

CIBC FICC Strategy and Economics

MONTHLY FX OUTLOOK

September 2023

A 'Higher for Longer' US Dollar

Currency	What's changed
USD	We're now expecting strength in the USD to stick around for longer. That's due to a deteriorating risk backdrop, alongside inconsistencies with how markets are pricing central banks for 2024.
CAD	With the BoC now at terminal, the focus turns to cuts next year. We still think there's room for additional easing to be priced in – which should weigh on the CAD in the coming months.
EUR	Weakening activity in the Eurozone imply that the ECB is already at its terminal rate. That should work to keep the EUR on the defensive in the near-term.
GBP	The UK appears headed for stagnation and/or stagflation, either way the BoE terminal rate should land at 5.50% which is still below market expectations.
JPY	The labour market is now in the spotlight and should guide the BoJ to adjust policy settings eventually.
Commodity FX	China headwinds alongside slowing activity due to tighter monetary conditions should continue to dominate all other risk factors in Q4.
LATAM FX	Latam central banks are ahead of the curve in terms of cutting rates. Alongside an unfavourable carry environment, this suggests that Latam FX weakness should take hold.
FX Asia	Deleveraging in China has yet to begin. While large scale fiscal stimulus appears unlikely at the moment; a slowing Chinese economy will continue to guide Asia FX.

Currency outlook

End of period:	Sept 8, 2023	Q4 '23	Q1 '24	Q2 '24	Q3 '24	Q4 '24
USD / CAD	1.37	1.39	1.37	1.34	1.33	1.31
EUR / USD	1.07	1.05	1.06	1.10	1.13	1.15
USD / JPY	147	144	140	135	125	120
GBP / USD	1.25	1.22	1.23	1.26	1.30	1.32
USD / CHF	0.89	0.92	0.92	0.91	0.90	0.89
USD / SEK	11.13	10.80	10.20	9.87	9.57	9.39
AUD / USD	0.64	0.63	0.63	0.65	0.66	0.68
NZD / USD	0.59	0.56	0.58	0.60	0.61	0.63
USD / NOK	10.68	10.50	10.15	9.75	9.50	9.30
USD / ZAR	19.13	19.00	18.15	17.75	17.45	17.20
USD / BRL	4.98	5.20	5.20	5.20	5.40	5.00
USD / MXN	17.49	18.00	18.50	19.00	19.20	19.00
USD / COP	4039	4300	4300	4400	4500	4300
USD / CLP	885	850	870	870	850	820
USD / CNY	7.34	7.45	7.38	7.35	7.30	7.25

Other crosses

End of period:	Sept 8, 2023	Q3 '23	Q4 '23	Q1 '24	Q2 '24	Q3 '24
CADJPY	108	104	102	101	94	92
AUDCAD	0.87	0.88	0.86	0.87	0.88	0.89
GBPCAD	1.71	1.70	1.69	1.69	1.73	1.73
EURCAD	1.46	1.46	1.45	1.47	1.50	1.51
EURJPY	158	151	148	149	141	138
EURGBP	0.86	0.86	0.86	0.87	0.87	0.87
EURCHF	0.95	0.97	0.98	1.00	1.02	1.02
EURSEK	11.92	11.34	10.81	10.86	10.81	10.80
EURNOK	11.42	11.03	10.76	10.73	10.74	10.70

Key indicators – Latest data point

End of period:	Quarterly real GDP (y/y %)	CPI (y/y %)	Current acct (% of GDP)	Central bank rate (%)
US	2.50	3.20	-3.42	5.38
Canada	1.12	3.30	-0.99	5.00
Eurozone	0.50	5.30	0.41	3.75
Japan	2.00	3.30	2.17	-0.10
UK	0.40	6.80	-2.14	5.25
Switzerland	0.60	1.60	9.45	1.75
Sweden	-0.80	9.30	5.02	3.75
Australia	2.10	6.00	1.18	4.10
New Zealand	1.80	6.00	-8.50	5.50
Norway	0.70	5.40	25.82	4.00
South Africa	1.60	4.70	-1.43	8.25
Brazil	4.00	4.18	-2.66	13.25
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	9.50
China	6.30	-0.30	2.23	

USD

Bipan Rai

Higher for Longer for the USD

DXY – Q4 2023: 106.00 | Q1 2024: 104.31

For the past few months, we've been writing in this space about the risks of tactical USD strength due to a confluence of themes. However, new information gleaned since our last monthly update suggests that USD strength will likely stick around for longer than we envisaged at the start of the summer.

