

CIBC FICC Strategy and Economics

FX MONTHLY

March 2024

Leaping Into March

Key points

- There's some room for a stronger USD through the end of March as we feel the Fed is priced to start easing a month too soon. However, a shift towards the middle of the 'dollar smile' should cause the overvalued USD to gradually depreciate through the end of 2024.
- Canadian growth appears strong at first glance, but a look beneath the hood reveals weak domestic demand. We expect the BoC to pivot increasingly dovish and cut 125 bps this year, as inflation and domestic growth come under pressure. This dynamic should cause CAD to underperform on the crosses through the second half of 2024.
- Central bank divergence looks set to be a theme among European currencies, with the ECB and SNB among the first G10 central banks to ease, while the BoE and Norges Bank lag. As such, we expect to see EUR and CHF weakness on the crosses.
- Antipodean central banks have remained relatively hawkish due to domestic inflationary pressures, however, this looks to be more talk than bite as we do not expect any further hikes.
- Within LATAM FX, low volatility continues to favour carry trades, but beware of an imminent decoupling from the Fed by Banxico.
- For CNH, we expect the regime of low volatility to persist as government authorities have exhibited a preference for muted asset price movements.

FX Forecasts

End of period:	Feb 29, 2024	Q1 '24	Q2 '24	Q3 '24	Q4 '24	Q2 '25	Q4 '25
USD / CAD	1.36	1.36	1.37	1.35	1.35	1.30	1.29
EUR / USD	1.08	1.07	1.09	1.11	1.12	1.14	1.16
USD / JPY	150	150	147	143	140	135	135
GBP / USD	1.27	1.26	1.29	1.31	1.32	1.33	1.35
USD / CHF	0.88	0.89	0.89	0.88	0.88	0.89	0.88
USD / SEK	10.31	10.47	10.14	9.86	9.69	9.34	8.97
AUD / USD	0.65	0.65	0.67	0.67	0.68	0.69	0.70
NZD / USD	0.61	0.61	0.63	0.64	0.65	0.66	0.67
USD / NOK	10.59	10.61	10.28	10.00	9.78	9.47	9.22
USD / ZAR	19.18	18.85	18.45	18.00	17.75	17.20	16.75
USD / BRL	4.98	5.00	5.10	5.20	5.00	5.20	5.40
USD / MXN	17.07	18.00	18.20	18.50	18.00	17.80	17.50
USD / COP	3927	4100	4300	4300	4100	4100	4000
USD / CLP	971	950	930	900	880	820	840
USD / CNH	7.20	7.25	7.25	7.20	7.15	7.10	7.10

CAD Crosses

End of period:	Feb 29, 2024	Q1 '24	Q2 '24	Q3 '24	Q4 '24	Q2 '25	Q4 '25
CAD / JPY	110	110	107	106	104	104	105
CAD / CHF	0.65	0.66	0.65	0.65	0.65	0.68	0.68
AUD / CAD	0.88	0.88	0.92	0.90	0.92	0.90	0.90
GBP / CAD	1.72	1.71	1.77	1.77	1.78	1.73	1.74
EUR / CAD	1.47	1.46	1.49	1.50	1.51	1.48	1.50

EUR Crosses

End of period:	Feb 29, 2024	Q1 '24	Q2 '24	Q3 '24	Q4 '24	Q2 '25	Q4 '25
EUR / JPY	162	161	160	159	157	154	157
EUR / GBP	0.86	0.85	0.84	0.85	0.85	0.86	0.86
EUR / CHF	0.95	0.96	0.97	0.98	0.99	1.01	1.02
EUR / SEK	11.19	11.20	11.05	10.95	10.85	10.65	10.40
EUR / NOK	11.49	11.35	11.20	11.10	10.95	10.80	10.70

