CIBC CAPITAL MARKETS

CIBC FICC Strategy and Economics

FX MONTHLY

June 2025

Balance Sheets Over Data

Key points

- **USD:** The evolving tariff outlook amid back and forth challenges between President Trump and the US legal system will cause short term moves in the USD. But over a longer time horizon, there are risks that we are in the early stages of an institutional re-evaluation of the US. While we have seen FX hedging activity increase, and some large asset managers suggesting that they are considering diversifying outside of the US, the flows data has yet to show a major shift in asset allocations. These decisions will take time and consideration, but because there are few true alternatives to US assets we do not expect the USD to swing from over to undervalued, but instead return closer to long term fair value.
- **CAD:** We expect USD/CAD to follow in line with the trend towards a weaker USD, but given Canada's dependence on the US, we expect CAD underperformance on the crosses. For the BoC, our expectation for the Bank to ease to 2.25% by end of 2025 is not far from market pricing. This implies that domestically driven FX volatility is likely to be muted, and CAD will trade more in line with its betas to the broad USD and to risk.
- **EUR:** Although EUR/USD may have moderated from the April 21st high of 1.1573, (we have not witnessed a higher threshold since November 2021), we anticipate underlying EUR resilience as the broad USD diversification narrative is set to persist. We continue to look for investor rotation into liquid eurozone assets, both equities and bonds, indeed the flow into the former in the year-to-date validates broad EUR impetus.
- **GBP:** After a £14bn fiscal tightening in the Spring statement, elevated financing costs and macro risks another fiscal contraction, potentially breaking manifesto commitments (tax hikes) into the autumn budget. Ongoing speculation of fiscal tightening, risks containing consumer sentiment, activity and Sterling gains. Despite ongoing discussions over the ending of USD dominance, we would be wary of anticipating significant further GBP/USD gains.
- **JPY:** The yen continued to react to external headlines on trades last month, but there were two notable domestic developments: (i) the weakness in long end JGBs and (ii) a dovish May 1st BoJ outlook. Despite ongoing questions over Japan's long term fiscal sustainability and the reduced likelihood of BoJ rate hikes, we still expect modest yen strength to 140 by end June and 137 by end September.
- **AUD and NZD:** In contrast to the expected RBA "hawkish cut," the May RBA press conference no longer pushed back against further expectations for cuts, and we now expect another 25 bps RBA cut in July. The RBNZ had the opposite tone – a "hawkish cut" was delivered when more dovish guidance was expected. We think the "sell America theme" will limit AUD and NZD weakness amidst tariff uncertainty. We expect AUD/USD to fall to 0.63 in Q3. The RBNZ nearing its easing cycle should help the Kiwi outperform the Aussie, and we expect NZD/USD at 0.59 in Q3. That would put the AUD/NZD cross at 1.07.
- **CNH:** A high-level Trump-Xi meeting is unlikely unless the White House tones down the rhetoric. In the meantime, China will stick to proportional trade retaliation as the response to Trump's unpredictability. "Bureaucratic delays" on Chinese rare earth exports are part of this playbook; we think China views "approved entity" whitelists as a reciprocal response to US restrictions on chip exports. There is no need to retaliate through unconventional means such as sudden yuan devaluation. Even so, we expect very gradual yuan weakness, but now to 7.25 by end Q2 (vs 7.40 previously) and 7.27 by Q3.
- **MXN:** Given the widening cracks in activity data, we suspect Banxico is starting to position itself for a longer easing cycle than currently priced in. Thus, we have revised our terminal rate forecast lower to 6.50% (6.75% previously), bringing real rates well within Banxico's neutral real rate range estimate (1.8%-3.6%), and ~80ps below current market pricing. Looking at the peso, despite the overall weakness of the greenback, we would not chase USD/MXN move lower below 19.20 and maintain our Q3 and Q4 USD/MXN forecasts at 19.55 and 19.60, respectively.

FX Forecasts

End of period:	Jun 3, 2025	Q2 '25	Q3 '25	Q4 '25	Q2 '26	Q4 '26
USD / CAD	1.37	1.38	1.37	1.36	1.35	1.34
EUR / USD	1.14	1.16	1.16	1.16	1.18	1.20
USD / JPY	143	140	137	135	133	132
GBP / USD	1.35	1.37	1.37	1.36	1.39	1.41
USD / CHF	0.82	0.81	0.83	0.83	0.84	0.84
USD / SEK	9.60	9.31	9.22	9.14	8.90	8.63
AUD / USD	0.65	0.64	0.63	0.63	0.64	0.65
NZD / USD	0.60	0.59	0.59	0.59	0.60	0.61
USD / NOK	10.13	9.96	9.83	9.66	9.32	9.04
USD / ZAR	17.92	17.80	17.60	17.40	17.20	16.75
USD / BRL	5.67	5.60	5.70	5.85	6.10	6.00
USD / MXN	19.24	19.40	19.55	19.60	19.80	20.00
USD / COP	4160	4250	4325	4350	4365	4250
USD / CLP	939	940	930	910	900	900
USD / CNH	7.19	7.25	7.27	7.26	7.22	7.20

CAD Crosses

End of period:	Jun 3, 2025	Q2 '25	Q3 '25	Q4 ‘25	Q2 ‘26	Q4 ‘26
CAD / JPY	104	101	100	99	99	99
CAD / CHF	0.6	0.59	0.61	0.61	0.62	0.63
AUD / CAD	0.89	0.88	0.86	0.86	0.86	0.87
GBP / CAD	1.85	1.89	1.88	1.85	1.88	1.89
EUR / CAD	1.56	1.60	1.59	1.58	1.59	1.61

EUR Crosses

End of period:	Jun 3, 2024	Q2 '25	Q3 '25	Q4 ‘25	Q2 ‘26	Q4 ‘26
EUR / JPY	163	162	159	157	157	158
EUR / GBP	0.84	0.85	0.85	0.85	0.85	0.85
EUR / CHF	0.94	0.94	0.96	0.96	0.99	1.01
EUR / SEK	10.93	10.80	10.70	10.60	10.50	10.36
EUR / NOK	11.53	11.55	11.40	11.21	11.00	10.85

