CIBC CAPITAL MARKETS

Economics and FICC Strategy

MONTHLY FX OUTLOOK

June 8th, 2023

There, and Back Again…

Currency	What's changed
USD	The T-bill deluge and a July rate hike could provide support for the greenback. USD sellers should still look to get active on rallies.
CAD	A weaker USD profile, alongside another BoC hike, leaves the door ajar for USD/CAD downside in the coming quarters.
EUR	We expect the ECB to hike two more times (25bps each) before it pauses. The EUR should benefit from reserve diversification.
GBP	Markets are pricing BoE terminal too high which should create some headwinds for the GBP in the near-term.
JPY	Rising wages and risks to the YCC program should keep the focus to the downside for USD/JPY in H2 2023.
Commodity FX	NZD expected to come under pressure as the RBNZ pauses while other peers (Norges Bank and RBA) look set to tighten further.
LATAM FX	Proximity to rate cuts in the region are coming into sharper relief. That should keep local currencies under pressure.
FX Asia	Rate cuts in China are expected in the months ahead. The real economy's response will be a key factor for the global macro.

Currency outlook

End of period:	Jun 8, 2023	Q3 '23	Q4 '23	Q1 '24	Q2 '24	Q3 '24	Q4 '24
USD / CAD	1.34	1.32	1.31	1.31	1.30	1.29	1.28
EUR / USD	1.08	1.06	1.08	1.11	1.14	1.15	1.15
USD / JPY	139	130	127	124	122	120	118
GBP / USD	1.25	1.24	1.27	1.29	1.32	1.32	1.32
USD / CHF	0.90	0.92	0.91	0.90	0.89	0.89	0.90
USD / SEK	10.8	10.71	10.37	9.91	9.52	9.30	9.13
AUD / USD	0.67	0.67	0.68	0.69	0.69	0.70	0.70
NZD / USD	0.61	0.61	0.61	0.62	0.63	0.63	0.64
USD / NOK	10.9	10.85	10.51	10.09	9.65	9.48	9.39
USD / ZAR	18.86	18.75	18.45	18.15	17.90	17.70	17.50
USD / BRL	4.93	5.20	5.40	5.20	5.20	5.40	5.00
USD / MXN	17.41	19.00	19.50	19.50	20.00	20.00	19.50
USD / COP	4176	4700	4700	4600	4600	4500	4500
USD / CLP	790	850	850	870	870	850	820
USD / CNY	7.11	6.85	6.79	6.75	6.73	6.71	6.69

Other crosses

End of period:	Jun 8, 2023	Q3 '23	Q4 '23	Q1 '24	Q2 '24	Q3 '24	Q4 '24
CADJPY	104	98	97	95	94	93	92
AUDCAD	0.9	0.90	0.90	0.90	0.91	0.90	0.91
GBPCAD	1.67	1.64	1.66	1.69	1.72	1.70	1.69
EURCAD	1.44	1.40	1.41	1.45	1.48	1.48	1.47
EURJPY	150	138	137	138	139	138	136
EURGBP	0.86	0.85	0.85	0.86	0.86	0.87	0.87
EURCHF	0.97	0.98	0.98	1.00	1.01	1.02	1.04
EURSEK	11.64	11.35	11.20	11.00	10.85	10.70	10.50
EURNOK	11.74	11.50	11.35	11.20	11.00	10.90	10.80

Key indicators – Latest data point

End of period:	Quarterly real GDP (y/y %)	CPI (y/y %)	Current acct (% of GDP)	Central bank rate (%)
US	1.60	4.90	-3.61	5.13
Canada	2.21	4.40	-0.68	4.75
Eurozone	1.30	6.10	-0.73	3.25
Japan	1.30	3.50	1.64	-0.10
UK	0.20	8.70	-3.77	4.50
Switzerland	0.70	2.20	10.08	1.50
Sweden	0.80	10.50	4.77	3.50
Australia	2.30	7.00	1.40	4.10
New Zealand	2.50	6.70	-8.90	5.50
Norway	3.00	6.40	30.35	3.25
South Africa	0.20	6.80	-0.45	8.25
Brazil	4.00	4.18	-2.66	13.75
Mexico	3.73	6.25	-1.19	11.25
Colombia	3.00	12.82	-5.72	13.25
Chile	-0.63	9.90	-6.79	11.25
China	4.50	0.10	2.23	

