and hike rates in December irrespective of the tightening in financial conditions. Furthermore, financial stability risks have also increased in recent weeks, with credit spreads widening in the US, bond defaults by Chinese property developers, and increased levels of insolvencies at a time when excess liquidity is being removed from financial systems. If these materialise and trigger more pronounced recessions, ushering in aggressive monetary easing as a response, we expect this to support the dollar on a haven basis. There is a risk that the financial stability concerns are concentrated just in the US similar to March, however, which will likely weigh on the greenback, especially against other reserve currencies. That said, we don't expect financial stability risks to become a realistic consideration for markets until 2024.

EUR

Overtightening risk to become more apparent

Following the Fed's more dovish set of communications, relatively stable real rate spreads and increased corporate demand for the euro at historically cheap levels – a similar dynamic to that in Q3 2022 – saw the euro's descent halt, with EURUSD spending most of the month in a relatively tight range centred at 1.06. The data flow out of the eurozone over the past month has also been mixed, potentially explaining why intraday volatility has remained high despite the single currency lacking fresh direction. Headline and core inflation has dropped considerably, largely due to base effects but also due to softening demand. Meanwhile, on an ex-Ireland basis, the eurozone economy was seen stagnating in the third quarter, marking a slowdown from the 23H1 growth pace and undershooting ECB expectations, but representing a positive beat relative to Q3's timelier growth signals. Nevertheless, preliminary data for October and leading indictors suggest the effective transmission of the ECB's monetary tightening is set to drag the eurozone economy into contraction in the fourth quarter. By simultaneously lowering inflation, some economists expect any contraction to be shallow and short-lived as real wage growth increases and provides a floor for consumption. However, with anecdotal reports suggesting weak demand conditions are filtering into firms hiring intentions, and in some cases resulting in outright layoffs, we believe there is a risk that the labour market won't remain at current levels of tightness. This would reduce the likelihood that improving real wages support growth in early 2024. If confirmed in subsequent data releases, this should lead markets to bring forward expectations of ECB easing. While we don't expect the first ECB rate cut until Q2 2024, we highlighted after October's ECB meeting that there is a serious tail risk that weak growth forces the first cut to take place in Q1, even as the ECB stresses the importance of wage data in Spring before any easing decision is made.

In our view, weak growth momentum in the eurozone should lead EURUSD lower to 1.03 in the final months of 2023, but will likely prove insufficient for another test on parity without bond market dynamics posing a risk to financial stability or another stagflationary shock from energy markets. Risks to our base case over the near-term are two-sided. Outside of energy and bond markets, a more pronounced impact from monetary tightening that materially increases the immediate recession risk for markets could see EURUSD trend towards parity, but not break it. Furthermore, stagnating progress on inflation in the US, despite the effective tightening of financial conditions since September's Fed meeting, could see policymakers embark on a December rate hike, raising real yields and re-exerting yield pressure on EURUSD. On the contrary, upside risks stem from a more resilient eurozone economy into year-end and the prospect that the Fed reneges on its forward guidance, an act that should weigh on real and nominal Treasury yields.

Over the medium-term, reduced transmission of monetary tightening globally should reduce pressure on growth conditions, and as such improve sentiment around EURUSD which is seen as a cyclical asset. That said, we don't expect the euro to regain ground historical averages until the middle of 2024, when we expect the commencement of monetary easing from the Fed.

GBP

BoE set to confirm Bank Rate has hit a peak

Last month saw us significantly downgrade our sterling forecasts, a move that came in light of an unexpectedly dovish Bank of England policy decision and an expected bout of dollar strength. Whilst the latter assumption has struggled to play out thus far, as detailed in our USD section, we still see a path for the dollar to move higher in the short term. We are increasingly confident in our call for the BoE in that the September announcement to hold rates at 5.25% effectively called an end to monetary tightening.