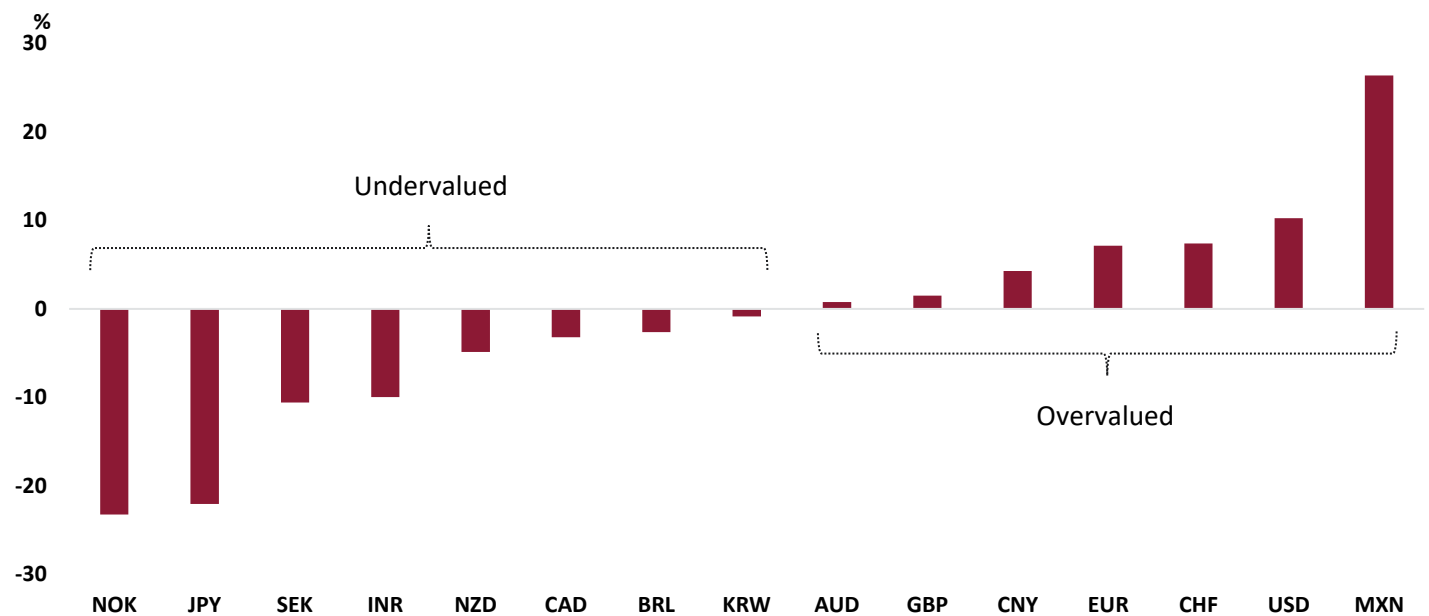
Central Bank Forecasts

	Current	Q1 '24	Q2 '24	Q3 '24	Q4 '24	Q2 '25	Q4 '25
Fed	5.38	5.38	5.38	4.88	4.38	3.88	3.38
BoC	5.00	5.00	4.75	4.25	3.75	3.25	2.75
ECB	4.00	4.00	3.75	3.50	3.25	2.50	2.25
BoE	5.25	5.25	5.25	5.00	4.75	4.00	3.50
SNB	1.75	1.75	1.50	1.25	1.25	1.00	1.00
BoJ	-0.10	-0.10	0.00	0.00	0.10	0.10	0.25
RBA	4.35	4.35	4.35	4.10	3.85	3.35	3.35
RBNZ	5.50	5.50	5.50	5.50	5.25	4.75	4.25
Banxico	11.25	11.00	10.50	10.00	9.25	8.25	7.75
BCB	11.25	10.75	9.75	9.00	9.00	8.75	8.50
BCCh	7.25	7.25	5.25	4.75	4.25	4.00	4.00
Banrep	12.75	12.25	10.75	9.25	8.25	7.00	6.00

