CIBC FICC Strategy and Economics

FX MONTHLY

May 2024

Emerging and Diverging

Key points

- The resilience of US data has led to a hawkish repricing for the Fed and amplified the divergence story. As a result, the trade-weighted USD has rallied by almost 2% since early March. We've recalibrated our view and are now expecting a firmer USD profile over the forecast horizon.
- The long awaited Canadian slowdown appears to be on the horizon, with domestic GDP looking to have tailed off at the end of Q1, as the labour market and core inflation ease. We expect that the BoC has more room to be repriced in a dovish direction over the course of the year. As such, we now see USD/CAD remaining elevated into Q4 2024.
- We're expecting the ECB and BoE to begin easing administered rates in June and to cut 25bps per quarter thereafter. This outcome is more closely priced for the ECB than for the BoE, which points to EUR outperformance on a relative basis.
- The RBA and RBNZ remain among the most hawkishly priced G10 central banks, and for good reason, as domestic inflationary pressures have remained elevated in both countries. However, at this point, we're in closer alignment with the market's views on the RBNZ rather than RBA. We expect continued US exceptionalism to lead AUD/USD and NZD/USD to depreciate in Q2.
- LATAM carry trades finally showed some weakness in April, as FX vols increased and risk went on the defensive. MXN was the hardest hit given its lofty valuation, while CLP withstood the pressure due to the rally in commodities. Looking forward, we're expecting further LATAM downside, amid a more hawkish Fed.
- Chinese growth beat expectations in Q1 amid government led stimulus and AI-related manufacturing demand. We expect USD/CNH stability to be broadly maintained over the course of 2024.

FX Forecasts

End of period:	Apr 30, 2024	Q2 '24	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
USD / CAD	1.37	1.39	1.38	1.38	1.36	1.35	1.35	1.34
EUR / USD	1.07	1.05	1.06	1.07	1.08	1.09	1.10	1.11
USD / JPY	157	162	157	153	150	147	146	145
GBP / USD	1.25	1.22	1.23	1.25	1.27	1.28	1.29	1.30
USD / CHF	0.92	0.93	0.93	0.93	0.94	0.94	0.93	0.93
USD / SEK	11.00	11.14	10.85	10.61	10.32	10.09	9.86	9.68
AUD / USD	0.65	0.64	0.64	0.65	0.65	0.66	0.66	0.67
NZD / USD	0.59	0.58	0.59	0.59	0.59	0.60	0.60	0.61
USD / NOK	11.07	11.05	10.75	10.47	10.19	10.05	9.86	9.73
USD / ZAR	18.79	19.25	19.10	18.95	18.60	18.30	18.00	17.80
USD / BRL	5.15	5.05	5.20	5.00	5.10	5.10	5.00	5.00
USD / MXN	17.06	17.50	18.00	17.50	17.50	17.80	17.80	17.50
USD / COP	3873	4000	4100	4100	4000	3950	3950	4000
USD / CLP	947	930	900	880	860	820	840	840
USD / CNH	7.25	7.33	7.30	7.25	7.23	7.20	7.18	7.15

CAD Crosses

End of period:	Apr 30, 2024	Q2 '24	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
CAD / JPY	115	117	114	111	110	109	108	108
CAD / CHF	0.67	0.67	0.67	0.67	0.69	0.70	0.69	0.69
AUD / CAD	0.89	0.89	0.89	0.89	0.88	0.88	0.89	0.89
GBP / CAD	1.72	1.70	1.70	1.73	1.73	1.73	1.74	1.74
EUR / CAD	1.47	1.46	1.46	1.48	1.47	1.47	1.49	1.49

EUR Crosses

End of period:	Apr 30, 2024	Q2 '24	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
EUR / JPY	168	170	166	164	162	160	161	161
EUR / GBP	0.85	0.86	0.86	0.86	0.85	0.85	0.85	0.85
EUR / CHF	0.98	0.97	0.99	1.00	1.02	1.02	1.02	1.03
EUR / SEK	11.77	11.70	11.50	11.35	11.15	11.00	10.85	10.74
EUR / NOK	11.84	11.60	11.40	11.20	11.01	10.95	10.85	10.80

