

CIBC FICC Strategy and Economics

FX MONTHLY

August 2024

Awaiting Calm

Key points

- **USD:** The USD was among the worst performers in the G10 over the last month due to an unwind of carry trades and the fear that the Fed is behind the curve on rate cuts. While we are revising our Fed profile to three cuts in 2024, this is still less than the market's pricing of four. As a result, we see some USD upside as volatility subsides over the next month.
- **CAD:** As we approach the beginning of the Fed's easing cycle, it's looking increasingly likely that we're nearing the end of the BoC-Fed divergence narrative. Should the Fed deliver a 25 bps cut in September instead of the non-standard sized cut priced in, we would expect another small bout of USD/CAD strength. However, as we move into 2025, we're expecting USD/CAD to weaken, as the Fed begins their own easing cycle. We have moderated the degree of CAD strength in 2025, on a weaker global growth backdrop.
- **EUR:** While Eurozone growth has remained robust in H1 2024, the speed has varied across countries, with Germany struggling relative to Spain. At the same time, inflation looks to be slowly moving back to target which should allow the ECB to ease again in September. We expect a final bout of EUR/USD weakness as Fed expectations are moderated, but then see EUR appreciating through 2025.
- **GBP:** As the BoE finally embarks upon its easing cycle, we expect some further GBP weakness given our expectations for a moderation in growth in H2 and a correction in aggressive easing expectations in Europe and the US. Meanwhile, a period of extended political stability should lead to increased inward FDI, which should be a longer term tailwind for GBP.
- **JPY:** There were two drivers of yen strength since late July: (i) BoJ tightening and (ii) consensus trade unwinds amid the sell-off in US tech. The macro narrative of focused on (i), but in our view, the primary catalyst was (ii) weakness in US tech stocks. USD/JPY began heading lower on July 25th Asia time – right after the disappointing earnings results of a couple of the “Magnificent Seven” stocks. Once Fed pricing normalizes to a more realistic forecast for 2024 FOMC cuts, we expect some marginal USD/JPY top-side to 149 in Q3.
- **AUD and NZD:** The prospects for the RBA and RBNZ have diverged materially given that the two are among the least and most restrictive central banks in the G10. We don't expect either central bank to begin the process of easing rates in the near term; counter to market expectations. As a result we see both AUD/USD and NZD/USD rallying over the coming months on more hawkish than expected central banks and then a global growth upturn in 2025.
- **MXN:** Given increasing local and external risks, we have modified our Q3 USD/MXN forecast to 19.20 from the previous 18.50, and our year-end estimate to 18.50 from 18.00. However, we highlight that we don't rule out sharp but brief spikes above 20.00 as risks are clustered in the month of September (constitutional reforms, CBs rate decisions, US Presidential debate). Hence, we maintain our preference for buying USD/MXN dips below 19.00 mark in the coming weeks.

FX Forecasts

End of period:	Aug 9, 2024	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
USD / CAD	1.37	1.39	1.38	1.37	1.36	1.36	1.35
EUR / USD	1.09	1.08	1.09	1.09	1.10	1.11	1.12
USD / JPY	146	149	148	145	141	137	134
GBP / USD	1.28	1.25	1.28	1.29	1.31	1.32	1.34
USD / CHF	0.86	0.90	0.92	0.93	0.93	0.92	0.92
USD / SEK	10.51	10.65	10.28	10.09	9.91	9.73	9.51
AUD / USD	0.66	0.66	0.67	0.68	0.68	0.69	0.69
NZD / USD	0.60	0.61	0.62	0.62	0.63	0.63	0.64
USD / NOK	10.82	10.84	10.32	10.00	9.82	9.64	9.46
USD / ZAR	18.31	17.95	17.65	17.25	16.95	16.80	16.66
USD / BRL	5.51	5.50	5.20	5.20	5.20	5.00	5.00
USD / MXN	18.82	19.20	18.50	18.20	18.00	18.20	18.50
USD / COP	4062	4100	4100	4000	3950	3950	4000
USD / CLP	932	900	880	860	820	840	840
USD / CNH	7.17	7.20	7.22	7.25	7.25	7.20	7.15

CAD Crosses

End of period:	Aug 9, 2024	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
CAD / JPY	107	107	107	106	104	101	99
CAD / CHF	0.63	0.65	0.67	0.68	0.68	0.68	0.68
AUD / CAD	0.90	0.91	0.92	0.92	0.92	0.93	0.93
GBP / CAD	1.75	1.74	1.77	1.77	1.78	1.80	1.81
EUR / CAD	1.50	1.50	1.50	1.49	1.50	1.51	1.51

EUR Crosses

End of period:	Aug 9, 2024	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
EUR / JPY	160	0.85	0.85	0.85	0.85	0.85	0.86
EUR / GBP	0.86	7.66	7.45	7.36	7.29	7.15	7.04
EUR / CHF	0.94	161	161	158	155	152	150
EUR / SEK	11.49	0.86	0.85	0.84	0.84	0.84	0.84
EUR / NOK	11.83	0.97	1.00	1.01	1.02	1.02	1.03

