CIBC CAPITAL MARKETS

CIBC FICC Strategy and Economics

# FX MONTHLY

January 2025

## T Minus 10 Days

### Key points

- USD: While the USD has demonstrated remarkable strength in recent months, we expect that it has a little bit further to go as Trump takes office and tariff threats amplify. However, moving into the back half of the year, we expect the USD to begin to come off high levels as the Fed eases more than is currently priced and US growth converges with growth in other parts of the world.
- CAD: We expect USD/CAD to rally through H1 2025 towards 1.46, as Trump tariff rhetoric ramps up and central bank pricing moves in favour of a relatively more dovish BoC. We see a reversal in H2, as we expect tariff rhetoric to prove to be more bark than bite and as rate spreads move back in favour of a stronger CAD. We'll note however, that given somewhat opaque and binary tariff risks, uncertainty around these forecasts are larger than usual.
- EUR: Although near term political risks in EUR remain, we think that negativity is nearly sufficiently priced. As a result, we think that we are approaching a bottom in EUR/USD near the 1.02 level. The ECB being priced to reach a roughly 2% terminal rate, which is around the bottom end of most neutral estimates, seems well priced. Thus a dovish repricing of the Fed later in 2025 should be a tailwind for a EUR/USD rally towards 1.07 by end of year.
- GBP: While GBP has been the 2025 to date underperformer within G10 FX, we expect a rally in the coming quarters as the negativity that has priced appears excessive. Recent data suggests that the consumer remains in decent health and we think that growth holding up a bit better than expected in 2025, will have GBP/USD bouncing back to 1.30 by end-of-year.
- JPY: Pricing for a January BoJ hike have recently crept higher amid recent data releases and BoJ speak, but we think the bank will prefer to wait for March to have increased certainty around wages and US trade policy. For this reason, we expect USD/JPY to remain roughly around current levels over the coming quarters before a moderate rally in the back half of the year on a dovish repricing of the Fed.
- AUD and NZD: We expect that AUD outperformance relative to NZD is well priced at this point, with New Zealand in a recession and Australian service prices resilient but easing. However, relative to the USD we think the bottom is likely to form in Q1 after Trump takes office. From there we see upside through the rest of the year for both AUD/USD and NZD/USD, as Fed pricing shifts marginally more dovish relative to the Antipodean central banks.

## FX Forecasts

| End of period: | Jan 10, 2025 | Q1 '25 | Q2 '25 | Q3 '25 | Q4 '25 | Q1 '26 | Q2 '26 | Q3 '26 | Q4 '26 |
|---|---|---|---|---|---|---|---|---|---|
| USD / CAD | 1.44 | 1.45 | 1.46 | 1.43 | 1.42 | 1.42 | 1.41 | 1.40 | 1.40 |
| EUR / USD | 1.02 | 1.02 | 1.04 | 1.06 | 1.07 | 1.08 | 1.10 | 1.11 | 1.12 |
| USD / JPY | 158 | 158 | 158 | 156 | 154 | 155 | 154 | 153 | 152 |
| GBP / USD | 1.22 | 1.24 | 1.26 | 1.29 | 1.30 | 1.31 | 1.33 | 1.35 | 1.35 |
| USD / CHF | 0.92 | 0.93 | 0.94 | 0.92 | 0.92 | 0.93 | 0.92 | 0.92 | 0.91 |
| USD / SEK | 11.23 | 11.18 | 10.82 | 10.47 | 10.23 | 10.05 | 9.77 | 9.59 | 9.46 |
| AUD / USD | 0.61 | 0.63 | 0.65 | 0.66 | 0.69 | 0.69 | 0.68 | 0.68 | 0.68 |
| NZD / USD | 0.56 | 0.57 | 0.58 | 0.60 | 0.62 | 0.62 | 0.61 | 0.61 | 0.61 |
| USD / NOK | 11.48 | 11.02 | 10.57 | 10.19 | 9.91 | 9.39 | 9.30 | 9.21 | 9.12 |
| USD / ZAR | 19.13 | 18.25 | 17.80 | 17.50 | 17.25 | 17.00 | 16.85 | 16.75 | 16.65 |
| USD / CNH | 7.36 | 7.36 | 7.39 | 7.40 | 7.30 | 7.29 | 7.27 | 7.29 | 7.31 |

## CAD Crosses

| End of period: | Jan 10, 2025 | Q1 '25 | Q2 '25 | Q3 '25 | Q4 '25 | Q1 '26 | Q2 '26 | Q3 '26 | Q4 '26 |
|---|---|---|---|---|---|---|---|---|---|
| CAD / JPY | 109 | 109 | 108 | 109 | 109 | 109 | 109 | 109 | 108 |
| CAD / CHF | 0.64 | 0.64 | 0.65 | 0.64 | 0.65 | 0.66 | 0.65 | 0.66 | 0.65 |
| AUD / CAD | 0.89 | 0.91 | 0.94 | 0.95 | 0.97 | 0.98 | 0.97 | 0.95 | 0.95 |
| GBP / CAD | 1.76 | 1.80 | 1.84 | 1.84 | 1.84 | 1.86 | 1.88 | 1.90 | 1.90 |
| EUR / CAD | 1.48 | 1.48 | 1.52 | 1.51 | 1.52 | 1.53 | 1.56 | 1.56 | 1.57 |

