Scotiabank

GLOBAL ECONOMICS & FX STRATEGY

FOREIGN EXCHANGE OUTLOOK

January 23, 2025

Contributors

Shaun Osborne
Chief FX Strategist
416.945.4538
shaun.osborne@scotiabank.com

Derek Holt
VP & Head of Capital Markets Economics
Scotiabank Economics
416.863.7707
derek.holt@scotiabank.com

Anibal Alarcón, Senior Economist
Scotiabank Chile
+56.2.2619.5465
anibal.alarcon@scotiabank.cl

Jackeline Piraján, Head Economist, Colombia
Scotiabank Colombia
+57.601.745.6300 Ext. 9400
jackeline.pirajan@scotiabankcolpatria.com

Eduardo Suárez, VP, Latin America Economics
Scotiabank Mexico
+52.55.9179.5174 (Mexico)
esuarezm@scotiabank.com.mx

Rodolfo Mitchell, Director of Economic and Sectoral Analysis
Scotiabank Mexico
+52.55.3977.4556 (Mexico)
mitchell.cervera@scotiabank.com.mx

Ricardo Avila, Senior Analyst
Scotiabank Peru
+51.1.211.6000 Ext. 16558 (Peru)
ricardo.avila@scotiabank.com.pe

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Market Tone

The outcome of the November US elections prompted a paradigm shift in our thinking on the outlook for the US dollar (USD). Ahead of the election, we had anticipated a gradual softening in the USD in 2025 as US growth moderated and US interest rates declined—taming the concept of “US exceptionalism” that has been the essential prop of bullish USD sentiment.

President Trump’s return to the White House and the Republican sweep of the House and Senate, change the calculus for the USD significantly. The USD responded positively to the prospect of a second Trump term but there is still a huge amount of uncertainty about how and when the new administration’s policies will be rolled out. Uncertainty is adding to the increase in FX volatility seen since mid-2024.

The anticipation of tax cuts and deregulation policies are supporting US growth expectations while the implementation of tariffs will support the USD and inflation risks in the US. At the same time, the Fed is adopting a more cautious approach to the policy outlook. Progress on inflation has stalled and policymakers may want time to assess the consequences of President Trump’s policies for the US economy.

Continued on next page …

FX Forecasts

		2024	2025f	2026f	2025f Q1	2025f Q2	2025f Q3	2025f Q4	2026f Q1	2026f Q2	2026f Q3	2026f Q4
Major Currencies												
Japan	USDJPY	157	160	150	157	157	160	160	155	155	150	150
Euro zone	EURUSD	1.04	1.00	1.07	1.02	1.02	1.00	1.00	1.03	1.03	1.07	1.07
	EURJPY	163	160	161	160	160	160	160	160	160	161	161
UK	GBPUSD	1.25	1.22	1.30	1.24	1.24	1.22	1.22	1.25	1.25	1.30	1.30
	EURGBP	0.83	0.82	0.82	0.82	0.82	0.82	0.82	0.82	0.82	0.82	0.82
Switzerland	USDCHF	0.91	0.92	0.87	0.91	0.91	0.92	0.92	0.89	0.89	0.87	0.87
	EURCHF	0.94	0.92	0.93	0.93	0.93	0.92	0.92	0.92	0.92	0.93	0.93
Americas												
Canada	USDCAD	1.44	1.45	1.40	1.43	1.43	1.45	1.45	1.44	1.44	1.40	1.40
	CADUSD	0.70	0.69	0.71	0.70	0.70	0.69	0.69	0.69	0.69	0.71	0.71
Mexico	USDMXN	20.83	21.30	21.50	20.70	20.80	21.00	21.30	21.30	21.40	21.50	21.50
	CADMXN	14.48	14.69	15.36	14.48	14.55	14.48	14.69	14.79	14.86	15.36	15.36
Brazil	USDBRL	6.18	5.95	5.83	5.99	5.98	5.96	5.95	5.92	5.89	5.86	5.83
Chile	USDCLP	995	890	870	950	930	910	890	880	870	870	870
Colombia	USDCOP	4,406	4,367	4,364	4,349	4,358	4,375	4,367	4,356	4,363	4,355	4,364
Peru	USDPEN	3.74	3.78	3.75	3.72	3.75	3.78	3.78	3.83	3.78	3.75	3.75
Asia-Pacific												
Australia	AUDUSD	0.62	0.60	0.66	0.62	0.62	0.60	0.60	0.63	0.63	0.66	0.66
New Zealand	NZDUSD	0.56	0.55	0.58	0.57	0.57	0.55	0.55	0.56	0.56	0.58	0.58