The next test of this view is set to come on November 2nd, with the MPC will deliver their latest rate decision along with an updated Monetary Policy Report and a press conference with Governor Andrew Bailey. We continue to expect a hold and the BoE to push back on prospect of early rate cuts, in line with policymakers expressed preference for a "Table Mountain" profile for Bank Rate, which should support sterling at the margin. Admittedly, current market expectations that see a Q3 2024 start to rate cuts seem reasonable to us. Still, policymakers will be conscious that market pricing of more rapid cuts effectively eases financial conditions at a point where the MPC would likely prefer them to remain tight. The big question is whether markets will buy this, or not. Notably a recent sell-off in Bank Rate expectations has been led by weakening economic activity data. In particular, retail sales data showed a much larger than expected 1% fall in in September, with PMI numbers also continuing to print in contractionary territory. This has raised some fears that the UK economy isn't just stagnating but could well follow the EU into what looks like recession, a dynamic that helped keep sterling under pressure last month.

That being said, an absence of pushback would be noticeable too and is a risk to our forecasts. This would suggest that policymakers are concerned about growth conditions, expecting a faster slowdown in activity to weigh on price growth, while it could also stoke concerns over financial stability, leading markets to price in increased risk premia in UK assets. It was notable that October data releases have begun hinting at such an outcome. Whilst inflation indicators were largely a wash, growth signals suggested that the UK may be slowing faster than expected. Though we still look for a UK stagnation rather than recession, downside risks for the UK economy have started to mount. If realised, such an eventuality would be clearly negative for the pound, with both weaker growth and a looser policy outlook adding downside pressure on sterling and posing a risk to our current forecasts.

> "The other potentially significant economic event coming up this month sees Chancellor Jeremy Hunt deliver his Autumn statement to Parliament."

Whilst we don't expect any significant bombshells from the government as our base case, with only one more fiscal event likely to take place before a general election, there is a risk that policymakers choose to roll the dice. If, however, the Chancellor delivers a snoozefest as we expect, the focus for the month is likely to rest on incoming data. Inflation should cool markedly as a rise in the energy price cap last year falls out of the annual CPI calculation, whilst we continue to expect growth figures to indicate the UK economy just escapes recession. Over time we anticipate this translating into sterling strength, as the UK's relative economic outperformance versus the eurozone and improving real rates profile make the pound look increasingly attractive. Even so, this may take longer than a month to play out. Combined with our underlying view for modest dollar appreciation in the short term, we continue to look for mild GBPUSD downside over a one-month time horizon. As such, we are rolling forward last month's forecasts, expecting GBPUSD to fall to 1.20 by month end, before a retracement back to 1.28 over a longer 12-month outlook.

CAD

Bearish on recession risk

The Canadian dollar weakened -2.3% over the course of October to reach its lowest level in 12-months, primarily due to a consistent deterioration across its cross-asset drivers—equities, oil, and yield spreads. Lingering concerns over global growth and tighter Fed policy coincided with pessimistic risk sentiment following the outbreak of war in the Middle East to generate another month of negative equity performance. Moreover, signs that the global manufacturing downturn has yet to conclude alongside indications that the war won't bring about further supply shocks for oil has prevented crude oil from structurally trading above $90 per barrel. In the meantime, domestic economic developments and speculation over greater issuance of US Treasuries have largely resulted in a widening of front-end yield spreads on the order of 20 to 30 basis points to the detriment of the Canadian dollar, as the BoC's hiking cycle looks more convincingly over with risks of an earlier-than-expected cut now mounting.