## EUR Crosses

| End of period: | Jan 10, 2024 | Q1 '25 | Q2 '25 | Q3 '25 | Q4 '25 | Q1 '26 | Q2 '26 | Q3 '26 | Q4 '26 |
|---|---|---|---|---|---|---|---|---|---|
| EUR / JPY | 162 | 161 | 164 | 166 | 165 | 167 | 170 | 170 | 170 |
| EUR / GBP | 0.84 | 0.82 | 0.83 | 0.82 | 0.82 | 0.82 | 0.83 | 0.82 | 0.83 |
| EUR / CHF | 0.94 | 0.95 | 0.98 | 0.98 | 0.98 | 1.00 | 1.01 | 1.02 | 1.02 |
| EUR / SEK | 11.49 | 11.40 | 11.25 | 11.10 | 10.95 | 10.85 | 10.75 | 10.64 | 10.60 |
| EUR / NOK | 11.76 | 11.24 | 10.99 | 10.80 | 10.60 | 10.14 | 10.23 | 10.22 | 10.21 |

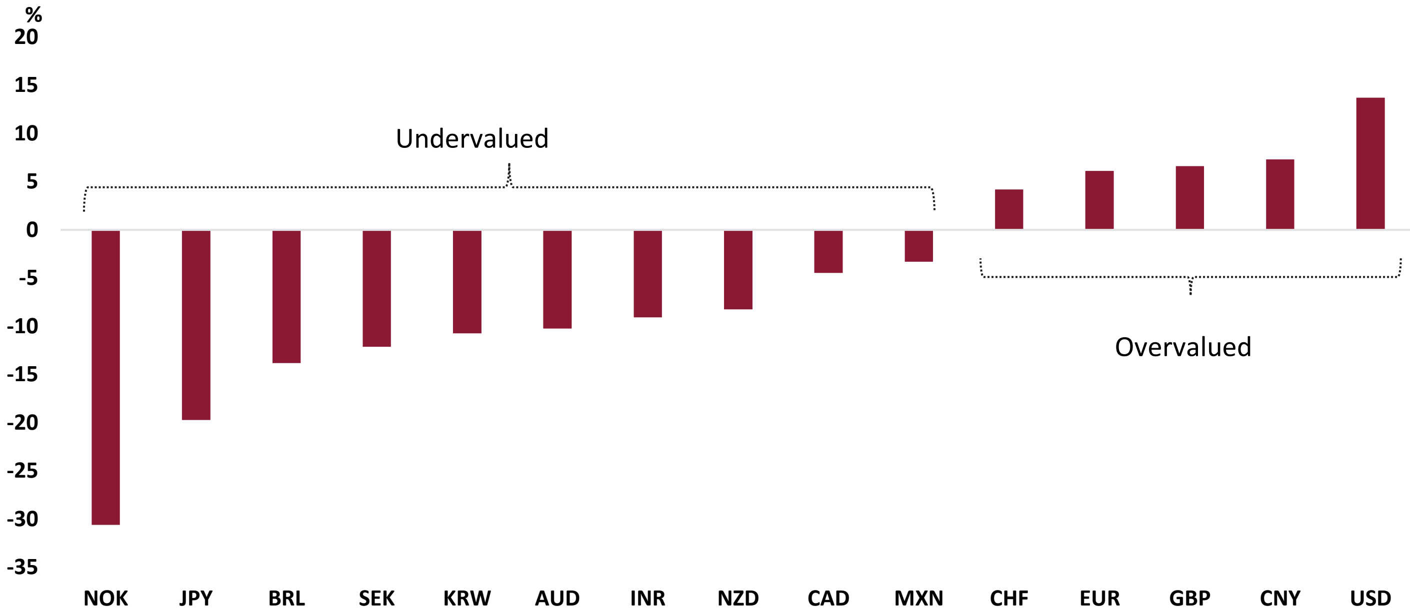
## Central Bank Forecasts

| | Current | Q1 '25 | Q2 '25 | Q3 ‘25 | Q4 ‘25 |
|---|---|---|---|---|---|
| Fed | 4.38 | 4.13 | 3.88 | 3.63 | 3.38 |
| BoC | 3.25 | 2.75 | 2.25 | 2.25 | 2.25 |
| ECB | 3.00 | 2.50 | 2.00 | 2.00 | 2.00 |
| BoE | 4.75 | 4.50 | 4.25 | 4.00 | 3.75 |
| SNB | 0.50 | 0.25 | 0.00 | 0.00 | 0.00 |
| BoJ | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 |
| RBA | 4.35 | 4.10 | 3.85 | 3.60 | 3.35 |
| RBNZ | 4.25 | 3.75 | 3.50 | 3.25 | 3.00 |

