CIBC FICC Strategy and Economics

FX MONTHLY

April 2024

A Different Cadence

Key points

- We expect some near-term upside for the USD – not least as the resilience of the US economy to higher rates portends to a different cadence for Fed easing this cycle relative to other central banks. Additionally, the liquidity backdrop should be less friendly for broad risk assets. Beyond Q2, valuation and poor US fiscal policy are among the factors expected to weigh on the USD.
- The BoC is expected to cut earlier and more aggressively than the Fed which should put upwards pressure on USD/CAD in the coming months. However, once markets have fully digested this, we expect CAD to rebound in the H2 2024 and 2025 as global growth picks up.
- The EUR and GBP look set to be supported in H2 2025, as the UK and Eurozone emerge from a period of weak growth.
- While hikes are no longer on the agenda in Australia or New Zealand, the RBA and RBNZ should still be slower to ease than other G10 central banks.
- For LATAM FX, carry dissipation into Q2 highlights risks for the MXN and COP.
- Chinese authorities look set to allow further CNH weakness as equity markets have been stabilized and there is an increased desire for growth through exports.

FX Forecasts

End of period:	Apr 2, 2024	Q2 '24	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
USD / CAD	1.36	1.37	1.35	1.35	1.33	1.30	1.30	1.29
EUR / USD	1.07	1.07	1.09	1.11	1.12	1.13	1.14	1.15
USD / JPY	152	155	147	145	143	140	140	140
GBP / USD	1.26	1.25	1.27	1.31	1.32	1.32	1.33	1.34
USD / CHF	0.91	0.93	0.92	0.91	0.91	0.91	0.91	0.91
USD / SEK	10.76	10.47	10.18	9.86	9.69	9.51	9.34	9.13
AUD / USD	0.65	0.66	0.66	0.67	0.67	0.68	0.68	0.69
NZD / USD	0.60	0.61	0.61	0.61	0.62	0.62	0.63	0.63
USD / NOK	10.90	10.61	10.28	9.91	9.78	9.60	9.47	9.35
USD / ZAR	18.85	19.15	18.85	18.45	18.00	17.75	17.50	17.20
USD / BRL	5.05	5.05	5.20	5.00	5.10	5.10	5.00	5.00
USD / MXN	16.63	17.50	18.00	17.50	17.50	17.80	17.80	17.50
USD / COP	3864	4000	4100	4100	4000	3950	3950	4000
USD / CLP	986	930	900	880	860	820	840	840
USD / CNH	7.26	7.30	7.25	7.20	7.18	7.15	7.15	7.15

CAD Crosses

End of period:	Apr 2, 2024	Q2 '24	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
CAD / JPY	112	113	109	107	108	108	108	109
CAD / CHF	0.67	0.68	0.68	0.67	0.68	0.70	0.70	0.71
AUD / CAD	0.88	0.90	0.89	0.90	0.89	0.88	0.88	0.89
GBP / CAD	1.70	1.71	1.71	1.77	1.76	1.72	1.73	1.73
EUR / CAD	1.46	1.47	1.47	1.50	1.49	1.47	1.48	1.48

EUR Crosses

End of period:	Apr 2, 2024	Q2 '24	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
EUR / JPY	163	166	160	161	160	158	160	161
EUR / GBP	0.86	0.86	0.86	0.85	0.85	0.86	0.86	0.86
EUR / CHF	0.98	0.99	1.00	1.01	1.02	1.03	1.04	1.05
EUR / SEK	11.56	11.20	11.10	10.95	10.85	10.75	10.65	10.50
EUR / NOK	11.72	11.35	11.20	11.00	10.95	10.85	10.80	10.75

