CIBC FICC Strategy and Economics

FX MONTHLY

October 2024

Entering a Lower Range in the USD

Key points

- USD: We expect that a continued softening in the US labour market will leave the Fed on track to end its easing cycle about one quarter faster than the market is currently pricing. This convergence in the spread between US and global front end yields should leave the USD vulnerable to a repricing in the quarters to come. Indeed, we expect that over the medium/long term the DXY will return to roughly it's pre-pandemic range of 90-100.
- CAD: After the mid-July to August volatility, it looks like USD/CAD is returning to a low volatility range; but this time in the 1.34-1.36 range. We're expecting USD/CAD to gently depreciate in the coming quarters as yields converge and the USD comes off slightly overvalued levels.
- EUR: A weak growth backdrop and still somewhat sticky service prices have gyrated near term ECB pricing. While the October meeting is currently nearly fully priced for a cut, we are sticking with the call for a skip given still elevated wages and service prices. We're expecting EUR/USD to rally over the coming quarters on a faster than priced convergence in EU/US rate spreads.
- GBP: The UK stood out among developed markets by maintaining a relatively strong growth trend through H1 2024. Moving forwards, the prospect of a return to annual trend growth in 2025, allied to a modest pace of policy easing, certainly compared to the Fed, validates positive UK sentiment into next year. Although we remain wary of extrapolating recent Q3 highs we would look to test early 2022 highs in GBP/USD above 1.36 in upcoming month.
- JPY: A dovish September BoJ meeting and the surprise results of the LDP leadership election have caused USD/JPY volatility in recent weeks. However, moving forwards we would expect a steady but moderate pace of depreciation towards 137 in Q4 on Fed-BoJ divergence.
- AUD and NZD: While domestic data in both Australia and New Zealand have eased lately, the announcement of a significant China stimulus plan has been a tailwind for both currencies. We expect that continued positive China sentiment, a correction in what we view as overly dovish RBNZ and RBA expectations, and a more dovish than priced Fed will lead to rallies in AUD and NZD against the USD in Q4 2024.
- MXN: Ongoing concerns related to the pipeline of reforms coming up in the next weeks/months, slower growth, a high fiscal deficit, and Banxico's steady easing cycle will continue to weigh on the MXN into the end of the year. We do not rule out a retest of the 20.21 on any negative credit rating action, but recognize that such large spikes are likely to be short lived as the MXN's still high carry comes back into play.

FX Forecasts

End of period:	Oct 1, 2024	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
USD / CAD	1.35	1.35	1.34	1.33	1.32	1.32
EUR / USD	1.11	1.12	1.13	1.13	1.13	1.13
USD / JPY	144	137	135	133	131	129
GBP / USD	1.33	1.34	1.36	1.36	1.36	1.36
USD / CHF	0.85	0.88	0.89	0.90	0.90	0.91
USD / SEK	10.24	10.09	9.82	9.69	9.60	9.51
AUD / USD	0.69	0.70	0.71	0.71	0.72	0.72
NZD / USD	0.63	0.64	0.65	0.65	0.66	0.66
USD / NOK	10.58	10.31	9.96	9.73	9.65	9.56
USD / ZAR	17.35	17.15	16.95	16.80	16.66	16.50
USD / BRL	5.46	5.40	5.20	5.20	5.00	5.00
USD / MXN	19.72	19.50	19.20	18.80	18.50	18.50
USD / COP	4220	4200	4100	4100	4000	4000
USD / CLP	899	880	860	820	840	840
USD / CNH	7.03	6.90	6.85	6.80	6.80	6.80

CAD Crosses

End of period:	Oct 1, 2024	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
CAD / JPY	107	101	101	100	99	98
CAD / CHF	0.63	0.65	0.66	0.68	0.68	0.69
AUD / CAD	0.93	0.95	0.94	0.94	0.94	0.95
GBP / CAD	1.79	1.81	1.82	1.81	1.80	1.80
EUR / CAD	1.49	1.51	1.51	1.50	1.49	1.49

EUR Crosses

End of period:	Oct 1, 2024	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
EUR / JPY	159	153	153	150	148	146
EUR / GBP	0.83	0.84	0.83	0.83	0.83	0.83
EUR / CHF	0.94	0.99	1.01	1.02	1.02	1.03
EUR / SEK	11.35	11.30	11.10	10.95	10.85	10.75
EUR / NOK	11.72	11.55	11.25	10.99	10.90	10.80