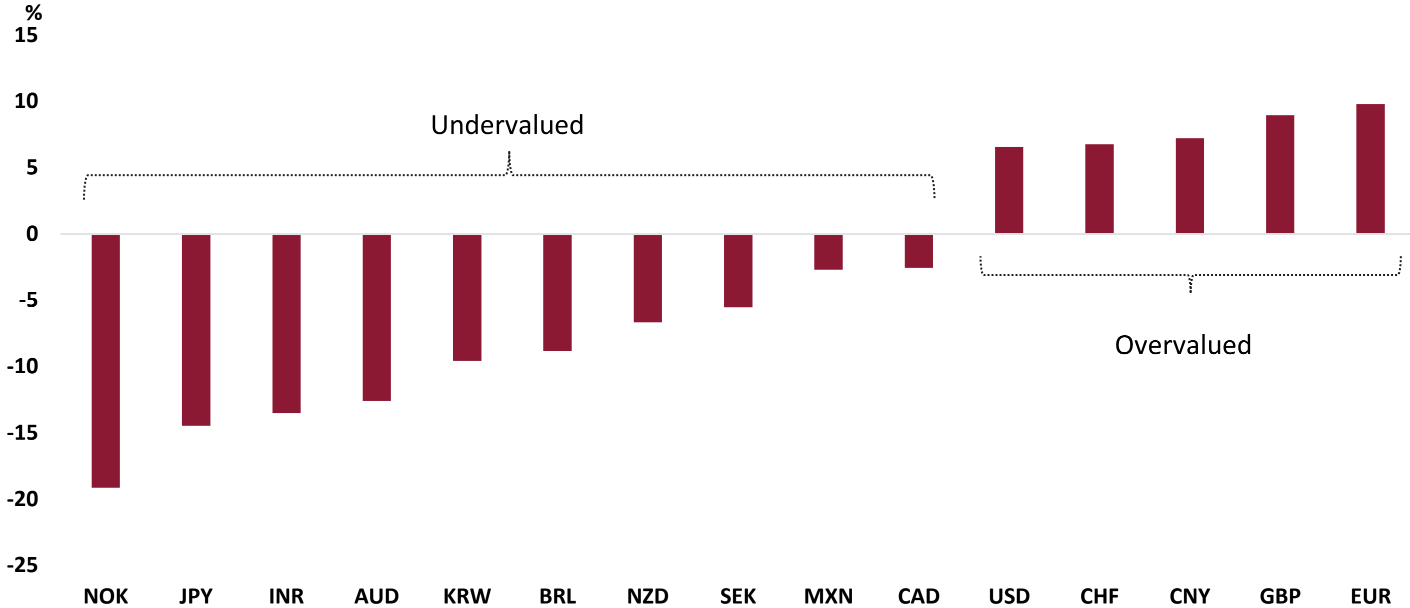
Central Bank Forecasts

	Current	Q2 '25	Q3 ‘25	Q4 ‘25	Q2 ‘26	Q4 ‘26
Fed	4.38	4.38	4.38	4.13	3.63	3.38
BoC	2.75	2.75	2.25	2.25	2.25	2.25
ECB	2.25	2.00	2.00	2.00	2.00	2.00
BoE	4.25	4.25	4.00	3.75	3.50	3.50
SNB	0.25	0.00	-0.25	-0.25	-0.25	-0.25
BoJ	0.50	0.50	0.50	0.50	0.75	0.75
RBA	3.85	3.85	3.60	3.10	3.10	3.10
RBNZ	3.25	3.25	3.00	2.75	2.75	2.75
Banxico	8.50	8.00	7.50	7.25	7.00	6.75
BCB	14.75	15.00	15.00	15.00	14.50	14.00
BCCh	5.00	5.00	4.75	4.50	4.25	4.25
Banrep	9.25	9.00	8.50	8.00	7.50	7.25

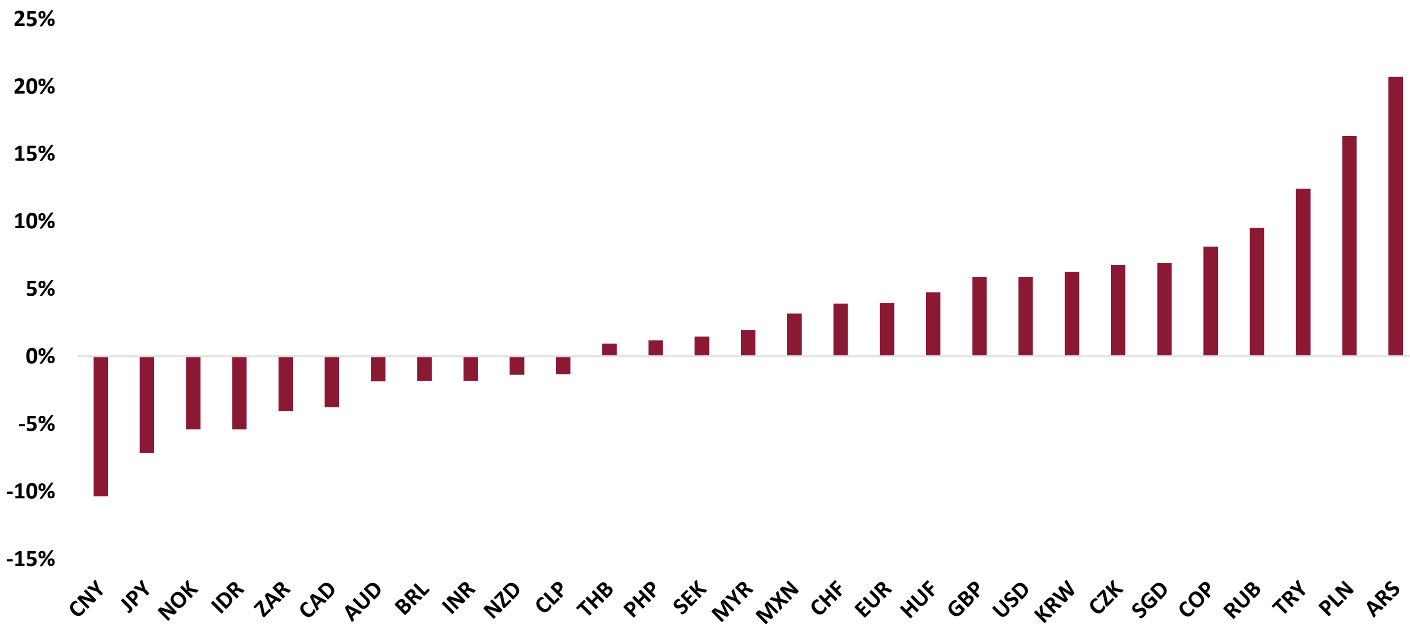
Market Pricing

	Current	Next Meeting	Q2 '25	Q3 ‘25	Q4 ‘25	Q1 ‘26
BoC	2.75%	Jun 4	2.70%	2.47%	2.34%	2.33%
Fed	4.38%	Jun 18	4.32%	4.11%	3.81%	3.59%
ECB	2.25%	Jun 5	1.93%	1.72%	1.60%	1.56%
BoE	4.25%	Jun 19	4.20%	4.02%	3.80%	3.68%
RBA	3.85%	Jul 8	3.64%	3.27%	3.03%	2.93%
RBNZ	3.25%	Jul 8	3.18%	2.98%	2.94%	2.98%
SNB	0.25%	Jun 19	-0.13%	-0.25%	-0.34%	-0.36%