f: forecast a: actual

CAD FX Forecasts

Canadian Dollar Cross-Currency Trends

FX Rate	Spot 23-Jan	25Q1f	25Q2f	25Q3f	25Q4f	26Q1f	26Q2f	26Q3f	26Q4f
AUDCAD	0.90	0.89	0.89	0.87	0.87	0.91	0.91	0.92	0.92
CADJPY	108.6	109.8	109.8	110.3	110.3	107.6	107.6	107.1	107.1
EURCAD	1.50	1.46	1.46	1.45	1.45	1.48	1.48	1.50	1.50
USDCAD	1.44	1.43	1.43	1.45	1.45	1.44	1.44	1.40	1.40

Market Tone

We adjusted our outlook for the USD in the wake of the election. The changes are material and reflect our view that the USD's recent dominant performance relative to its major currency peers will continue while investors focus on US cyclical positives—US economic outperformance and relatively high interest rates. The "exceptionalism" factor is expected to be a primary source of USD support in the coming months. In truth, these dynamics were already at play before the presidential election. Resilient US growth data forced markets to reconsider how far and how quickly the Fed would relax policy in late 2024 and 2025 and the election outcome has only served to reinforce those trends.

Our revised outlook for the USD anticipates recent strength persisting in 2025 as the new administration moves quickly to implement its policy priorities. The USD is likely to strengthen to (and potentially through) 1.00 versus the euro (EUR) in the coming months and retest recent peaks around 160 against the Japanese yen (JPY). The Canadian dollar (CAD) may trade back to near the low reached during the pandemic in 2020 (just under 1.47). Trade friction risks slowing growth in Europe and Asia relative to the US, adding to fundamental headwinds for the major currencies. The CAD may be severely affected by tariffs, of course, but slow global growth may also weigh on industrial commodities and energy prices, keeping already soft Canadian terms of trade weak.

Confidence around the bullish outlook for the USD should remain suitably measured, however. While aggressive tariff measures applied broadly will lift the USD materially, there are more than a few potential constraints on the USD's ability to strengthen sustainably. Firstly, markets have already discounted stiff tariffs being implemented quickly in the second Trump term, but early indications suggest a more considered approach may emerge. Too much "good" (i.e., bullish) news may be priced into the USD at this point. It is also unclear how economies that are subject to US tariffs will respond. Secondly, there were reports during the campaign that prominent figures in the Trump team were considering ways of using the (generally highly valued) USD exchange rate to help reshape global trade. President-elect Trump himself remarked on the "big currency problem" that the US has in the form of the super-strong USD (mainly focussing on the Chinese yuan—CNY—and JPY). Thirdly, a robust immigration programme could constrain US growth and drive wages and inflation up in the longer run. Finally, investors may start to question US fiscal policy sustainability as the new administration pursues lower personal and corporate taxes.

While investors are primarily focused on the USD's cyclical advantages now, developing structural imbalances—and the prospect for that trend to accelerate if fiscal policy is loosened significantly in President Trump's second term—do represent a potential challenge to the USD's longer run performance. Investors may demand higher compensation if President Trump's policies (tax cuts) prompt a significant increase in the US national debt. That compensation could come in the form of higher US yields on Treasury debt or a weaker USD or a combination of the two.