USD

Bipan Rai

The T-bill deluge matters for the USD

DXY - Q3 2023: 103.50 | Q4 2023: 101.53

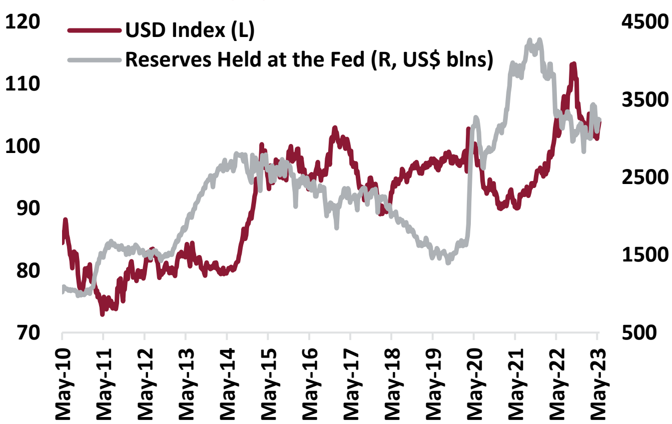
The impasse over the debt ceiling might be at an end, but that doesn't mean that we won't be dealing with the ramifications for the next little while.

For instance, an agreement on the debt ceiling gives the Treasury the greenlight to replenish cash buffers that have gone to zero. That means a massive amount of net T-bill issuance in a short period of time. Why is this important for FX markets? Because USD directionality over the summer could come down to which market player absorbs that T-bill issuance. If it's households or banks, that means a decline in banking system reserves which, as regular readers of ours are aware, points to more persistent USD strength given the inverse correlation between the two series (see Chart 1).

However, if it's money market funds that are primarily re-allocating to T-bills, then this is likely a neutral/bearish USD theme. A corresponding draw down on O/N RRP usage will offset the uptick in cash held in the Treasury general account. That's a liability transfer on the Fed's balance sheet which leaves reserves unchanged at the margin. In any case, keeping tabs on daily O/N RRP usage, weekly H.4.1 figures, alongside the details of T-bill issuance will be effective for pulse checks on broad USD moves as the issuance deluge proceeds.

Beyond this, we're expecting the Fed to hike policy rates in July. Taken with the aforementioned risk that banks/households could absorb incoming T-bill supply, we expect some near-term chop that should provide better levels for USD sellers to fade over the medium-term. Indeed, we're still of the view that the Fed's QT program is far too aggressive, and that this program is likely to slow towards the end of the year.

Chart 1: US banking system reserves and the USD



Source: Federal Reserve, CIBC

CAD

Katherine Judge and Avery Shenfeld

CAD to rely on external factors

USD/CAD - Q3 2023: 1.32 | Q4 2023: 1.31

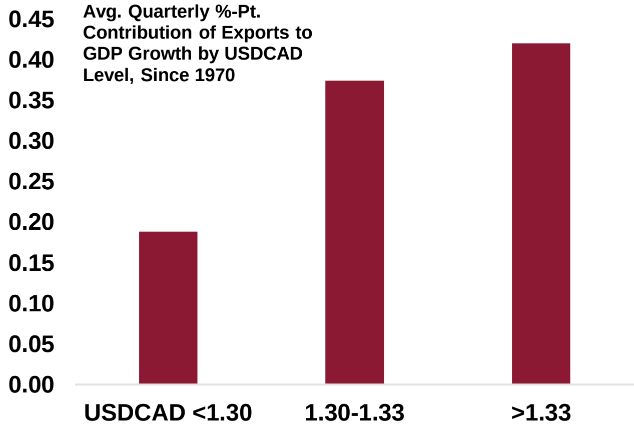
The loonie rallied after the Bank of Canada opted to hike rates this week as opposed to waiting for revised forecasts in July. The Bank was responding to the economic momentum apparent in the data of late. But its statement left the appearance that this was a fine tuning rather than the start of an aggressive move, as the Bank removed the reference in its conclusion to rates not yet being at a high enough level to return inflation to the 2% target. We therefore see only one final quarter point rate hike from the Bank in September. Meanwhile, in the US, we have the Fed eschewing action next week and most likely hiking the Fed funds rate by 25bps in July with a further quarter point hike soon after.