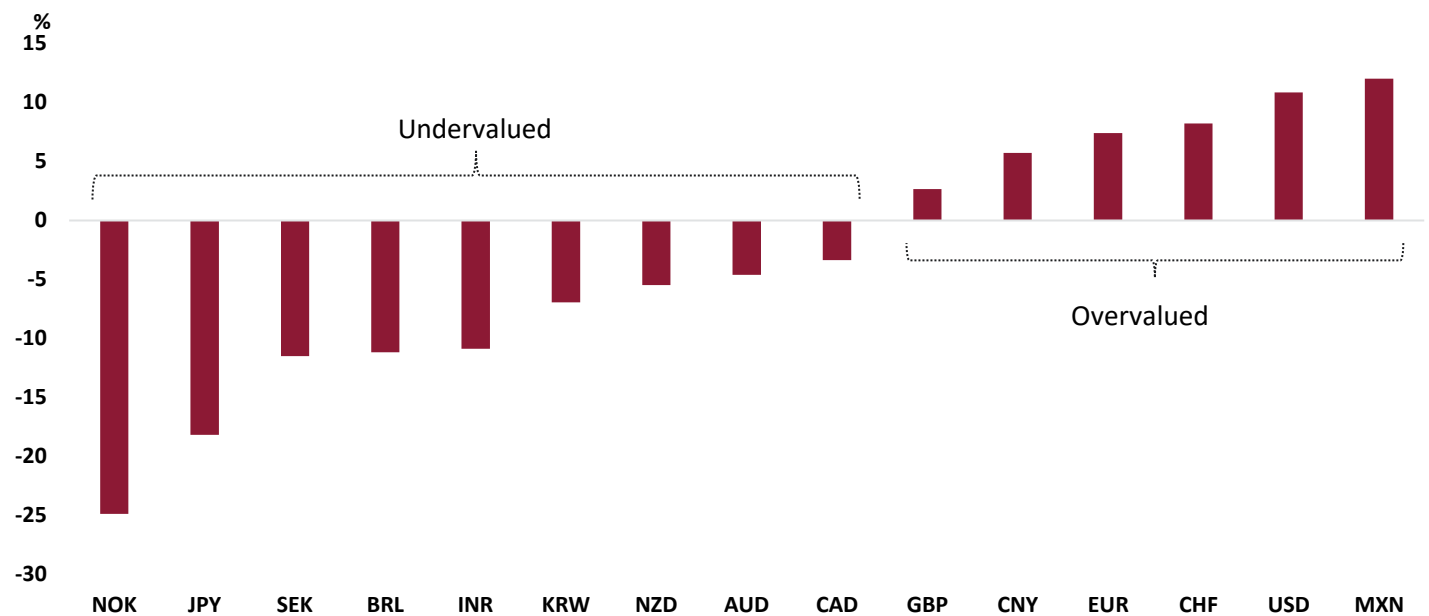
Central Bank Forecasts

	Current	Q3 '24	Q4 '24	Q1 '25	Q2 '25	Q3 '25	Q4 '25
Fed	5.38	5.13	4.63	4.13	3.88	3.63	3.38
BoC	4.50	4.25	3.75	3.25	3.00	2.75	2.50
ECB	3.75	3.50	3.25	3.00	2.75	2.50	2.25
BoE	5.00	5.00	4.75	4.50	4.25	4.00	3.50
SNB	1.25	1.00	1.00	1.00	1.00	1.00	1.00
BoJ	0.25	0.25	0.25	0.25	0.25	0.50	0.50
RBA	4.35	4.35	4.35	4.10	3.85	3.60	3.60
RBNZ	5.50	5.50	5.25	5.00	4.75	4.50	4.50
Banxico	10.75	10.75	10.50	10.00	9.50	9.00	8.50
BCB	10.50	10.50	10.75	11.00	11.25	11.50	11.75
BCCh	5.75	5.50	5.25	5.00	4.75	4.50	4.50
Banrep	10.75	10.00	8.75	7.75	7.25	7.25	7.00

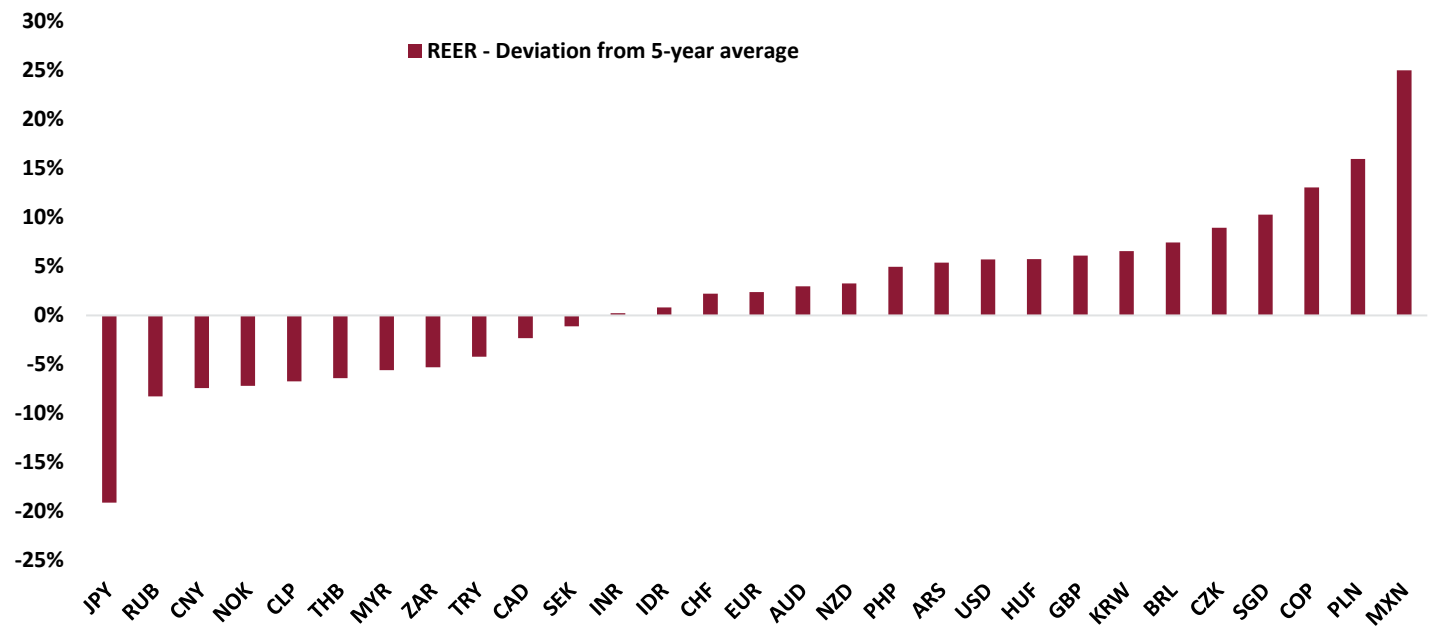
Market Pricing

	Current	Next Meeting	Q3 '24	Q4 '24
BoC	4.50%	Sep 4	4.24%	3.77%
Fed	5.38%	Sep 18	4.94%	4.28%
ECB	3.75%	Sep 12	3.41%	2.97%
BoE	5.00%	Sep 19	4.85%	4.50%
RBA	4.35%	Sep 24	4.29%	4.08%
RBNZ	5.50%	Aug 13	4.98%	4.57%
SNB	1.25%	Sep 26	0.92%	0.70%

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 – Waiting for Calmer Markets

DXY – Q3 2024: 104.40 | Q4 2024: 103.51

July was the month of multi-sigma events characterized by weakening US data raising concerns that the Fed is behind the curve, amplified by positioning and other quirks in the currency market. Cross market volatility has risen, with the VIX (S&P volatility) spiking to as much as 38.5 on August 5th close (for reference: YTD average of 14.2), and the CVIX (FX volatility) spiking to as much as 8.11 the same day (YTD average 6.8).