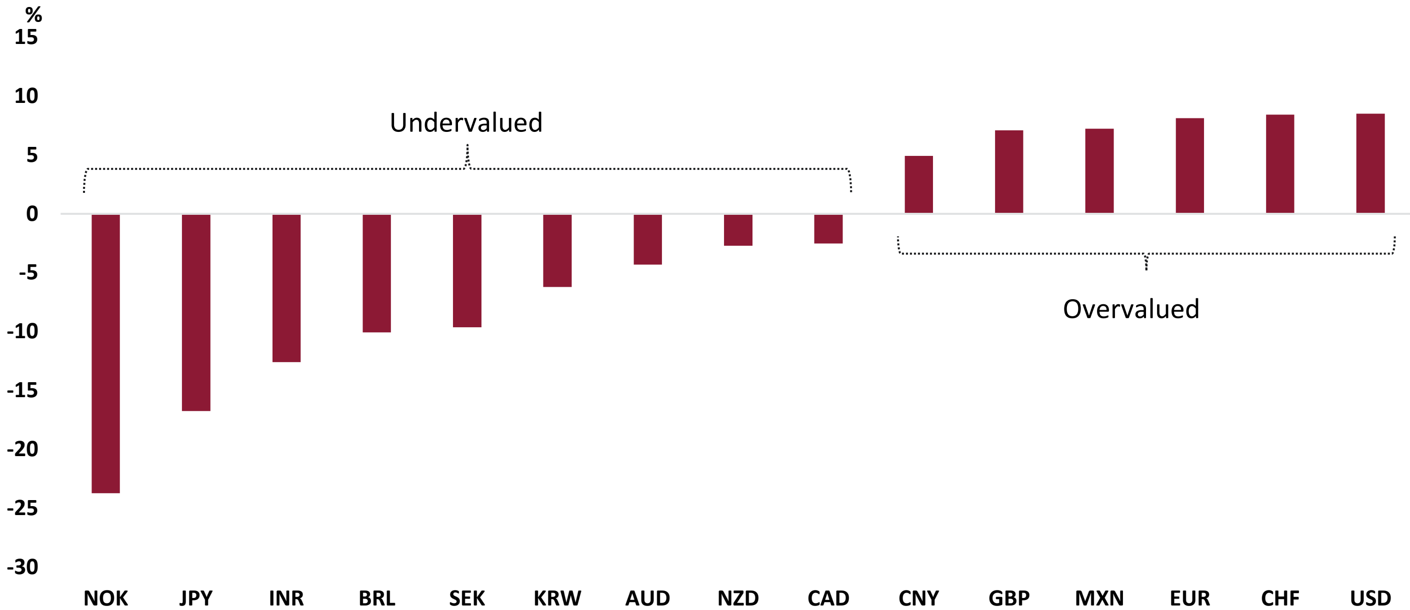
Central Bank Forecasts

	Current	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
Fed	4.88	4.13	3.63	3.38	3.38	3.38
BoC	4.25	3.50	2.75	2.25	2.25	2.25
ECB	3.50	3.25	2.75	2.25	2.00	2.00
BoE	5.00	4.75	4.25	3.75	3.50	3.50
SNB	1.00	0.75	0.50	0.50	0.50	0.50
BoJ	0.25	0.25	0.50	0.50	0.50	0.50
RBA	4.35	4.35	4.10	3.85	3.60	3.60
RBNZ	5.25	4.50	4.25	4.00	3.75	3.50
Banxico	10.50	10.00	9.50	9.00	8.50	7.75
BCB	10.75	11.25	11.75	12.25	12.50	12.50
BCCh	5.50	5.00	4.50	4.50	4.50	4.50
Banrep	10.25	8.75	8.00	7.50	7.25	7.25

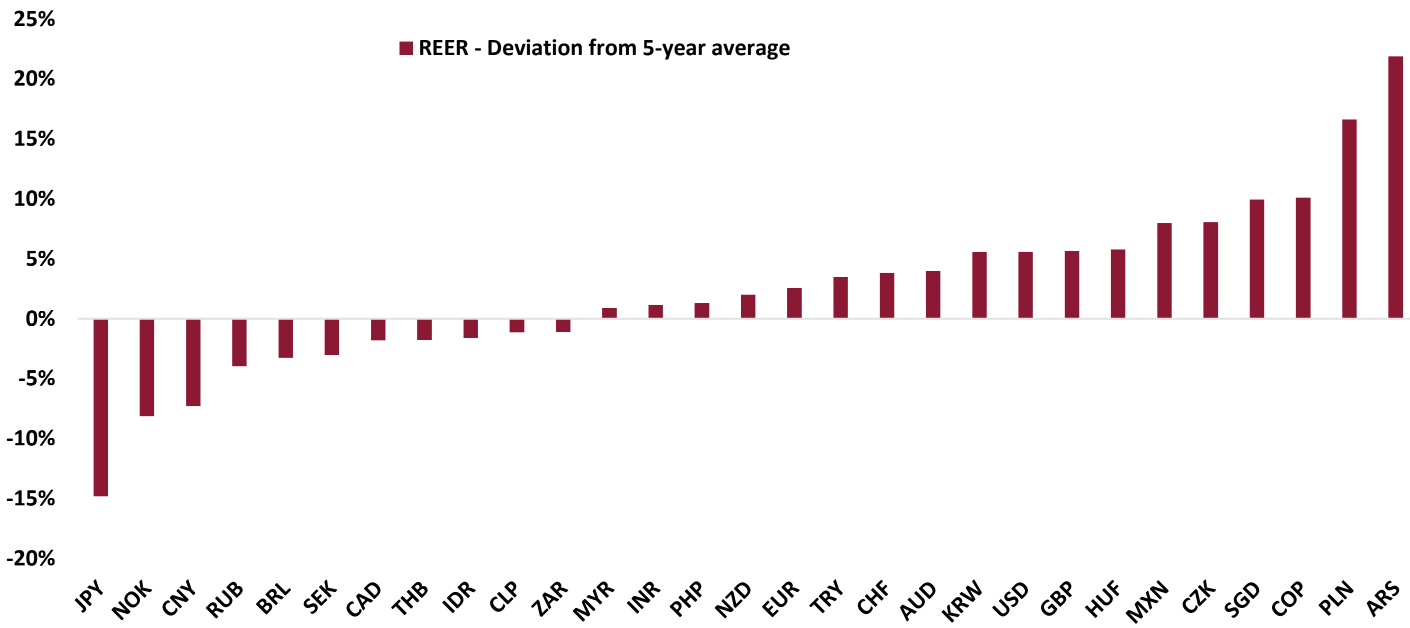
Market Pricing

	Current	Next Meeting	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
BoC	4.25%	Oct 23	3.55%	3.01%	2.65%	2.53%	2.47%
Fed	4.88%	Nov 7	4.11%	3.51%	3.14%	2.96%	2.93%
ECB	3.50%	Oct 17	2.86%	2.28%	1.88%	1.70%	1.67%
BoE	5.00%	Nov 7	4.56%	4.11%	3.74%	3.52%	3.40%
RBA	4.35%	Nov 4	4.17%	3.77%	3.46%	3.31%	3.31%
RBNZ	5.25%	Oct 8	4.32%	3.54%	3.29%	2.85%	2.81%
SNB	1.00%	Dec 12	0.64%	0.46%	0.34%	0.30%	0.28%

Long-Term Fair Value Model - BEER



Long-Term Fair Value Model – REER Reversion



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

**CIBC's REER reversion model looks at the deviation of a real effective exchange rate index from its long-term average. It is reported with a 1M lag.

