Long-term FX forecasts - The February 2024 update

Tony Nyman | 7 February 2024

FX MAJORS	Current	1-mth	3-mth	6-mth	12-mth	Rates **	Current	Direction of Next Policy Move	Upcoming CB meeting
EURUSD	1.0768	1.0800	1.1000	1.1250	1.1050	ECB refi/depo	4	Down	Mar 7 2024
EURGBP	0.8526	0.8650	0.8600	0.8650	0.8375				
GBPUSD	1.263	1.2500	1.2800	1.3000	1.2900	BOE repo	5.25	Down	Mar 21 2024
USDCHF	0.8718	0.8900	0.8700	0.9000	0.9300	Swiss 3mth libo	1.75	Down	Mar 21 2024
USDJPY	148.04	144.00	140.00	136.00	139.00	Japan o/n call	-0.1	Up	Mar 19 2024
USDCAD	1.3475	1.3500	1.3200	1.2850	1.2650	BOC o/n target	5.00%	Down	Mar 6 2024

IGM Long Term FX Forecasts are updated as at Feb 07 2024.

- A quick reminder we wrote in The 2024 IGM G10 FX Outlook titled 2024 offers no guarantees either that our base case and similar to the issues we encounter in our monthly FX Forecasts updates, if we're to follow the crowd and relegate the USD to an outsize loser, we need to be confident that there are genuine alternatives. We identified AUD as one of the potential winners, but even that looks dependent on a soft US landing and relatively risk on trade as well as genuine recovery out of China.
- So, similar to 2023 and the USD looks to have peaked at 114.78 and 107.35, but losses look like they will stay relatively contained also and we described ourselves asneutralon the USD.
- It is worth noting that DXY USD Index has already retraced/made back over 50% of its Q4 correction (107.35 - 100.62).
- At January's FOMC, Chair Powell accepted the policy rate is likely at its peak for this tightening cycle at 5.25-5.50%, as the Fed Funds were left unchanged, as expected, for the fourth straight meeting. However, the Fed is in no rush to cut either. The statement read it 'does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2.0%.' Powell added 'based on the meeting today, I would tell you that I don't think it's likely that the committee will reach a level of confidence by the time of the March meeting.'
- However, Friday's huge beat in the NFPs (353k vs 185k consensus)andthe AHE (0.6% m/m and 4.5% y/y vs 0.3% and 4.1%) now casts some doubt on even H1.
- Post-payrolls, Fed's Kashkari says a higher neutral rate gives the Fed room to wait on cuts; Goolsbee thinks we need to see more data showing inflation progress.
- On a cautionary note, the commercial real estate sector is a concern, where any regional bank stock coming under severe pressure would likely induce earlier Fed easing being repriced.
- Across G10 though, there has been a pushback against early rate cuts and those H2 2023 market expectations of aggressive easing cycles starting quick!
- Elsewhere, we wrote through much of 2023 and again in January, who is going to challenge US exceptionalism?

- We suspect part of EUR/USD underperformance so far has also been driven by China issues, ie stocks losses amid Beijing's ongoingproperty debt crisis, continued economic underperformance andlack of stimulus.

EUR/USD - Though we raised estimates in January, we maintained material upside beyond most recent peaks of 1.1276 (July 18 2023) and 1.1139 (December 28) could prove difficult. To reiterate, 1.13-1.15 could prove a cap region over the forecast period, as we struggle to identify many independent positives ahead. We stand by that. Much yet may depend on respective interest rate outlooks. The ECB mandate is price stability and sticky inflation would lend Euro material support.Late 2023 saw increasing expectations of more aggressive easing from the Fed than the ECB. Fed over ECB cutting stays priced, but we are more cautious and we would not even be surprised to see Lagarde moving first, at some point in Q2,even though she has been talking the 'summer'. Real EMU growth underperformance and rising risks of imported deflation from China may see the ECB and Fed switch round in the coming months as 'bad reasons' force hands in Europe.We suspect part of EUR/USD underperformance so far has also been driven by China issues, ie stocks losses amid Beijing's ongoingproperty debt crisis, continued economic underperformance andlack of stimulus.

USD/YEN - The broader USD continues with an underlying bid after Friday's huge beat in the NFPs (353k vs 185k consensus)and the AHE (0.6% m/m and 4.5% y/y). Fed speak since has intimated/indicated the board will be patient and March is likely to be too soon for a first easing of the cycle. Yield differentialsa driver through G10, but is a relative laggard right now here. Implied probability for a BOJ rate hike in April stands ~80% even after Japan labour cash earnings missed expectations in December at 1.0% y/y. But, the data is showing some signs of underlying momentum to keep market expectations of the BOJ ending YCC/NIRP policies in H1. Those key Japan annual wage negotiations have already kicked off, garnering big market attention ahead of expected BOJ action later in H1, maybe H2. Recall we wrote The2024 IGM G10 FX Outlook titled 2024 offers no guarantees either in December that policy wise we had previously been waiting on the Spring's wage talks as possible trigger for something more hawkish from the BOJ. We stand by that. Anecdotal evidence apparently indicates some firms plan to conduct wage hikes exceeding 2023's historic gains and topping the inflation rate. Japan's largest labor union federation Rengo is seeking 5%-plus increases and UA Zensen targets 6% vs a 3.85% forecast from the Japan Center for Economic Research. Flows will remain a focus, with one US house talking big USD/YEN supportive Toshins and MOF capital flows data (and Japanese investors on foreign bonds) ahead. In late January, the Japan's top FX official Kanda remarked it is important for FX rates to move stably reflecting fundamentals. In terms of verbal intervention, that's pretty light, but is a reminder to markets that the admin could act closer to or above 150.