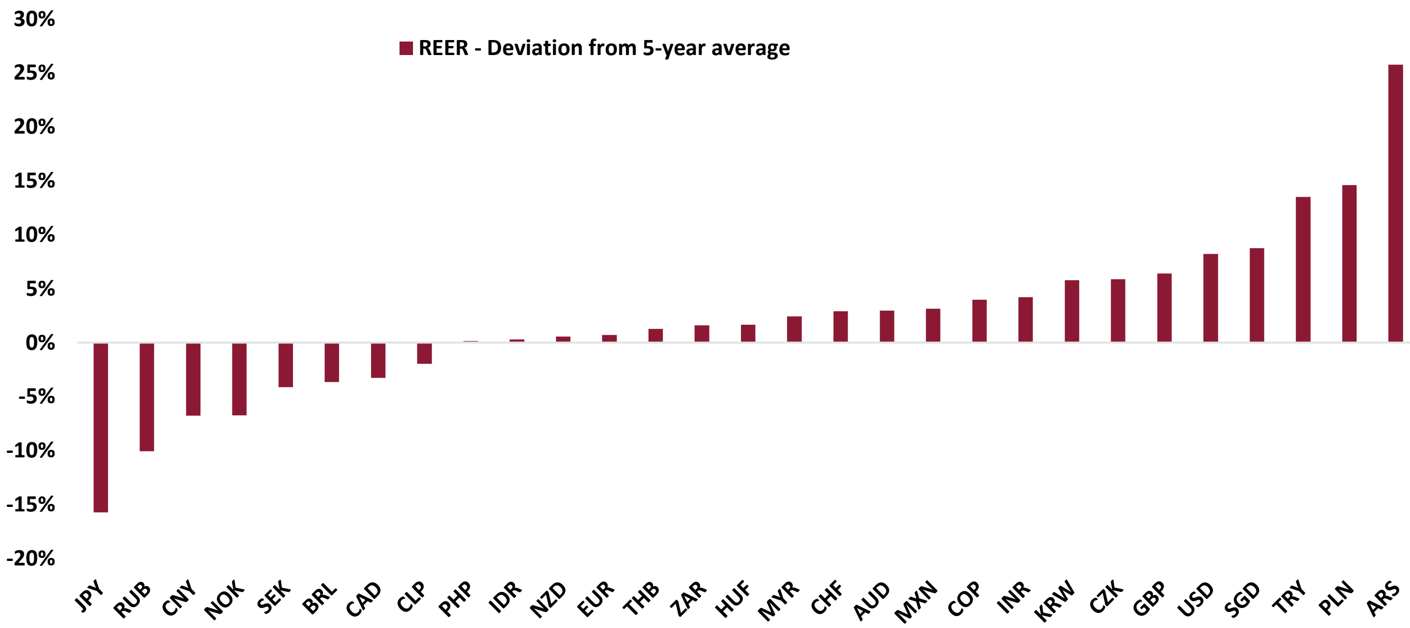
## Market Pricing

| | Current | Next Meeting | Q1 '25 | Q2 '25 | Q3 '25 | Q4 '25 |
|---|---|---|---|---|---|---|
| BoC | 3.25% | Jan 29 | 3.03% | 2.89% | 2.83% | 2.82% |
| Fed | 4.38% | Jan 29 | 4.27% | 4.14% | 4.07% | 4.04% |
| ECB | 3.00% | Jan 30 | 2.44% | 2.16% | 2.04% | 1.99% |
| BoE | 4.75% | Feb 6 | 4.49% | 4.36% | 4.29% | 4.24% |
| RBA | 4.35% | Feb 17 | 4.07% | 3.88% | 3.72% | 3.60% |
| RBNZ | 4.25% | Feb 18 | 3.43% | 3.26% | 2.94% | 2.93% |
| SNB | 0.50% | Mar 20 | 0.19% | 0.06% | 0.00% | 0.03% |

## Long-Term Fair Value Model - BEER




## Long-Term Fair Value Model – REER Reversion




*CIBC's BEER model gauges theoretical fair value for trade-weighted FX indices. This is done through a single panel regression over a long time horizon based on fundamental factors (including current account, terms of trade and labour productivity).

**CIBC's REER reversion model looks at the deviation of a real effective exchange rate index from its long-term average. It is reported with a 1M lag.

# United States

Sarah Ying and Noah Buffam

## USD – America-First

**DXY** – Q1 2025: 109.88 **|** Q2 2025: 108.34

The greenback has demonstrated remarkable strength since the US election in November: consider in Q4, the DXY had one of its best quarterly runs since early 2015, rising over 7.6% q/q. Anticipation of Trump's America-first agenda, including heightened tariff uncertainty, combined with a slower-moving Fed has pushed the greenback to highs not seen since late 2022 during the height of the Fed's hiking cycle.