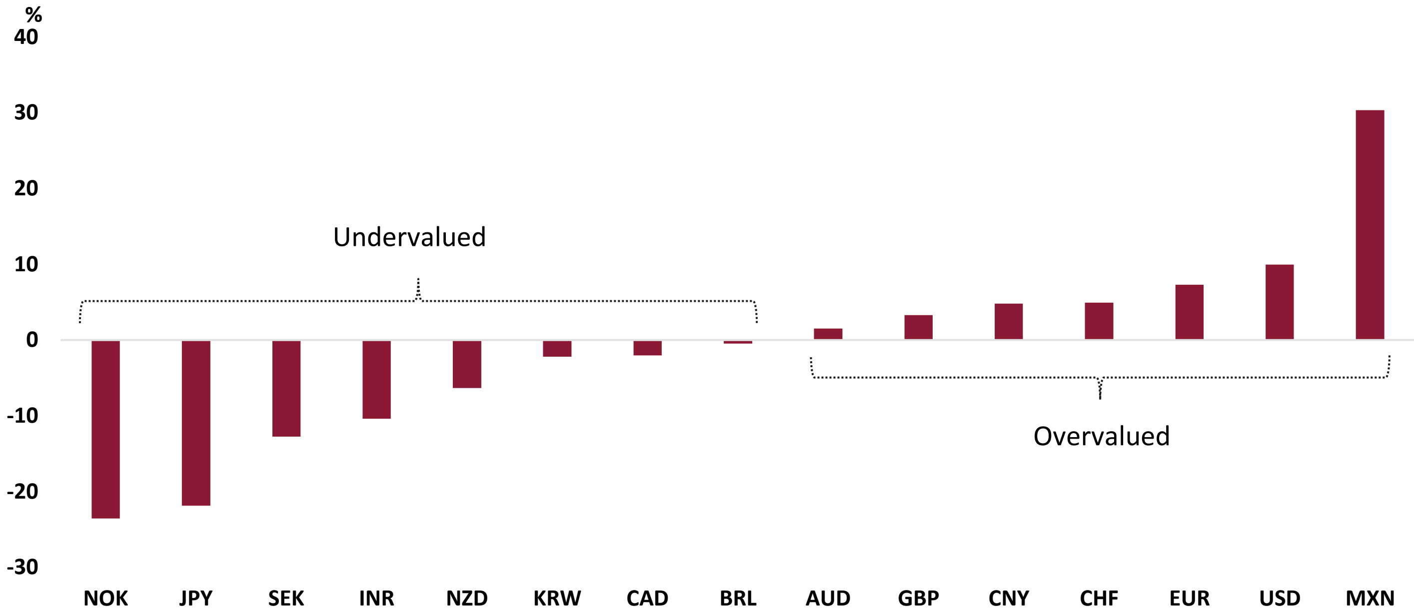
Central Bank Forecasts

	Current	Q2 '24	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
Fed	5.38	5.38	4.88	4.38	4.13	3.88	3.63	3.38
BoC	5.00	4.75	4.25	3.75	3.50	3.25	3.00	2.75
ECB	4.00	3.75	3.50	3.25	2.75	2.50	2.25	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	-0.10	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	4.25
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	7.25	5.25	4.75	4.50	4.50	4.50	4.25	4.25
Banrep	12.25	10.75	9.25	8.25	7.50	7.50	7.00	6.75

