CIBC CAPITAL MARKETS

CIBC FICC Strategy and Economics

MONTHLY FX OUTLOOK

November 2023

Bittersweet Cacophony

Currency	What's changed
USD	We still see further upside for the greenback over the coming quarters - not least as markets continue to look past important themes that distinguish the US economy in a higher rate environment
CAD	Growing risks of divergence between the Fed and the BoC bring additional upside risk to USD/CAD in the coming quarters
EUR	With significant negativity already priced for Europe, further EUR/USD weakness will come from the USD leg
GBP	The BoE is at terminal, but will lean into the 'higher for longer' theme
JPY	After the latest tweak to YCC, USD/JPY is likely to shadow moves in long-end UST over the coming months
Commodity FX	The 'higher for longer' theme to weigh on Antipodean consumer balance sheets
LATAM FX	Continued rate cuts imply risks to LATAM carry trades
FX Asia	CNH stability to persist amid continued government intervention

Currency outlook

End of period:	Nov 7, 2023	Q4 '23	Q1 '24	Q2 '24	Q3 '24	Q4 '24	Q2 '25	Q4 '25
USD / CAD	1.38	1.39	1.42	1.39	1.37	1.35	1.30	1.29
EUR / USD	1.07	1.03	1.03	1.05	1.08	1.11	1.15	1.16
USD / JPY	150	152	154	150	148	145	135	130
GBP / USD	1.23	1.18	1.18	1.20	1.23	1.27	1.32	1.34
USD / CHF	0.90	0.93	0.94	0.93	0.93	0.91	0.88	0.88
USD / SEK	10.93	11.21	10.87	10.43	10.00	9.68	9.35	9.30
AUD / USD	0.64	0.61	0.61	0.62	0.63	0.64	0.66	0.67
NZD / USD	0.59	0.56	0.56	0.56	0.57	0.58	0.60	0.61
USD / NOK	11.19	11.31	11.12	10.71	10.28	9.86	9.50	9.40
USD / ZAR	18.35	19.15	18.40	18.00	17.65	17.40	17.00	16.90
USD / BRL	4.87	5.20	5.20	5.20	5.40	5.00	5.20	5.40
USD / MXN	17.48	18.00	18.50	19.00	19.20	19.00	18.75	18.50
USD / COP	4007	4300	4300	4400	4500	4300	4100	3900
USD / CLP	889	900	920	900	880	850	840	860
USD / CNH	7.28	7.34	7.33	7.32	7.30	7.25	7.20	7.10

Other crosses

End of period:	Nov 7, 2023	Q4 '23	Q1 '24	Q2 '24	Q3 '24	Q4 '24	Q2 '25	Q4 '25
CAD/JPY	109	109	108	108	108	107	104	101
AUD/CAD	0.88	0.85	0.87	0.86	0.86	0.86	0.86	0.86
GBP/CAD	1.69	1.64	1.68	1.67	1.69	1.71	1.72	1.73
EUR/CAD	1.47	1.43	1.46	1.46	1.48	1.50	1.50	1.50
EUR/JPY	161	157	159	158	160	161	155	151
EUR/GBP	0.87	0.87	0.87	0.88	0.88	0.87	0.87	0.87
EUR/CHF	0.96	0.96	0.97	0.98	1.00	1.01	1.01	1.02
EUR/SEK	11.69	11.55	11.20	10.95	10.80	10.74	10.75	10.79
EUR/NOK	11.97	11.65	11.45	11.25	11.10	10.94	10.93	10.90

Key indicators – Latest data point

End of period:	Quarterly real GDP (y/y %)	CPI (y/y %)	Current acct (% of GDP)	Central bank rate (%)
US	2.90	3.70	-3.20	5.38
Canada	1.12	3.80	-0.99	5.00
Eurozone	0.10	2.90	0.24	4.00
Japan	1.60	3.00	2.22	-0.10
UK	0.60	6.70	-1.79	5.25
Switzerland	0.60	1.70	9.82	1.75
Sweden	-0.80	6.50	5.02	4.00
Australia	2.10	5.40	1.18	4.35
New Zealand	1.90	5.60	-7.50	5.50
Norway	0.70	3.30	25.82	4.25
South Africa	1.60	5.40	-1.43	8.25
Brazil	4.00	4.18	-2.66	12.25
Mexico	3.73	6.25	-1.19	11.25
Colombia	3.00	12.82	-5.72	13.25
Chile	-0.63	9.90	-6.79	9.00
China	4.90	0.00	2.23	