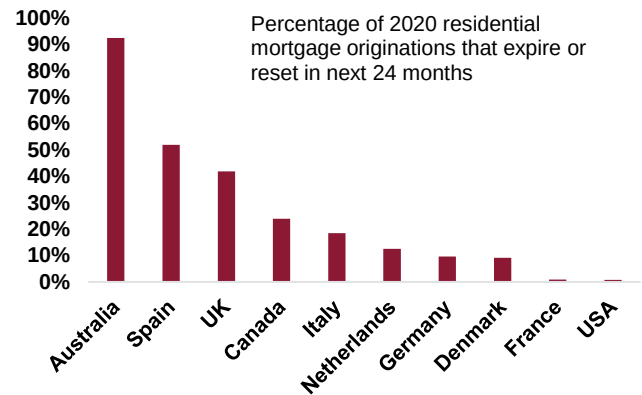
For instance, while we have shifted away from our call of another Fed rate hike later this year, we're still of the view that the US economy is better equipped to deal with higher rates than the market expects. And we mean that on a relative basis, as US households are less exposed to mortgage reset risks than most other countries. But that's not the way that the market is pricing things right now. Instead, extant pricing has the Fed easing by 100bps by the end of next year. That seems incongruent with pricing in other jurisdictions where reset risks are higher including in Canada (with roughly 55bps of easing priced by then), the Eurozone (50bps) and Australia (15bps). In the months ahead, we expect more in the way of easing to be priced in by end-2024 for those markets. That will be consistent with a stronger USD.

Additionally, we expect USD dips to be well supported as we enter a more challenging backdrop for broad risk. To a large extent, this is going to be driven by developments out of China where authorities appear to be against providing too much stimulus for households and businesses there. An uncertain backdrop for China means that key trade partners (Germany, Australia) are also compromised to a degree.

Finally, the liquidity backdrop appears to be getting worse at the margin. Recall, that there is an inverse relationship between USD valuation and financial system liquidity (reserves plus RRP). When the latter declines, the USD tends to rally. The drop in RRP of late suggests that the beta to UST issuance is still high – and that we could be in store for further declines with an abundance of Treasury supply still incoming.

According to proxies that we use (namely the futures market), USD positions are closer to being in balance now, while pricing for upcoming Fed meetings is closer to levels that we think are fair. Nevertheless, risks to OIS pricing for 2024 alongside a challenging backdrop for macro and financial system liquidity are expected to keep the USD firmer for a bit longer. We've adjusted our forecasts accordingly to account for this in the quarters ahead.

Chart 1: US households are less exposed to higher rates relative to other countries



*As of end-2022

Source: Fitch Ratings

CAD

Katherine Judge and Avery Shenfeld

More Room for 2024 Cuts to be Priced In

USD/CAD – Q4 2023: 1.39 | Q1 2024: 1.37

The market understands that the Bank of Canada is likely done with rate hikes, so that damage to the Canadian dollar as that got priced-in is behind us. What's left however, is a bit of loonie weakness that is likely to show up as it reassess the extent of rate cuts in 2024, where for reasons that aren't readily apparent, current pricing has far fewer eases in Canada than in the US. After all, Canadian household debt is higher, growth has slowed more markedly north of the border, and unlike Americans, Canadian would face a big squeeze from mortgages that will be reset at much higher rates in 2025 even with a significant easing in monetary policy in 2024.

Weaker Canadian labour markets from here to year end should see markets pricing in more BoC rate cuts, moving dollar Canada to 1.39 in the process. While we still expect to see the loonie benefit from a softer USD against other majors next year, and gain some support from expectations for better global growth in 2025, we've revised our CAD target for the end of 2024 to 1.31 (from 1.28), owing to a less bearish view for the USD next year.