United States

Sarah Ying and Noah Buffam

USD – Entering a Lower Range for the USD

DXY – Q4 2024: 99.85 **|** Q1 2025: 98.83

At its September meeting, Powell surprised most analyst expectations by starting the easing cycle with an outsized 50bps cut. One thing that Powell made clear was that the size and pace of upcoming rate cuts will be data dependent, and the market should not assume that the default size will be 50bps moving forward. At his post meeting press conference in September, Powell did mention that this outsized rate cut may have made up for not easing in July. Recall during the Fed's July decision (hold), Powell did not have the July nonfarm payrolls number on hand (July NFP 114k vs. expectations 175k) which came out the days after.

At the time of writing, there is a high amount of uncertainty in the market as to whether the next Fed move would be a 25 or a 50. By now the inflation story is largely on autopilot with forward looking inflation well anchored at 2%. Market attention has now shifted to nonfarm payrolls, as the Fed pays closer attention to the labor market. Current market pricing wavers around 35% in favor of an outsized cut in November. There are still two non-farm payroll numbers to go before the November meeting – which means there is ample scope for the market to reprice. We do suspect however, that there is room for the Fed to go larger in November. Consider that the breakeven level of employment in the US (the number of jobs required to keep the unemployment rate from rising) is estimated to range from 150k – 200k. We think this is a high threshold in an environment where the US labor market is cooling: consider we have not seen above-breakeven employment in over three consecutive months. The forward looking trajectory is also tepid with analyst expectations for the September jobs report coming in at 130k. For this reason, we are looking for another 50bps cut from the Fed in November.

We believe the start of the US easing cycle introduces a thematic shift in FX markets: that USD strength enjoyed for the better part of the post pandemic period is coming to a close. We believe in an overarching shift to a weaker USD in the quarters to come, with the DXY gradually moving back into its pre-pandemic range of 90-100. We are forecasting the US easing cycle to end by Q2 2025, roughly a quarter sooner than the market. If we are correct, we could see USD depreciation occur at a faster pace than currently expected.

Near term, we expect some volatility into the upcoming FOMC meeting, given a considerable number of event risks in early November (November 1: last NFP before Fed, November 5: US elections, November 7: FOMC meeting). We suspect that the major macro events sandwiched around the election will dampen near-term election-related volatility. Depending on the results of the election, and Fed guidance after the November FOMC, there could be conflicting forces on the USD near term that keeps it in a range.

Canada

Avery Shenfeld and Katherine Judge

CAD – Low Vol CAD Sees Slow Drift

USD/CAD – Q4 2024: 1.35 **|** Q1 2025: 1.34

Neither rain, nor snow, nor weak oil prices and negative rate differentials are causing the Canadian dollar to stray too far from its sideways path, and we expect more of the same over the upcoming quarters. At this point, with the Fed also on board with significant rate cuts, and like the Bank of Canada, still early in that process, markets aren't going to be as sensitive to which central bank's turn is next, and whether an individual move was 50 or 25 basis points. In any event, our end point for overnight rates in Canada (2.25%) and the US (3.38%) doesn't materially change interest differentials from where they've been of late. Oil prices are likely to recover some lost ground next year as rate cuts reduce global recession risks, but not to levels where we would expect a huge lift to Canadian growth from energy sector capital spending. Meanwhile, the US is itself now a significant oil producer, so the differences versus Canada in a rising oil environment aren't what they once were.

That leaves Canada as a low-beta follower of the overall direction of other major currencies versus the greenback. We look for a modestly stronger loonie in 2025 as the US dollar sheds some of what it gained by being a carry recipient. US fiscal and trade policies could alter that view post the US election, but at this point, there's too much uncertainty about who will take the White House, the make-up of Congress, or which Presidential campaign pledges would actually see the light of day, to factor that in to any significant degree.

Europe

Jeremy Stretch

EUR – Balancing Recession Risks

EUR/USD – Q4 2024: 1.12 **|** Q1 2025: 1.13

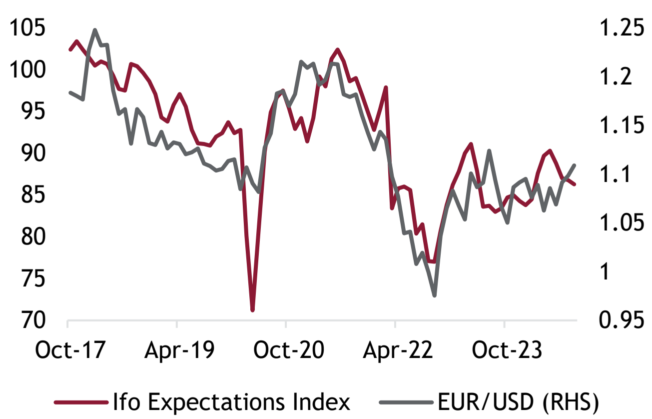
EUR/USD has traded to a fresh 2024 highs above 1.12 despite burgeoning Eurozone recession risks, centred around German manufacturing. Despite the ECB sanctioning a second cut in this cycle we expect the central bank to be reticent to accelerate the pace of policy easing, at least this side of year-end amidst ongoing inflation persistence concerns, centred around elevated wage growth, and/or service prices.

Given the broad range of ECB Governing Council viewpoints, we currently expect the bank to look at a graduated path of policy easing, namely quarterly moves in line with forecast updates, hence we expect an October ECB skip with the next 25bps adjustment, coming in December. However, as eurozone manufacturing continues to be impacted by Chinese growth concerns, recent stimulus measures notwithstanding, we have seen the amplification in October rate cut pricing. We would expect ongoing source stories from both sides of the policy agenda as the two factions, hawks and doves attempt to seize the policy initiative.

ECB staff GDP forecasts were moderately downgraded for both this year and next (by 0.1%) in the September forecasting round. Although headline 2025 HICP assumptions were maintained at 2.2%, the modest uptick in core price pressures suggests that the hawks are unlikely to be easily persuaded to accelerate the pace of adjustment, from the current quarterly profile. We anticipate that linear rate cuts, namely back-to-back eases, are likely to be a story for 2025. The ECB are clearly mindful of currently elevated domestic wages, the sub-text being that in order for the bank to up the pace of easing, the hawks will require confidence that wage pressures have materially dissipated.