USD

Bipan Rai

Two Themes That Markets Keep Looking Past

DXY – Q4 2023: 108.88 | Q1 2024: 109.19

It took a while, but markets are finally understanding that the “higher for longer” message is far more credible in the United States than it is for other countries. One way to see this is the build in net long USD positions among non-commercial market players (which are often used as a proxy for speculators). Also, there’s been a decent build in net shorts for currencies of economies that have a higher degree of household debt.

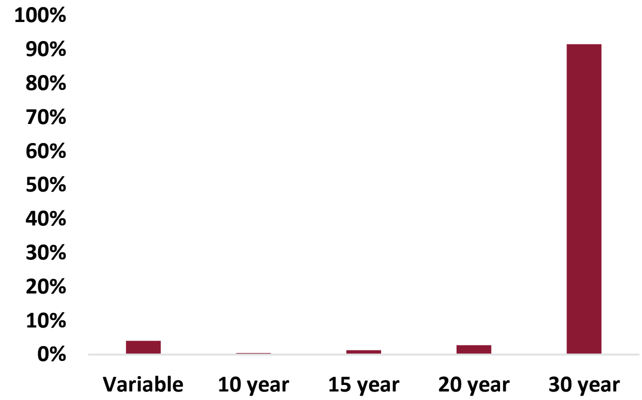
However, there are still some signs of dissonance in certain corners of the market. Indeed, futures markets are still keen to price in close to 100bps of easing from the Fed by the end of 2024. That compares to 77bps for the Bank of Canada, and 76bps for the Bank of England. The implication is that the market expects the Fed to be more reactive than other central banks over the coming year. But that doesn’t jive with the fundamentals on the ground.

For instance, consider US growth in Q3 – which registered an impressive near 5% q/q annualized clip. True, some of this was driven by inventory investment, but even if you strip that out, the US grew by a still-impressive 3.5% pace. That’s still leaps and bounds stronger than the Eurozone (-0.4% q/q), the UK and Japan (both are expected to be close to flat) and Canada (which is tracking just below zero for Q3).

In our minds, the resilient US economy is tied to two themes that the market is looking past. First, the stock of household debt in the US is lower than it is in places like Canada, Australia, and the UK on a relative basis. That means that debt servicing risks are still more acute in the latter economies at the margin. Second, the structure of the US mortgage market is different in the sense that an overwhelming majority of fixed rate mortgages are 30-years plus in duration. That shelters US households from the ‘higher for longer’ rate story to a considerable degree. By contrast, mortgages in Canada, Australia, NZ and the UK tend to be far shorter in duration – which means that households there face considerable refinancing risk in the coming years. Taking both together, we don’t sense that the market is paying full tribute to the two above themes – which it should over the next two quarters.

For now, the focus remains on incoming data – especially the October CPI print that is due next week. Despite the surprisingly cautious tone taken by Powell last week, we’re of the mind that stronger activity in the US is more likely to persist. That suggests that USD dips should be bought into, and CAD investors should pare hedges on USD inflows over the coming months. Towards H2 of next year, we expect USD valuation to peak as markets reassess the viability of the Fed’s QT program while the much anticipated JPY rally starts to take hold across the FX space.

Chart: US Fixed Rate Mortgages by Term



Source: FFEIC, HDMA, CIBC Capital Markets

CAD

Katherine Judge and Avery Shenfeld

Weaker for Longer

USD/CAD – Q4 2023: 1.39 | Q1 2024: 1.42

The C$ has been on a roller coaster ride lately, due largely to the surprise dovish shift in rhetoric from the Fed that caused the loonie to strengthen temporarily. Although the FOMC left the fed funds range unchanged as expected in November, Powell’s dovish shift in tone was a surprise to markets considering that policymakers had signalled a final rate hike before the end of the year in the September projection materials. It’s possible that the reversal of the tightening in financial conditions from the run up in long yields could still leave a December rate hike in play, but we’ll need to see a lack of progress in the upcoming CPI report add traction to that view. We’ve compounded our forecast for loonie weakness given the divergence in economic activity that the Canadian economy has seen versus US resilience, and we now see USDCAD peaking at 1.42 in early 2024.