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

Noah Buffam and Sarah Ying

USD – Balance Sheets Over Data

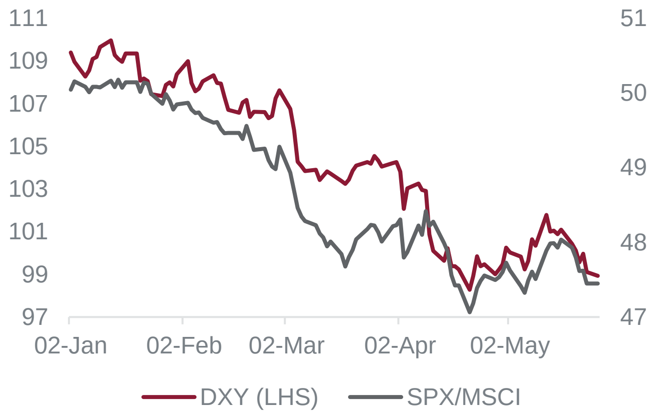
DXY – Q2 2025: 97.46 **|** Q3 2025: 97.15

Typical USD correlations have shifted in recent months, as the USD has lost its negative correlation with risk and has been less sensitive to moves in rate spreads. Instead, the USD has been driven by the world's long term outlook on US assets, and speculation that foreign money managers are pulling away. This is most notable in the strong correlation between the DXY and the ratio between the S&P 500 and the MSCI Global (chart below). The analysis and thinking behind trading the USD needs to change; while previously we had been focused on analysis of important data points, we now need to get an overarching understanding of the trajectory of capital flows and political discourse. To gauge where the USD goes, we need to increasingly understand the choices of institutional capital allocators rather than those of central bank heads.

To understand the USD's shifting correlation with risk, and increasing exposure to relative equity returns, we can attempt to understand the world's USD denominated balance sheets. We can roughly proxy for global USD assets and liabilities by taking the US net international investment position (NIIP) and total USD denominated bonds issued by foreigners, both as a share of GDP. Rising foreign USD denominated debt between the late 1980s and 2020s worked as flint for a number of international crisis, as risk off spilled over to a scramble to cover USD liabilities; resulting in a stronger USD. But the surge in the NIIP (which is inverted in the chart) since the late 2010s, at the same time as USD denominated debt to GDP has stagnated, means that foreigners will be increasingly concerned by the asset side of their balance sheet in risk off (especially when it is centered around the US). After years of US asset outperformance, the risks are now tilted towards a continued re-evaluation of US overweights.

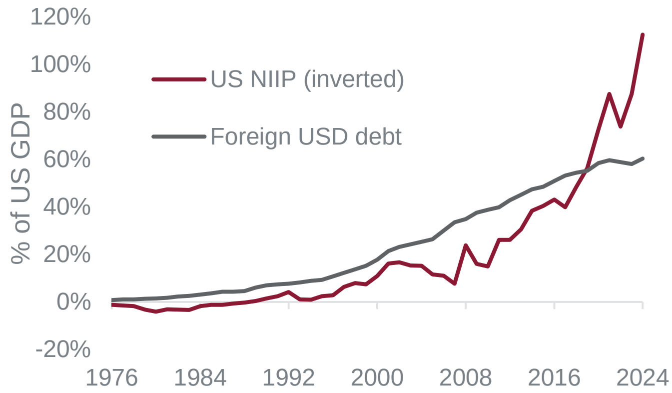
The evolving tariff outlook amid back and forth challenges between President Trump and the US legal system will cause short term moves in the USD. But over a longer time horizon, there are risks that we are in the early stages of an institutional re-evaluation of the US. While we have seen FX hedging activity increase, and some large asset managers suggesting that they are considering diversifying outside of the US, the flows data has yet to show a major shift in asset allocations. These decisions will take time and consideration, and ultimately there are few true alternatives to USD assets at the moment. But if there is a continued erosion of some of the institutions which drove US outperformance (i.e. highly open/free markets, skilled immigration, world class higher education), there are risks that sustained high US valuations could continue to converge with the rest of world and bring the USD lower with it. But because i) this is a slow moving process, and ii) there are few alternatives to US assets; we do not expect the USD to swing from over to undervalued, but instead return closer to long term fair value.

Chart: The USD Has Been Correlated With Relative US Equity Performance Rather Than Rate Spreads



Source: Bloomberg, CIBC Capital Markets

Chart: The Risks Now Lie On The Asset Side of Foreign USD Balance Sheets



Source: BEA, BIS, CIBC Capital Markets

Canada

Avery Shenfeld and Katherine Judge

CAD – C$ Pushed and Pulled by Trade Tensions

USD/CAD – Q2 2025: 1.38 **|** Q3 2025: 1.37

The loonie has strengthened slightly over the past month, but that's not entirely due to Canadian fundamentals; it's a reflection of the shaky ground that the broad USD remains on. But we expect the greenback will reverse some of its weakness in the near term if progress towards trade deals becomes evident in the weeks ahead, which could add some short-term pressure to the loonie.

On the domestic front, the recent heat in CPI trim and median readings is likely enough to see the Bank of Canada skip a cut at the June meeting. But the climb in the unemployment rate since the onset of trade tensions suggests that policymakers could still return to cuts in July, as economic slack has increased. That points to CPI undershooting the target next year, once the temporary lift to price-level pressures from tariffs is behind us. Moreover, the legal challenges to broad-based tariffs raises the risk that sectoral tariffs are boosted, in line with Trump's announcement at the end of May to double steel and aluminum tariffs to 50%, which would see economic slack in the Canadian economy rise further.

That strengthens the case for further BoC easing at the July meeting. But our target for the overnight rate to reach 2.25% by the end of the year isn't materially different from what markets are pricing in already. That therefore shouldn't stand in the way of a slight appreciation in the CAD into the end of 2025 on broad USD weakness, and even more so in 2026, when Canada's exports will be receiving a lift from better global growth prospects and higher commodity prices as demand recovers from its tariff-induced rout.

Europe

Jeremy Stretch

EUR – Investor Rotation

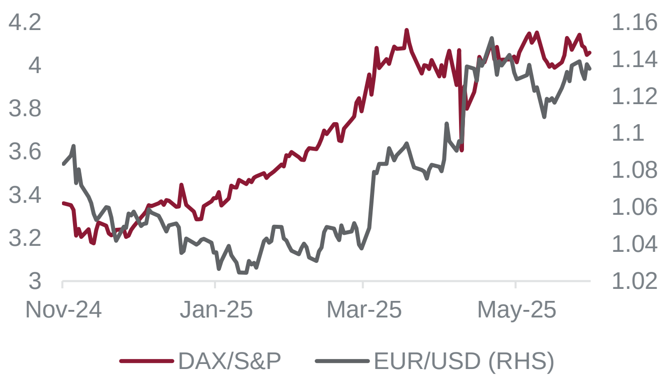
EUR/USD – Q2 2025: 1.16 **|** Q3 2025: 1.16

Although EUR/USD may have moderated from the April 21st high of 1.1573, (we have not witnessed a higher threshold since November 2021), we anticipate underlying EUR resilience as the broad USD diversification narrative is set to persist. We continue to look for investor rotation into liquid eurozone assets, both equities and bonds, indeed the flow into the former in the year-to-date validates broad EUR impetus.