EUR

Jeremy Stretch

Moderating Activity to Keep ECB on Hold

EUR/USD – Q4 2023: 1.05 | Q1 2024: 1.06

Widening cracks in the Eurozone economic facade underline an increasingly challenging policy perspective for a central bank that has shifted to data dependence, after a protracted period on policy auto-pilot. We head towards the 14th of September ECB decision on the back

of a July policy statement which suggested that administered rate settings are now proximate to 'sufficiently restrictive' levels. The ECB policy conundrum comes as core and headline HICP equalised in the flash August data. In this context, we would note Governing Council hawks such as Schnabel continue to detail that inflation remains "stubbornly high". However, we would highlight the correction in service prices. Moreover, while Schnabel underlines stubborn inflationary pressures she has also noted weakening growth prospects, beyond that discounted in the June staff forecasts.

Evidence of a weakening in real activity and survey data, notably the capitulation in the PMI indices (we would particularly note the transition from manufacturing into services), risks proving increasingly difficult for a data-dependent central bank to ignore. Moreover, the latest ECB bank lending survey detailed that both corporate and household borrowing materially decelerated on an annual basis into mid-year.

The moderation in activity indicators suggests that demand-driven dynamics within core prices are set to moderate. With the upcoming ECB decision set to witness another round of staff forecasts, the risks of a downgrade in macro activity underlines the prospect of building core inflation headwinds. The combination of moderating data dynamics and easing inflationary pressures points towards the ECB having already reached its terminal rate, at 3.75%. The paring in rate pricing, unwind in EUR holdings and widening in UST-Bund spreads favours near-term EUR headwinds.

JPY

Jeremy Stretch

Labour Market in the Spotlight

USD/JPY – Q4 2023: 144 | Q1 2024: 140

BoJ Chief Ueda used his recent appearance at the Fed's Jackson Hole policy symposium to reiterate that the BoJ is set to maintain its current easy policy trajectory for the foreseeable future, as underlying inflation still remains a bit below the 2% target. Key to any future policy adjustment remains the presumption of wage growth being integral to demand-driven CPI impetus. However, the loosening of the labour market in July, with the unemployment rate rising to 2.7% and the jobs-to-applicant ratio easing to 1.29, underlines the prospect of immediate BoJ policy inertia.

This year's annual Shunto wage round underlined above-CPI wage settlements. The BoJ anticipates the necessity of further wage inflation to validate future policy adjustment. However, should evidence of labour market loosening persist, we can expect tightening expectations to be further compromised. This should maintain UST-JGB spreads, which remain the primary arbiter of USD/JPY performance. Unless and until 10-year spreads head back towards July extremes, around

330bps, we can expect USD/JPY to remain underpinned.

The July BoJ YCC policy tweak aimed to ease long-end yields rather than necessarily preclude a drift towards the new threshold of 100bps, up from 50bps previously. We can expect yields to drift towards the new threshold over time, capping potential outflows looking for higher overseas returns. Such a scenario supports a lower USD/JPY over the forecast horizon. The release of a government White Paper that suggested that wage/price dynamics may soon reach a turning point in the long battle with inflation, suggests that while USD/JPY currently remains in the so-called intervention zone, we expect an eventual resolution lower. That being said JPY bulls need to remain patient.

GBP

Jeremy Stretch

BoE Nearly Done

GBP/USD – Q4 2023: 1.22 | Q1 2024: 1.23

Bank of England Deputy Governor Broadbent detailed at Jackson Hole that the BoE subscribes to the notion that it will take longer for the UK inflation bubble to deflate than inflate. The sub-text of that narrative is that the BoE is set to maintain a restrictive policy stance for longer. Such assumptions underline that policy easing is set to remain well into the medium term, namely beyond the Fed; markets are currently only pricing in moderate risks of BoE easing by August 2024.