With it's remarkable performance to end 2024, one frequent question that is commonly asked is whether American exceptionalism has already been fully priced in. After all, the market has already baked in an extra-patient Fed with only 30bps of cuts priced for this year after the stellar NFP print in December (+256k vs. consensus 165k). Cycle end delayed until at least mid 2026. Further, the possibility of the threatened 25% tariff on Canada and Mexico is at least partially in the price for USD/CAD and USD/MXN. Other currencies, such as EUR/USD, AUD/USD, and NZD/USD, have also been impacted by tariff concerns, even though they have not necessarily been targeted directly.

While there are many market participants looking to fade USD strength, we continue to believe that the America-first narrative could be sustained in the coming weeks. Our DXY target for Q1 end stands at 110, consistent with current levels, reflecting a market that will be reluctant to give up USDs in the face of high headline risk over Trump's first 100 days. Further, weak data out of the Eurozone and elevated fiscal concerns in the UK means that more 'attractive' alternatives to owning the USD are fairly limited for macro players. And with the Fed's easing cycle slowing down, the US sees the third best carry in the G10 (after GBP and NOK), making it appealing to yield harvesters.

In short, we think it may be too early to unwind the rally in the greenback, as risks look roughly balanced at current levels. Timing the pivot point in the greenback will be the holy grail of macro this year. We suspect that USD strength will start to wane in the latter half of 2025. If tariffs are less punitive than what is currently being proposed, we could see the Fed cut at a faster pace as inflationary expectations decline, or as more cracks in the economy start to appear. Currently, the timing of Fed cuts is highly uncertain, with the market pricing in partial cuts at every meeting, but at low odds. CIBC Economics has four rate cuts penciled in for the Fed this year (25bps/quarter). Should we see a faster pace of interest rate normalization, we could see the greenback head back down to earth in the latter half of the year.

# Canada

Avery Shenfeld and Katherine Judge

## CAD – To Tariff or Not to Tariff? That Is The Question

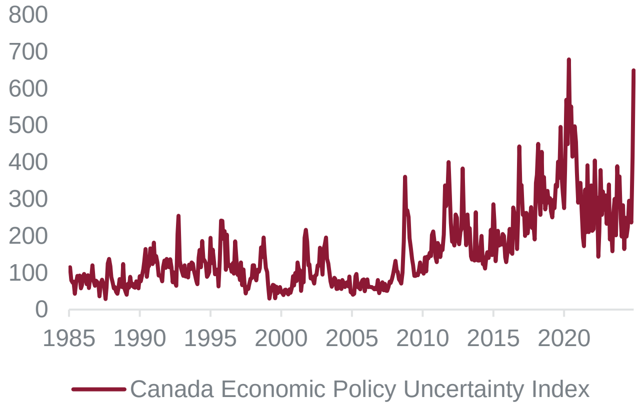
**USD/CAD** – Q1 2025: 1.45 **|** Q2 2025: 1.46

While generally on a sideways path in recent weeks, the Canadian dollar is still materially weaker than we had expected a few months before the US election. That's largely a reflection of a strong US dollar against other majors, which is tied to two policy risks: tariffs, which will depress the currencies of other countries that export to the US, and US deficits, which are bidding up longer term Treasury yields and increasing their spread over Canadas, and dampening expectations for Fed easing. Neither of these risks are likely to be clarified quickly, so US dollar dominance, and a bit of further Canadian dollar weakness, seems likely for the first half of this year, with our mid-year USDCAD target at 1.46.

Still, we see a reversal in direction thereafter, again largely emanating from US developments. If, as was the case in Trump's first term, the tariff threat proves to be more bark than bite, the fear of a trade shock hitting the Canadian economy will diminish. Canada is moving to address issues regarding the border, may offer to accelerate its increase in defense spending, and will draw on allies in the US corporate sector that depend on two-way trade across the Canada-US border. US Treasury yields could also drop, and thereby offer less of a premium over longer Canadian bonds, if fiscal hawks in Congress and among Trump Cabinet appointees find spending cuts to reduce the feared upturn in deficit financing. A spring election in Canada in which the Conservatives win a majority should at this point be priced into market expectations given where the polls stand, and if that's the result, we would not expect a material FX market reaction.

At the front end of the curve, our expectations for contained inflation and the need to close a substantial output gap will allow the Bank of Canada to nudge the overnight rate down to 2.25%. While that's a bit more aggressive than market pricing, so too is our expectation for the Fed to cut rates by 25 bps each quarter in 2025, with US PCE inflation performing better than what the Fed might now be fearing. So short rate differentials should not prevent a recovery in the Canadian dollar to our year end USDCAD target of 1.42 if, and it's a big if, Canada escapes the wrath of tariffs.