There are a few 'big' themes that contributed to this spike in FX volatility, most of which centers around an unwind of carry trades that have built up over the past few years (as early as the post-pandemic recovery in 2021). Since the Fed started hiking this cycle, the key carry trade lies in going long USD/JPY, driven by an attractive interest rate differential between the US and Japan. Going long USD/JPY became more crowded this year amid the Fed's higher-for-longer narrative keeping the interest rate differential wide. Meanwhile, in Japan, the Ministry of Finance (MoF) became concerned that the yen was too weak, trading at levels not seen since the early 1990s. On July 11, when US CPI came in weaker than expected (July headline: 3.0% y/y vs. consensus 3.1%), Japanese monetary authorities intervened in the currency markets, starting the chain of USD/JPY weakness, and in turn, DXY weakness heading into the end of the month.

Fear that the MoF will intervene again has kept carry trades at bay, compounded by risk sentiment that has remained poor since the S&P 500 reached all-time highs on July 16th. This has been attributed to i) a higher-than-normal amount of geopolitical risk over tensions in the middle east, combined with ii) earnings or earnings guidance that have generally disappointed in some way relative to expectations, especially in big tech. Risk appetite (or lack thereof) has so far prevented positive carry positions (such as long USD/JPY) from rebuilding.

On August 2, a disappointing payrolls number (July nonfarm payrolls: 114k vs. expectations 175k) drove the market to price in non-standard sized cuts for the Fed this year, with ~106bps of easing priced into the remaining three meetings of 2024. Further the BoJ also hiked interest rates (against our expectations) at its July meeting, leaving carry harvesters concerned that a divergent central bank narrative (the Fed easing + the BoJ hiking) would ruin the still-attractive interest rate differential in USD/JPY.

So far, the weakness in the DXY has been driven by some version of the carry narrative (whether it is from positioning unwind, recessionary risks in the US, MoF intervention, S&P weakness as earnings are unable to consistently beat expectations, or Fed/BoJ divergence). As such, it has followed that the currencies which have seen the most gains vs. the USD are the funders (JPY, and CHF), and the currencies that have seen the most losses are the high-betas (NOK, NZD, AUD, CAD). What is unusual in the current environment is the propensity of the greenback to weaken as risk sells off (historically, a flight-to-safety has broadly favored USDs, which is not what we see today). This is driven by the fear that the Fed is behind the curve, where any future data disappointments will lead to more non-standard sized cuts priced into the Fed over a very limited number of meetings left for 2024.

Moving forward, we suspect that volatility will take a breather into the remainder of the summer as the macro calendar remains light, with most DM central banks not meeting until September. But given that the data in the US has demonstrated pockets of weakness, we are revising our Fed forecast calling for three consecutive 25bps cuts this year. Market expectations for non-standard sized cuts seem like an overreaction, especially given that its in response to a single labor market print that may have been impacted by one-off weather effects. And last but not least for USD/JPY, we expect some stabilization with our Q3 target at 148. Ultimately, even with the considerable repricing for both the Fed and the BoJ last month, carry remains attractive with a long USD/JPY position earning roughly 5.2% annualized over a 3m holding period. When volatility cools, we suspect that this would be too tempting for the market to ignore. As such our Q3 DXY forecast has been revised to 104.40, on a stabilization of carry and a cooling of volatility.

Canada

Avery Shenfeld and Katherine Judge

CAD – CAD Has Weathered the Storm

USD/CAD – Q3 2024: 1.39 | Q4 2024: 1.38

We could still see one more bout of Canadian dollar weakness if, as we expect, the Fed still opts for only a 25 bp cut in September, which would be less dovish than what the market is now pricing-in, while the Bank of Canada delivers a third successive quarter point cut that month. But for the most part, the Canadian dollar has weathered the storm, really more of a shower than a hurricane, that was created by easing ahead of the Fed. That's not to say that central bank outlooks aren't in flux; we've added one cut to the Fed outlook for this year, reducing our year end targets for 2024 and 2025 by 25 bps as a result. But similar forces, including fading core inflation and a softening labour market, have us also tacking on another quarter point cut by the Bank of Canada, replacing the pause we had built in for December. Should the North American outlook see a further deterioration, that's now likely to see both central banks further accelerating the move to a more neutral interest rate setting.

That obviates the need for major adjustments to our trajectory for the loonie. We still see it rebounding as the Fed gets well into its own rate cutting cycle, and as the greenback sees a mean reversion that gives back some of the gains it rang up against the block of other major currencies. But we have taken one figure out of our targets for Canadian dollar appreciation in 2025. While we still expect a rebound for resource demand over the course of 2025, softer global growth has engendered a weaker starting point for commodity prices, including oil, natural gas, and base metals.

Europe

Jeremy Stretch

EUR – Looking Towards September – A Two Speed Europe

EUR/USD – Q3 2024: 1.08 | Q4 2024: 1.09

Advance Q2 GDP data details that Germany is rather more a Eurozone laggard than leader. Despite the fact that the German economy has contracted in two of the last three quarters other parts of the Eurozone, including France, but especially Spain, continue to perform strongly. As a consequence overall activity across the Eurozone confounded expectations in Q2, maintaining the same pace of quarterly expansion, 0.3% q/q, as Q1. Moreover, positive base effects underline that annual activity, while still lacklustre, has advanced to the fastest pace since Q1 2023.

German activity continues to be compromised by ongoing manufacturing headwinds. German manufacturing sentiment has retreated in the last two snapshots, underlining that weak GDP trends look set to extend into H2. Indeed, given that German business expectations have retreated in June/July, underlines that the recent accumulation in speculative long EUR positions, are likely to prove to be contained and could limit EUR upside.

While activity levels, at least in Germany continue to be tested, broad inflationary expectations remain well contained. While ECB hawks such as German Governing Council member Schnabel remain wary of 'last mile' inflation difficulties we continue to expect modest activity levels and benign inflation expectations to support current ECB pricing (note the 5y5y EUR inflation swap has eased below 2.22% for the first time since September 2022). After starting the process of easing restrictive monetary policy in June we would expect additional easing at the September ECB meeting.