However, we anticipate a lower terminal rate peak as price pressures gradually moderate, in this context we note that administered energy prices are set to decline again in October. That being said, we expect rates to remain restrictive for a prolonged period, as CPI risks remaining at more than double the 2% BoE target into early 2024. The perpetuation of above target CPI risks an extension of lacklustre macro activity, supporting near-term GBP underperformance.

Despite the capitulation in forward-looking survey data, headlined by flash services PMI, we still anticipate that the BoE will extend policy tightening for a 15th straight meeting, taking rates to 5.50% at the 21st of September MPC. However, the material moderation in activity data allied to the presumption of the slowest pace in real estate purchases in a decade, dragging on growth assumptions, underlines a lower-than-expected terminal rate profile, we now expect a 5.50% rate peak. The continued paring in terminal rate expectations, to around 5.65% from recent highs in excess of 6%, underlines that ongoing data dynamics imply stagnation at best and stagflation at worst. Although we favour the former we can expect weakening sentiment to weigh on GBP valuations.

CHF

Jeremy Stretch

Year-to-date G10 Leader Starting to Look Shaky

EUR/CHF – Q4 2023: 0.97 | Q1 2024: 0.98

The CHF has proved to be the leader in the year-to-date G10 performance league table, as it has gained almost 4.5% versus the USD and 3.5% versus the EUR. The currency has benefitted from its safe-haven status allied to the presumption of the SNB being keen to advocate a stronger currency. However, the latest KoF business sentiment survey underlines the perpetuation of domestic macro malaise. Although overall activity remains above recent cyclical lows, the dip back below the 3m MAV in the August reading underlines the presumption of the economy bumping along the bottom. Although the Swiss economic surprise index may have rebounded from mid-year lows, the series remains very much in negative territory, as it has done since the end of Q1.

The legacy of ongoing external headwinds, amplified by weakness in key trading partner Germany, underlines building domestic policy challenges. An example of internal macro pressures comes via manufacturing PMI having dipped below the 40 threshold for the first time since the global financial crisis. Sentiment having exceeded post-Covid lows underlines the SNB's building policy challenge. With inflation running below the 2% target threshold, and forecasts pointing towards CPI remaining well below target through 2024, implies increasing SNB restraint regarding the extension of support for an overly strong CHF. We assume that the SNB will remain reticent to further tighten policy, from the current 1.75%, in part due to weakening macro fundamentals and ongoing real estate concerns. Macro headwinds, allied to policy inertia and a rowing back in SNB currency support points towards CHF gains gradually unwinding.

SEK

Jeremy Stretch

Cheap but Headwinds Persist

EUR/SEK – Q4 2024: 11.34 | Q1 2024: 10.81

We previously highlighted our presumption of the SEK proving to be materially undervalued. It increasingly seems that the Riksbank members are of the same opinion, with Deputy Governors Floden and Bunge both suggesting that the SEK is undervalued; the former suggests the currency is around 20% below 'fair value'. It would appear that the policymakers are intent on encouraging the market to buy the currency, in an attempt to limit imported price pressures.

While the monetary authorities rail against excessive SEK cheapness, we can continue to expect the SEK's high beta status will drag on its performance, should global macro headwinds persist into Q4. Beyond external dynamics, domestic macro uncertainties maintain near-term SEK negativity. Quarterly GDP contracted by 0.8% in Q2. Although the quarterly contraction was less aggressive than feared (the market anticipated -1.3%), the retreat comes on the back of a downward revision to Q1.

Sliding GDP reflects the latest household lending data which detailed that the broad downtrend in annual borrowing extended for a 15th month. We have not witnessed a lower annual rate since the end of 1996. Ongoing real estate headwinds, amplified by aggressive Riksbank tightening, is reflected by nominal annual house prices having fallen by 12% in June. In real terms, prices have fallen for four consecutive quarters. For now, the impact of aggressive policy tightening continues to work through the system, (expect another 25bps on the 21st of September). The risk of a more protracted slowdown remains a function of the ongoing effects of monetary tightening in an environment of elevated domestic consumer debt and leverage. Only when macro headwinds moderate and risk sentiment improves can we expect EUR/SEK to head back towards early summer lows.