The weakening in growth that is already in evidence in Canada is what gave the Bank of Canada confidence to hold rates steady in October, as the past weakness in GDP growth is set to feed through more to prices ahead. Of particular concern is that the majority of mortgages have not yet renewed at higher interest rates, and that will put even more pressure on consumer demand, following a decline in per-capita consumption in Q2. Canada’s heightened interest rate sensitivity and the deterioration in domestic demand will result in the BoC trimming interest rates a quarter ahead of the Fed, likely starting in Q2 2024. And a shallower path for USD depreciation next year on extended economic resilience leaves less room for loonie appreciation in H2 2024. As a result, we now see USDCAD ending next year at 1.35, higher than our previous target.

EUR

Jeremy Stretch

Macro Headwinds Remain

EUR/USD – Q4 2023: 1.03 | Q1 2024: 1.03

The perpetuation of poor macro data, allied to a faster-than-expected moderation in inflationary pressures, continues to weigh on EUR implied rate expectations. After 10 straight hikes, including September's insurance adjustment, (taking rates from -0.5% to the current 4.00%) we anticipate that conventional monetary policy adjustment has concluded. The extension of the September statement reference to holding policy at current levels for a "sufficiently long duration" underlines that current restrictive policy will be maintained through to mid-2024, at which point we expect a cut by June at the earliest.

However, markets are pricing in an earlier reversal amidst a faster-than-expected correction in both headline and core HICP. Headline flash HICP eased to 2.9% in October; we have not witnessed annual prices below 3% since July 2021. The combination of sliding inflationary expectations, with the EUR 5y5y inflation swap having moderated to near five-month lows, and weakening growth (the eurozone economy modestly contracted in Q3), underpins the market attempting to price in cuts as early as April.

The market remains braced for a weak euro macro backdrop to extend into early 2024, as lacklustre Chinese data is far from helpful for the manufacturing sector. However, we would note the impact of weak data on EUR performance has moderated, in part as negativity is already discounted. However, as implied spread dynamics move against the EUR, we can expect real money players to further unwind excessive EUR longs. Although real money players may have almost halved EUR holdings from early August highs a further consolidation underlines the presumption of fresh 2023 EUR/USD lows prior to year-end.

JPY

Maximillian Lin

The Fed Drives USD/JPY; BoJ is a Passenger

USD/JPY – Q4 2023: 152 | Q1 2024: 154

As usual, there were press leaks and speculation just before the latest BoJ decision, and as usual the BoJ erred on the dovish side. We mistakenly expected a stronger "technical" adjustment to YCC. Our base case was that the BoJ would raise the upper bound (currently 1.00%) given the impact on higher US yields onto 10y JGBs and most notably USD/JPY, which briefly rose above 150 in late October. We were correct in noting that the BoJ would adjust YCC to make it more flexible to external pressures, but instead of shifting to a larger yield range, the BoJ opted to make the framework itself less rigid. The YCC adjustment ended up being a small tweak to the previous "strict cap" of 1.00% – it is now a "reference" yield.

The BoJ's very subtle actions show that Governor Ueda is mindful of even small adjustments higher to YCC targets and its impact on the economy. We think Ueda will wait patiently for further signs of wage inflation, and could raise the YCC upper bound at the April 26th BoJ meeting (after spring wage negotiations) at the earliest. That dovish BoJ stance for Q4 2023 and Q1 2024 means that US-Japan rate differentials will be driven by Fed policy and US data. Japan's authorities could intervene to slow yen weakness at 152 (they were very vocal about one-sided moves after the October BoJ decision), but our view for higher US yields points to USD/JPY peaking at 154 heading into a December Fed hike.