In terms of the economic fundamentals, the Canadian economy continued to stagnate even as the US economy accelerated, with August's GDP report suggesting Q3 growth could flatline once again after a marginally negative Q2 print. While this suggests a more negative output gap should soon lead the BoC to formally announce an end to its hiking cycle, concerns over the stalled progress on disinflation have so far prevented policymakers from doing so. The September inflation report did show that domestic price pressures have eased, with the breadth of inflation declining considerably. But core inflation metrics have merely returned to the 3.5% to 4% range that was previously worrying to the Bank of Canada following a surprise increase in August. Nevertheless, softer growth has been accompanied by a cooling labour market. Employment gains have fallen short of increases to the labour supply in 8 of 9 months this year, with March being the sole exception. This contrasts with 2022, when only 3 of 12 months showed the same dynamic. With leading indicators of labour demand and surging population growth suggesting that demand will continue to lag behind supply, wage growth should also begin to cool in the months to come.

"Taken together with indications from the BoC's surveys that Canadian inflation will likely cool as consumer spending declines, the data released over the past month have confirmed our view that the BoC has most likely completed its hiking cycle."

Looking into the new year, we now expect the Canadian economy to enter a recession in the first half of 2024, a view outlined in our CAD outlook last month. Though Governor Macklem continues to insist that it is too early to discuss rate cuts, the time for that conversation may arrive as soon as 24Q1. We hold a strong view that the Bank of Canada will likely deliver its first cut while the Federal Reserve remains in "higher for longer" mode, and the pace of cuts may also be more aggressive than the Fed's. This view has not yet been priced into markets, leaving considerable scope for further depreciation in the loonie as a result. A growing number of analysts have begun to share our thesis, and markets may soon follow suit—especially once monthly GDP growth starts to consistently print below zero. We expect USDCAD to intermittently break through 1.40 between now and the end of Q1 2024 and have upgraded our USDCAD forecast profile across the entire horizon to reflect this growing reality.

The main upside risks to our USDCAD view include the potential for a substantial escalation in the war in the Middle East and the possibility of a more severe-than-expected Canadian recession. To the downside, an improvement in growth in Q4 would catch most off guard and could therefore trigger a substantial re-pricing in USDCAD. There is also the possibility that core inflation could continue to hold steady, leaving the BoC in the same position as the Riksbank. This would lead markets to bet on yet another hike, irrespective of the growth outlook. But while this may trigger a knee-jerk move lower on USDCAD, markets have generally punished other DM currencies when central banks have hiked into weakening growth conditions, and a downward move on USDCAD is unlikely to be sustained in this scenario.

Scandi FX

At the back of the pack

Our October forecasts warned that whilst green shoots are beginning to emerge for Scandi FX, it was still too early to turn constructive. Whilst in large part this broad thesis played out in October, we did not see either NOK or SEK having quite as bad a month as they ultimately delivered, with both amongst the worst performers across the G10 FX complex.

There remain good reasons for continued SEK weakness in particular. Swedish inflation is still elevated, with price growth of 6.5% YoY recorded in September. Whilst down from December's 12.3% peak, this continues to overshoot market expectations. Cooling price growth has come at a cost too. Headline growth figures showed the economy flatling in Q3, whilst contracting 1.2% on a yearly basis. Balancing price stability with downside risks to growth and financial stability has left the Riksbank in a bind, unable to raise rates as fast as might be desired to bring inflation back to target without breaking the economy. The consequence however has been persistent depreciation pressure on SEK, with this in turn feeding further inflation via the import channel.

Given this, markets currently foresee a 70% chance of a hike at the next Riksbank meeting on 23rd of November, with broad consensus projecting more tightening is needed from Swedish policymakers. Whilst this is greater than the roughly 40% chance suggested by the central bank at the last policy meeting, we are inclined to think a further rate hike is likely to be delivered given the persistent inflation pressures. While inaction from the ECB at this point suggests SEK should strengthen against the euro, there is a discernible difference this time around given Sweden's weak macro fundamentals. It is notable too that the Riksbank's FX hedging program has also likely weighed against krona depreciation at the margin. This does not, however, negate the fact that continued krona weakness is occurring as a function of the poor economic fundamentals. But we suspect that any further sell-off should be modest as a consequence.