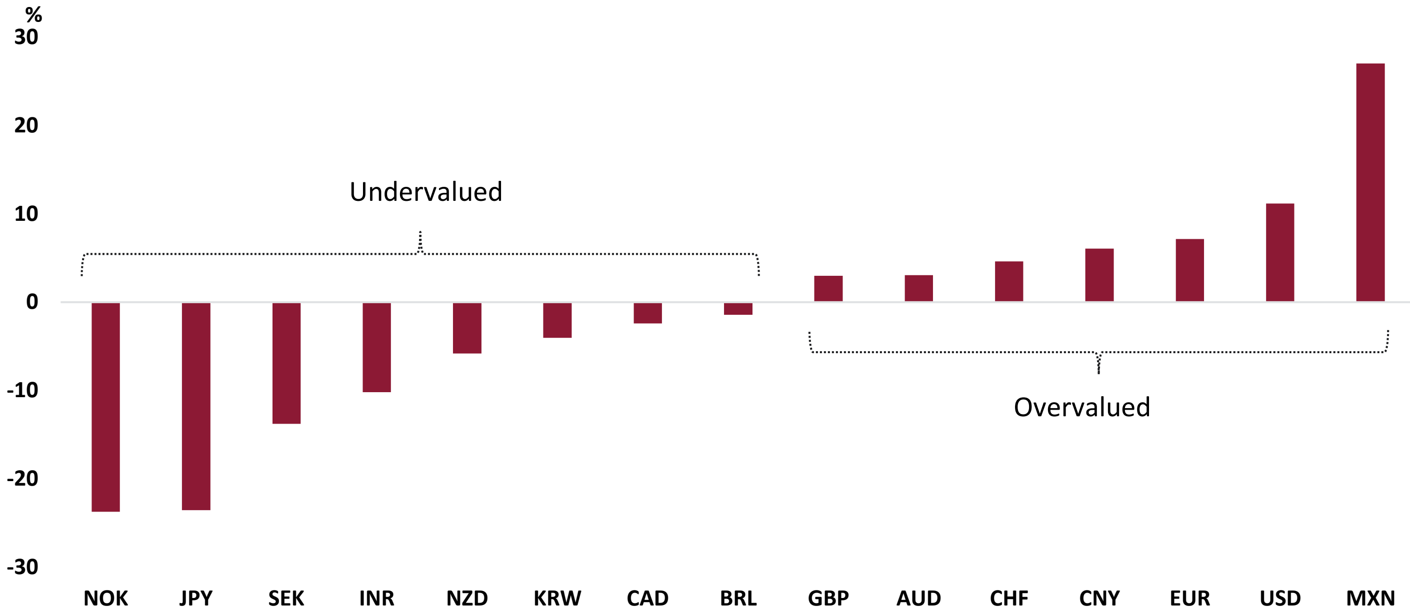
Central Bank Forecasts

	Current	Q2 '24	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
Fed	5.38	5.38	5.13	4.63	4.13	3.88	3.63	3.38
BoC	5.00	4.75	4.50	4.00	3.50	3.25	3.00	2.75
ECB	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.25
BoE	5.25	5.00	4.75	4.50	4.25	4.00	3.75	3.50
SNB	1.50	1.25	1.00	1.00	1.00	1.00	1.00	1.00
BoJ	0.00	0.00	0.00	0.00	0.15	0.15	0.15	0.15
RBA	4.35	4.35	4.35	4.10	3.85	3.60	3.60	3.60
RBNZ	5.50	5.50	5.50	5.25	5.00	4.75	4.50	4.50
Banxico	11.00	10.50	10.00	9.25	8.75	8.25	8.00	7.75
BCB	10.75	10.00	9.50	9.50	9.50	9.50	9.75	9.75
BCCh	6.50	5.25	5.00	5.00	5.00	4.75	4.50	4.50
Banrep	12.25	10.75	9.25	8.25	7.50	7.50	7.00	6.75