GBP

Jeremy Stretch

BoE Joins the Higher for Longer Camp

GBP/USD – Q4 2023: 1.18 | Q1 2024: 1.18

The BoE left rates at 5.25% for a second straight meeting in October. After a 5:4 split vote in September, with the Governor utilizing a casting vote, the latest vote was a slightly more clear-cut 6:3. Three of the four external members voted for an additional 25bps hike due to ongoing concerns over persistent inflation. Contingent to the hawks agitating for additional tightening proved to be the upward CPI revision contained in the latest quarterly forecast update. Apart from a modest downgrade to Q4 2023, the bank revised up the whole profile. Notably, the bank now only expects CPI to subside below the 2% target threshold until Q4 2025, two quarters later than that assumed in August. However, as the bank perceives it will attain its CPI target within the forecast trajectory it perceives that maintaining current policy restrictiveness is appropriate.

The perpetuation of BoE forward guidance, the bank reasserted that "Monetary policy will need to be sufficiently restrictive for sufficiently long to return inflation to the 2% target sustainably in the medium term", underlines that the BoE advocate a higher for longer narrative.

Irrespective of BoE macro forecast amendments, including higher CPI, and downgraded GDP, (the bank anticipates zero growth between Q2 2024 and Q1 2025), we continue to expect the BoE to maintain policy at the current rate, 5.25%, through to August 2024. Elevated and sticky UK CPI points towards the BoE being a policy laggard in terms of monetary easing, underlining macro underperformance well into 2024. The corollary of weak macro data and moderating rate expectations (we anticipate that Q1 terminal rate expectations should be pared, from the current 7bps), is the prospect of additional GBP downside into year-end.

CHF

Jeremy Stretch

Moderating SNB Intervention to Ease CHF Overvaluation

EUR/CHF – Q4 2023: 0.96 | Q1 2024: 0.97

After confounding market expectations in September, holding rates at 1.75%, the stalling in September price dynamics, annual headline CPI remained at 1.7%, validates the market effectively pricing in little risk of an adjustment at the 14 December policy gathering. While the moderation in price pressures supports immediate inertia, we can expect the market to continue to price in a policy reversal into mid-2024. After three consecutive gains in consumer confidence a 13-point capitulation in the Q4 reading, taking the series back towards Q4 2022 lows, validates building pressure on the bank to loosen policy conditions. Although rates remain relatively modest compared to counterpart economies, the leveraged nature of the consumer sector (only Norway has a higher ratio of household debt to GDP) underlines ongoing real estate pressures. Annual real estate prices have dipped back into negative territory for the first time since Q1 2019, we have not witnessed a faster annual correction since Q1 2000.

In the wake of SNB policy inertia, we have witnessed a rapid accumulation in CHF real money shorts; testing one-year highs. However, short positioning remains less than half of the 2019 extremes. The SNB shifted towards actively encouraging a stronger CHF in Q2 2022. However, we would expect the SNB to moderate FX activity as inflationary pressures remain contained and export competitiveness remains challenged, the OECD estimates that the CHF is the most overvalued major versus the EUR. The prospect of reduced SNB activism, allied to an eventual easing in CHF safe haven demand points towards a graduated reduction in Swiss valuations.

SEK

Jeremy Stretch

Undervaluation Against EUR to Reverse

EUR/SEK – Q4 2023: 11.55 | Q1 2024: 11.20

We head towards the 23 November Riksbank decision with the market pricing around a 60% probability of the bank pushing through an additional 25bps hike, taking the repo rate to 4.25% and levels not witnessed since October 2008. Presumptions of additional tightening (down from above 80%) come despite weak forward-looking PMI survey data, both manufacturing and services, remain heavily in negative territory, as they have since Q2 2022. Moreover, the heavily indebted and leveraged consumer remains materially exposed to higher rates, annual house prices are almost 10% below levels witnessed at the end of Q3 2022. Swedish net household debt is close to 200% of GDP according to the latest OECD data, underlining the impact of central bank tightening.

While conventional policy tightening looks set to run its course, once rates reach 4.25%, we expect the central bank to continue to look to limit immediate SEK weakness, in an effort to limit imported price pressures. We would note that Governor Thedeen continues to rail against SEK undervaluation, he suggested back in September that the SEK was undervalued by between 10-15%.

The bank has pledged to support the SEK by spending around a quarter of its FX reserves over the course of the next 4-6 months. Early evidence points towards some residual policy success. After losing around 20% of its value versus the EUR since November 2021 the bank has proved able to stem SEK weakness via selling US$2.2bn of the Greenback and €195m euros since the bank unveiled its intervention programme on 25 September. Although the SEK remain undervalued its high beta risk status remains a challenge. However, we would expect a more constructive SEK backdrop to encourage EUR/SEK to test 11.00 into mid-2024.