While German manufacturing looks set to remain compromised into 2025, rising real wages should continue to sustain services activity and consumption. However, EUR performance is likely to prove a function of interest rate spreads as much as regional economic performance. Given that the ECB is likely to be less activist than the Fed, at least in Q4, supports near term EUR resilience, almost irrespective of recession fears. The EUR has gained more than 5% versus USD since early April lows. An elevated correlation with front end (2-year UST-Bund) spreads suggests a contrast between Fed activism vs ECB gradualism. The result is likely EUR resilience almost irrespective of immediate recession fears.

Chart: Eurozone Sentiment is Weakening as Recession Risks Rise



Source: LSEG Datastream, CIBC Capital Markets

GBP – BoE to Remain Patient

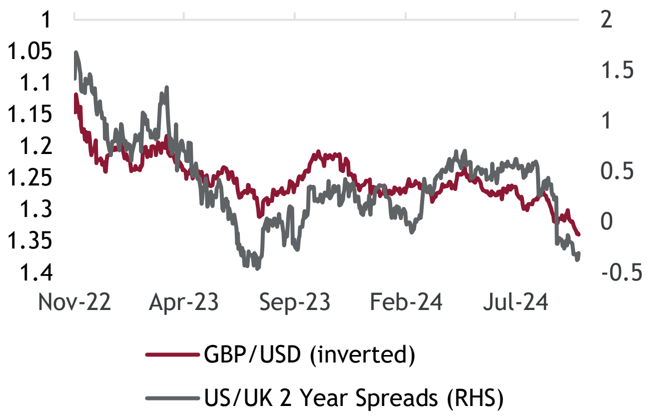
GBP/USD – Q4 2024: 1.34 **|** Q1 2025: 1.36

After witnessing a shallow H2 2023 recession, underlying UK macro activity has largely confounded expectations through 2024. However, after consecutive quarters of above trend GDP in Q1/Q2 (0.7/0.6% respectively) we anticipate activity easing back towards trend levels, around 0.3% per quarter, through H2. Having witnessed the BoE ease rates for the first time since March 2020, via a 5:4 split decision in August (Governor Bailey had to cast the deciding vote), we anticipate that the bank will maintain a gradualist approach to monetary easing. Given ongoing inflation persistence concerns, largely centered on service price stickiness and still elevated wages, we would expect the perpetuation of a steady pace of easing. Indeed given that the BoE assumes CPI rebounding back to 2.5% in Q4, the anticipated November cut, in line with the next round of MPC forecasts, is likely to be followed by a December skip, that is absent a material correction in price pressures or broad macro activity levels.

The transition to a Labour government post the 4 July election washed away immediate political risks. However, the prospect of a substantive fiscal tightening into the 30 October budget (the new Chancellor has detailed an unexpected £22bn budget shortfall in the current fiscal year) underlines why September GfK consumer sentiment witnessed the fastest monthly correction since April 2022. Sliding consumer sentiment coincides with a material correction in services PMI.

Despite looming macro headwinds real money GBP longs remain well above the one year moving average. Although quarterly growth may moderate, positive base effects underline an upward bias to annual GDP estimates; indeed the OECD have recently upgraded 2024 UK growth forecasts by the most across the G7. The prospect of a return to annual trend growth in 2025, allied to a modest pace of policy easing, certainly compared to the Fed, validates positive UK sentiment into next year. Although we remain wary of extrapolating recent Q3 highs we would look to test early 2022 highs above 1.36 in upcoming month.

Chart: GBP has Rallied Amid a Relatively Hawkish BoE



Source: LSEG Datastream, CIBC Capital Markets

CHF – Not Three and Done

EUR/CHF – Q4 2024: 0.99 **|** Q1 2025: 1.01

The last meeting under the stewardship of Thomas Jordan resulted in the SNB cutting rates for the third time in this cycle, (by the expected 25bps) taking the policy rate down to 1.0%. We went into the decision with 33.5bps priced, hence the market was mindful of a jumbo cut in the wake of a run of low CPI numbers, the last print came in at 1.1%. However, we would note that SNB inflation target is 0-2%; hence it has more flexibility than some of its global counterparts.

Contingent to the 25bps policy rate reduction proved to be a further downgrade in price expectations, in part due to the impact of a stronger CHF. The 2025 CPI profile proved to be materially revised for 2025 in particular; an annual projection of 1.1% in June has been trimmed to 0.6%. Prices are now expected to be 0.7% in 2026, below the mid-point of the target range, this compares with 1.0% previously. Despite the further moderation in the CPI profile the bank remains cognisant of inflation being driven by higher prices for domestic services. Although CPI expectations have continued to be pared, (partly due the currency) the SNB left the language regarding the CHF unchanged, namely the bank “remains willing to be active in the foreign exchange market as necessary”. However, we would note that the bank was happy to leave the prospect of intervention on the table. There had been suspicions that the bank could have chosen to harden the language on the CHF, there had been some suspicions of the reinstitution of references to the currency being overvalued. The failure to adjust the language, alongside a mere 25bps adjustment, could be deemed to be slightly more hawkish than expected.

The SNB detailed that “further cuts may become necessary in coming quarters.” This supports the notion that until the downtrend in the CPI profile is arrested we can expect a dovish backdrop. The downgrade in the CPI profile supports a further 25bps cut in December and an additional 25bps in Q1. The new lower SNB profile will prove contingent with a graduated depreciation in the CHF. A cheaper currency will boost growth dynamics while limiting underlying disinflationary tendencies.

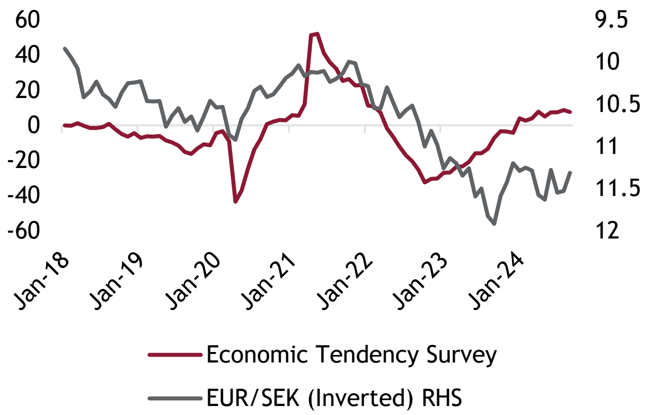
SEK – Looking to Test 2024 Lows?