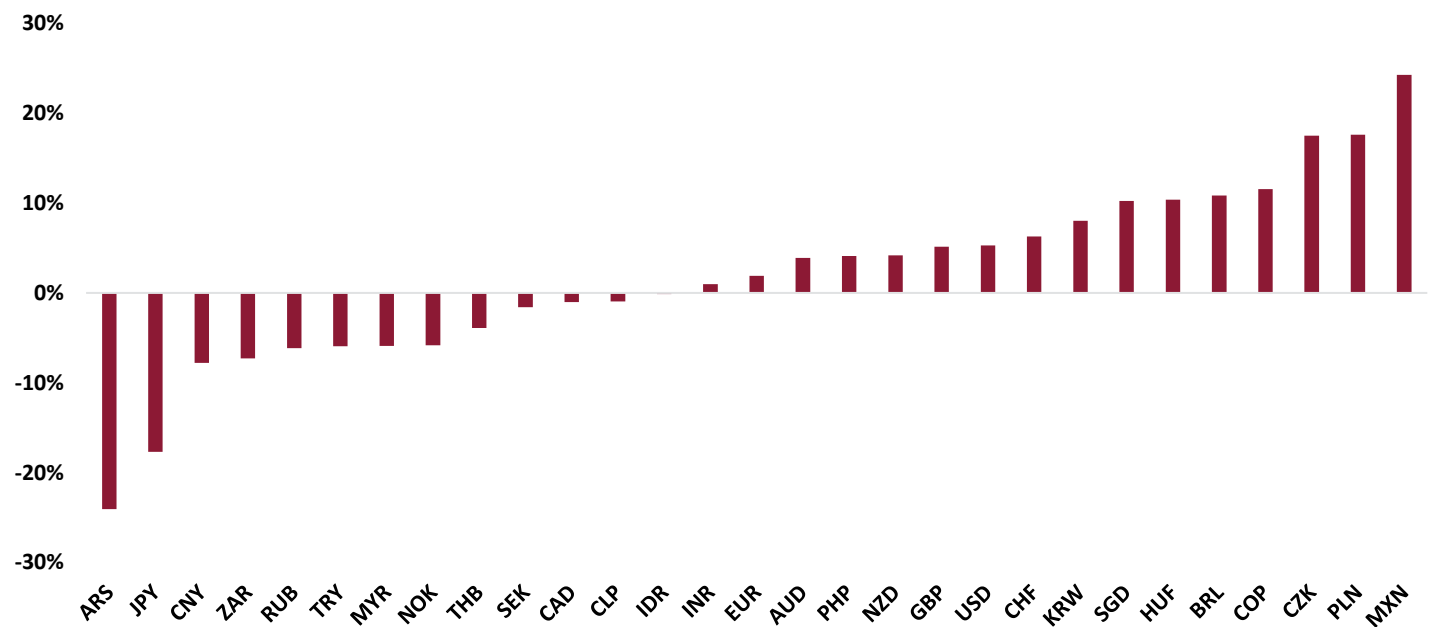
Market Pricing

	Next Meeting	What's Priced	Q1 '24	Q2 '24	Q3 '24	Q4 '25
BoC	Mar 6	-3 bps	-3 bps	-22 bps	-45 bps	-75 bps
Fed	Mar 20	-1 bps	-1 bps	-20 bps	-53 bps	-84 bps
ECB	Mar 7	-1 bps	-1 bps	-24 bps	-59 bps	-92 bps
BoE	Mar 21	-1 bps	0 bps	-13 bps	-37 bps	-63 bps
RBA	Mar 18	-2 bps	-1 bps	-9 bps	-24 bps	-37 bps
RBNZ	Apr 9	1 bps	1 bps	2 bps	-28 bps	-53 bps

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.

USD – Hedgers...Get Ready

DX – Q1 2024: 104.84 | Q2 2024: 103.07

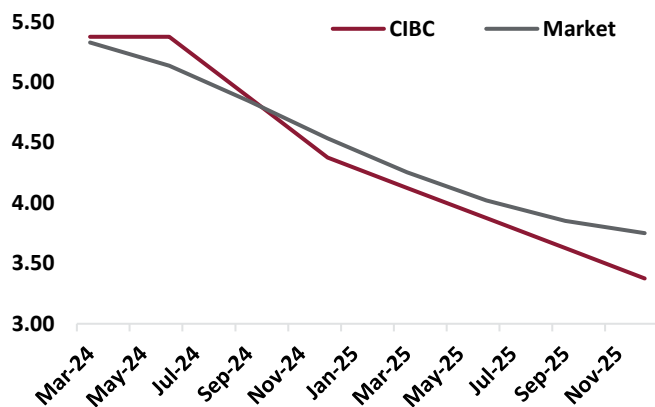
After a very strong start to 2024, broad gauges of the USD have mostly treaded water since the calendar rolled to February. Despite this, we're still resolute in our call for one last round of USD strength before this quarter is out. That's largely because there's enough evidence now that the US economy has adapted to higher rates far better than most have expected, and we still don't think markets are paying full tribute yet to this theme.

We don't have to look too far to find that evidence. For instance, after six consecutive quarters of 2%+ growth, Q1 US GDP looks to be tracking close to 2% yet again. Meanwhile, sentiment amongst households (University of Michigan survey) and businesses (ISM manufacturing) have recovered and are now the highest they've been in over a year at the least. On the employment side, the level of job vacancies appear to have stabilized, and they're still well above where they were pre-pandemic. Initial jobless claims have been trapped within the familiar 190k-230k range for months now.

Taking all the above with the surprise move higher in January CPI, and it's clear that any notion that the Fed was going to cut rates in March was always going to be fantasy. As such, markets have recalibrated and are now pricing in decent odds of that first cut coming at the June meeting. That's still a bit before when we expect the Fed will ease (July), and further recalibration there are in-keeping with our call for a firmer USD in the near-term.

Beyond March, we have the USD profile trending lower as the economic outlook outside of North America improves. Additionally, longer-term valuations still look very unfavourable for the USD. Market participants outside of the US should look to take advantage of the higher USD in the coming months and lock-in longer-term hedges while the getting is good.