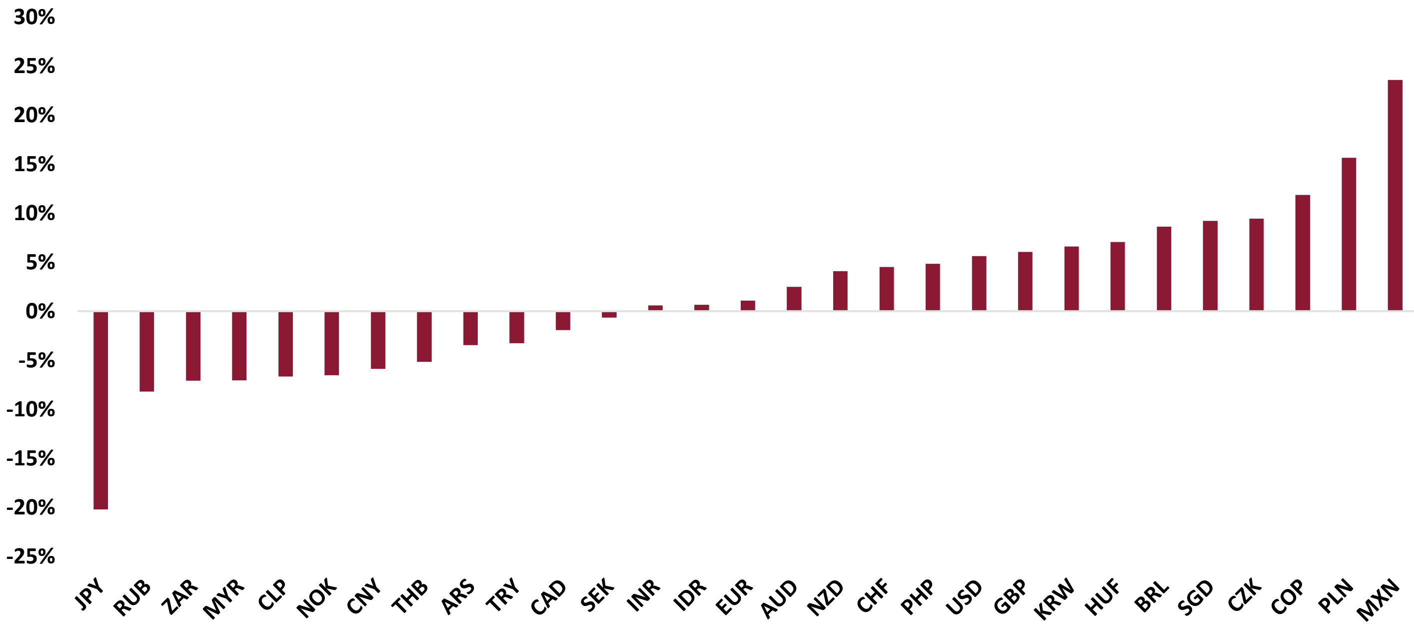
Market Pricing

	Current	Next Meeting	Q2 '24	Q3 '24	Q4 '24
BoC	5.00%	Apr 10	4.90%	4.63%	4.35%
Fed	5.38%	May 1	5.18%	4.92%	4.66%
ECB	4.00%	Apr 11	3.66%	3.30%	2.98%
BoE	5.25%	May 9	5.02%	4.75%	4.48%
RBA	4.35%	May 7	4.26%	4.13%	3.98%
RBNZ	5.50%	Apr 9	5.46%	5.05%	4.79%
SNB	1.50%	Jun 20	1.29%	1.1%	0.98%

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 – What's Another Metaphor for 'Goldilocks'?

DXY – Q2 2024: 105.63 | Q3 2024: 103.26

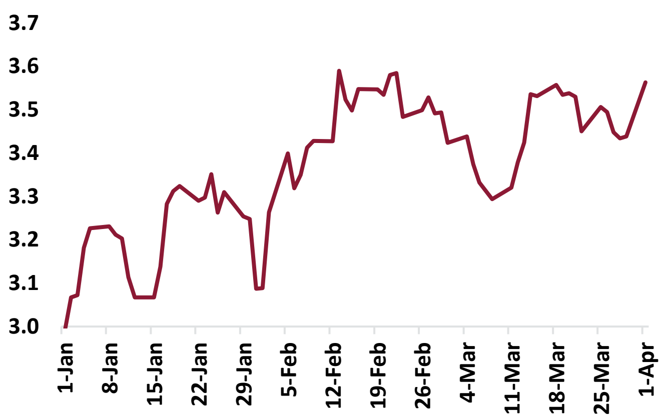
As we enter Q2, broad gauges of the USD are flirting with year-to-date highs. Recent data has been impressive enough to support calls for a "soft landing" in the US economy while also breathing some life into the "no landing" argument. Our own views are more closely aligned to the former which still implies the need for the Fed to start cutting rates as soon as this summer – though that still leaves room for the USD to rally modestly in the quarter ahead.

The 'goldilocks' metaphor gets thrown around way too often – but it's the best way to describe the state of the US economy at this juncture. Real GDP is tracking north of 2% for this quarter, which means the US is on track to exceed the Congressional Budget Office's estimate for potential for fourth quarter in a row. At the same time, the unemployment rate remains close to cyclical lows while wages are still at elevated levels. The above backdrop would normally be concerning for the Fed given the textbook implications for inflation – but PCE has been trending lower for some time now and continues to do so.

The cleanest explanation for the above is that supply side growth is unusually strong for this point in the cycle. And to be sure, fixed investment contributions to the quarterly growth numbers have been decent for several quarters now. That's exactly the type of growth that the Fed can look past as it calibrates policy for the coming months. But it also tells us that the neutral rate in the US is higher – which is the direction that the market has been moving in over the past few months.

Looking ahead, it does feel like the "higher neutral rate" narrative has become more fully reflected in the USD. That suggests only modest upside from here in the months ahead. Additional near-term upside for the USD could also come from a deteriorating risk backdrop. That's largely as the liquidity picture shifts in a manner that is less conductive to risk (net negative Treasury issuance in Q2 should mean funds flow back into the RRP at the margin). But beyond Q2, we expect the longer-term themes of over-valuation and poor US fiscal policy to make their presence more felt in the USD. Additionally, we're expecting activity to pick-up outside of North America towards H2 of this year. Taken together, that still suggests that USD sellers should use near-term rallies as opportunities to layer into hedges.