EUR/SEK – Q4 2024: 11.30 | Q1 2025: 11.10

A third 25bps ease by the Riksbank at their September meeting, taking the policy rate to 3.25%, underlines a continued easing bias. The ongoing downtrend in underlying inflation (CPIF), supports not only recent cuts but also further prospective easing into both year end and into early 2025. Previously central bank Governor Thedeen had suggested that the policy rate was likely to end the year at 2.75%. Given the fact that underlying inflation, CPIF came in both below expectations and/or the central bank's target at 1.2% in July, (compared to a 9.3% peak in February 2023) points towards further policy easing; the prospect of 2.50% cannot be discounted. Moreover, given the fact that the Riksbank has again revised down their inflation profile and or implied rate path, we must take seriously the central banks latest policy statement that a 50bps adjustment is possible at one of two final meetings of the year.

In terms of the potential rate path we would note that the central bank now assumes rates at 2.61% in Q1 2025, this compares with 3.08% previously. Moreover, end 2025 expectation have been cut from 2.64% to 2.25%. Lower 2025 CPIF assumptions are contingent to the lower rate path, core prices are now expected to be 1.6% which is two ticks lower than previously expected. We would note that inflation is only expected to return to target in 2027. A prolonged period of disinflationary dynamics supports the notion of loose monetary policy into next year. However, an extension in policy easing, supporting consumer demand, will combine with stronger global growth dynamics to encourage impetus in the cyclically correlated SEK. Consequently we remain mindful of a test of 2024 lows (11.0873) in upcoming months.

Chart: Swedish Sentiment has Picked up Amid the Riksbank Easing Cycle



Source: LSEG Datastream, CIBC Capital Markets

NOK – Norges to Remain Restrictive

EUR/NOK – Q4 2024: 11.55 | Q1 2025: 11.25

Unsurprisingly the Norges Bank held rates at 4.50% for a sixth straight policy meeting in September. Having only completed their tightening in December 2023, the bank hiked the deposit rate from 0 in September 2021 to 4.50%, a protracted period of policy patience can be expected, we would view it appropriate for an ultra-restrictive stance to remain in place for at least 12 months. Key to the current Norges Bank policy assessment is the judgement that policy still needs to remain restrictive in order to bring prices back to target. Governor Bache remains wary of inflation remaining above target for too long; core prices have been above target since January 2022. Although underlying price dynamics remain on a downward trajectory, (they eased to 3.2% in July, from a 7.0% peak) the implication is that the central bank remains concerned regarding the risks of de-anchoring inflation expectations.

The Norges bank continue to push back against the notion of a cut before year end, currently 15bps are priced. The central bank cite elevated business costs and weaker NOK (the currency has depreciated by more than 2.5% versus the EUR across Q3) as supporting prospect policy inertia into 2025. However, the latest MPR detailed a lower policy path, implying at least 75bps of easing by mid-2025, the market is currently pricing in more than 100bps. Immediate central bank policy reticence, especially compared to peers, comes despite the central bank having modestly trimmed 2025 growth assumptions. Tight labour markets, allied to domestic credit growth remaining on an upward trajectory suggests that a delayed, but graduated pace of policy easing will support NOK gains. Consequently, we anticipate EUR/NOK trading through the 200Day MAV, currently 11.57, in Q4.

Asia-Pacific

Maximillian Lin

JPY – Political Headlines Keep the BoJ in Focus

USD/JPY – Q4 2024: 137 **|** Q1 2025: 135

The September 20th BoJ decision surprised on the dovish side. Although the statement was relatively upbeat, Governor Ueda's press conference commentary on inflation ran counter to the statement's hawkish optimism. Most notably, Ueda noted that upside risks to inflation had receded since the July meeting. He elaborated that the change in upside risks "was due to yen weakness fading." The yen weakened 1.2% in reaction to Ueda's comments, and in the wake of the BoJ press conference, the market began pricing less than 10 bps of rate increases in Q4.

Just one week later the surprise LDP leadership election threw focus back onto the risk of faster BoJ hikes. On September 27th, former Defense Minister Shigeru Ishiba managed to surprise markets by defeating the presumptive favorite, Economic Security Minister Sanae Takaichi, for LDP president. Ishiba, the new party leader (and likely next prime minister), is widely considered to be both a fiscal and monetary hawk. By contrast, Takaichi favoured a continuation of dovish BoJ policies. As the yen strengthened in reaction to the LDP election results, Nikkei futures also fell by 6%.

We think the FX market may be over-reacting to the near-term implications of the LDP leader onto BoJ policy. It is important to remember that the BoJ will likely avoid rate hikes "while markets are unstable," a point previously emphasized by BoJ Deputy Governor Uchida. We think Japanese economic confidence is linked to domestic equity sentiment. Any further Nikkei weakness from fears of political pressure on the BoJ or hawkish fiscal policies (such as a consumption tax hike) should moderate expectations for an October BoJ hike. A December hike is possible, but we think March 2025 is more likely.

We expect the yen to strengthen to 137 by end Q4, but if USD/JPY falls too rapidly amid an aggressive Fed cutting cycle, it will also feed back into Nikkei levels and potentially weaken Japan's consumption outlook. Therefore, although BoJ-Fed divergence will continue to be a popular narrative, investors should be mindful that there is risk of dovish spillover from the US into Japan – from domestic equity sentiment as well as from the USD/JPY impact on imported CPI.

AUD – Less Hawkish RBA Versus Stronger External Tailwinds

AUD/USD – Q4 2024: 0.70 **|** Q1 2025: 0.71

The RBA subtly shifted to a more neutral stance in September. At the press conference Governor Bullock noted that the board "didn't explicitly consider a rate rise this time," in contrast to prior meetings where she usually noted that a rate hike was discussed. The RBA statement also noted that "wage pressures were easing." Although the RBA statement continues to note that "the board is not ruling anything in or out," the meaning of this outlook has shifted to two-way risks to policy rates, rather than a warning of impending hikes.