Chart: Economic Uncertainty in Canada is High Amid Political and Economic Risks




Source: Baker, Bloom, and Davis, CIBC Capital Markets

# Europe

Jeremy Stretch

## EUR – Substantive Negativity Already Discounted

**EUR/USD** – Q1 2025: 1.02 | Q2 2025: 1.04

We entered 2025 on the back of the EUR registering its weakest quarterly performance versus the USD, (-7.01%) since Q1 2015. Broad EUR negativity proved a function of ongoing political weakness, in both France and Germany, and tariff risks, allied to regions ongoing reliance on Chinese export demand. Moreover, the return of natural gas uncertainties amplified negativity. This combination of factors quickly encouraged EUR/USD to trade immediately through 2024 1.0335 lows. Energy related negativity returned as the benchmark Dutch gas future spiked to levels not witnessed since October 2023. The end of a gas supply contract between Russia and Ukraine risked an inventory drawdown which is problematic as gas storage tanks ended last year at a mere 72% of capacity, 14% below previous year levels.

Although gas dynamics risk complicating the ECB's policy picture, the presumption of moderating core CPI, a process supported by moderating wage dynamics, points towards an extension of ECB gradualism. We continue to expect the ECB to ease rates at a steady 0.25% per meeting pace until they hit neutral at 2.00%, at the end of H1.

We anticipate that a proliferation of EUR negatives having already been discounted. Moreover, real money EUR shorts are heading towards Q1 2020 extremes. As a consequence, we would be wary of anticipating a durable EUR/USD parity breach. Despite a recent correction the broad uptick in UST-Bund spreads leaves us comfortable in anticipating a lower EUR/USD profile than previously projected. However, the prospect of a graduated German fiscal expansion allied to ECB policy easing proving contained into mid-year, supports the notion of Q1 EUR/USD lows correcting through Q2.

## GBP – Testing The Fiscal Arithmetic

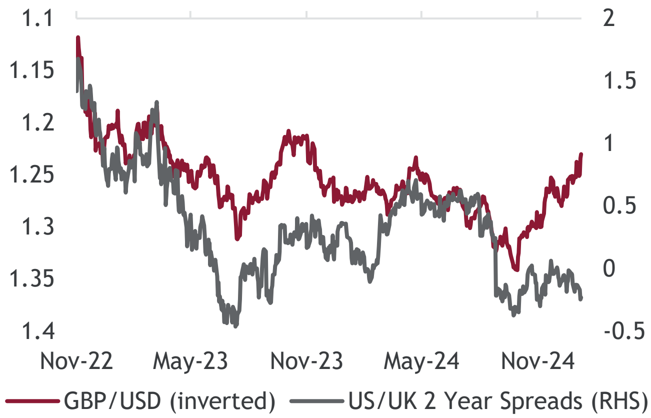
**GBP/USD –** Q1 2025: 1.24 | Q2 2025: 1.26

Sterling has proved an early 2025 laggard. An aggressive fixed income sell-off, with 30Y yields having traded at levels not witnessed since 1998, is a function of the market being unconvinced by the fiscal arithmetic underpinning the 30 October Budget. The Office for Budgetary Responsibility (OBR), the body responsible for the independent macro forecasts upon which the government based its revenue estimates, predicated GDP growth of 2.0% in 2025. Given that the latest British Chamber of Commerce survey, (covering 4800 members) revealed that the business community has not been this pessimistic since 2022, such targets appear over optimistic. Negative survey confidence is a function of a "pressure cooker of rising costs and taxes".

The upcoming OBR forecast update (26 March), is a key challenge for the Chancellor. Should yields remain near current elevated levels the government's limited fiscal headroom, (£10bn) will have been eliminated. In order for the Chancellor to maintain fiscal discipline the options include i) additional revenue may need to be raised, ii) additional austerity, or iii) an increase in issuance. None of the alternatives are particularly politically palatable.

While macro sentiment remains challenged we would note that the latest BRC retail sales monitor detailed that a strong rebound in December sales, led by non-food/discretionary spending. Annual total sales registered the strongest monthly uptick since January 2022, suggesting positive consumption dynamics into the end of Q4. Should flash services PMI remain in expansionary territory, (it has expanded for the last 14 straight months) suggests the UK macro backdrop is better than that recently discounted, Gilt market negativity notwithstanding. We would note that the early year GBP sell-off has likely flattened GBP real money longs. We would view the unwind in position and/or the erosion of GBP values as overdone should consumer data come in above increasingly pessimistic expectations. The retreat in UK fixed income markets and a more durable Fed outlook validates a lower GBP/USD profile through 2025 than previously anticipated.

Chart: GBP Has Disconnected From 2Y Spreads Given Political Premia




Source: LSEG Datastream, CIBC Capital Markets

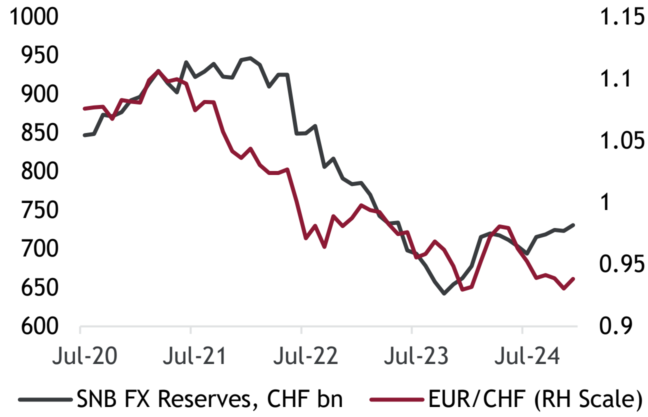
## CHF – Heading for The Zero Lower Bound