Chart: Market-Implied Neutral Rate in the US



Source: CIBC Capital Markets

CAD – Loonie to be Dragged Lower Temporarily as BoC Out-Cuts the Fed

USD/CAD – Q2 2024: 1.37 | Q3 2024: 1.35

The loonie continued to tread water over the past month, with another downside surprise in inflation in Canada offset by signs of a rebound in economic activity in Q1. If, as we expect, that growth spurt proves to be as short-lived as the one we saw in Q1 2023, an economic slowing this spring could help cement expectations towards the Bank of Canada cutting rates a bit earlier and somewhat more aggressively than the Fed, sending CAD to 1.37 around the middle of this year. The recent bounce in Canada was partly a one-off lift from the end of public sector strikes as well as improvements tied to supply chains and unusually mild winter weather. Rising business bankruptcies, and fewer business openings point to sluggish hiring ahead.

While we ultimately see the Bank of Canada cutting by 225 by the end of 2025, which is more than markets are pricing in, we similarly see markets as underpricing the 200 basis points we expect from the Fed over the same period. There should be a wider spread between front-end Canadian and US rates at the end of our forecast horizon, reflecting the greater drag that high rates have exerted on Canada's more indebted household sector. But that won't stand in the way of a gradual strengthening of the Canadian dollar later this year and into 2025. Our call for a general weakening of the USD against other measures will be a positive for the loonie, which could also gain some support from a pick-up in global growth in

2025, and the resulting positive for commodity currencies. Canada's trade balance will benefit from increased energy export volumes as a new pipeline and LNG facility come into operation over the forecast horizon.

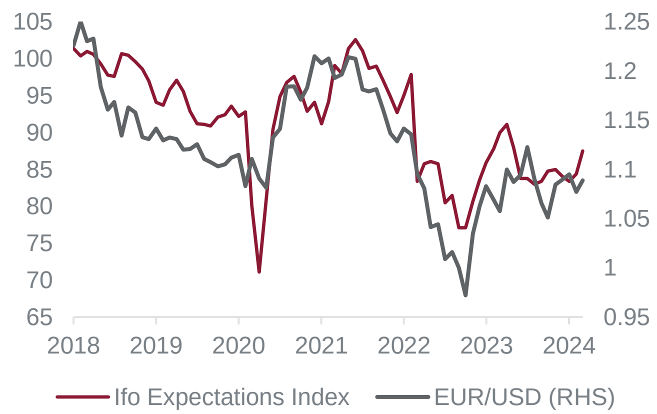
EUR – Expectations on the Rise

EUR/USD – Q2 2024: 1.07 **|** Q3 2024: 1.09

Although Eurozone flash composite PMI has remained below the 50 boom/bust line since May 2023, a fourth straight series advance, allied to services sentiment registering the highest reading since June 2023, points towards a graduated recovery narrative. Recovery dynamics also reflect substantive gains in both ZEW and Ifo expectations. While the former is often deemed largely a reflection of the German equity market (the DAX has advanced by 10% year to date) the latter reflects German business sentiment. The correlation between the two series supports the graduated recovery narrative which is baked into the latest round of ECB staff macro forecasts. Although the central bank may have revised down aggregate growth assumptions to 0.6% for this year, (marginally above our baseline assumption) ECB staff assume a strengthening recovery narrative into 2025 and 2026, the bank assumes GDP growth of 1.5% and 1.6% over the next two years. The uptick is expected to driven "initially by consumption and later also by business investment."

The broad recovery narrative remains at least partly contingent on increasingly benign price pressures encouraging an easier ECB monetary stance. Given that a rate cut was not discussed at the March meeting an April cut seems unlikely. Core price pressures and wage growth continue to worry certain ECB members. However, even hawks such as Slovakian central bank Governor Kazimir have moved to detail that the bank should acknowledge an improved inflation outlook. Indeed given President Lagarde effectively alluded to a June move in the most recent ECB press conference it seems only above expectations price data will preclude policy easing before the ECB summer recess, we expect a cumulative easing of 75bps in 2024, supporting growth and EUR sentiment into H2.

Chart: German Sentiment is Recovering from Weak Levels



Source: CIBC Capital Markets

JPY – The BoJ's Policy Will Depend on Fed and Currency Risks

USD/JPY – Q2 2024: 155 **|** Q3 2024: 147

The Bank of Japan "delivered" what consensus widely expected, hiking rates by 10 bps and dropping YCC. However, since the moves were so well-telegraphed (via leaks to the press) and the outlook sufficiently dovish, USD/JPY rallied back above the 151.00 level and towards the MoF's "red line" of 152.00.

On March 27th USD/JPY hit 151.97, prompting a more serious "warning" to markets via a trilateral meeting between the BoJ, MoF and FSA. Jawboning is losing its effectiveness, and we think actual intervention is likely. At the same time, Japanese officials know that FX intervention is unsustainable in the long-run. If the USD strength persists, 152.00 could break in April.