NOK in contrast has been a surprise underperformer over the course of the month, turning in the worst performance against the dollar of any major currency outside the shekel with a 4.32% decline. Whilst events in the Middle East have naturally weighed on risk sentiment, a dynamic that has seen high beta G10 FX underperform, NOK would ordinarily be expected to hold up better than SEK given an offsetting impact from high oil prices. In this case however, WTI has fallen by 7%, even as the Norges Bank continues to ramp up its krone sales, with these increased once again at the end of October to 1400m, up from 1200m in September. Moreover, with inflation having significantly undershot expectations three months in a row, it appears as if monetary policy has been set too tight. As such, it now looks increasingly likely that the Norges Bank has finished hiking, with falling rate expectations now putting further downwards pressure on the Norwegian krone.

"That said, at current levels NOK looks oversold, with this month's price action seeing NOKSEK finishing month end at close to parity."

In our view the better underlying fundamentals for the Norwegian economy should see NOK outperform, particularly as Fed rate cuts and a global growth rebound come into scope for FX markets. SEK in contrast will continue to struggle, albeit we think the psychological 12.00 barrier on EURSEK as too big a hurdle for the cross to overcome. As such, our near-term NOK and SEK forecasts are relatively unchanged, with the former staging a recovery in our view on a better underlying growth picture, whilst the latter continues to trade just below year-to-date highs as the economy continues to shudder under the effects of monetary tightening. Further out, we expect the SEK recovery to coincide with the DM easing cycle, a soft landing for the US, and growth recovery in the eurozone. But as we warned last month, it remains to soon to turn constructive with any confidence on Scandi FX just yet.

AUD

Still hot down under

Heading into October, we had expected to see a bounce in the Aussie, predicting that an RBA rate hike on October 3rd would set the scene for a rally in AUDUSD on the back of higher rates. Whilst this failed to play out this month, with the RBA instead standing pat, data since then continues to make our case that inflation down under remains too hot, with the RBA needing to deliver more to cool price growth back to target.

Notably, Q3 inflation data out last month showed prices growing 1.2% QoQ, above both the 1.1% rise expected and the 0.8% growth in Q2. On a yearly basis this leaves inflation at 5.4%, with both the trimmed mean and weighted median adjustments reading 5.2% YoY. Perhaps more worryingly for the RBA, even though the Australian economy managed to lose 40k jobs in September, the unemployment rate fell from 3.7% to 3.6% with even more workers exiting the labour force. Whilst we are conscious of inferring too much from just one data print, we would note that with inflation looking sticky and in large part domestically generated, the last thing policymakers need is a tightening labour market. Given this, we have rolled forward our expectations for a rate hike this month, with the next policy decision coming up on November 7th. Risks now look increasingly skewed towards needing multiple rate hikes too, though we suspect any further rate hikes are more likely to be a 2024 problem.

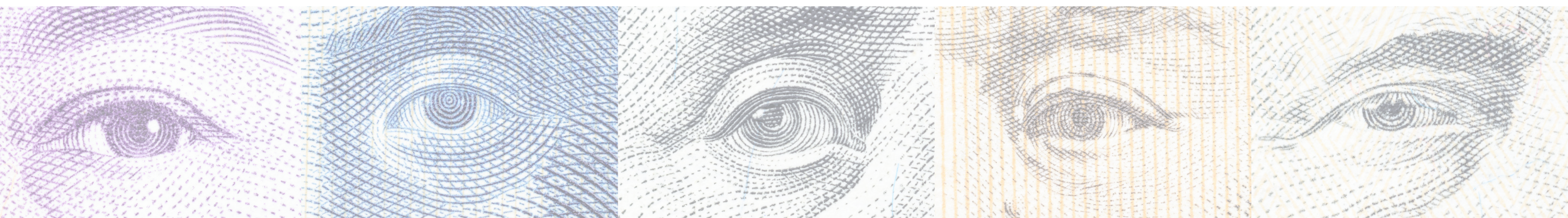
For AUD, tighter policy should help provide support, especially with Q2 GDP numbers showing growth continuing to hold up. Admittedly, signs of slowing in October flash PMI number are a concern, especially given composite PMI dropped sharply from 51.5 to 47.3. Even so, we think is too early to be overly worried just yet. The recently announced 1 trillion yuan Chinese stimulus package should help support Australian exports, growth and therefore AUDUSD in the process. All in all, whilst the Aussie failed to perform as expected last month, we still see our underlying thesis for higher rates and a pickup in Chinese demand as supporting AUD going forwards, leading us to roll forward last month's forecasts.