GBP/USD - GBP is a relative outperformer in 2024 so far, but Cable continues to stay well away from first big resistance at 1.2800-27. We have been attributing some of that 'success' down to some economic bright spots, particularly early 2024 housing reports similar to the 2023 start, in fact. It felt like the last BOE MPM was fairly seismic. The MPC is more divided than at any point since 2008, with a 2-6-1 surprise split, the one dove Dhingra (who said latterly said demand in the UK economy is so weak now that there's a risk of a big shock from maintaining restrictive interest rates). CB Governor Bailey was keen Thursday to avoid speculating about the timing of any rate cuts, merely stating the previous 'bias' towards hikes is gone. Forecasts wise, the BOE said if rates stay where they are, inflation will fall below the 2% target and the UK's growth potential was revised up slightly to 1.25%, but sub pre-COVID still. So, post-verdict, implied probability of a BOE rate cut in March is just10%;above80% in June, but no -25BPs rate cut is full priced until August. Growth and recession worries, driven by some recent retail sales plunges, could yet change the outlook to something (far) more dovish and prove an independent weight. We described ourselves asneutral-to-bearishin the 2024 outlook and think 1.3250-00 and 1.3500 will be fair obstacles.

EUR/GBP -Yield differentials looking an impacter here. And, the BOE's well publicised pushback on rate cutting against market expectations has perhaps been major reason for EUR/GBP pushing on the base of our well identified 0.8500 - 0.9000 medium-to-long term range (for much of the 2020s so far). The BOE and ECB continue to warn markets that imminent rate cuts are unlikely, but perhaps there is some upside potentialifrate cut expectations are raised again in Europe given the ECB is viewed as the more aggressive cutters in 2024. Growth differentials will also be closely watched, with very real recession worries attached to both. We would also continue to add politics as a big potential impacter here. GBP has had a little fillip recently of Northern Ireland and the return of power sharing government for the first time in two years, with the DUPending a boycott over post-Brexit trade rules. Meanwhile, perhaps one reason for continued EUR underperformance in 2024 is electoral concern through the year. Latest reports suggest Dutch lawmaker Wilders suffered a setback in his bid to form a coalition government and become PM after a center-right party said it wouldn't take seats in his cabinet. A number of Euro members will hold parliamentary elections this year and some others could also see a notable change in government and/or policy direction. Economist Intelligence say policymaking will remain constrained by the challenges of minority government (France), instability and in-fighting (Germany and Austria), a recent coalition collapse (the Netherlands) or a reliance on small hardline parties (Spain). And, rising disaffection with the political establishment increases the chances mainstream parties will co-opt some of the more radical policies of the far right/left into their policy platforms. A big sub-0.8500 break coming in 'a battle of the uglies'?

USD/CHF - So far in 2023, the Franc has been just a mid-ranking performer having been the undoubted G10 star last year. And, we're going to respond, a little, as we mull the possibility that late 2023's 0.8333 low forms a more medium-term base. Swiss CPI in December rose to 1.7% y/y. Core rose to 1.5% y/y too, but has now been below the 2% SNB target for the last eight months. At the December 14 meet, the SNB was seen nearing a dovish pivot with no explicit mention of the possibility of further tightening. The market is pricing in a cut by June. The Bank also announced it is no longer focusing on FX sales. Further, Jordan noted this week that while nominal CHF appreciation helped fight inflation, 2023's appreciation in real terms was concerning for Swiss firms. Meanwhile, Swiss reserves rose again in Q1, to Chf 662.4bln. The fight against inflation has been won at least for now. CHF strength could now be unwanted. Is the SNB now buying FX again to redress the balance? We have long seen the merit of holding CHF in an increasingly uncertain world. War is raging in the Middle East under continued escalation threat; the BRICS have been campaigning for expansion (Saudi Arabia etc) amid speculation it could begin the process of forming a currency/union and threaten the USD's dominance. Switzerland is a neutral actor and a natural haven, but has not been buoyed so far despite the geopolitical mess. We'll keep monitoring (as we wait on January CPI on the 13th next)!

USD/CAD - The BOC have been on hold for the last five meetings at 5.00%. In January, the Bank removed the possibility of a future hike from its forward guidance and pared GDP, inflation forecasts for 2024. At present, a full -25BPs rate cut is not quite priced for H1, ie June. US exceptionalism and growth differentials continue to support here, but once again we believe the CAD is at least part propped on the crosses by its close ties to the US, while Europe and Antipodeans FX are more pressured by their close associations to China and its difficulties. Our Forecasts look a stretch at this stage (too bearish), but we'll give it time. However, we do need to see a more favourable Loonie correlation with the relatively firm oil. Some firms say keep an eye on the Saudi government and no longer requiring Aramco to raise capacity from 12 to 13mln bpd. Global risk demand, as ever, a watch.