Commodity FX

NOK

Jeremy Stretch

Norges Bank Guidance Could be Tested

EUR/NOK – Q4 2023: 11.03 | Q1 2024: 10.76

The Norges Bank signalled that their latest 25bps adjustment was unlikely to be their last, even as the 4.00% deposit rate is the highest level since November 2008. The bank flagged the prospect of another 25bps at their next meeting on the 21st of September. However, the unexpected stagnation in Q2 GDP, allied to an unexpectedly large 0.8% decline in July retail sales, risks testing the Norges narrative. Within the weakness in mainland Q2 GDP, we would note that services sentiment dipped by 0.3%, and construction also had a negative impact. The realisation of the weakest quarterly GDP print since Q1 2022 underlines that rate expectations risk proving to be tested.

Ongoing Norges Bank fears regarding inflation pressures proving to become entrenched, amidst second-round wage effects, have been amplified by average annual earnings advancing to a cyclical high of 5.2% in Q2 (a year ago the series stood at 3.3%). Continued labour market tightness, as employment growth looks set to continue to outpace labour supply, underlines additional monetary policy tightening, despite the Q2 GDP undershoot.

Renewed oil price impetus, amidst ongoing supply restrictions gains, is likely to unwind recent NOK headwinds. Over the last month, the NOK has once again proved to be the G10 laggard. Ongoing global macro uncertainty, in part, centred around the pace of Chinese activity, suggests that the return to EUR/NOK levels last seen in February, at around 10.85/90, remains a scenario unlikely to be witnessed in the next six months.

AUD

Noah Buffam

August Selloff to Partially Reverse Over the Medium-Term

AUD/USD – Q4 2023: 0.63 | Q1 2024: 0.63

AUD faced a difficult August as the drawdown in risk, due to rising US rates and a continued slowing of the Chinese economy, hurt the high beta currency. Further, domestic data has continued to slow, with Australian inflation and labour market indicators coming in weak and leading the market to reprice the RBA lower for the coming meetings. We have revised our AUD/USD forecast for Q4 and beyond lower, given the backdrop of weak Chinese growth and risks to global growth.

While the continuation of negative Chinese sentiment and potential downside in risk will be a major headwind for the AUD, a potential hawkish repricing of the RBA should limit AUD downside. We think the RBA may still be forced to hike once more given core inflation remains sticky with core CPI (ex-volatile items and holiday travel) ticking up on 3-month and 6-month annualized bases. The RBA is unlikely to be content with the level of inflation until this measure is under control, especially since weather patterns and base effects are likely to keep headline CPI supported moving into the fall. However, we are wary of the slowing elsewhere in the domestic economy, so we will be watching closely for signs that underlying inflation momentum is moderating. Next month's CPI and employment reports will be vital for our call of one more RBA hike.

NZD

Noah Buffam

Fiscal and Monetary Policy Outlooks are Back in Focus

NZD/USD – Q4 2023: 0.56 | Q1 2024: 0.58

NZD, like other commodity currencies, was hit in August given the weak backdrop in risk markets. We have revised our Q4 forecast for NZD/USD lower given the weak Chinese growth outlook and risks to global growth in general. Further, the higher for longer USD narrative should hurt the high beta kiwi heading into year-end. While we are of the belief that the RBNZ is done with its

hiking cycle, there are upside risks to this forecast as the central bank bumped their August projections to highlight the possibility of another hike in Q4. While we continue to expect that the RBNZ is on hold, we will be watching the Q3 release of non-tradables CPI carefully for hints that the RBNZ will have to take policy into more restrictive settings.

Fiscal policy has re-emerged as a topic of discussion in New Zealand, with the government stating that they plan to cut spending by NZD 4bln due to lower than expected tax revenues. The IMF followed on by projecting that the RBNZ may have to hike again if the government does not follow through with its spending cuts. With fiscal and monetary policy outlooks back in the spotlight, there is likely to be more domestically sourced NZD/USD volatility through the end of the year.