**EUR/CHF –** Q1 2025: 0.95 **|** Q2 2025: 0.98

The perpetuation of downside CPI surprises, December headline prices eased back to 0.6% while core prices dipped to the lowest level (0.7%) since November 2021, maintains our presumption of the bank being headed towards the zero lower bound. The SNB eased policy for the fourth time in this cycle in December. However, the SNB surprised the market by lowering the policy rate by 50bps to 0.50%, we have not witnessed such an aggressive move in almost a decade. The incoming central bank President Martin Schlegel was clearly intent on accelerating the pace of easing in an attempt to preclude disinflationary dynamics. The SNB has clearly been unnerved by the fact that annual core prices remained below the 1% threshold in Q4, this compares with a 2.4% peak in February 2023. Moreover, the bank are likely to be concerned by the fact that the driver of the weak core print was domestic prices, which moderated to 1.5% y/y.

Given that the SNB continues to anticipate annual inflation running below 1% out to Q3 2027 we anticipate a test of the zero lower bound into mid-year. However, we would note that the SNB tempered previous references regarding the “risks to the inflation forecast remain to the downside.” Moreover, the new SNB President also pushed back against negative rates in the post December rate cut press conference. However, we expect rates to head to zero, while the bank is set to continue to attempt to cheapen up the CHF to boost inflationary influences. The perpetuation of deflationary headwinds underlined our bias to sell CHF in our year ahead publication.

Chart: SNB FX Purchases Could Be a Headwind to CHF Moving Forwards




Source: LSEG Datastream, CIBC Capital Markets

## SEK – A More Tentative Riksbank Ahead

**EUR/SEK** – Q1 2025: 11.40 | Q2 2025: 11.25

Although the Riksbank cut the repo rate by 150bps in 2024, we expect additional action in H1 as inflationary pressures continue to undershoot median Riksbank assumptions. The central bank appears intent on taking on a “more tentative” approach to policy easing, indeed the bank underlined post their latest rate cut on 19 December that rates “may be cut once again during the first half of 2025.” We expect another 25bps ease at the 29 January policy meeting with a further 25bps in play into the May policy decision. Beyond a January move we would expect the burden of policy proof for additional policy easing, namely softer data and/or disinflationary tendencies, to become somewhat higher. Beyond a January cut, expectations of additional easing could prove compromised by evidence of consumer impetus being underpinned by a continued downtrend in the unemployment rate.

We expect limited additional easing, given an expected uptick in domestic macro dynamics. Indeed we would note that the domestic economic tendency index ended 2024 at the highest reading since August 2022. The broad 2024 rebound underlines the notion of limited policy easing and or a cautiously positive SEK bias. However, we would expect ongoing EU macro headwinds; the EU remains Sweden’s key trading partner, to drag on SEK performance. Although the prospect of domestically generated growth is encouraging broad EUR headwinds suggest the scope for USD/SEK downside will prove somewhat contained compared to our presumptions in our year ahead outlook.

## NOK – Getting Ready to Act

**EUR/NOK –** Q1 2025: 11.24 | Q2 2025: 10.99

The Norges Bank has been a laggard as regards monetary easing, policy has been on hold since December 2023. However, policy inertia failed to preclude the NOK from battling the NZD for the title of the weakest 2024 G10 performer, with NOK depreciating by almost 11% in the calendar year. After a period of protracted inertia we expect the Norges Bank to embrace policy easing come the March policy meeting given that annual prices moderated to a four-year low of 2.2% in December. We anticipate a 25bps ease in line with the policy narrative detailed by Governor Walden Bache post holding policy at 4.50% in December. Given that price pressures moderated at a faster pace than expected into year-end, the central bank assumed 2.5% CPI, this should encourage the market to advance March policy probabilities well beyond 75%. Moreover, beyond March, assuming price pressures remain contained we could see additional easing in June.

The prospect of falling rates is particularly noteworthy as Norwegian households have the highest debt to income ratio amongst the OECD at 238% at the end of 2023. The combination of easier monetary policy, combined with a tight labour market, in addition to moves to ease lending regulations, opens up the prospect of a material house price acceleration. While the central bank forecasts home prices will gain 6.3% this year and 8.5% in 2026, others expect 10% growth this year. Although any such move would merely mitigate recent real price declines, the prospect of a strong rebound in household consumption supports the notion of the bulk of the 2024 NOK depreciation versus the USD unwinding into year-end.

# Asia-Pacific

Maximillian Lin

## JPY – The BoJ Is Waiting For Further Evidence of Wage Growth

**USD/JPY** – Q1 2025: 158 | Q2 2025: 158

The market is once again speculating on the possibility of an earlier BoJ rate hike ahead of the January 24th BoJ meeting. On Friday, Bloomberg reported (citing anonymous sources) that BoJ officials were "mulling" a January rate hike. That headline pushed USD/JPY 0.3% lower.