History suggests that US deficits (current account and fiscal) as a share of the overall economy do impact the performance of the USD, albeit with a lag. That history also suggests that the window for a negative reaction to rising deficits may open a little wider in the next year or two, especially if debt dynamics deteriorate significantly and growth momentum disappoints.

Shaun Osborne, Canada 416.945.4538

Federal Reserve and Bank of Canada Monetary Policy Outlook

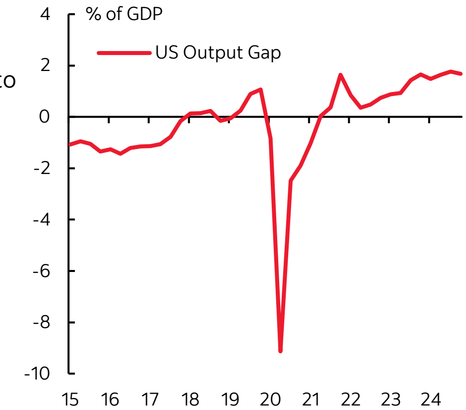
FEDERAL RESERVE—MODEST FURTHER CUTS IN 2025

We forecast two more quarter point cuts by the Federal Reserve in 2025. That would leave the rate around 100bps above the upper end of the estimated neutral rate range.

Key is the starting point whereby the US economy remains in excess aggregate demand. Applying fiscal and regulatory easing including for US banks could inflame imbalances and add to inflation risk. Immigration policies are expected to shrink the US population over the administration's four-year term, creating labour shortages that drive a stable to lower unemployment rate and support wage pressures. Tariffs on imports and retaliation by other countries would amplify inflationary pressures as capacity and labour shortages amplify passthrough risk.

In this context, Treasury yields and the dollar have been tightening financial conditions. For yields, this process may be interrupted by the debt ceiling negotiations, but higher yields are expected to resume thereafter. The Federal Reserve is expected to do likewise by sterilizing stimulus applied to excess demand conditions.

Excess Demand Under Trump 2.0 Vs. Slack Under Trump 1.0



Sources: Scotiabank Economics, CBO.

BANK OF CANADA—A FORK IN THE ROAD

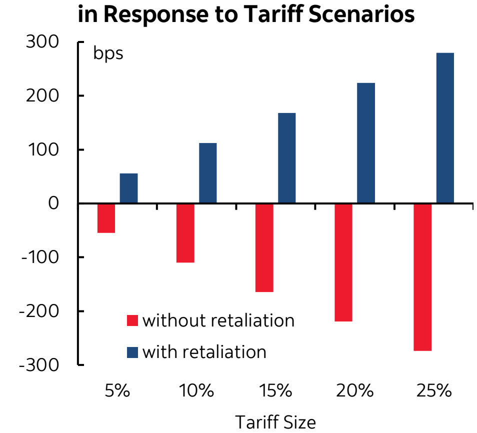
The Bank of Canada is at a fork in the road that requires preserving policy optionality. Our current forecast is for one more cut to a 3% policy rate that could arrive with the first meeting of the new year. Such a move would bring the rate 200bps below the peak and into the Bank of Canada's estimated long-run neutral rate range of 2.25%–3.25%.

Chief among the risks now are trade wars. Global supply chains remain at only a nascent stage of being revamped while posing structural long-run inflation risk. There is a small amount of excess capacity. Tariffs imposed on Canadian exports with no carve-outs for a meaningful period of time and—this is key—with no retaliation by Canada invite further easing. The economy would be tossed into recession, unemployment would rise, pricing power would be crushed, taking inflation down with it. That's a recipe for combined monetary, fiscal and regulatory easing. The Canadian dollar would tumble. In such a case, the policy rate could easily go below neutral and below anybody's present forecast depending in part on the degree of fiscal easing.