Australia monthly CPI for August showed headline price growth fell to 2.7% y/y, (vs 3.0% prior), well into the RBA's 2-3% target band. However in the August SOMP the RBA already noted that short-term decreases in CPI were expected due to the government's cost of living relief measures. Therefore, there will be no rush to cut rates, and we do not expect an RBA rate cut until February 2025. The September statement also noted that CPI (excluding the cost-of-living relief) won't return to target range until 2026. There is still some risk that rate cut timing is pushed back later into 2025.

Recent China stimulus headlines have resulted in stronger AUD. Although the RBA's relative hawkishness has been due to the resilience of Australia's services sector, FX markets still view the Aussie as a proxy for China risk sentiment. Because of the risk of additional China growth headlines, we think there is scope for AUD/USD to rise to 0.71 in Q4.

Amid the China headlines the Kiwi outperformed the Aussie. Although AUD/NZD has fallen from late July highs of 1.11, long AUD/NZD remains a popular trade due to the underlying narrative of a hawkish RBA vs a dovish RBNZ, and we think the cross will struggle to rally further. We think AUD/NZD will peak at 1.0950; further, large Fed cuts will benefit NZD more than AUD.

NZD – Dovishness Is Already Priced

NZD/USD – Q4 2024: 0.64 **|** Q1 2025: 0.65

The RBNZ's dovish outlook was made clear at the August meeting, where the central bank kicked off its easing cycle with a 25 bps reduction (to 5.25%). During the press conference, RBNZ Governor Orr noted the MPC actually debated between a larger 50 bps cut vs a standard 25 bps move. Orr also noted that there was "consensus" within the MPC on the decision to ease, and that 25 bps was "a reasonably low risk start" to the cutting cycle.

Given the “live debate” over a 50 bps move in August, and the fact that the Fed has already cut rates by 50 bps, we now think that 50 bps is the most likely scenario for the October 9th RBNZ meeting. The market is already pricing a dovish outlook for New Zealand, however. We therefore see little further downside in NZD/USD. NZD OIS pricing shows 40 bps of RBNZ cuts priced for October 9th, and cumulative 90 bps priced by November 27th. Given the RBNZ’s August MPS forecasted 50 bps of total cuts for Q4 (vs 90 bps priced) we think there is some scope for hawkish surprise in the coming months.

The China stimulus news has proven a boon for the kiwi, and we think a continuation of positive China headlines could result in kiwi strength. Even though the RBNZ proved more dovish than we expected in Q3 (we wrongly expected no change at the August 14th RBNZ decision), NZD/USD rose to 0.6350 by the end of September, outperforming our Q3 end forecast of 0.61. The larger Fed cut in September also boosted NZD. Because of expected USD weakness and China stimulus headlines, we forecast NZD/USD to rise to 0.64 in Q4.

CNH – Stronger Stimulus and Aggressive Messaging

USD/CNH – Q4 2024: 6.90 **|** Q1 2025: 6.85

China’s policymakers ended September with a surprisingly large package of pro-growth measures. The most notable of these were (i) new PBoC facilities totaling RMB 800bn to boost the equity market, (ii) a larger-than-usual (20 bps) broad policy rate cut, and (iii) a targeted ~50 bps reduction to existing mortgage rates. Together, these measures aim to kickstart China’s moribund domestic demand and weak confidence, which has been linked to three straight years of falling property prices.

The additional stimulus is much needed and very welcome. However we think it will take multiple quarters (or possibly years) of pro-growth policies to get the real economy on a sustainable footing. The US housing crisis serves as an example – after the 2008 crisis, the Fed was much more aggressive than the PBoC is now in easing policy. Even then, it was not until 2011-12 that monthly US hiring had achieved steady increases.

Unlike the US, China did not have a banking crisis, so arguably a Chinese recovery could be faster in comparison. However the US rebound benefitted from younger demographics (boosting consumption) and from American corporates undergoing fast bankruptcies and restructurings. In the China property space, restructuring has been slow.

That said, there is good news on the messaging front. Instead of the previous approach of incremental rate cuts and then a “wait and see” approach, authorities’ messaging strategy appears to have shifted to a steady drumbeat of pro-growth policy tweaks, which we think is aimed at sustaining equity market momentum. That should help paper over medium-term data weakness in the coming months. There will likely be an October data bounce (data released in November), but thereafter China data could stagnate (similar to the February 2024 one-off bounce). Therefore, further positive headlines will be needed in the months ahead.

For USD/CNH, there is further downside risk towards 6.90 in Q4 given the more aggressive pro-growth messaging from the government. The backdrop of Fed dovishness should also help strengthen the yuan. The CNY fix suggests that authorities are not yet concerned about yuan strength – although we think in the long run the PBoC wants a “competitive” yuan, in the short-term it will tolerate yuan strength because it is a signal of economic confidence (and correlates with China equities).

Emerging Markets

Latin America

Luis Hurtado

MXN – Local Risks and Banxico’s Easing Cycle Will Continue to Weigh on the MXN into Early Q4

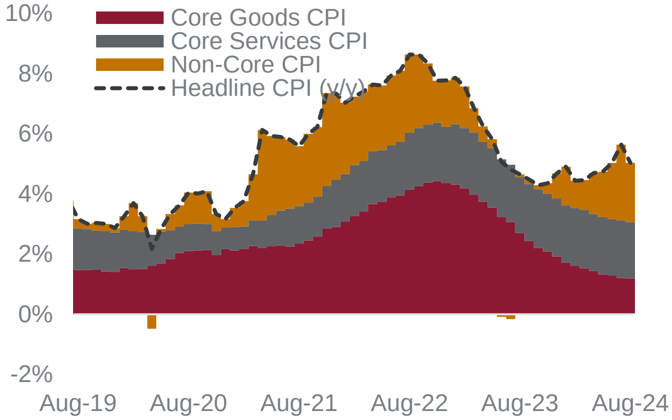
USD/MXN – Q4 2024: 19.50 **|** Q1 2025: 19.20

The overwhelming victory of the ruling alliance in congress has hit the markets from two different angles as, 1.) it allows the government to implement constitutional changes by convincing one member of the opposition parties in the Senate, and 2.) it eliminates/diminishes the counterweight currently offered by the Supreme Court, opening the door for the swift approval of other reforms in the pipeline (i.e. elimination of regulatory bodies, electricity reform, ban of GMO imports). Moreover, credit rating agencies have already warned about the negative implications of such move.