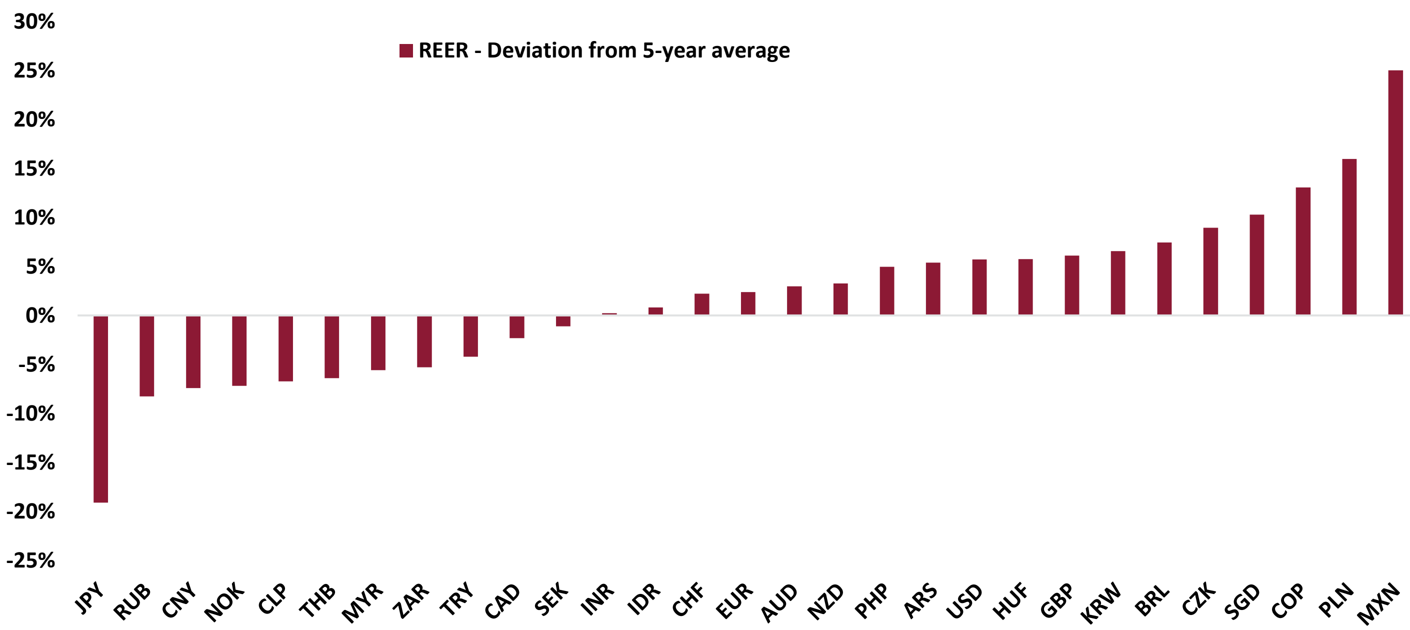
Market Pricing

	Current	Next Meeting	Q2 '24	Q3 '24	Q4 '24
BoC	5.00%	Jun 5	4.86%	4.63%	4.46%
Fed	5.38%	May 1	5.30%	5.18%	5.02%
ECB	4.00%	Jun 6	3.68%	3.45%	3.25%
BoE	5.25%	May 9	5.11%	4.93%	4.77%
RBA	4.35%	May 7	4.34%	4.39%	4.36%
RBNZ	5.50%	May 21	5.49%	5.35%	5.15%
SNB	1.50%	Jun 20	1.26%	1.11%	1.03%

Long-Term Fair Value Model - BEER



Long-Term Fair Value Model – REER Reversion



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

**CIBC's REER reversion model looks at the deviation of a real effective exchange rate index from its long-term average.

USD – Resurgent and Divergent

DXY – Q2 2024: 108.16 **|** Q3 2024: 106.82

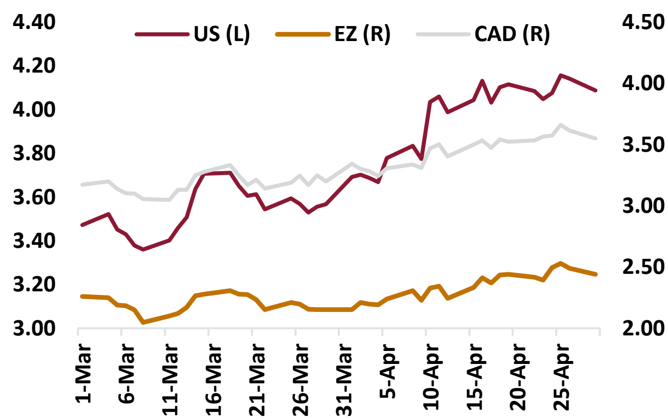
When discussing the US economy relative to others, a cursory read of financial media over the past few months has shown an uptick in words like “divergence” and “outperformance”. Both speak to the degree by which US data has surprised markets, and led to widescale recalibration for the Fed and the US dollar. For example, as recently as early March, Z4 SOFR contracts were implying almost 100bps worth of easing for the Fed this year. But almost two months later, the data backdrop has shifted and those same contracts are pointing to just over a 30bps worth of easing now. In lock-step, the trade-weighted USD is firmer by over 2% during that timeframe while position proxies point to the largest speculative length for net USD longs on record.

Why has US data been so resilient? There are several reasons, but among the most prominent is the resiliency of the US consumer. As many are aware, US households entered the rate hike cycle with balance sheets in much better shape relative other households in other countries and relative to the pre-2008 days. That’s primarily due to prolonged period of de-leveraging following the global financial crisis of 2008, and terming out of debt over the past several years. For instance, on the latter point, it’s estimated that over 90% of US mortgages are fixed under current market rates. That’s a huge safety net for households which disrupts the usual income effect of monetary policy tightening – as less is spent on debt servicing than usual.

Over the long-term, this blunts the impact of Fed tightening and implies that the r-star is higher. The market has caught up on this theme as well – with the implied neutral rate (taken as the minimum 1m forward OIS rate over the next two years) moving from around 350bps in early March to close to 400bps today. That’s also very different from what we’ve seen for other regimes (see Chart).

As such, we’ve revised our forecasts higher for most USD pairs. The divergence theme is real, and still credible though we feel like we’re getting closer to more realistic pricing here relative to earlier in 2024. That points to only modest USD upside from here though the staying power of a firmer greenback should be around for longer than we would have thought earlier this year.