GBP – Time For Position Paring

GBP/USD – Q3 2024: 1.25 | Q4 2024: 1.28

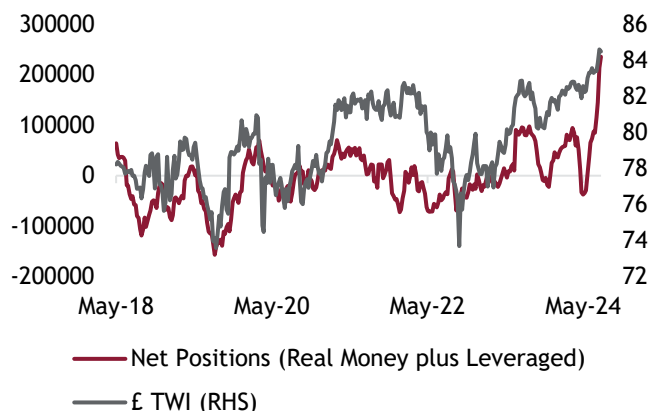
The last two months have witnessed an aggressive rebuild in Sterling positions, aggregated holdings extended beyond 2014 extremes in late July. A key constituent in Sterling's re-rating proved to be the expectation of a period of extended political stability post Labour gaining the biggest election majority since 1997. The market hopes the political transition will result in a graduated reset in UK/EU relations. The latter is a long term project, as are hopes for a graduated uptick in net foreign direct investment. Attempts to accelerate the trend rate of growth, improve EU relations, allied to a prospective increase in FDI flows provides scope for a long term upward re-rating of Sterling, albeit that could be more a story for 2026.

The positioning adjustment accompanied the mid-July spike beyond 1.30. However, we expect positioning to moderate as

investors digest the first BoE rate cut, to 5.00%, since March 2020. Although we anticipated an MPC cut in August, the move was far from fully priced. However, given the nature of the MPC vote, via a 5:4 split, Governor Bailey held the casting vote, underlines that while the BoE may have moved to cut rates the path towards easing monetary restriction will prove measured. We expect another 25bps ease in November.

Despite our bias towards a graduated easing, GBP/USD looks set to trade below the mid-point of the 2024 trading range, at 1.2672. As the economy is set to operate at well below trend into H2, we would expect building spare capacity to encourage an easier monetary policy stance into next year, containing GBP impetus into Q4. That being said we expect a graduated GDP acceleration into 2025. We expect the cyclically correlated currency to benefit from rising global trends alongside hopes of a graduated uptick in foreign direct investment.

Chart: GBP Long Positioning Remains Elevated



Source: LSEG Datastream, CIBC Capital Markets

CHF – SNB President to Ease the Transition

EUR/CHF – Q3 2024: 0.97 | Q4 2024: 1.00

The latest Swiss KoF business sentiment indicator which tends to lead GDP by 1-2 quarters, revealed the first correction in four months. The July survey retreat comes against the backdrop of the survey revealing weakening consumer demand and sliding foreign appetite for domestic products. Negative developments were noted in a number of sectors, including construction, services, hospitality and broader manufacturing.

The SNB are likely to pay close attention to the key business barometer, not least as manufacturing sentiment has proved to be well below the 50 expansion line since the start of 2023, the series has averaged a mere 44.0 since the start of 2023. Previously service sector activity had offset manufacturing headwinds. However, early signs of service headwinds, accompanied by renewed CHF strength, the Swiss currency is the strongest G10 performer over the last three months, supports the presumption of additional central bank proactivity.

Having already cut rates twice in this cycle, we continue to expect an additional 25bps in September, remember this meeting will mark the last for current SNB President Jordan. We anticipate that the outgoing president will be keen to ease the transition of his successor, current SNB Vice President Schlegel, by easing the target rate to 1.00%. However, beyond a third ease in this cycle, given the presumption of a persistent price undershoot, we would be unsurprised should the bank consider additional steps to boost export competitiveness and/or encourage imported inflationary pressures via a cheapening in the currency. Aggregated CHF shorts although marginally pared from recent extremes remain close to levels not witnessed in five years. The disconnect between the CHF and positioning reflect ongoing risk dynamics. Should we witness a moderation in the latter this supports the notion of a reversal in recent CHF outperformance.

SEK – Pressure on the Riksbank to Act

EUR/SEK – Q3 2024: 11.50 | Q4 2024: 11.21

After holding rates at 3.75%, as expected at the June Riksbank meeting, we anticipate a second policy ease in this cycle at the 20 August policy decision. Key to the easing narrative remains the broad downtrend in price pressures. Given that the central banks policy target, CPIF, has almost totally reversed the energy inspired price spike (CPIF peaked at 9.3% in February 2023) it's hardly surprising that the market is not only fully pricing in a move at the next meeting, but it's almost fully pricing an additional 25bps by November. The June MPR detailed a lower policy path than that assumed in March, indeed the 2025 Q1 rate path is now assumed to be 3.08%.

Assuming that inflationary pressures remain in line expectations we can expect the market to continue to anticipate three

cuts prior to year-end; there are four central bank decisions. Unsurprisingly in view of an ongoing bias towards easier policy consumer confidence and the broader economic tendency survey continue to remain well supported. A 10th straight gain in consumer sentiment has resulted in the series advancing to levels not seen in two and a half years. Although the economic tendency may have slightly moderated in July, the series remains comfortably above the 12m MAV. The combination underlines that amidst rising real wages and falling rates the backdrop for the cyclically correlated SEK should prove supported.

An easier monetary policy backdrop, supporting consumer demand validates the prospect of a substantive acceleration in underlying activity into 2025. The SEK remains sensitive to external policy dynamics. However, the prospect of stronger macro influences favours a graduated SEK recovery. Indeed we would expect EUR/SEK to head back towards the long-term average (10.76) over the next 12 months.

NOK – Rates Still Higher For Longer

EUR/NOK – Q3 2024: 11.71 | Q4 2024: 11.25

The brief EUR/NOK flirtation above the 12.00 threshold in late July underlines both a substantive undervaluation in the NOK, it remains close to 10% undervalued on a real effective exchange rate basis, but also its susceptibility to risk off episodes, irrespective of the support provided by an exaggerated current account surplus. Although the daily correlation between NOK and the VIX may have diminished from Q1 2023 extremes, episodes of risk negativity, underline ongoing NOK challenges.

Beyond immediate risk uncertainties we would underline that while investors across the continent of Europe continue to speculate on prospective Q3 easing, we anticipate that the Norges Bank will remain a monetary policy laggard. The presence of a higher for longer narrative suggests rates remaining at the current 4.50% threshold into Q4. Currently the market is pricing in around 17bps of easing by the December policy meeting. Policy inertia over the next three central bank decisions is a function of underlying inflation remaining above target, albeit CPI eased to a two year low of 3.4% in June. Immediate Norges Bank policy reticence remains a function of the bank remaining wary of prices holding above the 2% target threshold for a protracted period, out to 2027.