On the monetary policy front, Banxico cut the overnight rate by 25bps to 10.50% in line with our forecast and the consensus view. The CB's forward guidance hinted that the easing cycle will continue, but it showed no commitment to a specific magnitude or speed of rate cuts (market was pricing ~95bps in rate cuts for the remainder of 2024 before the meeting). It is clear that the deterioration of the economic outlook has gained relevance among the majority of the board and that this situation is unlikely to change for the remainder of 2024. Moreover, although recognizing the volatile environment for the MXN, board members have continuously reiterated the small FX passthrough to prices. This supports a continuous easing cycle throughout 2025, but, given still unanchored long-term inflation expectations and high core services CPI, only at a pace of 25bps in the short term. Our base case considers another 50bps in Q4 and 225bps in rate cuts throughout next year.

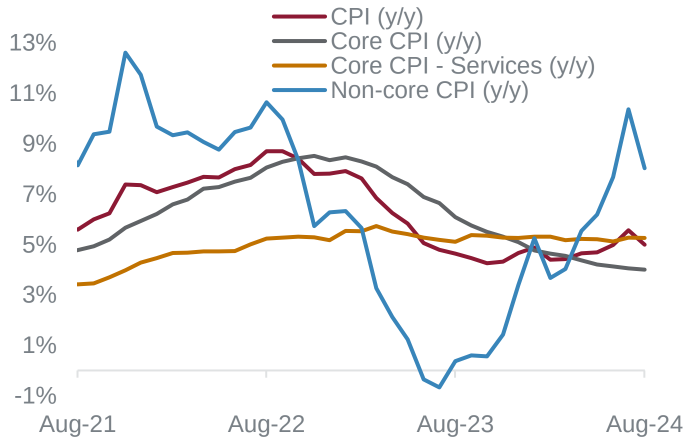
Looking at the currency, ongoing concerns related to the pipeline of reforms coming up in the next weeks/months, slower growth, a high fiscal deficit, and the continuation of Banxico's easing cycle will continue to weigh on the MXN into the end of the year. We do not rule out a retest of the 20.21 level on any negative credit rating action, but recognize that such large spikes are likely to be short lived as the MXN's still high carry comes back into play. We have revised our Q4 2024 and Q1 2025 USD/MXN forecasts upwards to 19.50 (18.50 prev.) and 19.20 (18.20 prev.), respectively.

Chart: Supply Shocks are Finally Dissipating Pushing Headline Inflation Lower



Source: Bloomberg, CIBC Capital Markets

Chart: Core Services CPI Remains Above 5.0%



Source: Bloomberg, CIBC Capital Markets

BRL – BCB Turns More Hawkish But Fiscal Risks Prevent a Sustained BRL Rally

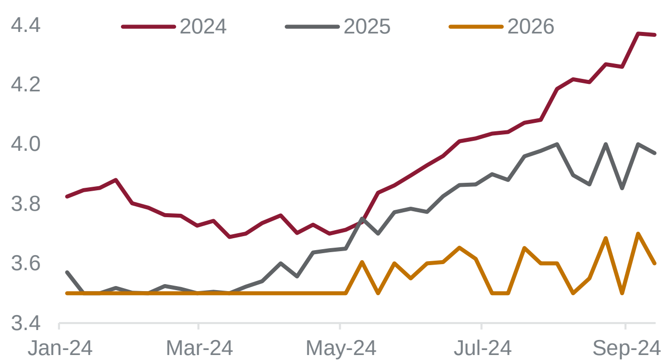
USD/BRL – Q2 2024: 5.50 | Q3 2024: 5.20

The Banco Central do Brasil (BCB) increased the Selic rate by 25bps to 10.75%, in line with the consensus call and our forecast. The statement portrayed a marked hawkish tone with the Bank highlighting the higher-than-expected growth (positive output gap), tight labor markets, the depreciation of the real, and the de-anchoring of inflation expectations (see charts below). Moreover, it revised its inflation forecasts to 4.3% (4.2% prev.) for 2024, 3.7% (3.6% prev.) for 2025, and 3.5% (3.4% prev.) for Q1 2026. Going forward, we expect the BCB to carefully balance the upside risks to its inflation outlook and any negative market repercussions arising from recurrent discrepancies with the government. Thus, we expect the CB to extend its tightening cycle until the end of H1 2025, bringing the Selic rate to 12.00%-12.25% instead of frontloading the rate increases in Q4 2024 and Q1 2025.

Nonetheless, fiscal uncertainties continued to weigh on the BRL. Note that the government reduced the spending freeze implemented in July from BRL15bln to BRL13bln, missing the additional BRL5-10bln freeze expected by the market. Moreover, expenses exempted from the fiscal rule rose to BRL40bln from BRL28bln. Although we don't see the 2024 fiscal target at risk, we don't anticipate the government's appetite to increase expenses to be contained in the near term. Moreover, without the approval of significant and, more importantly, permanent sources of revenue in congress, we expect the market to continue to question the government's ability to meet its fiscal targets into 2025.