But there are enough signs of a building North American and global slowdown that after September, the Fed and the Bank of Canada will both be on pause. A clearer end to Fed hikes should begin to unwind US dollar strength against overseas majors, helping push USDCAD to 1.32 by the end of Q3, with more firming for the loonie in store for 2024.

Beyond this summer, we could be in an extended wait for any interest rate moves by either the Fed or the BoC, putting other currency drivers into focus. The US dollar still looks unsustainably strong against other major currencies, and higher inflation in Europe will keep the threat of additional monetary tightening alive a bit longer overseas, taking some of the shine off of the greenback.

We don't see that taking USD/CAD below 1.28 next year, a bit less of a loonie appreciation than expected for some other majors that have more room to run. Trade fundamentals tend to rear up more decisively as the loonie strengthens from current levels, with exports historically looking weaker once the 1.30 threshold has been crossed (Chart 2). Oil prices could firm up later in 2024 as markets eye a global economic rebound, but these days it takes a much larger move for that to meaningfully lift the loonie relative to other majors, given the reduced response in Canadian oil and gas capital spending in a tighter regulatory climate.

Chart 2: Export performance weakens notably with USDCAD below 1.30



Source: Bloomberg, CIBC

EUR

Jeremy Stretch

Where the ECB terminal likely is

EUR/USD - Q2 2023: 1.06 | Q4 2023: 1.08

There are several signs that tighter ECB policy is working. For one, there's the broad moderation in EU price pressures (with the exception of Italy). In addition, there's also the downtrend in broad money supply growth, as annual M3 fell below 2% for the first time since 2014. Although we expect the hawks within the ECB governing council to continue to focus on strong core HICP into H2, we do not expect terminal rates to reach 4.00%. Moreover, we suggest that discussions of non-standard rate adjustments (i.e - more than 25bps) are now off the table. Indeed, we are looking for a 25bps hike this month.

However, updated ECB staff HICP forecasts accompanying the June ECB decision are still likely to detail a protracted period before CPI eases back towards the 2% target threshold (likely into 2025). And while we anticipate additional policy action, we still expect terminal to be at the 3.75% level for the deposit rate – which means 50bps of additional tightening still left. Near-term real economic headwinds, notably manufacturing, underline the prospect of a paring in EUR longs for now. But over the long-term, we still have the EUR forecast profile skewed higher given the expected benefits from flows related to FX reserve diversification.

JPY

Jeremy Stretch

Wages are the key

USD/JPY - Q3 2023: 130 | Q4 2023: 127

Although we remain biased towards USD/JPY downside, investors continue to wait on an obvious catalyst. Recent comments from BoJ chief Ueda, regarding the need to purchase JGBs until inflation sustainably reaches the 2% target, suggests that JPY bulls will need to remain patient. In terms of positioning, real money investors have recently extended net JPY shorts to levels not seen in seven-month. Key to this extension is the ongoing widening in 10-year UST-JGB spreads which are now appreciably wider from early April.

For the real economy, a surprising drop in the unemployment rate to 2.6%, underlines a tight labour market. Ongoing tightness comes as we await the impact of elevated annual wage agreements related to CPI assumptions. In this context, BoJ Governor Ueda referenced needing to "nurture green shoots" in wage growth to change deflationary norms. Additionally, improving corporate fortunes play into the broad recovery narrative with company profits in Q1 registering the largest quarterly expansion since Q2 2021. Rising corporate profitability provides scope to fund recently agreed-to high wage deals. We expect rising wage dynamics to impact the BoJ CPI forecasts in the July policy report and for CPI forecast adjustments to be a catalyst for potential policy (YCC) tweaks. That should support 10-year spread compression and buttress our call for downside in USD/JPY in H2 and beyond.