Chart: CIBC's Expectations for the FOMC Versus the Market's (%)



Note: Market expectations are extracted from 3-month SOFR futures

Source: CIBC Capital Markets

CAD – Further Weakening Before a Turnaround in H2

USD/CAD – Q1 2024: 1.36 | Q2 2024: 1.37

The loonie hasn't moved much in the last month, with USD/CAD bouncing around 1.35, but the C\$ could weaken a touch by the end of the first quarter, as markets continue to recalibrate central bank rate cut expectations. Markets are pricing in fewer rates cuts than the 125 bps and 100 bps that we expect from the BoC and the Fed respectively. While we've pared back our own call for BoC cuts by 25 bps on some modest upside surprises in jobs and growth, our call still has a larger gap to market pricing for Canada than for the US. That leaves room for a further Loonie depreciation by June, as markets respond to BoC dovishness.

The pop in Canadian growth during Q4 was mostly about trade, as supply constraints continue to ease. However, with domestic demand still looking sluggish, particularly in per-capita terms, the print shouldn't pose a threat to inflation, and makes the upside surprise in growth relative to the BoC's forecast for a flat quarter less meaningful. While inflation in Canada is clearly on a decelerating path, policymakers are looking for more definitive evidence that it isn't proving sticky. By June, there should be ample evidence that much of the excess above its 2% target is concentrated in shelter, where slower population growth ahead will be key to containing rents, and rate cuts will help with mortgage interest costs. But we don't expect the BoC to pivot further towards setting the stage for rate cuts until its April MPR, at which point the CAD is likely to weaken further, with USD/CAD set to peak at 1.37 in Q2. Once the Fed is on the policy normalization path starting in Q3, broad USD weakness should help give the C\$ a lift, with higher commodity prices in 2025 also boosting the currency. We continue to see USD/CAD reaching 1.29 by the end of 2025.

EUR – Wage Dynamics Remain Key

EUR/USD – Q1 2024: 1.07 | Q2 2024: 1.09

The Eurozone narrowly avoided joining the UK and Japan in technical recession in Q3/4. That being said the latest EU Commission macro forecasts point towards an increasingly lacklustre backdrop. Back in November, the EU anticipated the Eurozone economy would expand by 1.2% in 2024, versus a modest 0.5% expansion in 2023. The latest Commission forecasts now look for a modest 0.8% expansion this year, ahead of a rebound to 1.5% in 2025. The more constructive 2025 outlook is predicated on labour market resilience, rising real wages, and falling price pressures. The latter remains key to the ECB policy narrative. Indeed the updated ECB staff forecasts which will accompany the 7 March ECB decision (notably HICP) will prove instructive for the ECB policy outlook. We continue to favour ECB inertia until June, not least as ECB President Lagarde has underlined that the Governing Council does not want to make a “hasty decision” when it comes to policy easing.

The ongoing internal battle between the ECB Governing Council doves and hawks continues to pivot around wage dynamics. In this context, it is notable that the January policy statement and the accompanying press conference, (including the Q&A) referenced wages 36 times, more than double that of December. ECB Governing Council doves, (they are effectively outnumbered by a 2:1 margin) will undoubtedly be relieved that the uptrend in wage settlements corrected into the end of last year. The moderation in the Q4 annual rate to 4.5%, from a record 4.7% peak, merely confirms that wages are no longer accelerating. However, settlements remain well above levels consistent with the ECB inflation target. That being said more timely wage trackers are showing signs of moderating pressures, supporting the notion of a June policy easing, which is currently priced for 28bps of easing.

Speculative EUR longs have been more than halved over the last two months. However, there remains scope for additional unwinds should macro headwinds remain evident. The weak growth backdrop is especially apparent in Germany, with the manufacturing PMI registering the fastest monthly contraction since September 2021. The perpetuation of material macro malaise, at least through H1, suggests that EUR bulls need to remain patient.

JPY – USD Strength Could Lead to a Mildly Hawkish BoJ

USD/JPY – Q1 2024: 150 | Q2 2024: 147

The USD/JPY exchange rate is in focus again following the stronger-than-expected January US CPI print. With the pair now back in the 150 range, Japanese officials, including Vice Finance Minister Masato Kanda warned that “recent FX moves are rapid” and that authorities were “watching forex markets with a high level of urgency.” The post-US CPI warning by Kanda was his first in 2024.

The US CPI inspired move in JPY has proven our previous call for topside of 150-151 incorrect. Although we think “symbolic” intervention will still occur around 152, Japanese officials know that in the long run, FX intervention becomes unsustainable. If the USD strength persists, we think there is risk the 152.00 level breaks.

BoJ officials have successfully convinced markets that any rate hike will be accompanied with a dovish message. The end of negative rates is in sight, and Japanese officials have noted that there has been progress made during the shunto wage talks. In a bullish USD scenario we think the topside in USD/JPY could rise to 155. In that event, the BoJ could move the rate hike forward to March, or even deploy a mildly more hawkish message in March/April to trigger a rebound in yen back to 150.