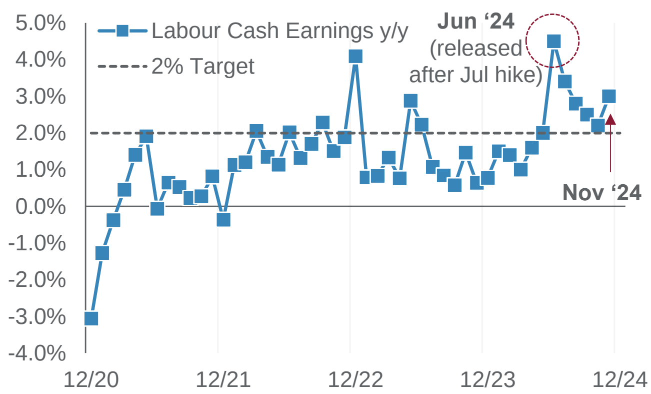
In our view, the January 10th Bloomberg article had little new information, and we still expect a hike in March. It is the job of the MPC to "mull" and consider policy rate at every meeting. Although we think there is some risk of a January hike – in December there was a hawkish dissent by BoJ board member Naoki Tamura – we still think the majority will wait for clarity on wage growth and Trump's trade policies.

In December Governor Ueda was unusually specific in highlighting key data releases to watch. He bluntly noted that the current lack of wage information was one reason why the majority voted for no change in December. Ueda also specifically mentioned that the "big picture of Japan's wage trend will be clear by March or April." On Thursday, minutes to the BoJ regional branch managers January meeting were released, and revealed that in most regions "small firms remain cautious on rate hikes."

We think the BoJ is right to wait for further progress on wage talks. The chart below shows that although Japan labor cash earnings growth surged at 4.5% y/y in June 2024. The June surge was due to the prior round of shunto wage talks, which were negotiated from February-April 2024 but became formally contracted (and visible in the data) in June 2024. Since then, wage growth has slowed to 2-3%. Although November Labor Cash Earnings (released Thursday) surprised higher, it is still below the June peak.

In our 2025 Year Ahead Outlook we noted that "Trump trade" USD momentum could persist in the short term through Q1. Even so, we think that USD/JPY is unlikely to breach the previous 2024 peak of 160-161. The MoF's show of force in July at 160-161 indicated its resolve. If "Trump trade" momentum continues in the coming weeks, we think officials will resume verbal warnings at USD/JPY levels of 159 so that expectations are set ahead of the key 160 level.

Chart: Year-on-Year Wage Growth Surged in June But Has Since Slowed




Source: Bloomberg, CIBC Capital Markets

## AUD – RBA Cuts Are Coming

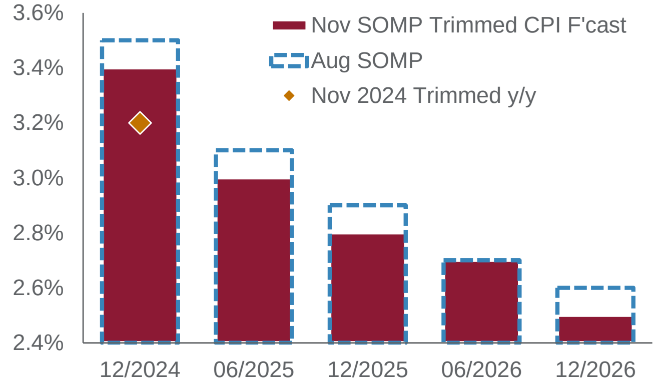
**AUD/USD –** Q1 2025: 0.63 | Q2 2025: 0.65

At the December meeting the RBA added another subtle dovish shift, dropping the previous line that the board "was not ruling anything in or out." This shift comes after the earlier language change at the September RBA meeting, when Governor Bullock noted that the RBA board "didn't explicitly consider a rate rise this time." The December RBA statement further noted that "the Board is gaining some confidence that inflation is moving sustainably towards target."

Australia monthly CPI for November (released Wednesday) showed headline price growth increased to 2.3% y/y, (vs consensus 2.2%), but AUD still weakened in reaction to the report, given that trimmed mean CPI for November eased to 3.2% y/y (from 3.5% in October). The latest reading is below the RBA's November SOMP forecast for December 2024. There is still some risk that rate cut timing is pushed back into April, but on balance we think it makes sense for the RBA to begin cuts in February. Consumption indicators have also been weaker than forecast; November retail sales and household spending released earlier this week missed to the downside.

The resumption of China pessimism, and a more hawkish Fed, have also weighed on AUD. Although the RBA's relative hawkishness has been due to the resilience of Australia's services sector, FX markets still view the Aussie as a proxy for China risk sentiment. PBoC management of CNY and CNH has led macro investors to short China proxies (such as AUD) instead – as a result, our long AUD/CNH position has been stopped out. We see limited scope for Aussie upside in Q1 and now revise our Q1 AUD/USD forecast lower to 0.63 (from 0.67 previously). In Q2, a reversal in USD amid Fed cuts and Trump fatigue means there is room for slight AUD upside to 0.64-0.65.