Chart: Market Implied Neutral Rates



Source: CIBC Capital Markets

CAD – Policy Divergence Leaves Loonie Under Pressure

USD/CAD – Q2 2024: 1.39 **|** Q3 2024: 1.38

The loonie depreciated over the past month as it’s now clear that the Fed won’t be easing as soon or as aggressively as previously thought, widening the divergence in policy expectations between the BoC and the Fed. We eliminated a Fed cut from our projection, leaving only two quarter point reductions for 2024 (September and December), which is in contrast to the four 25 bps cuts we see from the BoC. We’re still expecting more easing from each central bank relative to market pricing, but to a greater degree on the BoC side, which could see the loonie depreciate further ahead, as markets recalibrate. We see USD/CAD peaking at 1.39 by mid-year.

The Canadian economy lost strength over the first quarter, with the boost to activity earlier in the year from mild winter weather and the end of strikes quickly fading. Coupled with the downside surprises in core inflation metrics and the deterioration in the labour market, the BoC looks set to cut rates in June. Policymakers are still attuned to upside risks from the resilient economic backdrop being seen in the US, but we see that momentum fading over the months ahead, with the retrenchment in job openings and the quits rate pointing to a weakening in activity, which will likely see the Fed start to cut rates in September. We expect CAD to strengthen over the remainder of the 2024, with USD/CAD ending the year at 1.38. In 2025, we're expecting USD/CAD to depreciate over the year, due to a broad USD depreciation, as the Fed cuts rates, combined with higher commodity prices as global growth gets a lift from lower interest rates in 2025. Increased energy shipments out of Canada tied to the new Trans Mountain pipeline and LNG facility should be a marginal driver of CAD as well.

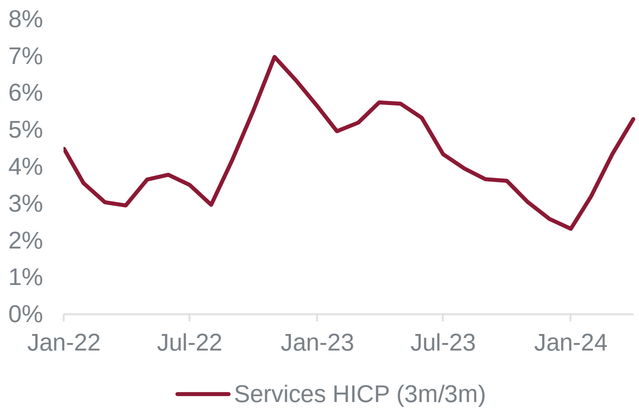
EUR – Start in June, Skip July

EUR/USD – Q2 2024: 1.05 **|** Q3 2024: 1.06

Although the Eurozone economic surprise index has moderated from early March highs, the flash composite PMI has gained almost 5 points since troughing at 46.5 in November while German investor expectations continues to rebound. Both business (Ifo) and investor (ZEW) expectations continued to advance into the start of Q2, indeed we would note that forward-looking investor sentiment reached extremes last witnessed in February 2022. While an uptick in business sentiment is usually a good lead indicator of EUR performance, indeed we would note that the sensitivity of the eurozone to macro weakness has moderated we have witnessed a succession of lower highs in EUR/USD.

The EUR broad downdraft in the year to date is commensurate with aggregated speculative EUR long positions, (leveraged + real money) capitulating from near three-year highs into the start of the year. We would note that investors moved net short of the EUR into early Q2, for the first time since the end of Q2 2022. Contingent to the position reversal and near-term EUR downside bias is the presumption that despite not wishing to pre-commit to policy action that in effect is exactly what ECB President Lagarde has done, notwithstanding immediate negative surprises in terms of wages and underlying service prices. We do not expect the ECB doves to be able to pressure the Governing Council into considering back-to-back rate cuts (June/July) into the summer recess. However, the ECB is likely to act both ahead and more aggressively than the Fed in 2024. Such a scenario points towards an extension of the negative positioning skew and additional EUR downside, towards 1.05 before finding a durable base and graduated recovery narrative into 2025.

Chart: Rebounding Service Price Momentum Advocates for a July Skip



Source: CIBC Capital Markets

JPY – 157-160 is the New Intervention "Danger Zone" for May

USD/JPY – Q2 2024: 162 **|** Q3 2024: 157

Japan's MoF is suspected to have intervened aggressively to prevent USD/JPY from breaking 160 on April 30th. That vigorous defense was at odds with the BoJ decision on April 26th, where the market was surprised by Governor Ueda's lack of concern over yen weakness.

We think this MoF-BoJ divergence is due to timing horizons – the BoJ does not have a long-term yen target, while the MoF sees 160 as an important psychological level for now. We think eventual BoJ hikes and QE taper are the only sustainable long-term solution to limit yen weakness amidst more hawkish Fed expectations. However, after listening to Governor Ueda reiterate prior dovish comments – that "*monetary policy is not aimed to control FX rates directly,*" we don't think the BoJ will be hiking rates to defend the yen in Q2 or Q3.