SGD

Moderate upside to shield against overtightening

With the Monetary Authority of Singapore holding its policy stance at its October bi-annual meeting, and central banks in Japan and China engineering soft currency pegs in the yen and yuan, USDSGD has traded relatively flat in October, mimicking the DXY index. With other Asian currencies continuing to slide against the dollar over the month, the stability of the Singapore dollar against the greenback, yen, and yuan, has seen slight appreciation in the S$NEER rate.

Under our base case of renewed USD appreciation into year-end and a gradual resumption of yen depreciation, we expect USDSGD to resume its uptrend, albeit at a slow pace. This should see the S$NEER basket trend higher over the coming months, further tightening MAS policy and



dampening down on inflation. While a more inflationary outlook relative to earlier in the year suggests the MAS may be more tolerant to let the Singapore dollar appreciate against the entirety of the S$NEER basket, cooling core inflation and weakness in Singapore's external sector suggest this is unlikely to occur. As such, we expect USDSGD to continue rallying to a limited extent for the remainder of the year, acting as a ballast against monetary overtightening. Looking into 2024, our view that the dollar won't structurally depreciate until Q2 2024 at the earliest leads us to believe that USDGSD won't retrace ahead of our 6-month forecast.

CE3

Poland sets the tone once again

Events in Poland set the tone once again for CE3 FX this month. On this occasion though, it was a general election not monetary policy that seemed to catch markets off guard. The ballot delivered a victory for a coalition of opposition parties that together claimed a majority of seats in the Sejm, in contrast to our expectations when writing Octobers set of forecasts. At the time we had expected a less clear-cut outcome, which we expected to weigh on the Polish zloty. Instead, with a pro-European government looking set to take power, PLN rallied 3.88% to be the second-best performing currency amongst the expanded majors last month.

The change of power in Poland is a significant one, with the two main parties offering very different visions for the future of the country and its relations with the EU. The outgoing PiS has a rocky relationship with Brussels, leading to the EU withholding funds in retaliation for alleged rule of law breeches. These relations should now improve significantly, especially with the opposition led by Donald Tusk, himself a former President of the European Council. Unlocking this economic support is naturally supportive for the zloty, though lessened concerns around the rule of law, longer term financial sustainability and reduced risk of unorthodox monetary policy also likely weigh positively at the margin.

Given this context, the NBP meeting last month was a sideshow. The central bank continued to cut rates but did not deliver a repeat of September's supersized 75bp of policy easing. Instead, it delivered a modest 25bp rate cut. Questions are likely to linger for markets around the central banks reaction function and if it has eased policy too early. For now, we pencil in further 25bp cuts for the remained of the year, though we expect to see zloty upside as and when the political hurdles are passed. It is notable that October inflation fell from 8.2% YoY to 6.5%, modestly undershooting expectations and likely allaying some fears of a pickup in price growth. Taken together, the better outlook for Poland-EU relations and the return of a more conventional monetary policy approach, forms a significantly improved backdrop for the Polish zloty, leading us to upgrade our forecasts for PLN across the entire forecast horizon.