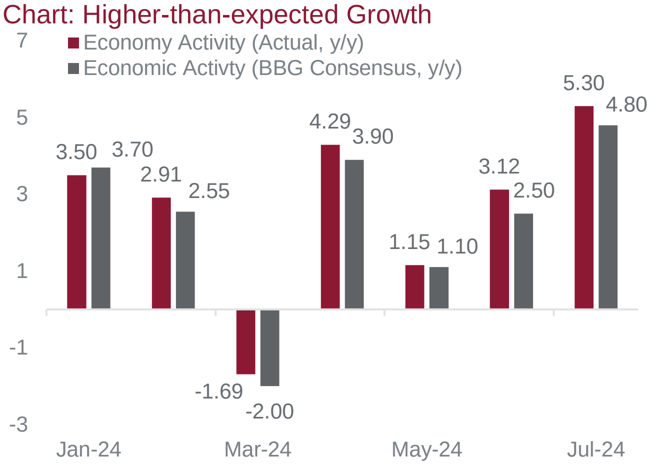
All in, although risk-on environment and the BCB's hawkish tone makes the BRL an attractive high carry currency, we highlight that given short-term local risks (municipal elections, discussion of revenue measures), we still do not see enough room for a sustained BRL rally and expect USD/BRL to remain confined within the 5.40-5.70 range in the coming weeks. That said, with China's new set of economic measures supporting commodity prices, and provided we don't see a further deterioration in the country's fiscal accounts into the end of 2024, we recognize that the BRL's attractive carry could open some space for a further USD/BRL leg downward towards the 5.00-5.20 range into early Q1 2025 as external (US elections, DM Central Bank noise) and local driven volatility dissipate.

Chart: Inflation Expectations Have Further De-anchored (BCB Target is at 3%)



Source: BCB, CIBC Capital Markets

Chart: Higher-than-expected Growth



Source: BCB, Bloomberg, CIBC Capital Markets

CLP – Faster Path to Neutral Rates

USD/CLP – Q4 2024: 880 | Q1 2025: 860

The BCCh cut the overnight rate by 25bps to 5.50% with a dovish tone in September. Moreover, the board highlighted that "if the assumptions of the central scenario of the September IPoM materialize, the reduction of the MPR towards its neutral level will be somewhat faster than expected in June." The dovish tone of September's rate announcement reflected weak consumption and reduced risks of further inflationary persistence in the medium term. We still anticipate four more 25bps rate cuts before the end of the cycle. However, we now expect the BCCh to implement them before the end of Q2 2025 rather than spread over the next 15 months.

Hence, provided we don't see a steady deterioration in copper prices, we remain optimistic about the CLP prospects for the remainder of 2024. Remember that fiscal and political risks are at their lowest levels since the end 2019, while we anticipate investors to put closer attention on intrinsic factors, taking refuge on those assets relatively shielded from US electoral noise. Moreover, China's new set of measures to spur growth have provided a lift to commodity prices into Q4, while the market is already pricing real rates below the CB neutral estimate two years from now (monetary policy horizon), limiting the odds of dovish surprises (minutes also mentioned a 50bps rate cut was quickly ruled out in the last meeting). We maintain our 2024 Q4 USD/CLP forecast at 880.

COP – Banrep Goes for a 50bps Rate Cut but Larger Cuts are Coming Soon

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

Fiscal risks have increased with the government pushing its COP523tln budget forward without the support from congress (deadlock over the last two months). Note that the 2025 Budget, on its current form, is not fully financed, a situation that could force the government to cut expenditures by the same amount if congress does not approve its financing law and/or lead to a constitutional challenge. Although on first instance the above only signals a cumbersome process ahead, if approved, the financing law will further delay Colombia's progress towards debt sustainability. Moreover, this situation has already put the country's credit rating on a slippery slope, as it has signaled further modifications to the fiscal rule, while the government's tax collection revenues have been deemed as optimistic (to say the least), by local and foreign analysts, and by the country's Fiscal Rule Autonomous Committee.

On the monetary policy front, although we expected the outsized rate cut by the Fed, and the downside surprise to headline and core inflation in August to provide Banrep some space to accelerate the pace of rate cuts in September, the CB erred on the side of caution reducing the overnight rate by only 50bps, as internal demand grew more than expected. Nevertheless, the vote was split with 3 out of the 7 board members already favouring a 75bps rate cut.

We expect the CB to accelerate its easing cycle and cut the overnight rate by 150bps in Q4 (two 75bps rate cuts). Moreover, with rates in Colombia remaining the most restrictive in the region, we see Banrep maintaining a steady pace of rate cuts in 2025, reaching 7.25% by the end of Q3 2025. Looking at the COP, given our expectations of an aggressive easing cycle into Q4, and persistent fiscal risks, we have revised our Q4 2024, and Q1 2025 forecast upwards to 4200 (4100 prev), and 4100 (4000). However, we do not rule out brief spikes to 4400 driven by negative credit rating comments into the end of the year.

South Africa

Jeremy Stretch

ZAR – Investors Loading Up

USD/ZAR – Q4 2024: 17.15 | Q1 2025: 16.95

In September, the SARB cut rates by 25bps to 8.00% for the first time since July 2020. Given that headline inflation dropped below the mid-point of the 3-6% CPI target range in August, (4.4% represents the lowest reading since April 2021) the move was hardly unexpected. The unanimous decision comes amidst internal discussion of both 25bps and 50bps. We would expect the bank to consider another 25bps reduction prior to year-end.

The presumption of a relatively benign CPI outlook as currency gains have helped contain imported inflationary pressures, supports the notion of a graduated policy easing over the next 12 months. We would note that Governor Kganyago detailed that he sees rates moving towards neutral next year, that suggests that nominal rates head towards 7%.

Despite the presumption of further rate cuts, undermining nominal domestic bond yields, the presumption of still elevated real rates underlines the residual allure of South African government bonds for international investors. The presumption of the moderation in domestic headwinds, including political risk, supports the aggressive uptick in ZAR speculative positioning. Real money ZAR longs have doubled in recent weeks, reaching all time highs (data goes back to 2015) in the process. Contingent to the increase in speculative ZAR holdings has been the most aggressive purchase of South African bonds by foreign investors (on a 3m MAV basis) since February 2021. The recent accumulation of ZAR holdings looks increasingly elevated, especially should supply side constraints, including distribution dynamics, due to restrictions at the ports, extend. While we remain mindful of some residual ZAR profit taking, we continue to look for ongoing ZAR gains into 2025, that is on the proviso that global risk dynamics remain encouraging.

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