GBP – Shrugging off Recession Concerns

GBP/USD – Q1 2024: 1.26 | Q2 2024: 1.29

The UK economy registered back-to-back quarters of negative growth (Q3/Q4 2023) for the first time since Q1/Q2 2020. Moreover, provisional Q4 data underlined the most aggressive quarter-on-quarter contraction, (-0.345%) since Q1 2021. Despite the UK economy having effectively stagnated since Q1 2022, we remain cautious regarding presumptions of early BoE policy action. Although the February MPC witnessed the first three-way vote split since the 2008 global financial crisis, we continue to expect that the BoE will be a relative policy laggard. We expect the BoE to remain on hold until they are more sure of inflationary pressures (notably from the labour market) becoming less embedded. We continue to expect the first cut in August, which is roughly in line with market expectations.

We expect protracted monetary policy inertia as signs of continued inflation persistence abound. Moreover, despite persistent macro stagnation concerns in Q4 2023, more contemporaneous data appears somewhat encouraging. Retail sales surged in January, with volumes at their strongest since April 2021. A record monthly budget surplus, due to income tax receipts, supports the prospect of politically inspired tax cuts in the 6 March budget. Moreover, evidence of a real estate rebound allied to service sector resilience (services PMI remains in line with the five-year average), suggests GDP

is running at a 0.2/0.3% pace in Q1.

While we expect the BoE to remain on hold at the next three BoE meetings, the BoE risks something of a presentational problem into early Q2 as base effects are set to temporarily drag CPI back towards the 2% threshold. However, price pressures remain embedded in the system. Moreover, we expect a net loosening of around £12-15bn in the upcoming Budget, which risks causing a further flareup of inflation. A more constructive growth backdrop, a looser fiscal stance, and still relatively restrictive monetary policy suggest Sterling is on course for modest gains through 2024.

CHF – Will the SNB be a First Mover?

EUR/CHF – Q1 2024: 0.96 | Q2 2024: 0.97

The Swiss currency continues to be a 2024 laggard, only the JPY and AUD have underperformed the CHF on the G10 crosses in the year to date. The correction comes as the central bank appears increasingly happy to tolerate a cheaper CHF, in large part as the necessity of maintaining an overly strong currency, to bear down on price pressures, appears to be no longer so relevant. Indeed, amidst ongoing demand challenges in their primary trading partner, the Eurozone, the central bank appears keen to tolerate a cheaper currency to enhance exporter competitiveness.

Despite the SNB moderating its CPI outlook at its December quarterly policy review, the 1.3% headline CPI reading in December heightens the prospect of inflation undershooting the SNB's assumption of 1.8% in Q1. The fall in January CPI is all the more surprising in the context of VAT having been increased by 0.4% into the start of the year. The slide in prices caused the March OIS to briefly price in around 20bps of easing at the 21 March quarterly meeting, this compares to around 13 bps currently.

Our long-term baseline assumption for the SNB has been for a first cut, coming at the June quarterly decision. However, should weakening price dynamics remain a function of the February CPI print, due on 4 March, we can expect March rate cut pricing to accelerate, encouraging further EUR/CHF gains.

SEK – Leaving the Door Ajar

EUR/SEK – Q1 2024: 11.20 | Q2 2024: 11.05

The Riksbank may have raised the prospect of a H1 policy retreat, after unanimously holding rates at their first policy meeting of 2024. However, immediate SEK headwinds proved short-lived as the high beta status of the currency leaves the Swedish currency amid the top G10 performers over the last six months. The latest central bank policy statement underlined that “there is less risk of inflation becoming entrenched at levels that are too high.” Yet despite the bank adjusting its policy guidance and leaving the door ajar for a H1 rate cut, Governor Thedeen noted in the post-event press briefing that the guidance should not be interpreted as excessively dovish.

We would heed such a warning given the graduated uptick in key macro variables, including the underlying PMI trend and NIER economic tendency survey. The latter survey is back in positive territory for the first time in almost two years which suggests that despite unexpectedly dovish language, the central bank may prove reticent regarding the rate cut profile. Although long-term inflation expectations continue to moderate, with the Prospera 5-year inflation expectations series easing to 2.2%, an unexpected uptick in January core inflation, suggests that the Riksbank may postpone easing to the August meeting. The combination of recovering macro variables, with the economic surprise index having increased strongly over the last two months, and potential Riksbank policy reticence, underlines a bias for SEK gains continuing. Indeed we remain mindful of EUR/SEK returning towards end of 2022 levels into year-end.