In terms of terms of the fiscal backdrop, much has been made of the upcoming German fiscal expansion. We expect increased infrastructure investment in addition to an aggressive acceleration in defence spending to result in positive macro spillover effects. Beyond the rotation of investor funds into European equities, we also note ongoing external appetite for German government bonds. However, the compression in eurozone peripheral bond spreads, including BTP's and Bonos, underlines external investor appetite for portfolio diversification. Appetite for higher yielding, but still liquid, peripheral paper supports the notion of international investors remaining intent on looking beyond just German government bonds. Moreover, we would note that ECB President Lagarde has underlined that current US uncertainties and USD tribulations as providing something of an “opportunity” for the eurozone.

However, in order for the Eurozone to fully embrace the opportunity would likely require a strengthening of the bloc’s financial and security architecture. While such hopes, likely including fiscal coordination, are unrealistic, at least in the near term, should the eurozone underline its commitment to free trade, enhancing trade openness, suggests that the eurozone can continue to narrow the gap in terms of the scale of IMF allocated reserves in EUR relative to those in USD. We would expect the perpetuation of the long term (USD) diversification narrative. This supports flows into European stocks, bonds and de facto the currency.

Chart: EUR/USD and Dax/S&P



Source: Bloomberg, CIBC Capital Markets

GBP – Trade Deals Limited Impact

GBP/USD – Q2 2025: 1.37 **|** Q3 2025: 1.37

The market is fully anticipated a fourth cut in the current easing cycle, taking the base rate to 4.25% at the May MPC. However, it was not anticipating a three-way MPC split. That external doves Dhingra and Taylor both voted for 50bps was far from a shock. That two members, including Chief Economist Pill, voted for steady policy was a surprise. The bulk of the committee, including Governor Bailey maintain the narrative of gradual and cautious easing. However, the Chief Economist is mindful of the fact that policy easing since August 2024 is too aggressive given “the balance of risks to price stability.” The breadth of BoE viewpoints underlines residual UK uncertainties. Despite internal policy divergence, we continue to expect the policy of once a quarter policy easing to extend into early 2026.

We expect cautious policy easing as the economy remains afflicted by the twin terrors of low productivity and tariffs. In terms of the latter the UK-US trade (tariff) agreement has merely eased the worst of the ravages of US trade policy. The reduction in the auto tariff threshold, to 10% for the first 100,000 units (the UK exported 102k cars last year) sustains sectoral activity. While the US deal merely limits the scale of potential economic destruction, the announcement of a free-trade deal with India, allied with an easement in UK-EU trade frictions will prove accretive for UK plc, albeit the gains are marginal, even over the medium run.

Of course consumer performance remains integral to the UK outlook. Although Q1 GDP came in above median expectations at 0.7% q/q, that consumption and/or government spending were below expectations underlines potential trade distortions, Q1 net exports were the strongest in three years, as US importers built up inventories. Despite the lower than expected government spending UK public finances remain pressured. After a £14bn fiscal tightening in the Spring statement, elevated financing costs and macro risks another fiscal contraction, potentially breaking manifesto commitments (tax hikes) into the autumn budget. Ongoing speculation of fiscal tightening, risks containing consumer sentiment, activity and Sterling gains. Despite ongoing discussions over the ending of USD dominance, we would be wary of anticipating significant further GBP/USD gains.

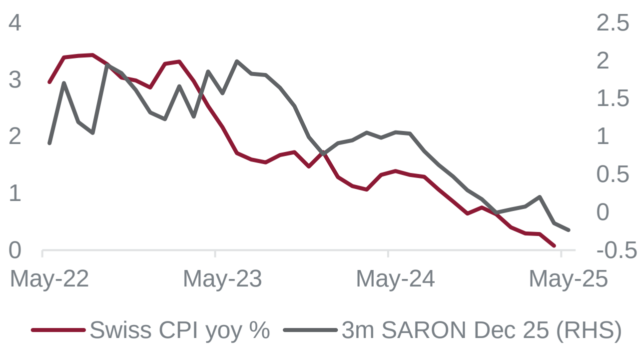
CHF – Braced For More CPI Challenges

EUR/CHF – Q2 2025: 0.94 **|** Q3 2025: 0.96

As we have highlighted previously, ongoing Swiss disinflationary tendencies support the notion of further rate cuts, including potentially taking rates back into negative territory for the first time since September 2022. Falling energy prices and CHF resilience are key factors supporting disinflationary dynamics. The safe haven status of the CHF has prompted real money shorts to be trimmed by around a third over the last couple of months. Moreover, the oil price downtrend has been amplified in CHF terms; the Swiss currency has appreciated by 10.3% over the last three months. It is against this broad disinflationary backdrop that markets continue to speculate as to whether the SNB will maintain a gradualist stance, via standard sized moves (25bps) or move to adopt a more aggressive 50bps adjustment on June 19th, taking rates back into negative territory.

The central bank remains acutely aware of competitiveness pressures and disinflationary tendencies, especially should EUR/CHF consistently remain below the 200Day MAV, currently 0.9399. SNB President Schlegel has reminded the market that while negative inflation cannot be ruled out, the Bank's focus remains on medium term price stability. The subtext is that the bank is attempting to warn the market against overreacting to individual data releases, and in the process amplifying the pricing of cuts. We continue to expect the Bank will be reluctant to embrace FX intervention to cheapen the CHF given the risks of being returned to the US Treasury Currency Manipulation list. The US Treasury is expected to update its monitory list at some stage this month. The desire to avoid being added to the list amplifies risks of a return to negative rates, albeit we currently expect such a scenario only in Q3.

Chart: Swiss CPI and 3m SARON



Source: Bloomberg, CIBC Capital Markets

SEK – Retail Resilience

EUR/SEK – Q2 2025: 10.80 | Q3 2025: 10.70

Not only did the Swedish economy unexpectedly contract in Q1, the 0.2% contraction represented the weakest performance in six quarters (the market had expected a modest 0.1% expansion), Q4 activity was also revised from 0.8% to 0.5%. The unexpected contraction contrasts with the Riksbank's MPR assumption of a 0.5% expansion. Sliding household consumption and weaker business investment were catalysts for macro underperformance. The downturn would have been even more pronounced absent unexpected US tariff related export distortions.

Given that household consumption has declined in two of the last three months, while the Economic Tendency Survey has moderated to the lowest level since October suggests residual pressure on the central bank to act. After holding rates at 2.25% since January, the GDP miss risks amplifying rate cut pricing into the June 18th central bank decision, currently around 13bps are priced.

Of course GDP data is inherently backward looking. Hence, despite the fact that Q1 household consumption disappointed April retail spending proved unexpected resilient, monthly sales increased by 0.9%, leaving annual spending at the highest level since November 2021. Contingent to the retail boost implied evidence of household lending continuing to rebound from its early 2024 nadir. Annual household lending has more than quadrupled over the last twelve months, validating the presumption of relative macro outperformance versus the G3.