In addition to rates potentially remaining at current levels into year-end, we would note that a tight labour market supports ongoing wage growth. Rising real earnings tend to correlate well with the trade weighted NOK. Moreover, rising wages point towards the notion of stronger household consumption, boosting economic activity into next year. Central bank policy reticence and improving macro fundamentals favour a correction in NOK undervaluation, external risk dynamics notwithstanding.

Asia-Pacific

Maximillian Lin

JPY – Blame Stretched Japanese Investor Positions, Not the BoJ

USD/JPY – Q3 2024: 149 | Q4 2024: 148

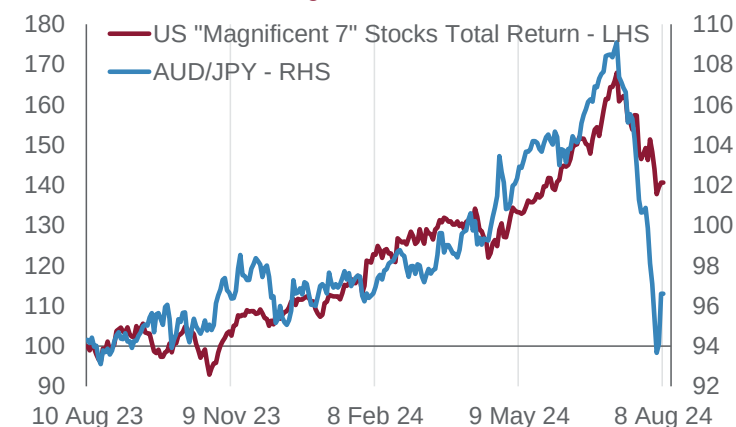
There were two drivers of yen strength since late July: (i) BoJ tightening and (ii) consensus trade unwinds amid the sell-off in US tech. The macro narrative of focused on (i), but in our view, the primary catalyst was (ii) weakness in US tech stocks. USD/JPY began heading lower on July 25th Asia time – right after the disappointing earnings results of a couple of the “Magnificent Seven” stocks.

The best way to see this relationship is to look at a chart comparing the AUD/JPY cross against the M7 total return (first chart below). As risk sentiment stabilize, we think that the temporary yen strength will continue to reverse. Much of the normalization in the USD/JPY already happened. On Wednesday August 7th USD/JPY rose in reaction to dovish comments by BoJ Deputy Governor Uchida, who noted that the BoJ “won’t raise rates when markets are unstable.” Uchida’s remarks follow press articles criticizing the BoJ, with critics claiming the BoJ should not have hiked ahead of the equity market volatility.

In our view, criticism of the BoJ is unfair. Although it’s true that stretched positioning in Asia exacerbated market fears, we think the BoJ was a bystander in this whole episode. It is hard to attribute extreme yen strength and the Nikkei’s declines to a minor 15 bps rate hike. On Friday August 2nd (ahead of the US NFP print), 2y JGB yields actually fell, reflecting more dovish BoJ expectations as risk sold off. The JGB rally amid weak sentiment continued on Monday August 5th (second chart below).

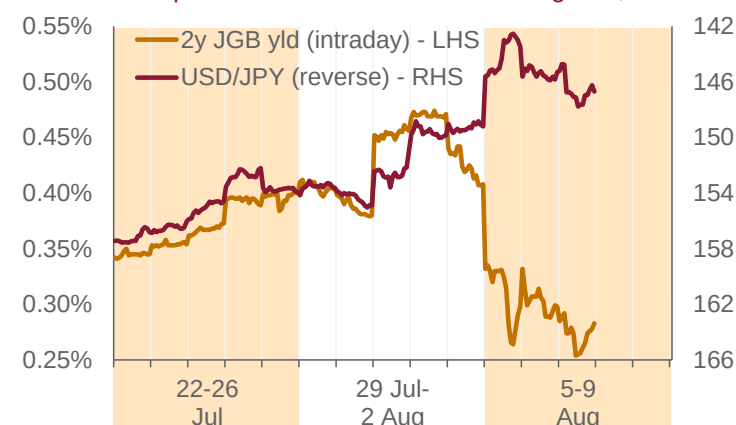
Once Fed pricing normalizes to a more realistic forecast for 2024 FOMC cuts, we expect some marginal USD/JPY upside to 149 in Q3. We think USD/JPY topside will struggle above 150; after living through the squeeze to 142, the FX market will be wary of being overly extended cross yen, just likely the equity market will be wary of retesting the July highs in “Magnificent Seven”.

Chart: AUD/JPY and “Magnificent 7” Stocks Rose and Fell Together



Source: Bloomberg, CIBC Capital Markets

Chart: BoJ Expectations Shifted Dovish on Aug 2nd, Ahead of US NFP



Source: Bloomberg, CIBC Capital Markets

AUD – Risk Recovery and a Hawkish RBA Should Support AUD

AUD/USD – Q3 2024: 0.66 | Q4 2024: 0.67

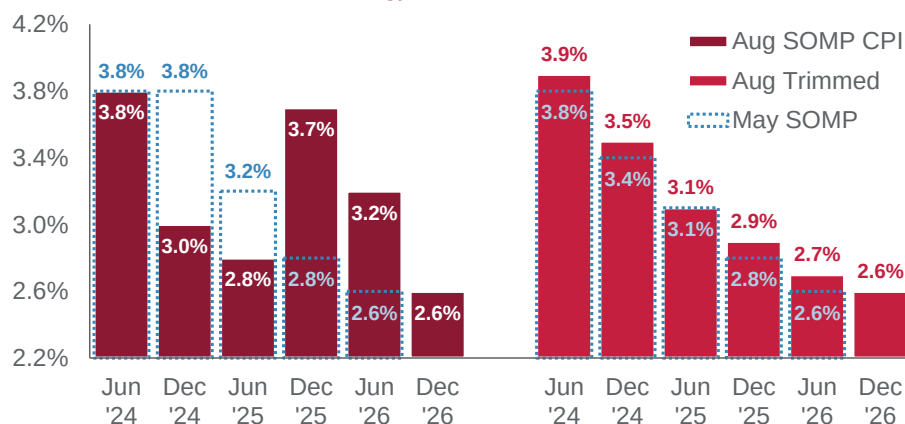
As we noted in the JPY section, AUD/USD weakened sharply in July as long AUD/JPY carry trades unwound. Weaker Australian Q2 CPI data relative to consensus also led to unwinds in AUD/NZD, which was a popular trade amid the narrative of a hawkish RBA (risk of hikes in August) vs a dovish RBNZ.