Commodity FX

NOK

Jeremy Stretch

Norges Bank Terminal Rate Uncertainty Remains

EUR/NOK – Q4 2023: 11.65 | Q1 2024: 11.45

The Norges Bank left rates on hold at 4.25%, as expected, at the November policy meeting. The central bank upgraded their assumed rate peak, to 4.50%, back in September. Contingent to the more hawkish central bank narrative were presumptions of an improved external environment. However, recent data has proved far from supportive. Mainland GDP contracted by 0.2% in August, retail spending unexpectedly dipped by 0.3% in September, and manufacturing PMI retreated below the 50 threshold (47.9) for the first time in four snapshots, in October. The weak data backdrop, resulting in the economic surprise index remaining heavily in negative territory, risks testing Norges Bank resolve.

We would view the November rate statement as somewhat dovish. The key variable that will determine whether the bank follows through with a final 25bps comes via its assessment of underlying inflationary pressures. The November rate statement detailed that “if the committee becomes more assured that underlying inflation is on the decline, the policy rate may be kept on hold." The acknowledgement that policy could remain on hold has weighed on NOK sentiment. Indeed we would note NOK performance could prove instrumental to the December policy outcome. The NOK is currently the worst-performing G10 currency over the last three months, it has depreciated by around 7.8% versus the Greenback. As a consequence the risk of imported price pressures, constraining the CPI downtrend, looks set to persist.

After being a policy leader in terms of tightening we still expect the bank to follow through in December, not least as labour markets remain tight. The combination of additional tightening allied to a still exaggerated current account surplus points towards EUR/NOK to eventually head back towards the 200Day MAV into Q1.

AUD

Maximillian Lin

Strong Labour Market Continues to Cause Inflation

AUD/USD – Q4 2023: 0.61 | Q1 2024: 0.61

With the Q4 RBA rate hike now behind us, we think the central bank will pause and patiently monitor the effects of prior tightening, during which time the impact of high policy rates will begin to bite the property market. Mortgage resets, a frequent topic of contention in Australian newspapers, will weigh on the economy much sooner than the US economy, and we have previously noted that US mortgages don't need to be renegotiated at any point from initiation to the end of the mortgage term (in contrast to Australian and Canadian mortgages).

That means that the US economy will be able to better weather a "higher for longer" stance than Australia. Despite those structural differences in the mortgage market, the US curve is still more aggressive in pricing policy rate cuts relative to the Aussie curve. The Australia cash rate futures market currently shows the December 2024 cash rate virtually unchanged from current levels (4.35%). That contrasts with 87 bps of Fed cuts priced by December 2024. Once the futures more accurately price the Australia-US housing divergence, we think AUD/USD will weaken towards 0.61 by Q4.

NZD

Maximillian Lin

Early to Hike, Early to Pause

NZD/USD – Q4 2023: 0.56 | Q1 2024: 0.56

New Zealand's domestic activity is slowing – the latest data showed sequential inflation for all major categories (bar transport) slowed in Q3 (after seasonal adjustment). For year-on-year inflation, favourable base effects have also helped bring all-items inflation lower to +5.6% y/y in Q3 (from +6.0% y/y in Q2). Notably, housing inflation has fallen to +5.3% y/y, down from its June 2022 highs of +9.1% y/y. That slower pace of inflation has led many economic commentators to declare that the RBNZ has "already defeated inflation" with its pre-emptive rate hikes which began in October 2021 – well before the Fed and other G10 central banks.

Although it is too early for the RBNZ to declare victory and consider cuts, we agree that the RNBZ's earlier tightening moves allow it to take an extended pause to assess economic conditions. That is contrast to the Fed, which we think will hike once more. Employment data also supports the view that rates in New Zealand have hit peak; Q3 jobs showed a surprise decline (-0.2% q/q vs consensus +0.4%). We think that the more neutral policy rate outlook in New Zealand, and a more rapidly resetting kiwi mortgage market relative to the US mortgage market, imply downside risks for NZD/USD. We forecast further NZD/USD downside towards 0.56 by Q4 2023. Additionally, New Zealand's negative trade balance (weighed by weak Chinese demand) points to NZD underperformance vs AUD – given Australia's steady trade surpluses.