We think that yen concerns led to an earlier March hike and YCC removal. QQE will continue, but JGB yields can rise above previous caps. We think any QQE "taper" and additional rate hikes depends on the Fed outlook. With the inflation target "in sight," we think the BoJ is shifting focus to stabilizing USD/JPY. Our Fed easing profile is consistent with no further BoJ hikes this year, but a more hawkish Fed path could lead to an additional 10-15 bps BoJ hike in Q4. We raise our Q2 forecast to 155.

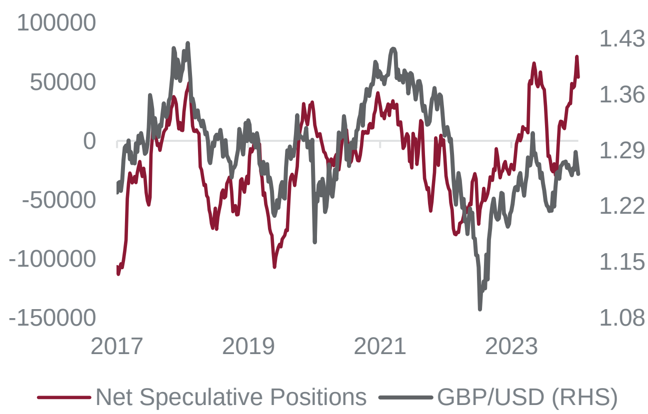
GBP – Walking a Narrow Path

GBP/USD – Q2 2024: 1.25 | Q3 2024: 1.27

The UK economic surprise index has proved to be on a steady upward path since mid-February. Contingent to the uptrend has proved to be forward-looking PMI data which suggests quarterly growth is running at around 0.3%. Such a rebound underlines that the Q3/4 recession was likely both shallow and short-lived. Signs of consumer resilience, allied to real estate impetus, as mortgage rates moderate from recent peaks, underline why cumulative UK rate cut expectations have moderated from around 150bps at the turn of the year to around 75bps now.

The improved data trend and moderation in rate expectations have paced GBP gains, only the USD has performed better amongst the G10 across Q1. Improving macro dynamics encouraged real money speculative GBP longs to extend to levels last witnessed in 2007 before the BoE's dovish hold at the March MPC. The immediate aftermath of the softened BoE policy guidance proved to be the most aggressive weekly correction in GBP real money longs since October. While markets may consider May a 'live' MPC meeting we would expect policy inertia to extend to June, we had previously assumed an August policy ease. We expect the BoE to require more confidence that discretionary service sector prices are easing and average hourly earnings are correcting before voting to ease. Although our immediate GBP forecasts have been pared back, due to an earlier and more aggressive BoE easing cycle, (June and 75bps of cuts this year) we would expect near-term GBP dips to prove contained. An improving macro backdrop, benefitting from rising real earnings and easier monetary policy points towards a graduated H2 GBP/USD uptrend.

Chart: GBP Positioning Looks Somewhat Stretched



Source: CIBC Capital Markets

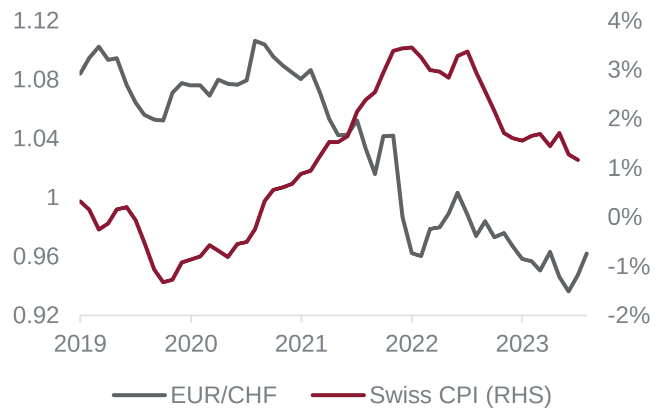
CHF – After the Policy Shock

EUR/CHF – Q2 2024: 0.99 | Q3 2024: 1.00

The SNB surprised the market at its March quarterly policy review by trimming rates, for the first time since 2015, by 25bps to 1.50%. Although we had highlighted residual risks of an early policy adjustment, we had assumed that the bank would wait until June. However, the key factor behind the unexpected move proved to be further substantive inflation forecast downgrades, beyond those from December. The bank now assumes an average of 1.4% in 2024 (from 1.9%), 1.2% in 2025 (from 1.6%), and 1.1% in 2026. While the inflation profile underlines a persistent inflation undershoot the bank assumes modest GDP growth of 1% this year.