Governor Ueda's apathy about FX suggests the current JGB purchase amount will be carried over at the June 14th BoJ meeting. Over the next few weeks, we think USD/JPY will test the MoF's new "intervention zone" (between 157-160) as US-Japan rate differentials react to US data and Fed speak. Just as the MoF "retreated" from defending 152 in April, we think US data can push USD/JPY to break past 160 and rise to 162 in June before another MoF warning ahead of 165.

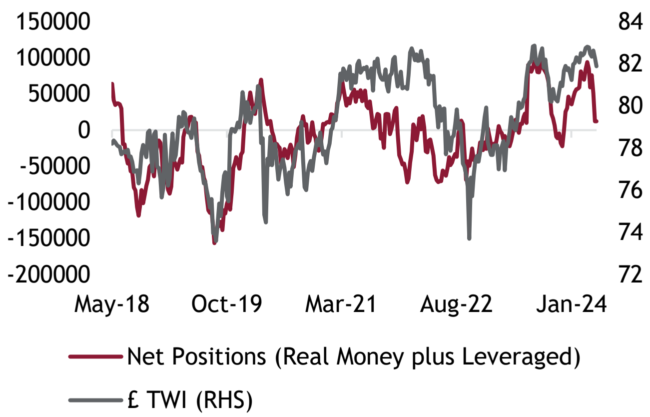
GBP – Shifting MPC Views

GBP/USD – Q2 2024: 1.22 | Q3 2024: 1.23

Early-year GBP gains were fuelled by the realization that the H2 2023 recession was both shallow and short-lived. While annualized Q1 growth of around 1.5% is hardly stellar that activity is above that discounted by the BoE in the Monetary Policy Report, justified GBP impetus. Contingent to early year gains proved to be real money longs reaching extremes last witnessed in July 2007. However, the scale of position accumulation left the market vulnerable to moves in front-end (2-year spreads).

Although the BoE continues to worry over the perception of inflation persistence, via elevated wage growth and amplified service sector prices, annual service price inflation remained at 6.0% in March (the BoE regards that as the best guide of domestically generated inflation) we have moved to consider an earlier and more aggressive BoE easing profile, we assume a first cut in June, with a further two cuts likely in 2024. However, Chief Economist Pill has pushed back against the notion of early cuts, he underlined that “there are greater risks associated with easing too early should inflation persist rather than easing too late should inflation abate. ” Although Pill may err on the side of caution we would note that hawkish BoE insider David Ramsden detailed the notion of downside CPI risks compared to February MPR assumptions. The Ramsden rhetoric comes as previous BoE hawks have rowed back from advocating additional tightening. The combination of factors has prompted a substantive move in front-end (2-year) spreads while excessive GBP longs have been largely unwound. Signs of a loosening labour market are likely to ease wage pressures, supporting a more aggressive BoE reaction function. Consequently, we anticipate GBP/USD retesting extremes last witnessed in November down around 1.22.

Chart: GBP Positioning has Begun to Roll Over



Source: CIBC Capital Markets

CHF – More Easing to Come

EUR/CHF – Q2 2024: 0.97 | Q3 2024: 0.99

In the wake of the unexpected SNB rate cut at its March quarterly policy meeting, we have witnessed real money investors anticipating additional rate cuts via an aggressive extension in CHF shorts. The negative positional skew has extended to levels last witnessed in 2019 in the wake of investors adding to CHF shorts for 11 straight weeks. The negative bias comes as the market continues to look towards a more activist SNB, that activism is perceived to include a tolerance of a cheaper CHF.

Although Swiss consumer confidence may have rebounded for the first time in four months in March, likely due to the unexpected monetary policy stimulus, it is notable that the economic surprise index remains close to extremes last witnessed in the aftermath of the global financial crisis in 2009. The presumption of SNB activism, including tolerating a cheaper CHF, to boost both competitiveness and encourage imported price pressures, has proved to be amplified March CPI unexpectedly moderated to 1.0% y/y, annual food prices dipped into disinflationary territory. The inflation undershoot not only vindicated the recent unexpected policy action but also validates the notion of more easing to come, we assume an additional 25bps of easing in June, currently around 19bps are priced, ahead of a further 25bps in September. With only 31bps of cumulative cuts currently discounted by September should a more aggressive policy reaction be forthcoming this supports the notion of additional CHF weakness. Indeed the toleration of a cheaper currency, temporary safe haven influences notwithstanding, comes via the realization that the latest monthly FX reserve data detailed the fastest pace of foreign reserve accumulation since December 2014.

SEK – Riksbank up Next?