The latest central bank Financial Stability Report (FSR) underlined that the monetary authorities remain wary of the Swedish financial system being "large, concentrated and interconnected." However, the FSR suggests that domestic banks continue to have high profitability and strong margins. In summation, we would agree with central bank deputy Jansson who has suggested that SEK gains are set to persist given ongoing international appetite to reduce exposure to US assets.

NOK – Norges Bank Remains a Laggard

EUR/NOK – Q2 2025: 11.55 | Q3 2025: 11.40

The fastest rate of monthly spending (0.7%) in three months (also note positive base effects in the annual reading) validates ongoing Norges Bank policy reticence. Retail sales have grown by 1.5% in the February to April period. Activity is proving to be supported by elevated real wage growth, strong employment gains and an easing in mortgage rate headwinds.

In terms of the labour market, after a one month pause, due to substantial data revisions, the latest unemployment data suggests that the May reading of 2.1% is a tick above that from April and that discounted in the most recent monetary policy statement. We would note that the Norges Bank assume that the seasonally adjusted unemployment rate is set to remain around 2.0% this year. Despite the modest uptick in unemployment, we would anticipate residual labour market tightness, including elevated wage growth, to extend Norges Bank policy inertia through Q3; rates have remained at 4.50% since December 2023.

The May 8th Norges Bank policy meeting witnessed unchanged guidance. Remember the bank switched from meeting specific guidance to merely detailing that policy would "most likely be reduced during the course of 2025" back in March. That guidance remained unchanged is unsurprising ahead of the June meeting considering it will be accompanied by updated forecasts. However, given underlying macro resilience, we would expect immediate policy inertia to extend until at least September. Signs of a moderation in core CPI, the ex-energy series dipped to 3.0% in April, supporting the notion of 50bps of easing by year end, most likely in September and December. The immediate macro impetus allied to widening spreads underlines why only the SEK has proved to outperform the NOK over the last three months.

Asia-Pacific

Maximillian Lin

CNH – The Geneva Suspension?

USD/CNH – Q2 2025: 7.25 **|** Q3 2025: 7.27

Just three weeks ago (on May 12th) US Treasury Secretary Bessent met with his Chinese counterpart in Geneva. At the time, markets had enthusiastically welcomed the news that the US had agreed to lower tariffs. However in a tweet last Friday (May 30th), President Trump has raised doubts about the deal. Trump noted that "*the bad news is that China, perhaps not surprisingly to some, HAS TOTALLY VIOLATED ITS AGREEMENT WITH US.*"

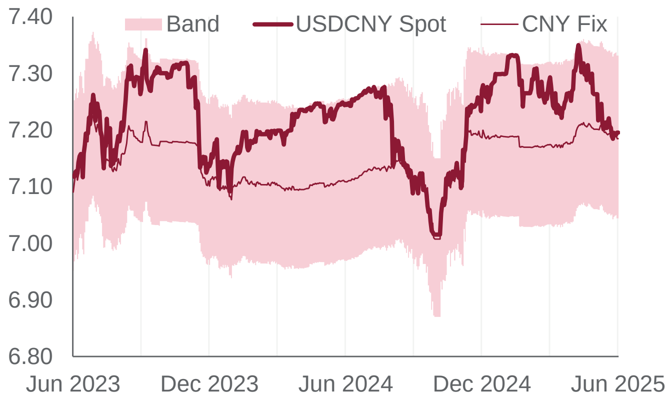
A weekend report by the New York Times suggested that Trump's tweet may refer to China withholding supplies of rare earths used for EV production. On Monday, China's Ministry of Commerce (MOFCOM) called the president's tweet "baseless." The MOFCOM spokesman said China continues to honor its agreement responsibly, while accusing the US of "discriminatory restrictive measures."

MOFCOM's response included complaints over a wide range of issues, including the US revoking Chinese student visas. That shows that even topics not directly related to trade can derail the short-term truce. The White House knows that being "tough on China" is popular, just as it was under Trump 1.0. Unlike the 2018-19 trade war, however, Beijing is now paying closer attention whenever Washington "smears China." Chinese officials have repeatedly emphasized that "mutual respect" is a prerequisite for talks.

President Trump has vaguely mentioned his plans to talk with Chinese President Xi "soon," with a date never specified. In our view, such a high-level meeting is unlikely unless Trump tones down the rhetoric. In the meantime, China will stick to proportional trade retaliation as the response to Trump's unpredictability. "Soft restrictions" on Chinese rare earth exports such as bureaucratic delays are part of this playbook, and were deployed against Japan during a 2012-13 territorial dispute. China views bureaucratic hurdles such as "export licenses" and "approved entity" whitelists as reciprocal to US restrictions on high tech chips to Chinese firms.

There is no need for China to retaliate through unconventional means such as sudden yuan devaluation. Even so, we expect gradual yuan weakness, but now to 7.25 by end Q2 (vs previous forecast of 7.40). The dollar is weakening, but China's growth outlook (and global demand for yuan) are still challenged by longer-term trade uncertainty. The PBoC will likely limit yuan strength to maintain export competitiveness. Unlike the bout of USD weakness in Q3 2024, the PBoC has now allowed the USD/CNY fix to fall with USD/CNY spot. For Q3, we forecast USD/CNH to 7.27.

Chart: Unlike Q3 2024, the PBoC has prevented the USD/CNY fix from following spot lower



Source: Bloomberg, CIBC Capital Markets

JPY – The Ultra Long JGB Spillover

USD/JPY – Q2 2025: 140 | Q3 2025: 137

The yen continued to react to external headlines on trades last month, but there were two notable domestic developments: (i) the weakness in long end JGBs and (ii) a dovish May 1st BoJ outlook. Despite ongoing questions over Japan's long term fiscal sustainability and the reduced likelihood of BoJ rate hikes, we still expect modest yen strength in June and into Q3.

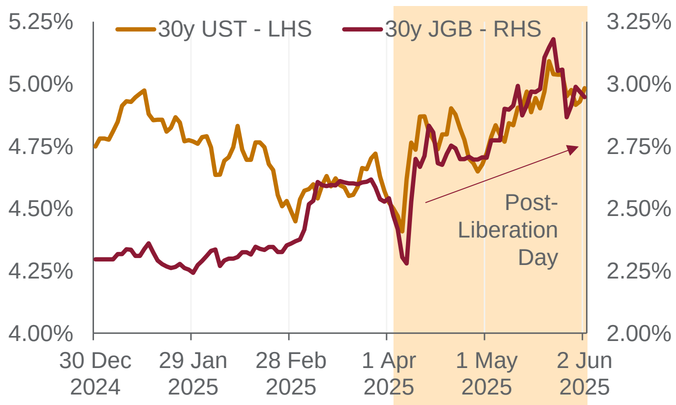
For (i), weakness in long end JGB auctions on May 20th and 28th have reminded investors of Japan's high public debt (250% of GDP, according to the IMF). In our view, however, this should not be a catalyst for yen weakness. It's important to remember that US uncertainty is the main driver of long-end JGB weakness. The first chart shows that since Liberation Day, 30y JGBs have followed 30y UST yields higher.