NOK – The Norges Bank to be a Policy Laggard

EUR/NOK – Q1 2024: 11.35 | Q2 2024: 11.20

With the September 2021 hike, the Norges Bank proved to be an early adopter of monetary tightening. The first 25bps hike came in the wake of rates having been held at zero for the preceding 16 months. It seems likely that the bank will prove a relative laggard in terms of the timing of policy easing, as we assume September at the earliest. Moreover, we expect the scale calendar year easing to be a relatively modest 50bps.

In terms of the policy outlook, Norges Bank Governor Wolden Bache remains mindful of elevated wage pressures and inflation expectations. In terms of the former, the Q1 wages survey underlined that wage growth remains in line with that from the December MPR, namely 5.0% in the current year and 4.3% y/y in 2025. Although consumer inflation expectations are on the retreat, reflecting tight monetary policy dynamics, underlying price assumptions remain well above the CPI target threshold, suggesting the bank will not be in a rush to cut. The latest central bank inflation expectations survey details that Norwegians expect annual inflation to remain around 4.0% over the next two to three years. Although assumptions have moderated from 4.2% in Q4, the combination of above-target inflation expectations and elevated earnings underlines a higher for longer policy narrative as the central bank aims to maintain monetary policy credibility.

Monetary policy inertia, modest real earnings growth, and twin surpluses, current account and budget balance, point towards graduated NOK gains.

AUD – Too Soon for Cuts, but Hikes Are Unlikely

AUD/USD – Q1 2024: 0.65 | Q2 2024: 0.67

In contrast to upside surprises in US January payrolls, Australian payrolls data has been notably weak, gaining by just +0.5k (vs consensus +25.0k). Headline jobs growth tends to be noisy, and most economists were expecting a stronger rebound after the large decline seen in December (-65.1k, now revised to -62.7k). Unemployment rose by 0.2 ppt to 4.1%, despite a stable participation rate of 66.8%.

Although shifting seasonality could be exaggerating January weakness, there is no doubt that Australia's labour market momentum continues to slow, and that should be welcome news to the RBA. At the 6 February meeting the RBA signalled a willingness to hike rates further, a hawkish scenario we do not expect to be realized.

The Phillips curve suggests that unemployment must rise to 4.5-5.0% before CPI returns to target and the RBA can consider easing. We think that ongoing labour market tightness and its services sector means the RBA will ease after the Fed. That suggests AUD/USD will remain stable (near our Q1 forecast of 0.66), despite US-Australia data divergence. The RBA will maintain a mildly hawkish tone, but less so than the RBNZ. That points to AUD/NZD downside to 1.05.

NZD – The RBNZ Disappointed, but It Is Still More Hawkish Than the Fed

NZD/USD – Q1 2024: 0.61 | Q2 2024: 0.63

The Feb 28th RBNZ decision proved more dovish than we and consensus had anticipated. Although we did not expect a hike in February, we had assumed that Governor Orr would use the February MPS drive a home a hawkish message. The RBNZ rightly noted that falling inflation expectations were encouraging, but we wrongly thought that the RBNZ would maintain some hawkish optionality and manage expectations for easing.

The RBNZ will continue to remain data-dependent, but Governor Orr's optimistic assessment on available capacity in the economy, as well as stabilizing inflation expectations, does suggest that incoming data will continue to soften. We think that the RBNZ will only begin cuts in Q4 (October 9th at the earliest).

Although NZD/USD fell 1% in disappointment post-RBNZ, it has still been one of the better performing G10 currencies in February, outperforming CAD, AUD, CHF and JPY for the month. On the face of it, the RBNZ surprise goes against our constructive view for kiwi. However we still expect NZD/USD to rise to 0.63 by Q2 – the Feb MPS was much less hawkish than November, but the RBNZ is still more hawkish than the Fed. For Q1, we revise our forecast lower to 0.61 due to recent USD strength.

ZAR – Needing More Confidence to Cut

USD/ZAR – Q1 2024: 18.85 | Q2 2024: 18.45

A second back-to-back unanimous vote to hold rates at 8.25% in January underlines the presumption that while policy tightening may have concluded, the bank needs greater confidence in terms of the price outlook before easing. Indeed in light of January headline CPI rising for the first time in three months to 5.3% y/y (higher food and fuel prices drove the uptick), we can expect central bank Governor Kganyago to remain resistant to sanctioning easier policy. A shift to more dovish guidance should only come when there is clear evidence of prices falling back towards the mid-point of the 3.0-6.0% target threshold in a sustainable fashion. Such a backdrop likely remains a story for H2.