Consensus were expecting a “hawkish hold” heading into the August RBA decision. Although some of the broad market panic late last week led to increased dovish expectations, equity sentiment had already stabilized in the hours ahead of the RBA meeting on Tuesday. Notably, there were no last minute calls for an August cut by onshore economists during the Monday Asia panic, given Australian markets were closed for holidays.

Governor Bullock was fairly blunt (and hawkish) when she noted that market expectations for a rate cut “are a little ahead of themselves” and that “a near-term rate cut doesn’t align with the RBA board’s thinking.” That likely rules out a rate cut at the November and December meetings, in our view. We (and the market) had expected a slight upside revision to trimmed mean CPI forecasts within the updated August SOMP. For the RBA, the “bottom line” is that Q2 core CPI was not low enough for a pivot.

For AUD/USD, The sell-off in US tech equities during the last two weeks coincided with AUD/USD declining, and on Monday AUD/USD was squeezed to lows of 0.6350 as AUD/JPY carry trades continued unwinding. We think AUD liquidity likely exacerbated the squeeze, given the Australian holiday. Now that prior consensus long AUD/JPY positions have been reduced, we think AUD/USD has scope to rebound to 0.67 in Q3 as risk sentiment recovers.

Chart: The August SOMP Raised Core CPI Forecasts Higher. All-items CPI Saw High Inflation Shift to Dec 2025 and June 2026, Due to One-Off Energy Rebates



Source: Bloomberg, CIBC Capital Markets

NZD – The August RBNZ is a Close Call; we Think Patience Will Prevail

NZD/USD – Q3 2024: 0.61 | Q4 2024: 0.62

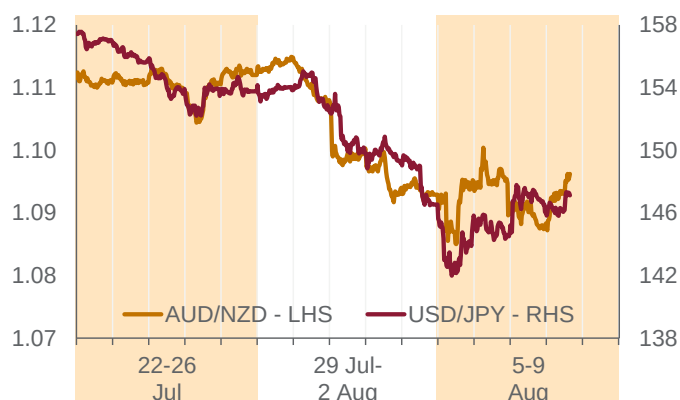
Similar to the Aussie, the Kiwi weakened sharply in July as long cross-yen carry trades unwound. However, the kiwi did outperform its antipodean peer amid the risk-off move. Like US tech shares, long AUD/NZD was a popular trade which faced unwinds during late July and early August. The first chart shows that USD/JPY was also correlated to AUD/NZD, particularly on Monday August 5th (the depths of the Nikkei sell-off).

Long AUD/NZD was a popular trade due to the underlying narrative of a hawkish RBA (possibly hiking in August) vs a dovish RBNZ (possibly cutting in August). Although the RBA decided to leave rates unchanged on August 6th, investors still like long AUD/NZD as a thematic trade. The New Zealand economy is showing relative weakness, and the RBNZ, which hiked more aggressively in 2022-23, is believed to be closer to its cutting cycle.

We agree that the RBNZ is marginally more dovish than the RBA, but we are not 100% sold on a RBNZ cut next week. It's true that during the July RBNZ meeting Governor Orr was more confident about the disinflationary trends. On balance, however, we think the RBNZ will wait until October or November before cutting. Although Q2 CPI was below expectations (and below the May MPS forecast level), it was above the February MPS forecast level (second chart below). Our forecast for Q3 CPI (based on Q3 expectations data) is 2.9% y/y; the second chart below shows that would be above the Feb MPS level.

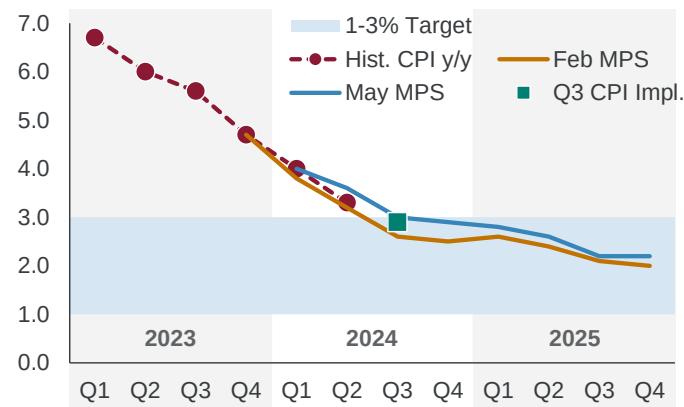
We mention the February MPS because that set of forecasts still showed the OCR rate for Q4 at 5.57% (7 bps higher than current). Hikes are clearly off the table, but the February MPS (and more hawkish May MPS) forecasts conveyed the RBNZ's overall cautious / hawkish stance. For NZD/USD, the normalization in risk sentiment and a less dovish than expected RBNZ point to a rebound to 0.61 in Q3.