GBP

Jeremy Stretch

Recessions risks are overpriced

GBP/USD - Q3 2023: 1.24 | Q4 2023: 1.27

After proving to be the top performing major currency in Q1, the GBP has struggled to maintain momentum. That comes as GBP longs have extended to levels last seen in November 2021. Continued gains in UK consumer sentiment reflect the moderation in utility price pressures. However, despite positive April base effects, headline CPI have only eased from 10.1% to 8.7% y/y. Moreover, core prices accelerated to a fresh cyclical high at 6.8% y/y. In the wake of core prices gaining a full percentage point since the start of the year, the market has materially boosted BoE terminal rate assumptions towards 5.50%, stoking renewed recession concerns.

The higher-than-expected CPI outturn underpins our presumption that the BoE will hike rates at the next two meetings. However, we expect the terminal rate to top out at 5.00%, as rates in excess of such levels would amplify recession risks. Indeed, early signs of a roll-over in food prices, while labour markets and wages appear set to moderate, points towards a graduated reduction in UK terminal rate assumptions in the next few months.

But looking beyond, we don't expect a recession in the UK. As such, an easing in recession fears combined with a softer USD should support the broad GBP recovery narrative.

CHF

Jeremy Stretch

CHF to lag in the coming quarters

EUR/CHF - Q3 2023: 0.98 | Q4 2023: 0.98

Amongst the majors, the CHF has been one of the outperformers so far in for Q2. Since EUR/CHF tested the parity threshold at the end of Q1, amidst domestic banking sector pressures, we have witnessed progressive CHF gains. The substantive uptick in the trade-weighted CHF has proved a function of investors paring net CHF shorts. Indeed, we note that aggregated speculative positions, real money plus hedge funds, moved back into positive territory for only the second time in two years into the end of May.

Although April CPI may have come in below expectations, prices remain above the 2% threshold, as they have for the last fifteen months. In view of CPI remaining above target, the SNB are unlikely to be overly concerned by recent CHF gains. Although the central bank remain wary of the impact of higher rates on the real estate market, we'd expect the SNB to follow through with an additional 25bps policy hike at the next policy meeting (June 22nd). However, the SNB is likely to be wary of the policy rate reaching 2%, due to ongoing real estate concerns. Consequently, we'd expect recent CHF resilience to moderate, this comes as we expect the CHF to gradually depreciate versus the EUR.

SEK

Jeremy Stretch

Core prices likely to remain sticky

EUR/SEK - Q3 2023: 11.35 | Q4 2023: 11.20

The SEK's high beta status and macro challenges have led the EUR/SEK cross higher over the past month. Indeed, the cross has surged above the 11.65 mark for the first time since 2009. When it comes to the Riksbank, we're sticking with our call of another 25bps hike on June 29th. While real estate remains a residual drag, we don't expect that to deflect the Riksbank from the primacy of bringing CPI back down to target.

However, the need for aggressive tightening has been obviated by April core CPI coming in below the Riksbank's expectations. The correction from recent three-decade highs comes as food inflation moderates. Even still, the macro picture in Sweden remains strong, while price pressures are likely to remain sticky. Retail sales have rebounded, while the unemployment rate has retreated for the third time in four months. At the margin, this supports our call for a EUR/SEK reversal into H2.

Commodity FX

NOK

Jeremy Stretch

A higher rate path

EUR/NOK - Q3 2023: 11.50 | Q4 2023: 11.35

In Norway, the upside surprises for both April CPI and Q1 GDP have led the economic surprise index to register three month highs. Moreover, the Norges Bank noted in the May policy statement that inflation remains "high and markedly above target." The bank also underlined that "the labour market is tight, and wage growth is set to be higher in 2023 than last year." Unless the labour market proves to moderate from here, we can expect further policy adjustments in the coming period.

It is noteworthy that April CPI came in above expectations (at 6.4% y/y), given that it is above the central bank's estimate of 5.6%. Indeed, that will bring further pressure on the market expectations for where the terminal rate is. We expect additional 25bps rate hikes for both June and September, taking the deposit rate to 3.75%. This is also supported by other evidence – including a robust profile for activity, with the uptick in consumer sentiment and labour market surveys which continue to point to further tightening in conditions. A more constructive macro backdrop underlines the view of EUR/NOK looking overbought and ready for a correction into H2.