Given immediate SARB policy reticence any near-term correction in inflationary pressures over the next six months points towards real rates remaining relatively attractive. In that context, we note that speculative investors have maintained a constructive ZAR bias over the last six months. However, we would note that the performance of USD/ZAR remains sensitive to the UST yield dynamics, the ZAR struggles when UST yields spike higher. Nevertheless, while external factors, such as UST yields matter, we expect a more constructive domestic backdrop, not least as domestic budgetary factors appear increasingly encouraging. A lower debt trajectory in the recent budget, coming in at 75.3% of GDP in 2025-26, below the 77.7% assumed in the November mid-term budget, allied to the presumption of a lower medium-run budget deficit, have helped boost investor sentiment. However, external dynamics and political risks, ahead of the 29 May election, are likely to contain early moves through the 200Day MAV around 18.75.

LATAM FX

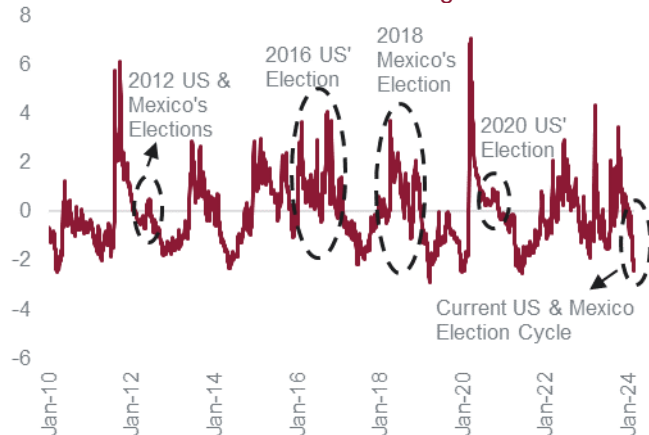
MXN – Banxico Will Decouple From the Fed in March

USD/MXN – Q1 2024: 18.00 | Q2 2024: 18.20

With no changes to the convergence of inflation back to the 3% target and Banxico opening the door for a March rate cut, we keep our call for consecutive rate cuts starting next month and our overnight rate year-end forecast at 9.25% (vs. 9.65% expected by market). The ex-ante real rate has continued its steady upward path and is now over 100bps above its March 2023 level (Banxico's last rate hike). The ex-ante real rate has never been this restrictive, providing Banxico plenty of room to implement a more aggressive easing cycle than currently priced in.

The attractive carry of the MXN has been the main driver of its resilience since the start of the year. Nevertheless, a sooner than anticipated decoupling from the Fed, and increasing odds of a faster pace of rate cuts by Banxico, point to a rapid dissipation of the MXN's carry. This underscores the potential for sharp USD/MXN moves higher amid already large net long MXN positions by non-commercial players (speculative). Moreover, at-the-money USD/MXN vols, another key item for carry plays, remain unusually low in comparison to previous US and Mexico election cycles. Notably, the USD/MXN ATM 3m vol is more than two standard deviations below its one year average. A significant deviation from the positive z-scores recorded during election cycles over the last 12 years. We maintain our Q1 and Q2 USD/MXN forecasts at 18.00 and 18.50 respectively.

Chart: ATM USD/MXN 3m Vol – Rolling 1Y Z-score



Source: CIBC Capital Markets

BRL – BCB's Credible Forward Guidance Keeps Reinforcing BRL Stability

USD/BRL – Q1 2024: 5.00 | Q2 2024: 5.10

The Banco Central do Brasil (BCB) cut the Selic rate by 50bps for the fifth time in a row, meeting market expectations and our forecast. Similar to the start of the easing cycle and all of the rate announcements in H2 2023, the January 31st decision was well telegraphed by the market. As the BCB's forward guidance remained unchanged, USD/BRL did not show a significant reaction to the rate decision.

That said, we point out that as GDP growth decelerates, and with two new government appointments at the Central Bank's board, we are likely to see increasing government pressure to at least maintain the same pace of rate cuts for all of Q2 and perhaps into early Q3. However, barring new external or local fiscal surprises, we don't anticipate a disorderly USD/BRL move higher in the coming months. Hence, we maintain our Q1 USD/BRL forecast at 5.00.