With retaliation? Now that's a different tale, depending upon the form of retaliation. Import tariffs applied by Canada would raise prices paid by Canadians. A tumbling currency would add price pressures. Supply chains that are still at a nascent stage of being revamped at home and globally would be severely disrupted in a version of the pandemic. Tariffs rippling through US industry in the context of capacity pressures would result in pass through stateside and create trickle through effects across supply chains into Canada. The outcome would strain the ability of the BoC to achieve 2% inflation, thereby requiring incremental tightening especially with signs core inflation and wages remain hot at the margin. Export taxes instead of import tariffs could change the calculus somewhat depending upon what happens with the proceeds.

If trade wars persist for a lengthy period—à la McKinley, or Smoot-Hawley—then it is probably long-term deflationary. We are assuming that 'the art of the deal' will settle long before then; hello mid-terms. The intervening path requires the Bank of Canada to maintain maximum optionality.

Canadian Policy Rate Changes in Response to Tariff Scenarios



Source: Scotiabank Economics.

Derek Holt, Canada 416.863.7707

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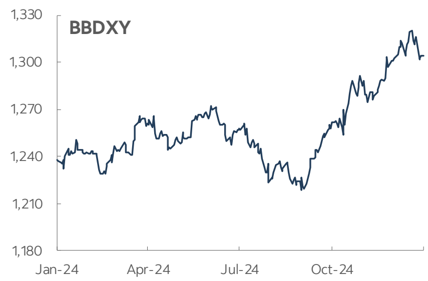
North America

USD

Expectations of Aggressive Tariffs Boost USD **Current spot 1,299.89**



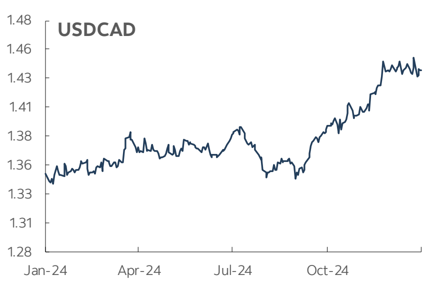
Source: Bloomberg.

USD—The USD is already well on the way to reaching some of our revised forecast targets which anticipate USD strength in the short- (to medium-) term before some moderation. This is broadly in line with the developing consensus following the US election. Technical signals and seasonal trends are USD-supportive for now. But sentiment and positioning data suggest USD gains are starting to look a little "frothy". An "over-owned" and overextended USD may struggle to advance materially in the short run if early policy initiatives (especially on tariffs) do not match market pricing that appears to have discounted quite stiff tariffs being applied broadly and early in President Trump's term.

Shaun Osborne, Canada 416.945.4538

USDCAD

Tariff Risks and Spreads Drive Soft CAD Outlook **Current spot 1.4337**



Source: Bloomberg.

USDCAD—The CAD has struggled in the wake of the US presidential election. President Trump's threat of massive and universal tariffs on Canadian exports to the US has weakened sentiment materially, given the extensive economic harm that tariffs would do. We assume a more measured tariff regime will eventually emerge but downside risks to the economic outlook will ensure that Canadian interest rates remain very low relative to the US for some time, keeping the CAD relatively weak. A return to sub-1.40 levels appears unlikely for some time. A potential change in political direction at home may not improve trade relations significantly—as the UK's Conservative government discovered in the first Trump term following 2016's Brexit.

Scotia Forecasts	Q1-25	1.43	Q2-25	1.43	Q3-25	1.45	Q4-25	1.45

Shaun Osborne, Canada 416.945.4538

USDMXN

Peso Poised to Retain a Weaker Bias **Current spot 20.3307**

Source: Bloomberg.

USDMXN—The Mexican peso could face medium- and long-term pressure due to Trump's tariff policies. Trade uncertainty and the possible imposition of tariffs on strategic sectors, mainly automotive and machinery, could affect investment and international trade, while also hurting the purchasing power of Mexicans (with imported goods consumption massively outpacing that of domestic goods over the past year). Given a dovish Banxico and a hawkish Fed, as well as important Trump headwinds and fiscal worries at home, we believe the MXN will retain a weakening trend over the forecast horizon to trade in the mid-21s zone by end-2025 (with risks tilted towards a higher USDMXN).