EUR/SEK – Q2 2024: 11.70 | Q3 2024: 11.50

Market expectations for 8 May Riksbank meeting spiked in the wake of the material undershoot in the March CPI report. Underlying inflation, CPIF, unexpectedly dipped to 2.2%, we have not witnessed a lower level since July 2021. The retreat contrasts with the market which had anticipated a modest uptick to around 2.6%. The downside price surprise is a function of several factors, including food, down 0.7% in the month, allied to a commensurate retreat in household goods prices.

Market pricing for the upcoming central bank decision has moderated, indeed we are currently pricing in around 16bps of easing, such pricing underlines the policy dilemma for the central bank, in particular by acting ahead of both the ECB and Fed. The uptick of such a scenario risks an extension in near-term SEK underperformance, the SEK has lost more than 3% versus the USD in the last month. However, we would note that central bank deputy Governor Breman appears to be relatively unconcerned SEK weakness. The First Deputy Governor suggested that current SEK levels are “something we can cope with when you look at Swedish inflation.” That suggests concerns over imported price pressures are not yet viewed as a material concern. Hence an early cut, despite presumptions of SEK underperformance, including versus the NOK, remains real.

NOK – Norges Bank to Remain Patient

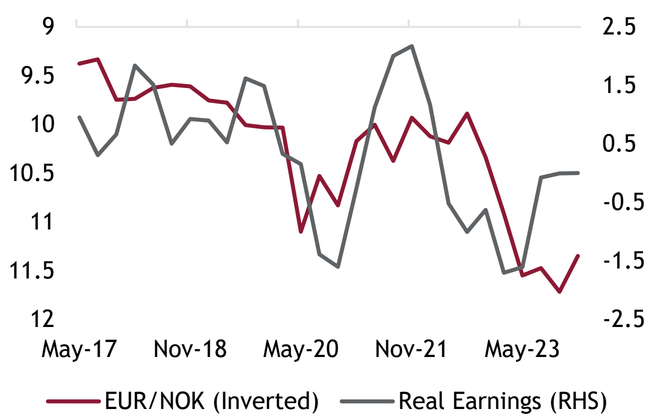
EUR/NOK – Q2 2024: 11.60 | Q3 2024: 11.40

The NOK has remained a G10 laggard over the last three months, the currency has depreciated by more than 5% versus the Greenback. Underperformance is consistent with the economic surprise index retreating towards November lows around -40. The ESI retreat is a function of disappointing early-year data, including GDP. The 0.2% decline in mainland GDP in February equates to a third monthly correction in four months.

Despite disappointing real economy data we expect the Norges Bank to be a policy laggard due to persistent wage pressures. Although underlying March CPI undershot expectations, the 4.5% outturn was below the 4.7% discounted by the Norges Bank, we expect an extended period of policy reticence. The recent policy statement anticipated rates being maintained “at the current level (4.50%) for some time ahead.” As the central bank assumes CPI is likely to remain above the target threshold through to the end of the forecast profile, (to Q4 2027) suggests that risks of an early policy adjustment need to be kept in context, irrespective of the fact that Norges Bank Chief Wolden Bache raised the possibility of a September adjustment.

Currently, the market is only pricing around 9bps of easing by September. We expect the bank to remain reticent to act amidst persistent wage pressures. Unions negotiating for frontline workers (who compete internationally) have recently agreed to a 5.2% wage deal, 0.3% above that anticipated by the central bank. Should the higher outturn not be compensated for via productivity growth we can expect an increased contribution from wages into CPI, maintaining price pressures. Should the Norges Bank hold rates until year-end, currently only 19bps of easing is priced by December, we can expect recent underperformance to gradually dissipate.

Chart: Real Earnings in Norway Have Begun to Rebound



Source: CIBC Capital Markets

AUD – Stubborn Inflation Points to a Patient RBA

AUD/USD – Q2 2024: 0.64 | Q3 2024: 0.64

Similar to Fed expectations in the US, upside surprises to Australian Q1 CPI data have shifted the market's views on the RBA, with some commentators now noting the RBA could even hike rates. We acknowledge that the Q1 CPI data was higher than we expected – there was a notable acceleration in sequential inflation to +1.0% q/q, up from the Q4 pace of +0.6% q/q. Trimmed mean CPI also accelerated to +1.0% q/q (from +0.8% q/q in Q4).

The usual suspects of housing costs and services inflation (insurance, education and healthcare) are still high in year-on-year terms. However the upside surprises were broad-based, with food CPI quickening to +0.9% q/q and alcohol CPI accelerating to +1.8% q/q. Sequential housing CPI actually slowed in Q1, but this was not enough to offset the broad increase in other categories.

We expect the RBA to re-iterate "nothing is ruled in or out" in May, but Q1 CPI points to upside revisions to the May SOMP forecasts. We think hikes are unlikely, but Q1 CPI justifies a prolonged pause, and we still expect the RBA to cut only after the Fed. Although the RBA is still hawkish, US data shows "more exceptionalism." We revise our Q2 AUD/USD forecast lower to 0.64.