ZAR

Jeremy Stretch

Carry and Improving Domestic Macro Picture to Spur the ZAR

USD/ZAR – Q4 2023: 19.00 | Q1 2024: 18.15

After again threatening to extend into overbought extremes in early August, we have seen USD/ZAR retreat back towards the 50-Day MAV (currently 18.52). The ZAR rebound comes as real money ZAR shorts have been more than halved from mid-year extremes. Having witnessed the SARB unexpectedly hold rates at 8.25% last month, albeit by a mere 3:2 split vote, markets have become increasingly optimistic that monetary policy tightening has come to an end, post the longest phase of tightening since 2006. Yet while CPI may have come back inside the SARB's 3-6% CPI corridor, central bank Governor Kganyago remains keen to remind the market that "the job is not done."

Despite SARB caution, the bank anticipates that inflationary pressures are set to gradually moderate. The latest SARB monetary policy statement forecasts average CPI will be at 5.0% in 2024, down 0.1% from previous estimates. In view of the SARB having likely ended policy tightening, we can expect real yields to remain supportive as inflationary pressures gradually moderate. Positive yield spreads are likely to amplify international investor appetite for South African bonds, in that context we would note an aggressive uptrend in SA bond interest over the last three months. Although carry may be smaller than for other EM markets, such as Mexico and Brazil, the prospect of improving carry alongside a graduated reduction in domestic macro friction, including an expected improvement in electricity generation, points towards graduated yields based ZAR impetus.

LATAM FX

MXN

Luis Hurtado

MXN Remains the Favorite During Quiet Global Dynamics, But...

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

Despite the lack of a rate cut signal by Banxico (contrary to other CBs in the region), we expect the latest volatility bout in equity markets, and the increase of global yields experienced in early August, to put a dent on the MXN carry trade going forward. Moreover, we point out that growth and labour market dynamics in the US remain the largest risk for the MXN into late 2023 and early 2024. We have written extensively about the importance of the US growth story for Mexico in two of our previous notes, but in a nutshell, remember that we found that a mild 3% increase in the Hispanic unemployment rate could lead to a USD600mln decline in remittances flow every month. This represents roughly 11% of the monthly average for the past year.

Moreover, Despite the lack of a rate cut signal by Banxico (contrary to other CBs in the region), we expect the latest volatility bout in equity markets, and the increase in global yields experienced in early August, to put a dent on the MXN carry trade going forward. Further, growth and labour market dynamics in the US are the largest risk for MXN moving forwards. Hence, we maintain our 2023Q4 and 2024Q1 forecasts at 18.00, and 18.50 respectively. However, as the MXN will likely continue to benefit from its attractive carry during low volatility episodes, we prefer to trade this view via USD/MXN call spreads.

BRL

Luis Hurtado

Fiscal Noise Will Keep BRL Under Pressure

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

With the approval of the new fiscal framework out of the way, we expect the market to start focusing on the government's ability to meet its fiscal targets, and the approval/implementation of several revenue measures into next year. We would highlight that despite the government's ability to negotiate some measures into approval, it remains difficult for the government to achieve 1.3% of GDP (BRL168bln) in additional revenues in order to eliminate its 2024 budget deficit. Local rates are certainly responding to such stance, following the rally experienced post the discussion of the new fiscal framework earlier this year.

From an FX perspective, despite the apparent high bar to increase the pace of rate cuts beyond the 50bps per meeting signaled for the remainder of this year, we see risks skewed towards an acceleration of such a cycle into early 2024. Here, we note that the market has only

priced in 378bps in rate cuts for the next year (8 meetings). Assuming a pace of only 50bps for the next three, that suggests the market sees the BCB sustaining that pace well into Q3 2024 – an unlikely scenario as the ex-ante real rate remains almost 470bps above the BCB's neutral real rate estimate. Hence, we maintain our 2023 Q4, and 2024 Q1 USD/BRL forecasts at 5.20, and 5.20 respectively.