Scotia Forecasts	Q1-25	20.70	Q2-25	20.80	Q3-25	21.00	Q4-25	21.30

Rodolfo Mitchell, Mexico +52.55.3977.4556

Major Currencies

EURUSD

EUR at Risk of Parity Test **Current spot 1.0432**

Source: Bloomberg.

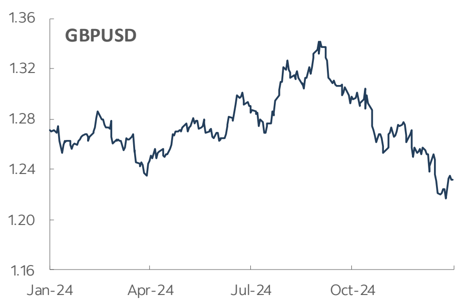
EURUSD—Slow growth prospects and lower interest rates are combining to keep the EUR outlook soft. The EUR weakened sharply following the US presidential election, with European manufacturing susceptible to US import tariffs. Spot losses have moderated but growth and yield disadvantages for the EUR will persist. Markets expect at least 100bps of ECB rate cuts over the coming year. Scotia anticipates total easing may reach 125bps (putting the target rate at 1.75%) by mid-2025, however. A weaker exchange rate might be welcomed by policymakers to help the Eurozone economy recover. A tilt to the right in Germany's Federal election in February may lift the EUR if investors expect a bolder approach to domestic economic policy.

Scotia Forecasts	Q1-25	1.02	Q2-25	1.02	Q3-25	1.00	Q4-25	1.00

Shaun Osborne, Canada 416.945.4538

GBPUSD

Trade Risks and Soft Growth Weigh on GBP **Current spot 1.2369**



Source: Bloomberg.

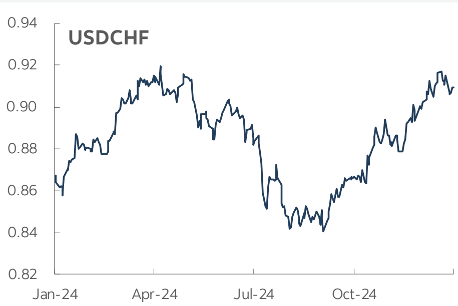
GBPUSD—The GBP ranks among the weakest (with the NZD) major currencies in the aftermath of the US presidential election. The US is a major trading partner for the UK but flows are dominated by services which may leave the domestic economy less exposed to higher tariffs than the Eurozone, for example. Still, the UK economy has its challenges. Demand remains weak and growth is at risk of stagnating. The BoE has been slow to cut interest rates amid sticky domestic inflation and the rise in UK bond yields is threatening the new Labour government's fiscal plans. Spending cuts or more revenue enhancements risk undercutting growth prospects further.

Scotia Forecasts	Q1-25	1.24	Q2-25	1.24	Q3-25	1.22	Q4-25	1.22

Shaun Osborne, Canada 416.945.4538

USDCHF

SNB May Cut Policy Rate to Zero **Current spot 0.9065**



Source: Bloomberg.

USDCHF—The CHF has softened in line with its major currency peers following the US presidential election. The uncertainty that followed the election did drive some initial outperformance in the CHF versus the EUR but the cross based around the 0.92 level which had held the EUR decline earlier in the year. The recent EURCHF lows equate to weakest levels for the cross since the CHF's early 2015 surge and investors may be reluctant to push the currency much stronger. The SNB cut its policy rate 50bps in November, to 0.50%. More rate cuts are expected—swaps anticipate a return to zero rates effectively by the end of the year—and policymakers are not ruling out negative rates to support growth and stem currency gains.