ZAR

Jeremy Stretch

Underinvestment Amplifies Capacity Concerns

USD/ZAR – Q4 2023: 19.15 | Q1 2024: 18.40

The domestic macro backdrop, in terms of H2 macro-economic expectations, remains somewhat challenged. Indeed we would note that the central bank continues to warn of the risks of protracted underinvestment in key infrastructure sectors, such as electricity generation. Long-term structural headwinds leave the central bank mindful of ongoing cyclical price pressures. Ongoing underinvestment amplifies capacity concerns, leaving the economy at risk of apparent overheating should activity quickly accelerate. Indeed it is the fear of demand-driven price pressure, despite CPI being inside the 3-6% target threshold, that has maintained an aggressive SARB tightening bias. Having unexpectedly held rates at 8.25% in July, policy inertia remained at the September gathering, once again via a 3:2 split vote. Headline CPI moved back into the upper portion of the target threshold in September, with annual prices advancing by 5.4%, up from 4.8%, due to higher energy and food prices. The possibility of further energy price pressures is likely to leave the market mindful of additional policy tightening into 2024.

While the market remains mindful of ongoing capacity pressures, potentially risking a final rate hike (although, we assume that we are already at terminal), signs of a graduated upturn in leading indicators, allied to still elevated real yields and elevated spreads versus UST provide potential appetite for international investors. Speculative ZAR long positions reached one-year highs at the end of October as international investors perceived there to be value in high-yielding ZAR assets, external fears risks and global risk concerns notwithstanding. Ongoing appetite for high-yielding paper, albeit that remains on the proviso that inflationary pressures remain contained, provides scope for USD/ZAR to correct towards August lows, around 18.40 in Q1.

LATAM FX

MXN

Luis Hurtado

Approaching Turbulent Times

USD/MXN – Q4 2023: 18.00 | Q1 2024: 18.50

Since the start of August the MXN has posted daily currency moves exceeding two times its 1Y trailing daily volatility in nine occasions. Excluding the volatility around the US' banking sector concerns in March, this occurred in one other occasion this year (February 3rd). From a local point of view, there aren't any significant factors that could explain the increase of the somewhat large daily currency moves experienced over the last three months. However, we have seen a substantial increase of external risks. Global yields, led by the move in US Treasuries, have considerably increased amid the Fed's higher-for-longer narrative and the US' economic resilience relative to other major economies. Moreover, new geopolitical risks emerged in the Middle East, while concerns about China's growth outlook and its construction sector increased EM FX volatility.

We recognize that the early November retreat in UST yields following Fed Chair Powell's reference to a higher potential output (which was interpreted as a hint to a higher bar for further monetary tightening), put popular carry trades back in the spotlight. However, we don't see that move as one that could be sustained into the rest of the year. In the case of the MXN, we continue to disagree with the cautious pricing of Banxico's monetary policy easing path in 2024, while we expect US sectors sensitive to high interest rates (i.e. construction and manufacturing) to exert downward pressures on remittances to Mexico going forward. Hence, we maintain our USD/MXN year-end and Q1 2024 forecasts at 18.00 and 18.50, respectively.

BRL

Luis Hurtado

Fiscal Risks Increase

USD/BRL – Q4 2023: 5.20 | Q1 2024: 5.20

In unanimous decision, the Banco Central do Brasil (BCB) cut the Selic rate by 50bps for the third time in a row, in line with our forecast, and consensus expectations. Moreover, the BCB reiterated that "if the scenario (inflation), evolves as expected, the committee unanimously anticipates further reductions of the same magnitude in the next meetings". However, similar to the September rate decision, the bank suggested a high bar for a further acceleration of the easing cycle in the short term.