Soon to depart SNB Chair Jordan detailed that the fight against inflation had been effective over the last couple of years. The material downward adjustment in the CPI profile, out to 2026, validates both the unexpected adjustment and/or the notion of another policy adjustment in June. Meanwhile, SNB President Jordan has recently underlined the negative impact of the CHF strength on foreign demand (CHF was the top G10 performer in 2023). Given the revised inflation profile and SNB language we expect a more activist SNB. We now anticipate that the policy rate will reach 1.00% by the September quarterly policy review. Although the bank did not amend its FX communications it appears that the SNB appears happy to foster additional CHF weakness, to boost imported inflation, and to maintain exporter competitiveness. Such a scenario underlines an earlier-than-expected EUR/CHF parity return, underlining our bias for additional CHF underperformance.

Chart: Inflation has Rapidly Retreated in Switzerland



Source: CIBC Capital Markets

SEK – A Lower Rate Trajectory

EUR/SEK – Q2 2024: 11.20 | Q3 2024: 11.10

The Riksbank maintained its policy rate at 4.00% at the March monetary policy meeting. However, the central bank materially revised its underlying rate path, it now assumes rates will be around 100bps lower at the end of the policy profile (end 2026). The moderation comes as the bank remains confident of attaining its medium-run CPI target. Although the bank revised up its 2025 core CPIF assessment to 1.9%, from 1.7% (2024 estimates remained at 2.3%), prices are expected to retreat, as inflation expectations appear well anchored and wage pressures moderate. The combination underlines the rationale for the bank to assume an average policy rate of 3.93% in Q2, supporting the notion of a rate cut in either May or June.

If the bank is to move in May they will have just one more CPI print, due on 12 April, to consider. By waiting until June they will have three CPI readings plus a further round of forecast revisions. Although Central Bank Governor Thedeen may have suggested that a May cut should be viewed as a 50% probability we would expect the bank to wait for more information. That being said the Governor was intent on pushing back against any notion of ECB policy timing proving decisive for the Riksbank. Despite such considerations we expect the Riksbank to join the concert of central banks looking to ease in June.

The SEK has proved to be something of a year-to-date performance laggard. We would expect monetary policy caution to encourage EUR/SEK to retreat from a test of the 200Day MAV. We expect a correction back towards early March levels (around 11.20) into mid-year, before a retreat towards the mid-point of the long-term trading range into year-end.

NOK – On Hold Through the Summer

EUR/NOK – Q2 2024: 11.35 | Q3 2024: 11.20

The latest Norges Bank decision maintained previous policy guidance, namely that rates would be “maintained at the current level (4.50%) for some time ahead.” We would expect policy inertia into Q3 even though underlying CPI has proved to undershoot market assumptions in the last two CPI snapshots; core prices eased below the 5% threshold for the first time since August 2022. Although the bank revised down its core inflation assumptions through this year and next, compared to the December Monetary Policy Report, prices are not expected to reach the 2% target threshold across the forecast profile. The protracted above-target price profile supports the notion of policy remaining restrictive for longer. Despite the downward revision to the CPI profile, the central bank maintained its policy rate path, indeed Q3 and Q4 rate assumptions remained unchanged at 4.44% and 4.29% respectively, supporting NOK dynamics in the process.

Post-meeting monetary policy commentary from Norges Bank Governor Wolden-Bache further validate our long-held assumption of policy rates being held through the summer, currently, the market is pricing in a mere 9bps for easing at the August policy assessment. The central bank has a mandate that includes stable output and employment. With manufacturing PMI on a steady uptrend and labour markets remaining tight, supporting wages growth, together support a graduated acceleration in domestic output into 2025. Policy inertia, a supportive growth environment and twin surpluses underline a constructive NOK backdrop.

AUD – Shifting to Neutral, But Will Be More Patient Than the Fed

AUD/USD – Q2 2024: 0.66 | Q3 2024: 0.66

The March RBA decision (which was overshadowed by the BoJ) also triggered a dovish reaction in AUD. The main focus was a shift in language on further rate hikes. The February phrasing "a further increase in interest rates cannot be ruled out" was moderated to "the Board is not ruling anything in or out," which the market interpreted as more neutral.

Neither we nor the market expected the next RBA move to be a hike, but the change in message surprised us. In our view, the shift indicated the RBA Board is no longer restraining expectations for cuts. Still, the RBA will stay patient. 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 don't expect unemployment rise to this level until Q3 at the earliest.