CLP – Dovish BCCh Risks USD/CLP Move Above 1000

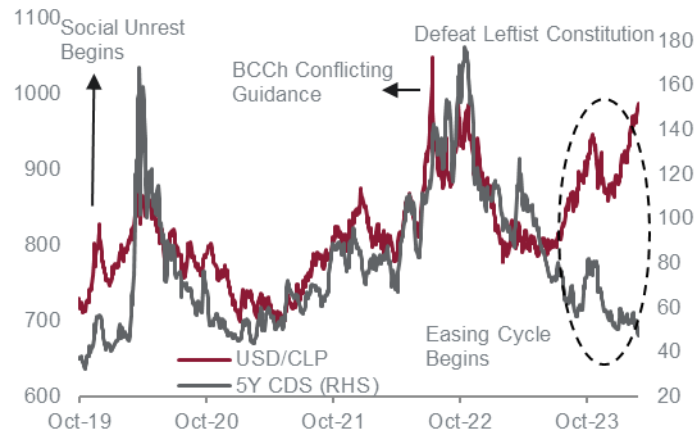
USD/CLP – Q1 2024: 950 | Q2 2024: 930

Despite the dissipation of political uncertainties following the end of the long new constitution process, the BCCh's increased dovishness, and the lack of a credible forward guidance have risked a disorderly USD/CLP upward move above 1000 once again. We do not need to go too far back to find a situation in which the lack of a proper guidance by the central bank pushed USD/CLP aggressively higher. For instance, after starting the easing cycle with a 100bps rate cut and a very dovish rate announcement in July 2023, the BCCh had to reduce the pace of rate cuts in September and October, and pause its reserve building program as USD/CLP jumped above 950.

We experienced a similar situation in mid-2022 following what appeared to be a miscommunication about a possible intervention in the FX market between the Ministry of Finance and the central bank sent USD/CLP above 1000. This move ended with the BCCh implementing a USD20bln FX intervention program (Spot and NDFs combined).

That said, although we have revised our USD/CLP forecast for Q1 upwards to 950, we maintained a steady downward trend for the pair for the remainder of 2024 (Q2 at 930, Q3 at 900, and Q4 at 880). This reflects our expectation of an FX intervention and/or a slower pace of rate cuts than initially signaled by the central bank, mimicking the BCCh's response to the CLP depreciation of mid-2022 and October 2023.

Chart: BCCh's Dovish Forward Guidance is the Sole Driver of the CLP's Underperformance



Source: CIBC Capital Markets

COP – Timid Rate Cut Cycle for Now...

USD/COP – Q1 2024: 4100 | Q2 2024: 4300

Banrep cut the overnight rate by 25bps to 12.75%, against our 50bps forecast. The vote was not unanimous with 2 out of the 7 members voting to cut rates by 50bps. Although the Bank did not commit to increase the pace of rate cuts, we highlight that the ex-ante real rate in Colombia is 538bps (after January's cut) above Banrep's estimated neutral real rate and the most restrictive in the region. We expect Banrep to cut the overnight rate by 50bps in March, and further increase the magnitude of rate cuts to 75bps per meeting in Q2 and Q3, bringing the overnight rate to 9.25% by the end of September. However, looking at the COP, the temporary inflationary risks due to El Niño should prevent the market from pricing in a more aggressive rate cut cycle in the short end of the curve. We expect USD/COP to trade within the 3870-4100 range, in line with our Q1 USD/COP forecast.

The latest fiscal numbers confirmed overcompliance with the 2023 target. The nominal fiscal deficit landed at 4.2% of GDP, slightly lower than the 4.3% deficit expected in June. Nevertheless, within the reported numbers there are a few signs of concern into 2025. First, despite the lower budget executions (0.6% of GDP below expected – investment under execution and lower interest payments), revenues fell by 0.5% of GDP mostly due to the lower economic growth. Second, Finance Minister Ricardo Bonilla stated that new 2024 deficit target was set at 5.3% of GDP (4.4% of GDP previously). The dramatic change in the deficit projection accounts for a 1.7% of GDP drop in revenues, while the decline in government spending was limited to ~0.7% of GDP. The deterioration in fiscal revenues and the meagre economic growth posted in 2023 should continue to put pressure on Banrep to increase the magnitude of rate cuts in the short term.

Asia FX

CNH – Suppress Volatility and Minimize Negative Headlines

USD/CNH – Q1 2024: 7.25 | Q2 2024: 7.25

Authorities have successfully created the “appearance” of market stability following the Lunar New Year holidays. Equity stability has been supported by ETF purchases by state funds and regulatory restrictions on short selling. In the FX space, the preferred tools for price stability continue to be a stable daily USD/CNY fix and FX intervention by state-owned banks.

We expect volatility to continue to be suppressed in USD/CNH – recent dollar strength has pushed the pair above our previous target of 7.20, but we think there will continue to be firm defensive measures in the 7.20-7.25 range. Therefore, we revise our USD/CNH forecast for Q1 slightly higher to 7.25 (our Q2 forecast level).

For forecasts beyond Q2, we expect dollar weakness to result in very slight USD/CNH downside relief to 7.20 and 7.15 in Q3 and Q4, respectively. The yuan will benefit from USD weakness, but less so than North Asian peers JPY and KRW. There is some risk of possible pro-growth measures after the “two sessions” in March, but we do not expect large scale stimulus, and equity sentiment could remain lackluster. For 2025, we don’t expect yuan strength beyond 7.10 – China will want to keep the yuan competitive to minimize supply chain realignment.

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