Although the US Government has comparably lower public debt (119% of GDP), global diversification flows away from the dollar will outweigh any foreign retreat from the yen. International investors (including Japanese institutions) are heavily long US treasuries. By contrast, the JGB market is primarily owned by Japanese investors. The BoJ itself owns around 46% of all JGBs, while foreigners account for just 12%. As such, unwinds of long-end JGBs will not lead to huge USD/JPY or cross-yen buying. Instead, domestic banks, insurers and pension funds will reduce long end JGB exposure and go long the front end JGB. This has already been playing out; since Liberation Day the JGB curve has twist steepened sharply (see second chart below).

On May 28th, the Nikkei Asian Review reported that the Ministry of Finance would "sound out" market participants on demands for long end JGB issuance. The Nikkei did not mention a possible BoJ QT change in response, but if volatility persists we think the BoJ could also adjust its ongoing JGB purchases (currently ¥4.1tln per month) away from the 1-3yr tenors and into >25yr tenors.

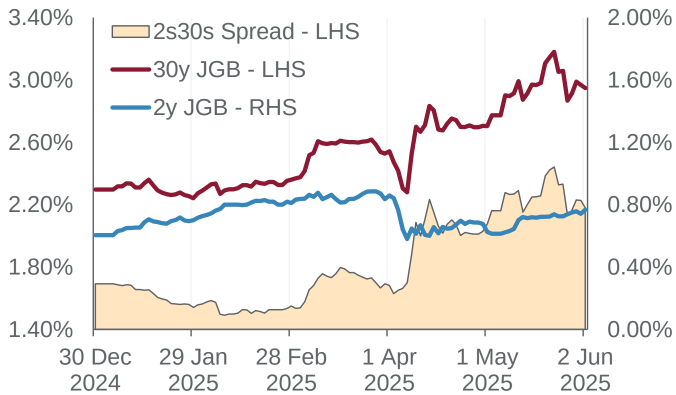
The erosion of US exceptionalism points to yen strength. We do however mark-to-market our Q2 forecast to 140 (from 136 previously) and Q3 to 137 (from 133 previously). In an extreme risk-case scenario, the BoJ could reimpose some form of YCC, which would be at the detriment of the yen. We do not envision such an emergency scenario. We do think, however, that the dovish May 1st BoJ meeting points to no more rate hikes for 2025 as tariffs make Japanese exporters more cautious on wage hikes.

Chart: Since Liberation Day, 30y JGBs have moved with 30y US treasuries



Source: Bloomberg, CIBC Capital Markets

Chart: JGB 2s30s twist steepened sharply, with demand for front end JGBs strong in May



Source: Bloomberg, CIBC Capital Markets

AUD – No More Push-back against Sequential Cuts

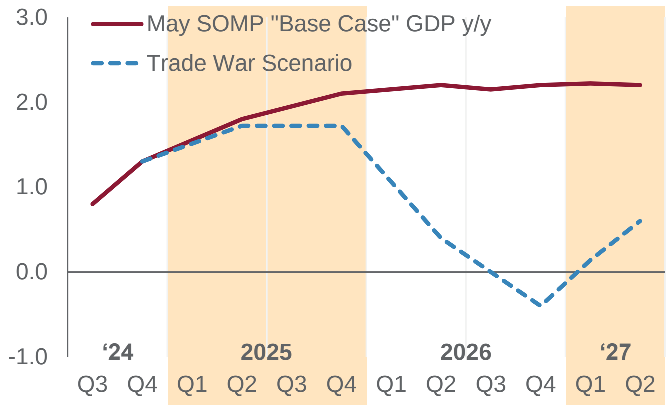
AUD/USD – Q2 2025: 0.64 | Q3 2025: 0.63

The RBA cut rates by 25 bps (to 3.85%) on May 20th as widely expected by consensus. However, in contrast to the "hawkish cut" that was widely anticipated by markets, the RBA's language and press conference no longer pushed back against further expectations for cuts. Notably, the May SOMP also introduced a much more dovish trade war scenario "risk case" that forecasts a recession in late 2026. A comparison of Australian GDP growth under the "trade war scenario" vs the RBA's base case is shown in the chart below.

Prior to Liberation Day, the RBA was much more attuned to upward inflation risks in Australia. Now, the RBA has shifted focus from inflation momentum to the knock-on effects from Trump tariffs. Given the difficulty of predicting the US president's ever-evolving stance on US tariffs, another RBA rate cut in July cannot be fully ruled out. The market is now pricing 18 bps of cuts by July (72% chance) and a cumulative 42 bps by August. We, the RBA (and the market) will maintain a data-dependent approach to the policy outlook. If President Trump ends up lowering tariffs on China within the next six weeks, that could lead to no RBA change in July.

However the current 30% tariff on China, if prolonged, should lead to deteriorating Chinese data and a consecutive RBA cut (this is our base case). Additional China stimulus is another wildcard in the RBA forecast. We adjust our Q2 AUD/USD forecast 0.01 higher to 0.64 and forecast mild downside to 0.63 in Q3, slightly weaker than current levels. Although the "sell America" theme should benefit other currencies at the expense of the US dollar, the RBA's more dovish outlook is still linked to US demand and global equity sentiment amidst the trade war. With USD/CNH volatility still tightly managed, macro investors still view Antipodean currencies as China proxies.

Chart: The May RBA showed a 2026 recession as a “risk case” scenario



Source: RBA, ABS, Bloomberg, CIBC Capital Markets

NZD – Hawkish Dissent as the Terminal Rate Approaches

NZD/USD – Q2 2025: 0.59 | Q3 2025: 0.59

In contrast to the dovish BoJ and RBA meetings in May, the RBNZ decision on May 28th surprised mildly hawkish. The central bank delivered another 25 bps cut to the OCR rate (to 3.25%), but the tone of the statement and press conference did not give strong hints for another move in July. A surprise 5-1 vote revealed one dissent for no change.

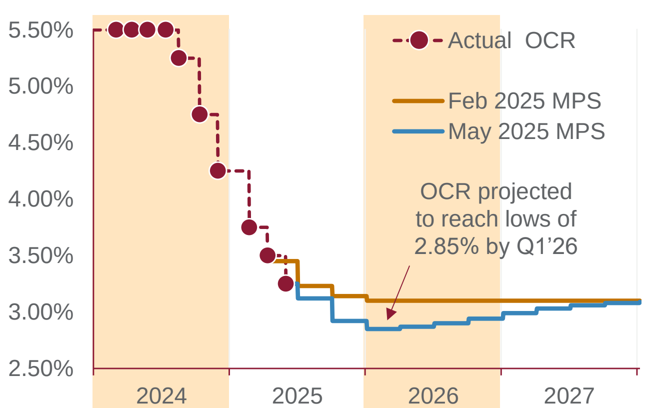
The new MPC vote disclosure is a departure from previous meetings under Governor Orr. During Orr’s terms, the governor was the main driver in setting the agenda and narrative for rate decisions. We think that the change to a formal vote effectively dilutes the governor’s ability to drive the decision-making process.