Chart: Unwinds in USD/JPY Coincided with Unwinds in AUD/NZD



Source: Bloomberg, CIBC Capital Markets

Chart: Q2 CPI Was In-line With the Feb and May MPS. The Prior MPS Statement Still Forecasted Hikes in Q4



Source: Bloomberg, CIBC Capital Markets

CNH – The PBoC Cut Rates, But the Yuan Still Strengthened Amid Unwinds

USD/CNH – Q3 2024: 7.20 | Q4 2024: 7.22

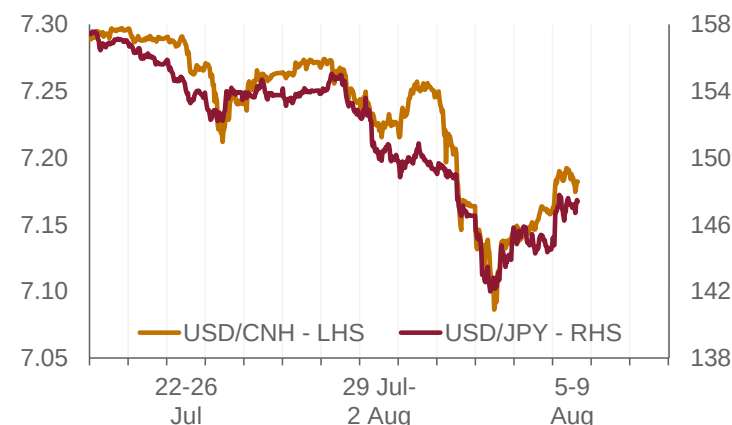
The PBoC surprised markets in late July by cutting the 7-day reverse repo rate 10 bps (from 1.80% to 1.70%) and cutting the 1y MLF rate by 20 bps (to 2.30%). The decision to cut rates comes as a surprise to us. In our FX Thematic Note published last month, we noted that a Q3 rate cut was unlikely because such a move would run counter to the PBoC's recent efforts to slow / reverse the rally in Chinese Government Bonds (CGBs).

We remain skeptical that such a minor reduction in lending costs will revive consumer faith in property or business demand for loans. As we noted last month, the fact that 1y CGB yields lows are below the 7d rate points to weak demand for loans, which has resulted in excess balance sheet capacity amongst Chinese commercial banks.

Yuan strength in July, despite the rate cuts, is counterintuitive. The unwind in consensus trades spurred a correction in USD/JPY as well as USD/CNH, and Chart 1 shows the correlation between the two exchange rates since late July. The yuan does not usually share the yen's reputation as a "haven currency," but still strengthened amid unwinds. For macro investors, one-way gradual yuan weakness (on sluggish China growth) was seen as a one-way bet. Not only is the PBoC cutting rates, it has also nudged the USD/CNY fix higher so that China could maintain export competitiveness and minimize outbound supply chain realignment amid US-China tensions.

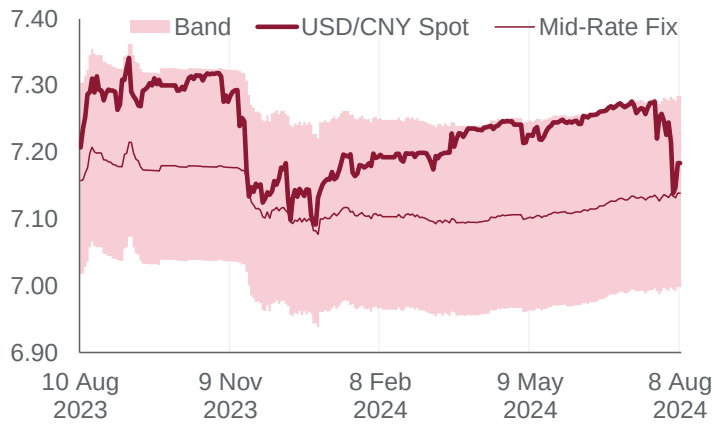
Chart 2 shows that the USD/CNY onshore spot corrected back to mid-point amid the squeeze in yuan shorts. Prior to July, USD/CNY spot was near the upper limit amid the gradual rises in the USD/CNY fix. In hindsight, the risk-reward profile for chasing weaker yuan was poor, given the incremental USD/CNY upside. However as equity sentiment normalizes, we expect gradual USD/CNH topside back towards the upper limit. We forecast a rebound to 7.20 by Q3 and 7.22 by Q4..

Chart: CNH Correlation with JPY Reveals the Yuan's Haven Status



Source: Bloomberg, CIBC Capital Markets

Chart: Amid the Risk-off, CNY Spot Traded Back to the Midpoint



Source: Bloomberg, CIBC Capital Markets

Emerging Markets

Latin America

Luis Hurtado

MXN – US Election Risks, and Constitutional Reforms Will Keep the MXN Under Pressure For the Remainder of Q3

USD/MXN – Q2 2024: 19.20 | Q3 2024: 18.50

Among the sticky points into the November 5th election we see: tariffs/USMCA review, migration, and security/drug trafficking. Credible tariff threats will add an extra layer of uncertainty ahead of the USMCA review, and expected constitutional reforms in Mexico, triggering nearshoring related investment delays, and muddying the growth outlook this year and into 2025. Moreover, note that beyond the first two weeks of June, the weakness in the MXN has been driven by external factors (i.e. of winding of carry trade as JPY appreciated, Middle East tensions). While on the monetary policy front, the market overcorrected to increased expectation of rate cuts in the US for this year - a situation that appear to have corrected with the gradual/ cautious easing cycle signaled on August 8th, but that doesn't alter our view of consecutive rate cuts throughout 2025.

The market forgets quickly but long USD/MXN positions during risk-off episodes were the norm before the carry trade frenzy (see chart below). August 5th move in USD/MXN is a good example on what we can expect for the remainder of Q3. The pair moved as much as 5.4% to 20.2181 (highest since Sep 2022) before correcting towards the 19.50 area the following day. Moreover, recall that in the 2014-2017 period USD/MXN maintained a steady upward trend despite Banxico intervening to contain volatility. This is a situation we would not rule out for the remainder of Q3 and into the November US Presidential election.

All in, given increasing local and external risks, we have modified our Q3 USD/MXN forecast to 19.20 from the previous 18.50, and our year-end estimate to 18.50 from 18.00. However, we highlight that we don't rule out sharp but brief spikes above 20.00 as risks are clustered in the month of September (constitutional reforms, CBs rate decisions, US Presidential debate). Hence, we maintain our preference for buying USD/MXN dips below 19.00 mark in the coming weeks.

BRL – Hawkish BCB but No Rate Hike Signal

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

We have already seen a significant depreciation of the BRL since the start of June. Intrinsic fiscal risks and the increase in FX vols driven by external events, and the subsequent decline of popular carry trades were the main factors behind this trend. Although the government's spending freeze announcement in the last week of July provided a brief support to Brazilian assets, the current administration's ability to comply with its fiscal targets remains seriously compromised. This situation should limit BRL gains despite a cautious/hawkish stance by the BCB and rate hike expectations in the coming months. Moreover, the negative dynamic between the government and the BCB will keep concerns about a dovish shift in

the BCB's stance into 2025 intact as BCB President Roberto Campos Neto is replaced at the end of the year. We also highlight that the increase in hawkish remarks by the BCB will not be well received by the government, and anticipate any BRL gains from such stance to be offset by the negative rhetoric from Lula's government.