AUD

Noah Buffam

Upside risks to AUD

AUD/USD - Q3 2023: 0.68 | Q4 2023: 0.69

We expect AUD/USD to appreciate in the coming quarters due to continued RBA hawkishness, and medium-term USD weakness alongside an anticipated pick-up in Chinese demand over time. After surprising markets with rate hikes in May and June, RBA Governor Lowe has remained hawkish in recent speeches as he focuses on the problem of low Australian labour productivity. We think there are upside risks to the policy rate, given the persistence of high unit labour costs and high core CPI relative to other developed markets. In the near-term, there are slight headwinds from the USD side, which should cap short-term AUD/USD strength, but we still expect slow appreciation over the forecast horizon due to the above factors.

External influences on Australia have been negative of late with declining global manufacturing demand and disappointing Chinese data. However, we still think that there are likely to be spillovers from higher Chinese incomes – including for Australian tourism. Further, should Chinese credit conditions ease, there is likely to be an increase in commodity demand over time. These factors are likely to help AUD/USD rally over the medium term.

NZD

Noah Buffam

Stagnating NZD

NZD/USD - Q3 2023: 0.61 | Q4 2023: 0.61

The NZD has declined against most G10s since the RBNZ surprised the markets a few weeks back by signalling the tightening cycle is likely over. We anticipate short term stagnation in NZD/USD, before the pair trends up in the medium term due to broad USD weakness. We are of the view that the RBNZ is on hold, as short-term inflation expectations are moving back within the RBNZ's inflation target, while the labour market is cooling. The dovishness of the RBNZ should keep expectations for any further hikes tempered, even if other central banks resume their hiking cycles. This dynamic should spill over to NZD weakness against G10 currencies.

Over the medium-term, New Zealand terms of trade should hold up better than its key trading partners, as the relative inelasticity of agricultural demand in the face of a global slowdown should keep exports supported. Our expectation for relative strength in the terms of trade should allow the NZD/USD to appreciate in the later part of this year and into 2024.

ZAR

Jeremy Stretch

SARB likely to hike further

USD/ZAR - Q3 2023: 18.75 | Q4 2023: 18.45

Speculative investors extended ZAR shorts to record levels into the end of May. Investors have moved aggressively against the Rand as domestic macro headwinds have mushroomed, while geo-political risks, linked to allegations of the country engaging in arms shipments to Russia, have amplified ZAR negativity.

Last month, the SARB hiked rates to 8.25%, levels not seen since 2009. Still, the aggressive year-to-date capitulation in the ZAR (at almost 12% against the USD), underlines imported price pressures, which necessitates additional action. As such, watch for a further 25bps hike in July. Policy tightening risks further compromising already fragile domestic demand. Moreover, ongoing load-shedding has resulted in annual electricity consumption being 8.1% below year-ago levels. For USD/ZAR, a retracement back to 18.75 would be consistent with long-end spreads easing back to 800bps from post-crisis levels at 880bps. Such a scenario will require confidence that the SARB cycle has peaked while ZAR geo-political tensions need to dissipate.

LATAM FX

MXN

Luis Hurtado

Keeping an eye on the ex-ante real rate

USD/MXN - Q3 2023: 19.00 | Q4 2023: 19.50

In its latest inflation report and minutes, Banxico maintained its cautious stance and steered away from signaling the start of the easing cycle, in line with our expectation of an on-hold central bank until at least Q4 2023. However, various comments within the minutes of the May 18th rate decision reaffirmed our thesis that board members are paying particular attention to the ex-ante real rate (which is the overnight rate minus 1-year inflation expectations). In addition, we point out that one member explicitly mentioned the need to maintain said range within 6%-7%. This, of course, gains particular relevance following recent downside inflation surprises and another print lower in 1Y inflation expectations (and a higher ex-ante real rate) in May.

We maintain our call for two 25bps rate cuts in Q4. Moreover, we restate our upward USD/MXN bias for the rest of the year with an 19.00 forecast for Q3 and a 19.50 estimate by year-end 2023. As mentioned in previous notes, a deceleration in US growth coupled with our expectations of tighter MEX-US yield spreads remain the largest risks to MXN.