By publishing the vote, Acting Governor Hawkesby noted that his goal is to boost transparency of the RBNZ’s decision-making process, while also matching the norms of other G10 central banks. When he was asked about whether the dissent implied a lack of consensus, Hawkesby replied that there is MPC consensus on the direction of rates, but some differences in opinion on timing. Given that it is still “early days” in Trump’s trade war, future data releases will play an important role in assessing the timing of rate cuts. We expect a pause in July.

On the terminal rate, the updated May 2025 MPS projected further cuts to the OCR to lows of 2.85% by Q1 2026 (see chart). Even though the projected low in OCR was shifted to 2.85% (from 3.10% previously), with the OCR now closer to terminal it makes sense for the RBNZ to act more slowly. Beyond the expected August cut, we think the final cut in the RBNZ easing cycle will take place at the November 26th meeting.

Similar to our AUD/USD view, we think the “sell America theme” will limit NZD weakness. We revise our Q2 NZD/USD forecast of 0.59; slightly weaker than current levels. The RBNZ nearing its easing cycle should help the Kiwi outperform the Aussie. Weaker Australian data ahead of the July RBA meeting points to mild AUD/NZD downside towards 1.07 in Q3.

Chart: The May MPS point to cuts an Q3 cut, but the timing will likely be in August.



Source: RBNZ, Bloomberg, CIBC Capital Markets

Emerging Markets

Latin America

Luis Hurtado

MXN – Growth Concerns Will Limit Enthusiasm on the MXN

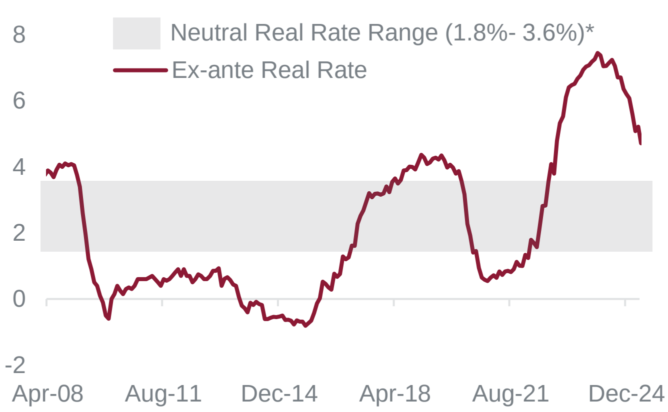
USD/MXN – Q2 2025: 19.40 | Q3 2025: 19.55

Banxico cut the overnight rate by 50bps to 8.50% last month in line with our forecast and the consensus view. Moreover, the CB signaled it could cut the overnight rate by another 50bps this month. Once again the decision was unanimous. All in, the board continues to emphasize the deterioration of growth over potential inflationary measures. However, as the announcement reiterated that “the inflationary environment will allow to continue the rate cutting cycle, albeit maintaining a restrictive stance,” the market is still anticipating the overnight rate to reach ~7.25% by Q2 2026, with a terminal real rate near the upper band of Banxico’s neutral real rate range estimate (1.8-3.6%).

That being said, note that Banxico’s Quarterly Inflation Report (May 28th) revised Mexico’s 2025 GDP growth outlook to 0.1% (0.6% previously) and slashed its 2026 growth estimate to 0.9% from 1.8% a quarter prior. While Banxico recognized the recent resilience of Mexico’s exports, the bank sees the weakening of the US economy and that of industrial production in the US to still having a negative impact on the demand for Mexico’s exports. Banxico also cited weaker internal demand and investments in an uncertain environment as the main reasons for its lower forecast revisions.

Given the widening cracks in activity data, we suspect Banxico is starting to position itself for a longer easing cycle than what is currently priced in. Thus, we have revised our terminal rate forecast lower to 6.50% (6.75% previously), bringing real rates well within Banxico’s neutral real rate range estimate (1.8%-3.6%), and ~80bps below current market pricing. Looking at the peso, despite the overall weakness of the greenback, we would not chase USD/MXN to move lower below 19.20 in Q2 and maintain our Q3 and Q4 USD/MXN forecasts at 19.55 and 19.60, respectively.

Chart: Banxico Could Cut Rates by Another 123bp This Year and Still Remain in Restrictive Territory



Source: Banxico, CIBC Capital Markets

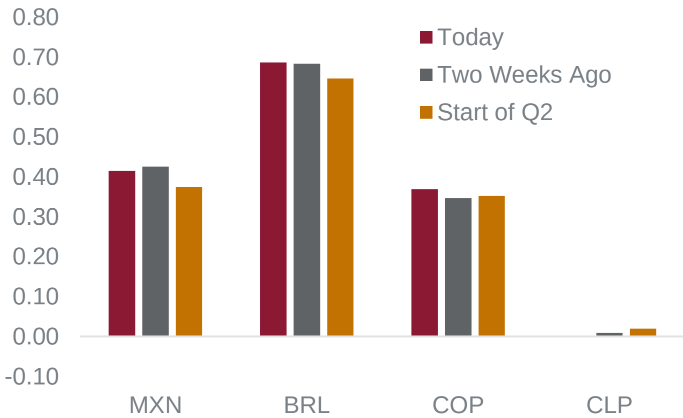
BRL – Fiscal Concerns Limit BRL Upside

USD/BRL – Q2 2025: 5.60 | Q3 2025: 5.70

The last week of May was a rollercoaster ride for the real with USD/BRL swinging between 5.60 and 5.75 before stabilizing near 5.70 into the start of June as usual fiscal headlines were the main culprit. While initial reports suggested that the government was going to implement a budget freeze of R$10bln higher than expected by consensus, it was later revealed that this was only in response to a larger than expected increase in expenses and lower revenues (not a proactive measure). Finance Minister Fernando Haddad also mentioned that additional revenue measures will be needed in order to comply with Brazil’s fiscal target. However, there was a significant negative market reaction to the financial transactions tax mulled by the government which was soon after discarded, exposing the government’s lack of alternative revenue generating sources.

On the monetary policy front, although the BCB maintained a cautious tone in May, the CB appeared to prepare the market for the end of the tightening cycle in June/early Q3 – a situation that should limit any enthusiasm on the BRL into next quarter. We now expect the BCB to end its tightening cycle at 15.00% (15.25% previously) and to cut the Selic rate by 200bps next year. Decelerating economic activity growth and the 2026 election cycle are obviously in favour of a dovish BCB in late Q4 and early next year as reflected in the latest BCB Focus survey (terminal Selic rate seen at 14.85%, and 225 bps in rate cuts expected in 2026). Hence, although we continue to anticipate sporadic tactical USD/BRL shorts back to the 5.60 resistance level driven by the BRL's high carry (see chart below), we maintain our Q3 and Q4 USD/BRL forecasts at 5.70 and 5.85, respectively.