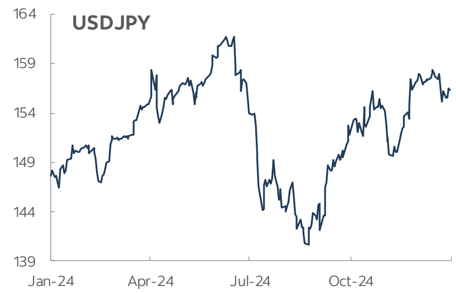
Scotia Forecasts	Q1-25	0.91	Q2-25	0.91	Q3-25	0.92	Q4-25	0.92

Shaun Osborne, Canada 416.945.4538

Major Currencies *(continued…)*

USDJPY

BoJ Policy Normalization Helps Anchor JPY **Current spot 155.95**



Source: Bloomberg.

USDJPY—Further steps towards BoJ monetary policy normalization will look more likely in the coming months, if Japan avoids the imposition of stiff trade tariffs under President Trump. US/Japan interest rate convergence—if only modest in the year ahead—should help steady the JPY near recent lows against the USD at least. The JPY may strengthen more obviously on those crosses where policy convergence will compress spreads more significantly (EUR, CHF). Japanese policymakers have been pre-occupied with managing JPY weakness amid resilient US growth and firm interest rates over the past year. Aggressive intervention suggests a firm ceiling on USDJPY above 160.

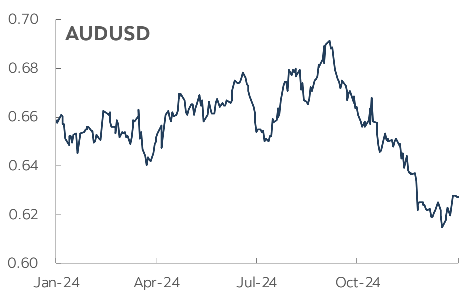
Scotia Forecasts	Q1-25	157	Q2-25	157	Q3-25	160	Q4-25	160

Shaun Osborne, Canada 416.945.4538

Australia

AUDUSD

Threats to Global Trade Hurt AUD **Current spot 0.6296**



Source: Bloomberg.

AUDUSD—The AUD weakened to its lowest since 2020 in the aftermath of the US presidential election although losses have steadied just below the recent range low around the 0.62 cent point. Sticky domestic inflation has left the RBA slow to cut interest rates, leaving the policy rate stuck at 4.35% since November 2023 as rates have fallen elsewhere. That has provided the AUD with little protection against the USD's advance, however. We anticipate some further, moderate weakening in the AUD this year to reach the 0.60 cent point. Losses could become more significant if harsh tariffs are imposed on Chinese exports to the US which would further slow demand for key Australian commodity exports.

Scotia Forecasts	Q1-25	0.62	Q2-25	0.62	Q3-25	0.60	Q4-25	0.60

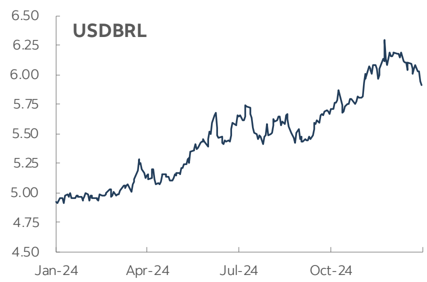
Shaun Osborne, Canada 416.945.4538

January 23, 2025

Latin America

USDBRL

Intervention and Rate Hikes Steady BRL **Current spot 5.8834**



Source: Bloomberg.