That said, Polish elections were also consequential in Hungary too. Notably, both Poland and Hungary had used their respective vetoes over EU some disciplinary tools to prevent the other from being sanctioned for breaches of EU rules, particularly rule of law violations. With Poland now realigning with the rest of the EU, Hungary now has much more to lose by continuing to thumb its nose at European authorities. Whilst on its face this poses an immediate downside risk if Viktor Orban's government fails to play ball, it also raises the likelihood that Hungary reaches a rapprochement with European authorities. This outcome should, amongst other things, finally unlock the significant quantity of funds that the EU is currently withholding, similar to Poland, meaning that HUF saw a similar, if less spectacular boost last month as a result of Polish elections.

On the monetary front, the NBH trimmed rates by 75bps this month, bringing the main policy rate to 12.25%. Suggestions by Deputy Governor Virag that the main policy rate could reach 11% by year-end suggest that a series of jumbo-sized rate cuts will follow, spurred in part by rapidly cooling inflation. Indeed, the run rate of price growth has been broadly consistent with the central bank's target range for the past 6 months, with headline YoY inflation set to fall to 7-8% by year end. Given this and with the economy continuing to struggle, a rapid policy easing seems reasonable. From an FX perspective this should see the forint trade under pressure over coming months, with the likely speed of policy easing set to rapidly erode HUF's preferable carry traits in line with our prior forecasts. That said, the prospect of unlocking EU funding is a clear offsetting boost for HUF. Given this, we have adjusted our HUF forecasts to reflect the better starting point.

> "Finally, in the Czech Republic, whilst the CNB did not have a meeting in October, market expectations look for 25bp of policy easing on November 2nd. "

It was notable that CNB forecasts from the Summer 2023 MPR suggested disinflation would flatline between Q3 and Q4, with price growth across both quarters anticipated to print at 8.2%. September CPI inflation came in at 6.9% YoY, however, well below both CNB forecasts and consensus that looked for a 7.5% YoY reading. Economic resilience is likely to be a growing concern too, with a 0.3% contraction in Q3 GDP, undershooting expectations that had looked for an inline print. Given their hawkish bias, we think CNB policymakers will want to wait a little longer to see if these undershoots persist. This suggests a hold on Thursday in our view, though considering recent data we do now expect a first rate cut in December. Nevertheless, risks are skewed towards Czech policymakers kicking off rate cuts sooner than we expect, meaning that though our one-month CZK forecasts came in only marginally above our October prediction, we are taking the opportunity to adjust this month's projections to reflect the faster policy easing that we now expect.

LatAm

Outlook until year-end should prove less challenging but the easy days are gone

Conditions remained difficult for LatAm currencies in October following September's broad-based sell-off. This led the whole LatAm complex to depreciate against the dollar, with even the revered Colombian peso falling 1.25% on the month. Fragile risk sentiment, continued bear steepening in the Treasury curve, and saturated long positioning can largely explain the drop in most LatAm currencies, although generally we believe it was developments in the rates space that inflicted most of the damage even as the US 10-year failed to break above 5%. This is because the 30bps rally in the US 10-year largely reflects an increase in risk premia, a characteristic that high yielding EM currencies also embed. As such, the sell-off in duration largely coincided with the sell-off in LatAm FX, with the moves only exacerbated by the reduction in nominal carry for some currencies due to the commencement of monetary easing cycles.

While we expected that the solidity of Mexico and Brazil's fundamentals would lead MXN and BRL to be relatively more insulated from these forces, the reality was not necessarily so. With the market more saturated in long MXN positions, the more challenging carry environment caused the peso to significantly underperform the rest of the region's high beta currencies, accumulating losses in excess of 3% on the month. This saw the peso underperform the real even as the currencies fundamentals diverge in favour of the peso and Banxico is seen delaying any decision on easing until 2024, compared with the BCB that has already commenced. Despite the past month's price action, we believe that the "good carry" offered by MXN and the currency's stronger economic fundamentals provide a basis for MXN to outperform BRL up until year-end.