BRL

Luis Hurtado

BCB easing cycle and political risks likely to play against the BRL into H2

USD/BRL - Q3 2023: 5.20 | Q4 2023: 5.40

As the market assigned greater odds of rate cuts starting in August, USD/BRL returned above the 5.00 mark late in May. Note that the downward trend in inflation expectations for year-end 2023 drove part of this move as recent inflation numbers surprised to the downside. However, we highlight that government criticism of the BCB's hawkish stance has continued, fueling market concerns about a potential change to the inflation target during June's National Monetary Council meeting.

Moreover, despite the likely approval of the new fiscal rule this month (already in the price) and considering difficult revenue measure negotiations ahead, we do not see enough room for USD/BRL to achieve a sustained downward move below the 4.90 mark. On the contrary, we have maintained our Q3 forecast and year-end forecasts at 5.20 and 5.40, respectively. This reflects higher risks of a larger/sooner start of the easing cycle, and the recent lack of strong a support in congress for measures backed by President Lula (i.e. cabinet structure).

CLP

Luis Hurtado

BCCh likely to lead easing cycle in Latam

USD/CLP - Q3 2023: 850 | Q4 2023: 850

Strong signs of political moderation, as right and centre-right political parties obtained more than 3/5 of the seats in the new constitutional assembly, provided support to the CLP in Q2. However, although we expect radical ideas to be shut down in congress, we do not anticipate a smooth ride for the CLP going forward as President Boric's pension and tax reforms increase political risks.

Furthermore, on the monetary policy front, the BCCh decided to activate the counter-cyclical capital buffer (CCyB) setting it at 0.5% of risk-weighted assets, due in one year. This should drain some liquidity from the market and the corresponding tightening provides the BCCh with some room to relax on its hawkish monetary policy stance into H2. Hence, we continue to expect the BCCh to implement its first rate cut at the July meeting, and maintain our USD/CLP upward bias towards the 820 mark into early H2, and to 850 by the end of the year.

COP

Luis Hurtado

COP to come under pressure

USD/COP - Q3 2023: 4700 | Q4 2023: 4700

In its latest rate announcement, Banrep increased the overnight rate by 25bps. That marks a deceleration from the 50bps rate hike in February. Moreover, the central bank stated that further decisions will depend on new information available, highlighting the importance of upcoming inflation prints. On this front, March inflation print came in at 13.34% y/y, above the 13.28% y/y expected by consensus, and the 13.28% y/y print in February. Moreover, core prices jumped to 11.42% y/y following the 10.86% y/y print in February.

Although the recent appreciation of the COP was driven by the rebound in oil prices and resistance to some radical reforms in congress, stubbornly high inflation expectations and firm inflation prints for March should continue to penalize the COP. Indeed, we maintain our bearish COP view for the remainder of the year and keep our year-end USD/COP at 4800. This is due to the lack of a more aggressive monetary policy stance by Banrep against still high inflation and inflation expectations. Additionally, our forecast hinges on the high current account and fiscal deficits, populist structural reforms, and increasing global growth uncertainties – all of which remain the largest headwinds for the COP.

Asia FX

CNY

Bipan Rai

Rate cuts are coming

USD/CNY - Q3 2023: 6.85 | Q4 2023: 6.79

The past month has been a challenging one for both the onshore/offshore renminbi. USD/CNH has made new highs on the year largely due to strength on the USD leg, but also because of endogenous factors that might provide a more persistent headwind to our downside USD/CNY profile than we'd like. For instance, real activity is showing signs of slowing after the initial 're-opening' bounce late last year. Industrial production and investment data for April came in slower than markets expected.

However, while there is some concern with the degree of debt held at a local government level, there's still some room for authorities to provide stimulus going forward. Indeed, the risks are becoming skewed towards a cut to the RRR in the coming months which should serve to spur activity via credit channels in the quarters ahead. Taken with our medium-term expectation of general USD weakness, we still expect the USD/CNY profile to be lower, albeit with a Q3 forecast revised higher now.

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