We emphasize that with the approval of the fiscal rule in congress in August, the market is now focusing on when and where debt/GDP will stabilize. The discussion of revenue measures will continue to be the main catalyst for BRL movements to either side, while headline risks, as in previous negotiation rounds, should keep upward pressure on USD/BRL vols. Hence, given President Lula's comments suggesting expenditures will not be cut to meet the new 2024 fiscal target, we expect USD/BRL to resume its upward path towards 5.10, and on a break above that level, retest the 5.20 mark in line with our year-end forecast. As for the Selic rate, we expect the BCB to maintain the current pace of rate cuts in December, bringing it to 11.75% by the end of 2023 and another 50bps rate cut in the first meeting of 2024, after which we expect the BCB to adjust its forward guidance (likely a slower pace of rate cuts as fiscal risks materialize/persist).

CLP

Luis Hurtado

Throwing Forward Guidance Out the Window

USD/CLP – Q4 2023: 900 | Q1 2024: 920

The Banco Central de Chile cut the overnight rate by 50bps to 9.0%, against our forecast of a 75bps rate cut. As we mentioned in the weeks leading up to the October 26th rate announcement, given the large depreciation of the CLP since the September meeting, we expected the BCCh to adopt a more cautious tone and signal the possibility of ending its reserve building program and/or reducing the pace of rate cuts into the December meeting. Nevertheless, in a clear signal that the bank is not comfortable with the CLP's trend, they decided to proceed with these two options last month.

We would highlight two points following October's rate decision. First, it seems the BCCh has not learnt from previous mistakes. We do not need to go too far back to find instances where the BCCh backtracked from its forward guidance just a few weeks after providing it (i.e. rate cut pace change in July, and the FX intervention saga in 2022). Second, with memories of the rapid USD/CLP spike above 1000 in 2022 still fresh, it is very clear that the BCCh is increasingly concerned on USD/CLP spikes above 940, providing a near term cap on USD/CLP upward moves. Hence, despite the persistence of global risks, and the final leg of the second new constitution process approaching, we remain comfortable maintaining our year-end and Q1 USD/CLP forecasts at 900, and 920, respectively.

COP

Luis Hurtado

On Hold and Cautious but Wishing to Start Easing Cycle

USD/COP – Q4 2023: 4300 | Q1 2024: 4300

Banrep maintained its overnight rate at 13.25%, in line with consensus and our revised forecast. Although the announcement didn't reveal an explicit signal on the timing and magnitude of the easing cycle, two board members continued to vote in favour of a 25bps rate cut. We expect Banrep to start its easing cycle in December, cutting the overnight rate by 25bps to 13.00%. However, we don't see the Bank committing to a specific pace of rate cuts or a continuous easing cycle into 2024 and recognize that such forecast is contingent on the consolidation of the downward trend in headline and core inflation in October, and November.

Looking at USD/COP, we highlight that contrary to earlier in 2023, the COP's carry will likely prevent USD/COP from jumping above the 4300 mark in a sustained manner, rather than act as the main positive driver for the currency. Remember that FX vols have considerably increased since the start of August, while new global risks will likely continue punishing popular carry trades into next year. Hence, we maintain our USD/COP year-end and Q1 forecasts at 4300.

Asia FX

CNH

Maximillian Lin

Mandatory Stabilization

USD/CNH – Q4 2023: 7.34 | Q1 2024: 7.33

We share the consensus view that China's leaders face an uphill battle in reviving growth, given the overhang of property sector debt and ongoing sluggishness in consumption. Authorities will continue a moderate easing stance, but will refrain from "flood-style" stimulus, in an effort to revive business and consumer confidence. We think it will take at least another half year for domestic momentum to rebound – although authorities are making small pro-growth adjustments to property policies, the government is still mindful of long term debt risks, and does not seem willing to bail out distressed developers. Without stronger signals from policymakers, we think China's "animal spirits" will continue hibernating.

For the yuan and China's financial markets, the "good news" is that the central bank has made a more explicit commitment into stabilizing market sentiment. Although domestic demand won't be revived suddenly, upward momentum in USD/CNH past 7.35 has been effectively halted. The PBoC's statement on November 1st, a response to guidelines made in China's Financial Work Conference on October 30-31st, noted that the central bank "will implement comprehensive policies to stabilize market expectations" and "prevent the risk of large fluctuations in the RMB exchange rate." We expect the authorities to continue intervening in both equity and currency markets after both neared two-year lows in October. US data strength points to some limited USD/CNH upside – we forecast 7.34 by Q4 – but the PBoC has effectively drawn a line just below 7.40.

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