Chart: 3M Vol Adjusted Carry



Source: CIBC Capital Markets

COP – Carry Temporarily Shields COP from Local Risks

USD/COP – Q2 2025: 4250 | Q3 2025: 4325

Although the COP enjoyed a significant rally for most of May, the question going forward is whether the subsequent move lower in USD/COP vols, and the attractive nature of the COP will be enough to restart a self-reinforcing carry cycle, or if the current environment will only lead to sporadic and brief COP bids throughout the year. We see the latter as more likely.

We highlight that Banrep cut the overnight rate by 25bps to 9.25% in late April, against our (and consensus) on-hold call. This was the obvious risk as there were already 3 board members voting in favor of a 50bps (vs 4 votes in favour of on-hold) rate cut in the previous meeting. Moreover, while inflation remains elevated, real rates (ex-ante and ex-post) are significantly above neutral, and Banrep lowered its GDP growth estimate to 2.6% (vs. 2.8% previously) for this year. In our view, this implies a continuous pace of 25bps rate cuts throughout the year, instead of the 50bps pace suggested by the board members with closer ties to the government. That being said, the market is still pricing Banrep to cut rates to 8.36% by the end of May 2026, still above the 7.63% expected by local economists in the latest Banrep survey (released early May), suggesting plenty of space for a further repricing lower in local rates. Thus, given ongoing fiscal risks (large spending cuts aren't expected), and our 7.25% overnight rate forecast by the end of Q2 2026, we expect USD/COP to resume its upward path and maintain our Q3 and Q4 forecasts at 4325 and 4350, respectively.

Table: Excluding the still cautious BCB, Banrep and Banxico Have the Most Room to Cut Rates in the Short-term…

	Banxico	BCB	Banrep	BCCh
a. Neutral Real Rate	3.60	5.00	2.70	1.00
b. Current O/N Rate	8.50	14.75	9.25	5.00
c. 1Y Inflation Exp.	3.67	4.88	3.96	3.50
d. Ex-ante Real Rate (b-c)	4.83	9.87	5.29	1.50
e. Bps Above Neutral (d-a)	123	487	259	50

*Upper band of Banxico's neutral real rate estimate (1.8%-3.6%). Source: Banxico, BCB, Banrep, BCCh, CIBC Capital Markets

CLP – Cuts to Terminal Already in the Price

USD/CLP – Q2 2025: 940 | Q3 2025: 930

The Banco Central de Chile kept the overnight rate on hold at 5.0% but highlighted that "changes in global trade policy have deteriorated the prospects for global growth, while increasing uncertainty about its evolution." We recognize that the usual uncertainty brought by tariffs rhetoric, the upside surprise to economic activity in April, and the November presidential election are still clouding how quickly the Banco Central de Chile may reach its terminal rate. However, Chile's ex-ante rate remains approximately 50bps above its neutral level still providing space for cuts in the very short term. Hence, while we agree with the market pricing of 75bps to 80bps in rate cuts over the next year, we do not rule out the BCCh restarting its easing cycle this month (only 6bps are priced in).

Looking at the CLP, while we see limited upside on the CLP in the very short term, local dynamics provide a better outlook into H2 2025. First, despite the noise created by potential copper tariffs in Q3, the US search for copper supply remains net positive for the CLP into the medium/long term. Second, right and center-right presidential candidates continue to lead Chile's presidential race, enhancing the odds of fiscal consolidation in 2026, and providing a comparative advantage to the CLP vs the other more volatile fiscal dynamics in Brazil, Colombia and Mexico. And third, the Central Bank of Chile is very near the end of its easing cycle, and with the market pricing the BCCh's terminal rate at 4.16%, we see limited expectations for dovish surprises into next year. Thus, we expect USD/CLP to consolidate near the 940 into the end of H1 before starting a gradual downward trend to end Q4 2025 in the 900-920 range.

Table: CIBC 1Y Overnight Rate Forecast Versus Market Implied Rates and Recent CBs' Surveys

	CIBC	MIPR	CB Survey
Banxico	6.75	7.29	7.00
BCB	14.25	14.20	NA*
Banrep	7.50	8.36	7.63
BCCh	4.25	4.16	4.00

*End of 2026 Selic rate expectations is at 12.5%. vs. our forecast at 13.00%. Source: Banxico, BCB, Banrep, BCCH

South Africa

Jeremy Stretch

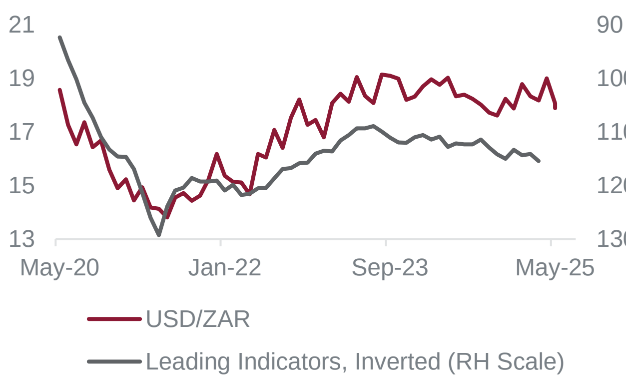
ZAR – Reconsidering The CPI Corridor

EUR/ZAR – Q2 2025: 20.65 | Q3 2025: 20.42

A fourth SARB rate cut, taking rates to 7.25%, leaves policy broadly in the neutral policy zone. While the move was largely discounted, it is notable that one of the six committee members opted for an immediate 50bps adjustment. That more aggressive response is perhaps a reflection the central bank revising down their inflation profile while simultaneously amplifying discussion regarding reassessment of the broad 3-6% CPI corridor target (which has been in place for 25 years). Although headline inflation unexpectedly ticked higher in April (to 2.8%), due to rising food prices, the headline rate has been below the target corridor in four of the last seven CPI snapshots. With recent ZAR gains, the currency has proved to be the strongest performer versus the USD since the pause in US reciprocal tariffs on April 8th, (the ZAR has gained more than 10%) is disinflationary. We would also note that the broad downtrend in global energy prices, a move amplified in ZAR terms, also supports a lower CPI dynamic.

The central bank has revised its CPI profile for both this year and next. The bank now assumes 3.2% this year and 4.2% in 2026. The latter was previously assumed to be 4.5%. However, the combination of the Treasury amending plans to raise VAT, alongside a stronger FX narrative and sliding oil prices, eases price dynamics. The lower inflation profile, alongside a prospective reduction in the CPI corridor (technical work on a threshold review is at an advanced stage), supports the notion of lower medium run borrowing costs, a move which benefits the macro backdrop. The perpetuation of a broadly benign inflation environment, alongside elevated real rates supports the notion of ongoing investor inflows, maintaining a broadly constructive ZAR bias.

Chart: USD/ZAR and Leading Indicators



Source: CIBC Capital Markets

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