NZD – Prior Aggressive Hikes Have Led to More Progress on CPI

NZD/USD – Q2 2024: 0.58 | Q3 2024: 0.59

The April 10th RBNZ meeting was a "placeholder event," given that there was little tier-1 data since the February meeting. The technical recession in Q4 did lead the MPC to acknowledge that growth is weak, but the RBNZ was still focused on upside risks to inflation rather than downside risks to growth.

At the April meeting the RBNZ did warn about upside risks to Q1 CPI due to higher trends in the monthly Services Price Index (SPI). However when Q1 CPI was released a week later, the data showed sequential inflation of +0.6% q/q, in-line with expectations and on par with the Q4 2023 pace of +0.5% q/q.

The May 22nd RBNZ meeting should be more interesting following Q1 CPI data, which notably showed sequential inflation in New Zealand is much lower than Australia. Q1 CPI and GDP argue that the high RBNZ OCR (5.50%, or 115 bps higher than the RBA cash rate) is already cooling activity. Q1 unemployment could rise as strong immigration boosts labour supply. We think the RBNZ will also wait for the Fed, but markets will perceive it as less hawkish than the RBA. NZD/USD will stay sensitive to US data, and as such we revise our Q2 NZD/USD forecast lower to 0.58.

ZAR – Political Risks Contrast With Improving Macro Backdrop

USD/ZAR – Q2 2024: 19.25 | Q3 2024: 19.10

Opinion polls ahead of the 29 May election suggests that the vote share of the ruling African National Congress (ANC), vote risks dropping below the 50% threshold for the first time ever. Back in 2019 the party took 55% of the vote, extending their domination of domestic politics which stems back to the advent of the current liberal democracy in 1994. The fortunes of the ANC have retreated against the backdrop of high unemployment, broad economic stagnation, elevated crime and corruption, and ongoing power blackouts. While the ANC remains on course to be the largest party in the Parliament should their support dip towards 40% the risks of political instability, adding additional ZAR headwinds, will become notable. For those wary of rising political uncertainty the recent political experience of local politics in Johannesburg, the ANC lost local control in 2021, heralding infighting and deepening political delivery problems, is hardly likely to encourage ZAR sentiment.

Yet despite the looming political risk, it is notable that speculative investors have added to ZAR long positions in three of the four weeks into mid-April. The uptick in positions contrasts with a sharp downward correction in appetite for local bonds over the last three months. Reduced foreign appetite for SA government bonds is likely a function of the central bank Governor reiterating upside risks to inflation and or financial conditions. Such fears notwithstanding we would expect interest to add to positions should CPI continue to moderate, towards the lower portion of the central bank's 3-6% price stability mandate. The prospect of falling food prices, benefitting the lower income strata most significantly, supports the concept of a more constructive medium to long run macro backdrop, political risks notwithstanding.

LATAM FX

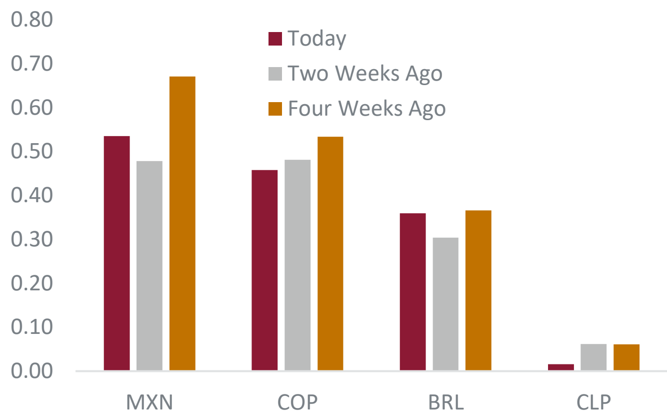
MXN – A Long Awaited Reversal

USD/MXN – Q2 2024: 17.50 | Q3 2024: 18.00

USD/MXN has rallied in the month of April, as LATAM carry trades reversed amidst a rise in FX vol and a drawdown in risk assets. MXN was the hardest hit among the LATAMs, which is in line with our long term fair value models that had been flagging MXN as the most overvalued currency for some time now. We're expecting further upside in USD/MXN over the remainder of 2024, as we disagree with the extent of cuts priced for Banxico. Indeed, while the market is currently pricing Banxico to cut to roughly 10.50% by end of 2024, we're expecting the overnight rate at 9.25% by then. Our forecast is predicated on the steady decline in 1Y inflation expectations and the continued decline in core CPI. We do not expect the Fed's more hawkish outlook to materially impact Banxico's own outlook, given the strength in MXN and still large Mexico-US overnight interest rate differential.

We continue to expect USD/MXN to rally towards 17.50 in Q2 and 18.00 in Q3 as a more dovish Banxico rate profile is priced. Given that net long positions in MXN remain near 10Y highs, there could be further sharp USD/MXN moves higher, as Banxico eases by more than is currently priced and political noise increases ahead of US and Mexico presidential elections.