The May 6th RBA meeting will overlook the February jobs print surprise (which we suspect was distorted by seasonal shifts). March jobs (April 18th) and Q1 CPI (April 24th) will be more important. We think ongoing labour market resilience means the RBA will ease after the Fed. That suggests AUD/USD will remain stable (near our Q2 forecast of 0.66), despite US-Australia data divergence.

NZD – RBNZ Will Further Acknowledge the Slowdown, but Will Stay Patient

NZD/USD – Q2 2024: 0.61 | Q3 2024: 0.61

The Feb 28th RBNZ decision proved more dovish than we and consensus had anticipated. Similar to our RBA view, we did not expect the RBNZ to hike further, but we had assumed that Governor Orr would use the February MPS to drive home a hawkish message and maintain "optionality" for hikes to manage expectations for easing.

We expect the April 10th RBNZ decision to further acknowledge the slowdown in demand – the Q4 GDP release indicated New Zealand entered a "technical recession, with a -0.1% q/q decline in Q4 following the Q3 decline of -0.3%. Even so, we think the RBNZ will continue to emphasize a data-dependent stance in April.

Recent USD strength against peers (AUD and CNH in particular) lead us to revise our Q2 NZD/USD of forecast to 0.61 (from 0.63 previously). Overall, however the kiwi should remain relatively steady, and we still expect the RBNZ to only begin cuts after the Fed in Q4 (October 9th at the earliest), with strong immigration growth helping to offset the slowdown in per capita consumption demand.

ZAR – Investor Retreat

USD/ZAR – Q2 2024: 19.15 | Q3 2024: 18.85

The central bank (SARB) left policy on hold at 8.25%, as expected, at their March policy meeting. The committee agreed, by unanimous vote, to hold rates at a 15-year high for a fifth straight meeting. The decision was perceived to be a hawkish hold as the committee now anticipates that it will take longer than expected to return CPI to the mid-point of its 3-6% target range. Given that the SARB does not expect policy to reach the mid-point of the target range (4.5%) until the end of 2025, policy normalization is likely to be pushed closer to year-end, or even into early 2025.

The central bank can justifiably argue that inflation dynamics warrant an extended period of policy inertia. That being said, we can expect the central bank to face external criticism, as real rates remain restrictive as the 29 May election comes into view. The recent budget detailed a degree of fiscal restraint. However, the looming political challenge being faced by the ANC, risks a degree of fiscal backsliding. A looser fiscal backdrop risks monetary policy staying tighter for longer. The combination of latent political risk and fiscal uncertainty supports the unwind of real money ZAR longs. After running a positive ZAR positioning skew for nearly six months domestic risk factors have resulted in investors unwinding ZAR holdings at the fastest pace in 12 months. Risk uncertainties favour near-term ZAR underperformance, at least until there is a degree of political clarity.

LATAM FX

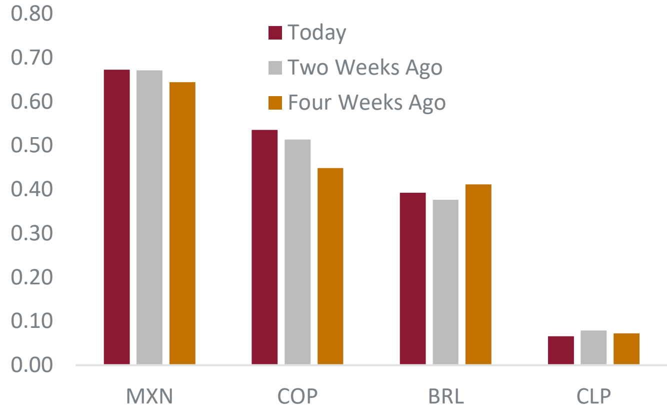
MXN – Despite 25bps Rate Cut, Cautious Forward Guidance Prevails

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

The MXN's attractive carry continued to drive the peso's strength and its outperformance against regional peers (ex-COP) and G10 currencies over the last month as the Fed continues to signal a pivot toward looser monetary policy this year. On the local front, despite cutting the overnight rate by 25bps in March, Banxico did not commit to a continuous easing cycle just yet. The market expects the overnight rate to land at ~9.80% by the end of the year, well above our 9.25% forecast. However, we do not anticipate this stance to last, as the steady decline in 1Y inflation expectations, the deceleration in recent growth metrics, and the still large Mexico-US interest rate differential, provide Banxico enough room to cut rates by another 25bps in May.