The spike in the price of default insurance on Mexican and Brazilian 10-year debt is evidence of the associated increase in the level of risk premia, which explains part of the deterioration in carry over the last two months

Looking ahead, we think that external headwinds are likely to moderate from now on. First, we believe that overall market volatility could diminish by the end of the year due to the more than likely tendency of DM central banks to keep their monetary policy intact as they wait for indications to assess whether the current degree of tightening is too restrictive or not. Second, the Fed's recognition that rising Treasury yields could substitute for higher rate hikes is likely to place a cap on front-end yields. For longer-term rates, this should provide an anchor. This became visible in October when commentary by US policymakers over the necessity of a Q4 rate hike saw the marginal buyer return to the 10-year Treasury at yields around 5%. However, while this should provide necessary conditions for markets to re-engage in good carry positions at better valuations, we note that the uptake in this trade is likely to remain far more restrained owing to the recent erosion of total returns, the risk of another sell-off in core duration, and the likelihood that overall risk conditions will remain tentative given geopolitical considerations and the fact that global growth has yet to hit a bottom.

Beyond the aforementioned differentiating factors, we believe that, in general, risks to our view of mild appreciation in MXN and BRL are tilted to the downside. In the case of Mexico, Banxico's plans to reduce its hedging programme, announced at the end of August, together with the government's more aggressive interventionist policies, have stood out in recent weeks. While we believe that Banxico's decision to reduce its hedging programme will have a limited impact, we cannot rule out further government intervention in industry matters ahead of the 2024 elections. In our view, this should weigh on investor sentiment, reaffirming our view in recent months that MXN won't re-test its year-to-date high. In Brazil, the more moderate than initially feared BCB easing cycle and the apparent easing of tensions between the central bank and the executive has provided some respite for investors who for much of the year have had to contend with heightened political risk. However, the resurgence of uncertainty surrounding the Lula government's fiscal plans mean that political risks once again threaten to weaken the real.

Forecasts

Currency Pair	1-month (30th November 2023)	3-month (31st January 2023)	6-month (30th April 2024)	12-month (31st October 2024)
G10				
EUR/USD	1.03	1.05	1.08	1.14
USD/JPY	153	155	140	130
GBP/USD	1.20	1.22	1.24	1.28
USD/CHF	0.92	0.91	0.91	0.86
USD/CAD	1.37	1.40	1.38	1.34
AUD/USD	0.655	0.665	0.68	0.68
NZD/USD	0.60	0.60	0.63	0.65
USD/SEK	11.5	11.0	10.4	9.6
USD/NOK	10.9	10.5	9.9	9.2
DXY	108.7	107.4	103.7	98.3
Emerging Markets				
USD/CNY	7.3	7.3	7.0	6.8
USD/INR	83.4	83.4	80.0	80.0
USD/SGD	1.38	1.38	1.37	1.35
USD/ZAR	19	19	18	17
USD/TRY	29.2	31	30	28
USD/PLN	4.37	4.38	4.21	3.95
USD/HUF	379	381	352	316
USD/CZK	24.0	23.6	23.3	21.6
USD/BRL	4.9	4.9	5.0	5.2
USD/MXN	17.6	17.4	17.2	17.0
Euro Crosses				
EUR/GBP	0.86	0.86	0.87	0.89
GBP/EUR	1.17	1.16	1.15	1.12
EUR/CHF	0.95	0.96	0.98	0.98
EUR/CAD	1.41	1.47	1.49	1.53
EUR/SEK	11.8	11.5	11.2	11.0
EUR/NOK	11.2	11.0	10.7	10.5
EUR/TRY	30.0	32.6	32.4	31.9
EUR/PLN	4.50	4.60	4.55	4.50
EUR/HUF	390	400	380	360
EUR/CZK	24.75	24.8	25.2	24.6
EUR/BRL	5.05	5.15	5.40	5.93
EUR/MXN	18.1	18.3	18.6	19.4

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