Chart: 3M Vol Adjusted Carry*



Source: Banxico, CIBC Capital Markets
* (3m MXN forward implied yield – 3m SOFR)/ATM USD/MXN 3m Vol

BRL – Slightly Less Dovish BCB Offsets Carry Drawdown

USD/BRL – Q2 2024: 5.05 | Q3 2024: 5.20

While BRL also suffered from the unwind in LATAM carry trades, some hawkish commentary out of the BCB offsets some of this drawdown. In a recent speech, BCB President Roberto Campos Neto warned investors of growing uncertainties (i.e fiscal/external risks) which is a clear signal that the BCB may be considering slowing the pace of rate cuts sooner than anticipated. The hawkish shift could imply that 50 bps rate cuts are now off the table, after 6 consecutive adjustments, and that we could see 25bps incremental cuts as soon as May. The BCB should show continued caution ahead, as the 2025 fiscal target implies that there will be a lower fiscal surplus in the coming years as service inflation remains elevated. We're expecting smaller rate adjustments into late Q2/early Q3 2024 or even a temporary halt in the easing cycle.

We expect the BRL to have the highest carry in the region by the end of 2024 and into 2025, however, fiscal risks are set to resurface as we move closer to H2. Recall that President Lula's popularity is declining, while the government's political capital has diminished after the approval of the new fiscal rule last year, among other reforms. This should prevent the BRL from appreciating in a sustained manner as the market focuses on the government's ability to comply with its fiscal goals, and the seeming government meddling at Petrobras and Vale. We see USD/BRL trading in the 5.00-5.20 range as we move into late Q2 and early Q3.

CLP – Incrementally Hawkish BCCh and Terms of Trade Support CLP

USD/CLP – Q2 2024: 930 | Q3 2024: 900

A relatively more hawkish Banco Central de Chile (BCCh) and the rally in copper prices has led the CLP to outperform on LATAM crosses and to rally against the USD. In a unanimous decision, the BCCh cut the overnight rate by 75bps to 6.50% on April 2nd, in line with the consensus estimate. Although we expected to see a split decision (at least one vote in favour of a 100bps rate cut) following the dovish comments by BCCh's President Rosanna Costa a few weeks prior, higher-than-expected economic activity indicators, and the recent depreciation of the CLP were the main factors listed behind the smaller rate cut implemented. While the BCCh has shifted incrementally hawkish, they still expect to reach neutral (4%) at some point in the next 2 years.

While our BCCh rate outlook shows a somewhat more aggressive pace of cuts than that priced by the market, we still expect to see some further USD/CLP downside through the year given the BCCh's cautious stance regarding CLP valuation, further USD selling by the Ministry of Finance, and continued support for Chilean terms of trade as a global growth rebound supports commodity prices.

COP – USD/COP to Break Back Above 4000 in the Months Ahead

USD/COP – Q2 2024: 4000 | Q3 2024: 4100

USD/COP rallied in April largely due to the unwind of the EM carry trade, as FX vols rose amidst a risk off backdrop. We're expecting continued upside in USD/COP and forecasting a move to 4000 and 4100 by Q2 and year end respectively.

The April Banrep meeting resulted in another 50 bps rate cut to 11.75%, with five of seven members supporting the move. This follows the March meeting in which the Bank stated that they expect inflation to return back to target by mid-2025. We have a more dovish than expected outlook on Banrep for the rest of the year, as we're expecting the policy rate to end the year at 8.25%. As a result of our dovish outlook, we're expecting USD/COP to rally towards 4000 during Q2.

Asia FX

CNH – China Wants a "Competitive" Yuan, But Not at the Cost of Stability

USD/CNH – Q2 2024: 7.33 | Q3 2024: 7.30

China's Q1 GDP growth surprised stronger, helping to dispel the previous bearish narrative that a 5% growth target would be difficult to achieve. The stable growth trajectory was not a surprise to us, even when taking into account ongoing property weakness. Direct investment by the government in infrastructure projects – modernizing and expanding China's power plants – are helping to boost GDP.

Exports also rose in Q1 – that shows China is maintaining competitiveness despite US trade barriers which have restricted China's access to cutting edge chips. The ongoing, gradual rotation by multinationals' manufacturing supply chains away from China is a long-term headwind, but in the short-term, A.I.-related tech demand by foreigners should help support Chinese manufacturing.

In-line with our "US exceptionalism" thesis, we raise our Q2 USD/CNH forecast to 7.33. The PBoC will manage the pace of weakness around the 7.30 level – but will tolerate the move past 7.30 as long as it is done in a gradual / incremental manner. Although CNH/JPY is nearing all-time highs, we do not expect a one-off yuan devaluation to "catch-up" with yen. Positive exports and PMI data show there is no urgent need for devaluation, and China equity market stability (which relies on a stable yuan) is still a priority.

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