Hence, although revising our USD/MXN forecasts lower, we maintain our upward USD/MXN bias for the remainder of the 2024 with our Q2, Q3, and Q4 estimates at 17.50, 18.00, and 17.50, respectively. Recall that although the continuous upward trend in net long positions have mimicked the upward move seen in MXN's vol adjusted carry, net long speculative positions are more than 2 standard deviations above its 3Y average. This suggests increasing risks of sharp USD/MXN moves higher as Banxico begins its easing cycle ahead of the Fed, and political noise increases as we approach the US and Mexico's presidential election cycles.

Chart: 3M Vol Adjusted Carry*



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

BRL – BCB opts for Greater Flexibility Beyond May's Rate Decision

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

The Banco Central do Brasil (BCB) cut the Selic rate by 50bps for the sixth consecutive time, aligning with both market expectations and our forecast. Moreover, the BCB adjusted its forward guidance to "due to heightened uncertainty and the need for more flexibility in the conduct of monetary policy, the Committee anticipate a reduction of the same magnitude in the next meeting", shifting from the previous "the committee unanimously anticipates further reductions of the same magnitude in the next meetings". This alteration grants the BCB some room to adjust the magnitude of rate cuts beyond May, hinting 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 potential 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 – Erratic BCCh Forward Guidance Continues to Penalize the CLP

USD/CLP – Q2 2024: 930 | Q3 2024: 900

In reference to the headline inflation surprising to the upside in February, BCCh's president Rossana Costa highlighted the recent change in methodology, dismissing the latest inflation print. Moreover, Costa stated that Chile's interest rate should converge toward neutral level in line with the January rate announcement. The market does not expect the overnight rate to reach 4% (its neutral level) over the next two years.

Either the market has become too cautious, or the CB is once again failing to provide a clear route for its monetary policy. Both situations are bad for the CLP. Moreover, as the market pushes USD/CLP closer to the psychological 1000 level, we see increasing risks of a slower pace of rate cuts and/or central bank intervention in the FX market (refer to our Exploring the BCCh's FX Intervention Strategies note published in the March 8th FX Weekly). We maintain our preference for selling USD/CLP on spikes above 990 and our Q2 USD/CLP forecast at 930.

COP – Timid Rate Cut Cycle Continues

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

Banrep cut the overnight rate by 50bps to 12.25%, in line with our forecast and market expectations. The vote was not unanimous with 1 out of the 7 members voting to cut rates by 75bps, and another favouring a 100bps rate cut. Banrep did not commit to accelerate the pace of rate cuts in the next meeting, but the statement and press conference had some dovish tints. The Bank inflation forecast was revised lower to 5.4% (vs. 5.9% previously), while it expects inflation to return back to the target range 2-4% by mid-2025. We expect a 75 bps rate cut at the end of April and maintain our upward bias towards 3920 in the short term.

Notably, the Ministry of Finance, Ricardo Bonilla, stated that he would prefer to see USD/COP at around 4000 in the short term. Nevertheless, we would take Bonilla's comment with a grain of salt, as he was the board member that voted for a 100bps rate cut. Overall, we continue to expect USD/COP to move upward for the remainder of the year, but would not anticipate Bonilla's comment to cause too much damage to the COP in the immediate term, especially as the statement was in line with market expectations. However, with Banrep yet to officially commit to an acceleration of its easing cycle, and the COP's high carry prevailing into Q2, we have adjusted our Q2, and Q3 USD/COP forecasts to 4000 (4300 prev.), and 4100 (4300 prev.), respectively.

Asia FX

CNH – Gradually Shifting the FX Goal Posts

USD/CNH – Q2 2024: 7.30 | Q3 2024: 7.25

The PBoC surprised markets in late March by letting USD/CNY onshore spot rise above the key 7.20 level to new YTD highs. We think Chinese official's newfound tolerance for yuan weakness is driven by two factors: (i) the "national team" has successfully stabilized its equity markets and (ii) policymakers are placing greater reliance on tech manufacturing and exports to offset property weakness.

On (i) the equity side, mainland indices have risen 10-15% above the February lows, and relative quiet in stock markets has made investors less pessimistic. As such, the PBoC is less concerned with equity sentiment spillover from yuan weakness. For (ii) tech exports, recent KRW, TWD and JPY weakness means that the yuan's prior 7.20 "peg" against the dollar made Chinese exports less competitive amid ongoing tech supply chain realignment.

As such, the PBoC saw a window for limited yuan weakness after post-BoJ (and post-FOMC) Asian FX weakness. However, we think the yuan will continue to be managed. USD/CNY fixes continue to be stable, despite the move higher in onshore spot. For April we think the PBoC's yuan barriers are 7.25 (in CNY) and 7.30 (in CNH), and we raise our Q2 USD/CNH forecast to 7.30 accordingly.

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