CLP

Luis Hurtado

Battered CLP Could Find Some Relief

USD/CLP – Q4 2023: 850 | Q1 2024: 870

The CLP has underperformed its LATAM FX peers for most of 2023, dropping 0.1% against the USD so far this year. The Chilean peso performance in 2023 is explained by three main factors. First, the Chilean Central Bank (BCCh) was the first major central bank in the region to signal and implement a rate cut. Second, following the optimism about China's reopening earlier in 2023, the CLP, given its dependence on copper exports (~40% of total exports), was the first currency in Latin America to be penalized by increasing concerns regarding China's growth. And third, the BCCh started to build its international reserves in June, announcing a plan to buy USD10bln in 12 months (USD40mln per day).

Nevertheless, USD/CLP has already started to feel toppish. Here, we note that after surprising the market with 100bps rate cut in July, the BCCh cut the overnight rate by 75bps on September 5th and signaled the overnight rate will end the year at 7.75%-8.00%. This has fully reversed the downward move in local rates which, at the end of July, pointed towards an overnight rate close to 7.25% by the end of the year. Moreover, the Ministry of Finance recently announced it would sell USD2bln per month until the end of the year (max USD150mln) more than offsetting the position adopted by the BCCh since June. Finally, we would point out that further and, perhaps, larger growth boosting measures by the Chinese government should bode very well for the CLP from current levels. Our USD/CLP targets for 2023 Q4 and 2024 Q1 remain at 850 and 870, respectively.

COP

Luis Hurtado

COP Funding Concerns Dissipate, While Banrep Prepares for Rate Cut Cycle

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

As we mentioned last month, Banrep signaled that its easing cycle will likely begin in September, in line with our expectations, however the magnitude of the

upcoming rate cuts have been left up for debate. Amidst cautious remarks by Banrep board members driven by persistent inflation (expected to end 2023 at around 9%), the pass-through from a weaker COP, and potential upside risks from El Niño, the market is pricing a timid 25bps pace of rate cuts in each of the last three meetings of 2023. Thus, similar to Brazil, we highlight that this situation could quickly change in favour of a more aggressive easing cycle as Colombia's monetary policy is the second most restrictive in the region.

Moreover, despite the appreciation in the COP and the surge in the COP basis across the curve during the first half of August (1M COP basis surged above 600bps), funding concerns are dissipating as Banrep stepped in to provide liquidity via repos at extended maturities. In addition, regulators appear to be working towards implementing a rule that would allow local banks to use the deposits of financial institutions (e.g. pensions funds) to comply with regulatory ratio similar to the Net Stable Funding Ratio (NSFR), addressing the underlying issues for COP funding. We also point out that the COP's liquidity has been impacted by the slow execution of the government's budget, however, we expect spending to quickly accelerate ahead of the country's regional election on October 29th. Therefore, we maintain our USD/COP forecasts for 2023 Q4 and 2024 Q1 at 4300 each.

Asia FX

CNY

Noah Buffam

Continued Pessimism

USD/CNY – Q4 2023: 7.45 | Q1 2024: 7.38

USD/CNH maintained its upward trend through August as Chinese growth expectations continued to deteriorate. Note that since mid-July consensus expectations for Chinese GDP have been revised down from 5.50% to 5.10% for 2023, and from 4.80% to 4.50% for 2024. Ultimately, we think that this trend can continue, as key drivers of growth in the past, the real estate sector and local governments, are over-leveraged and cannot be relied upon to boost the economy. For this reason we expect USD/CNH and USD/CNY to continue their upward moves with the latter shifting to an average of 7.45 through Q4.

While stimulus constantly appears to be on the horizon, it has consistently disappointed. China has tried to jawbone asset prices through the loosening of financial restrictions, speeches, and yuan fixings, but real economy stimulus has been lacking. Ultimately, the economy needs to deleverage, and expectations can

continue to weaken until this happens. By 2024, we expect a rebound in the CNH and CNY as the economy slowly recovers. However, this forecast hinges on the Chinese government beginning to implement targeted fiscal stimulus, alongside measures to boost household consumption, and a stabilization of the real estate sector. Hence, we expect the CNH and CNY to recover some ground lost with USD/CNY tracking towards 7.25 by Q4 2024.

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