Chart: November Trimmed CPI Data Was Below the SOMP Forecast




Source: RBA, ABS, CIBC Capital Markets

## NZD – Approaching the Terminal Rate

**NZD/USD –** Q1 2025: 0.57 | Q2 2025: 0.58

In November the RBNZ made another "large" 50 bps cut to the OCR (to 4.25%), the second consecutive 50 bps move. A similar move is widely expected for the upcoming February meeting; in November Governor Orr strongly guided the market towards another 50 bps, noting that the latest MPS OCR projections (published alongside the rate decision) were "consistent with a 50 bps cut in February."

As a result, the NZD OIS market now prices 50 bps of cuts for February, which in our view makes it difficult for the RBNZ to surprise on the dovish side. In November Orr also noted that there was no pressure to cut by 75 bps ahead of the holiday break. By similar logic, we think there is no need for a 75 bps "catch-up" move in February to make up for the holiday gap.

Although the RBNZ's November MPS forecasts for the OCR path differed greatly from the August MPS, the projected terminal rate was virtually unchanged at around 3.1% by end 2026. After a likely 50 bps cut in February 2025 (to 3.75%), the RBNZ will have reduced rates by a cumulative 175 bps for this cycle. After February, there will be just 50-75 bps of "room" for cuts before the RBNZ hits the terminal rate. As such, the scope for large rate cuts is greatly reduced from April onwards.

With the RBNZ nearing the end of its easing cycle, and the RBA about to begin its easing cycle, we think the rally in AUD/NZD is mostly behind us, and the cross will remain in a range of 1.10-1.11. NZD/USD, like AUD/USD, will still react to China risks and the Fed. As such, we think a reversal in USD in Q2 amid Fed cuts and Trump trade fatigue means room for slight NZD appreciation to 0.58 by Q2.

## CNH – The PBoC is Holding The Line (For Now)

**USD/CNH –** Q1 2025: 7.36 | Q2 2025: 7.39

The threat of Trump tariffs has resulted in additional wave of US dollar strength against Asia FX. Although Trump has been more vocal about tariffs on Mexico and Canada, the market is rightly concerned about what an increase in US tariffs on China would mean for CNH.

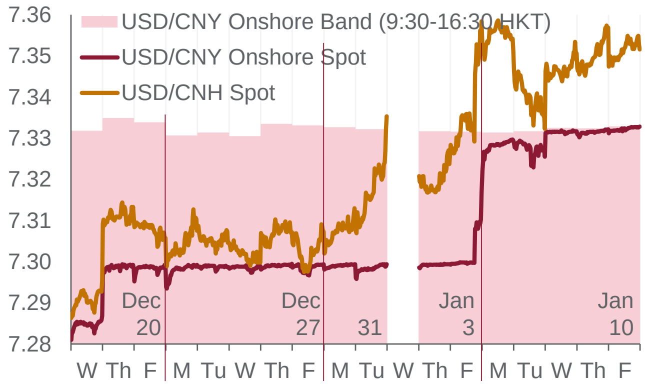
China has also "allowed" for additional yuan weakness in the new year. On January 3rd the CNH market showed brief panic about possible devaluation. The chart below shows that the PBoC had previously held the 7.30 level in USD/CNY onshore spot since December 19th. When this level "broke" on January 3rd, there were fears that the USD/CNY fix on Monday (January 6th) would also break 7.20.

Price action this week shows that the status quo of CNY stability continues. The chart below shows that the USD/CNY onshore band limit (which is 2% from USD/CNY mid-rate fix) has barely moved. That is reassuring in the short term, but is arguably unsustainable in the long run, and the USD/CNY onshore spot rate is now trading at the limit. So although a stable CNY fix is good for “stability optics” – China’s onshore interbank FX dealing system ignores bids and offers outside of the band – it is still a form of price-fixing which sets the USD/CNY rate at artificially low levels.

We think that further yuan weakness is inevitable in a global tariff (or China-only tariff) scenario. Broad USD strength and a tightly controlled USD/CNY exchange rate since November have resulted in the yuan rising alongside USD against peer currencies. As a result, the yuan is arguably over-valued in trade-weighted terms compared to China’s export outlook.

For now, however, Chinese leaders have reasons “wait and see.” They want to avoid upsetting mainland equity markets – and Trump – by keeping the yuan relatively stable. Timing is difficult to predict, given China is waiting to react to Trump’s unpredictability, but we still expect weakening pressure on the yuan to continue, and we now forecast USD/CNH rising to 7.39 and 7.40 by Q2 and Q3, respectively.

Chart: USD/CNY Spot Has Been Stable, But is Trading Against the Band Limit




Source: Bloomberg, CIBC Capital Markets

# Emerging Markets

*Please note that the Emerging Markets FX Forecast update will be released in a separate note to be released on January 15, 2025.*

# CIBC Capital Markets

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