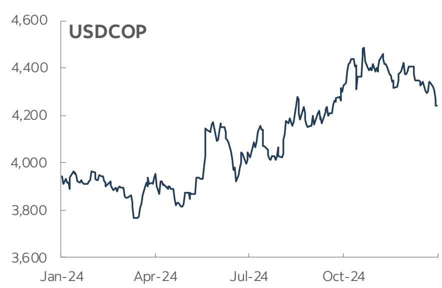
USDBRL—The BRL was one of the two worst performing last year, hurt by uncertainty over fiscal adjustment and 325bps of SELIC rate cuts. However, recent BCB FX intervention and hikes in the SELIC rate to 12.25% have helped stabilize the currency. In a world where a big share of FX volatility is driven by President Trump's tariff threats, Brazil's closed economy is relatively sheltered, even if the US is Brazil's second most important trading partner. Total trade with the US sits at around US$80bn, or around 3.5% of GDP. The biggest impact from President Trump's agenda on Brazil could come from interest rates, as Brazil's fiscal position remains challenging, and the average maturity of its public debt is relatively short.

Scotia Forecasts	Q1-25	5.99	Q2-25	5.98	Q3-25	5.96	Q4-25	5.95

Eduardo Suárez, Mexico +52.55.9179.5174

USDCOP

BanRep Policy Caution Steadies COP **Current spot 4,232.98**



Source: Bloomberg.

USDCOP—After weakening in late 2024 (due to the return of President Trump, a "high for longer" Fed outlook and uncertainty around local fiscal policy), the COP has picked up in early 2025 amid expectations of a more cautious BanRep which is driving carry trade demand. From the fundamental perspective, external accounts are not supporting strong trends in USDCOP. That said, the 4350 level is a macroeconomic anchor for the medium term, and any deviation from that level should be temporary. Fiscal uncertainty supports the outlook for a cautious approach to the easing cycle that may conclude the year with a rate between 7%, according to BanRep's survey, and 7.75%, according to Scotiabank's projection.

Scotia Forecasts	Q1-25	4349	Q2-25	4358	Q3-25	4375	Q4-25	4367

Jackeline Piraján, Colombia +57.601.745.6300 Ext. 9400

USDCLP

Higher Copper Prices to Help Lift CLP **Current spot 986.99**

Source: Bloomberg.

USDCLP—The CLP has depreciated 8% since the previous FX Outlook, reflecting a 7% appreciation in the USD, despite a 1% rise in copper prices. Over this period, the CLP's depreciation was less than that of most of its Latin American peers and has been accompanied by a reduction in bullish bets on the currency by non-residents. Going forward, the start of the Fed's easing cycle, a more hawkish view by the BCCh, and a slight recovery projected for copper prices lead us to anticipate an appreciation in the CLP towards 890 by December this year. In addition, the moderation in political pressure regarding structural reforms seen in recent months would also support our scenario.

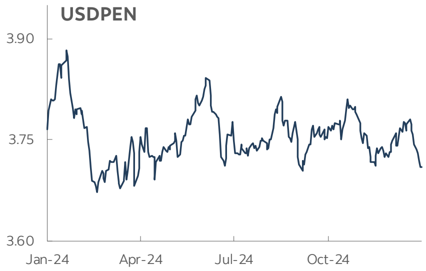
Scotia Forecasts	Q1-25	950	Q2-25	930	Q3-25	910	Q4-25	890

Aníbal Alarcón, Chile +56.2.2619.5465

Latin America *(continued…)*

USDPEN

Broad Range Trade in PEN May Extend **Current spot 3.7110**



Source: Bloomberg.

USDPEN—During 2024, the PEN was the best-performing currency in the region, depreciating by just 1.4%. This occurred in a context of narrowing BCRP and FED rate differentials throughout the year, progress in controlling local inflation, leading to capital outflows (exchange rate depreciation) and increased positive dollar flows in the Balance of Payments (exchange rate appreciation). In 2025, we expect the exchange rate to fluctuate between 3.70 and 3.80, moving higher towards the end of the year as the 2026 general election campaign begins to intensify.

Scotia Forecasts	Q1-25	3.72	Q2-25	3.75	Q3-25	3.78	Q4-25	3.78

Ricardo Avila, Peru +51.1.211.6000 Ext. 16558