All in, we expect the BCB to carefully balance upside inflationary pressures and any negative market repercussions arising from recurrent discrepancies with the government by keeping the selic rate at 10.50% for as long as possible. However, the BCB will continue to repeat the need to keep the ex-ante real rate at significantly restrictive levels (currently 227bps above neutral) going forward, leaving the door open for small rate hikes ("policy tweaks") if inflation expectations start to move in the wrong direction (one or two 25bps rate hikes are possible this year). We maintain our Q3 USD/BRL forecast at 5.50, but recognize that fiscal noise, external risks, and the uncertain monetary policy path for the BCB could cause abrupt but likely brief moves towards the 5.75-5.90 range this quarter.

CLP – Are Intermittent Rate Cuts the Norm Now?

USD/CLP – Q2 2024: 900 | Q3 2024: 880

In a unanimous decision, the Banco Central de Chile kept the overnight rate at 5.75% in line with our forecast. Note that despite consensus expectations of a rate cut on July 31st, market pricing was evenly split between a cut and a no cut. Hence, provided we don't see a steady decline of copper prices. We expect the BCCh's pause to push USD/CLP towards the 920-930 range in the coming weeks.

We are also optimistic about the CLP prospects for the remainder of 2024. Fiscal and political risks are at their lowest levels since the end of Q3 2019, while we only expect two additional 25bps rate cuts this year (September and December). Moreover, we anticipate investors to put closer attention on intrinsic factors, taking refuge on those assets relatively shielded from US electoral noise (Chile and Brazil have the least exposure to the US via the trade channel) and improving growth prospects. Hence, we maintain our Q3 and Q4 USD/CLP forecasts at 900, and 880, respectively.

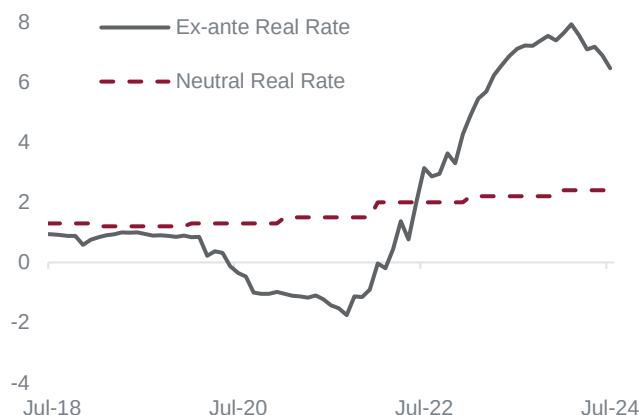
COP – Risks Are Skewed in Favour of Dovish Surprises

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

Despite Banrep's still cautious easing cycle, we point out that while core prices (CPI exc. energy and food prices) have remained above target since January 2022, their downward trend has consolidated. Moreover, 1Y and 2Y inflation expectations have steadily declined since late 2022/early 2023. Notably, 2Y inflation expectations are already inside Banrep's 2%-4% target range and the ex-ante real rate is 426bps above its 2.2% neutral level (the most restrictive in the region). Finally, we are cautious about Banrep's optimistic comments on growth as the government restricts spending to comply with its fiscal targets, and odds of further expenditure cuts announcements in late 2024 and early 2025 are nonnegligible. Please refer to our Persistent Fiscal Risks Will Keep COP Under Pressure note published on our July 12th FX Weekly for more details.

Therefore, with core inflation maintaining its downward trend, a significantly restrictive ex-ante real rate, and downside risks to the growth outlook, we maintain our call of another 200bps (vs. 160bps priced in) in rate cuts by the end of the year. Our forecast entails two 75bps rate cuts (September and October) and a 50bps rate cut in December. Looking at the COP, we expect USD/COP to remain within the 4000-4200 range, with a bias towards the top of the range driven by fiscal risks and larger rate cuts in the coming months.

Chart: Colombia's ex-ante real rate is more than 400bps above neutral



Source: Banrep, CIBC Capital Markets

South Africa

Jeremy Stretch

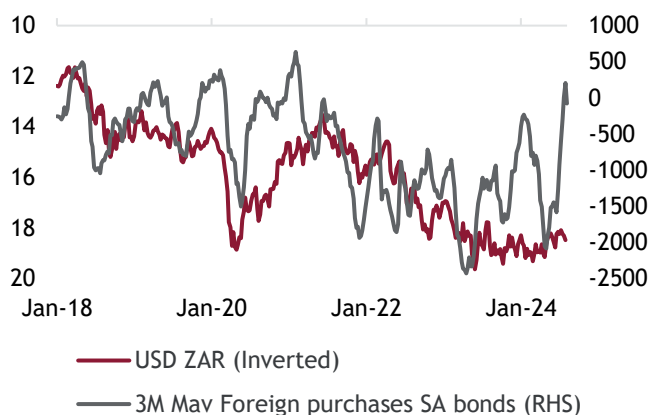
ZAR – Investors Attracted by Real Rates

USD/ZAR – Q2 2024: 17.95 | Q3 2024: 17.65

The ZAR has proved the strongest major spot performer in the year to date. However, in total return terms, including the impact of elevated nominal rates, the SARB held rates at 8.25% at their most recent meeting on 18 July, ZAR outperformance is even more notable. The combination of elevated real yields allied to continued investor optimism in the wake of the formation of a government of national unity (GNU) has resulted in an aggressive accumulation in speculative ZAR long positions. Although ZAR longs maybe only around half July 2022 all-time highs, the net accumulation over the last six weeks is notable, net holdings have accumulated by a factor of eight since mid-June, supporting ZAR outperformance.

Annual headline inflation remained in the upper portion of the 3-6% target band in the June CPI print. Although the 5.1% outturn remains well above recent cyclical lows, 4.7% in July 2023, falling food, fuel and transport prices support the presumption of headline inflation falling below the mid-point of the target range in Q4. Such a retreat, helping anchor inflation expectations, supports the presumption of easier monetary policy into Q4. However, real rates will remain in positive territory amplifying ongoing foreign interest in domestic government bonds. Over the last three months we have witnessed the strongest external purchases of SA bonds since Q1 2021. Assuming a relatively benign political environment, an avoidance of a return of load shedding and/or ongoing investor inflows maintains a constructive ZAR bias.

Chart: Foreign Appetite for ZAR Bonds



Source: LSEG Datastream, CIBC Capital Markets

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