Scotiabank.

GLOBAL ECONOMICS & FX STRATEGY

FOREIGN EXCHANGE OUTLOOK

June 13, 2024

Contributors

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

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

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

Sergio Olarte, Head Economist, Colombia
Scotiabank Colombia
+57.601.745.6300 Ext. 9166
sergio.olarte@scotiabankcolpatria.com

Luisa Valle, FX & FI Strategist
Scotiabank Mexico
+52.55.5123.1725
lvallef@scotiabank.com.mx

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Broad US dollar (USD) strength has moderated a little since April when the Bloomberg dollar index (BBDXY) peaked around 1271. The rising trend in the USD through Q1 and early Q2 was supported by the rebound in US rates and it is no coincidence that the peak in the BBDXY coincided with the peak in US short rates around the 5% level as markets reacted to stronger-than-expected inflation and employment data. Progress on inflation remains glacial, notwithstanding the lower-than-expected CPI data for May, but signs of some slowing in the US economy and the labour market may start to weigh on US yields and the USD moving forward.

Federal Reserve (Fed) policymakers remain cautious on the rate outlook. The latest FOMC decision saw rates left unchanged, as expected, but did reveal a shift in Fed thinking on the rate outlook. The dot plot showed that policymakers only expect one 25bps rate cut this year now, down from the three cuts implied in the March round of estimates. A little more (relative to the March estimates) easing was reflected in the view for 2025, however. Chairman Powell reiterated that the dots were not a "plan" and can "adjust". Swaps pricing suggest markets continue to bet on closer to two rate cuts emerging over the rest of the year.

Continued on next page …

FX Forecasts

		2023	2024f	2025f	2024f Q1a	Q2	Q3	Q4	2025f Q1	Q2	Q3	Q4
Major Currencies												
Japan	USDJPY	141	150	140	151	150	150	150	145	145	140	140
Euro zone	EURUSD	1.10	1.09	1.15	1.08	1.07	1.07	1.09	1.11	1.11	1.15	1.15
	EURJPY	156	164	161	163	161	161	164	161	161	161	161
UK	GBPUSD	1.27	1.27	1.31	1.26	1.25	1.25	1.27	1.29	1.29	1.31	1.31
	EURGBP	0.87	0.86	0.88	0.85	0.86	0.86	0.86	0.86	0.86	0.88	0.88
Switzerland	USDCHF	0.84	0.90	0.89	0.90	0.89	0.92	0.90	0.91	0.91	0.89	0.89
	EURCHF	0.93	0.98	1.02	0.97	0.95	0.98	0.98	1.01	1.01	1.02	1.02
Americas												
Canada	USDCAD	1.32	1.36	1.30	1.35	1.38	1.38	1.36	1.34	1.32	1.32	1.30
	CADUSD	0.76	0.74	0.77	0.74	0.72	0.72	0.74	0.75	0.76	0.76	0.77
Mexico	USDMXN	16.97	18.90	20.00	16.56	18.70	18.80	18.90	19.50	19.60	19.80	20.00
	CADMXN	12.80	13.90	15.38	12.23	13.55	13.62	13.90	14.55	14.85	15.00	15.38
Brazil	USDBRL	4.86	5.09	5.09	5.01	5.37	5.11	5.09	5.07	5.05	5.07	5.09
Chile	USDCLP	879	870	870	979	940	900	870	870	870	870	870
Colombia	USDCOP	3,855	4,116	4,150	3,852	4,078	4,102	4,116	4,120	4,125	4,140	4,150
Peru	USDPEN	3.70	3.75	3.75	3.72	3.75	3.80	3.75	3.75	3.75	3.80	3.75
Asia-Pacific												
Australia	AUDUSD	0.68	0.68	0.72	0.65	0.66	0.68	0.68	0.70	0.70	0.72	0.72
New Zealand	NZDUSD	0.63	0.61	0.65	0.60	0.60	0.60	0.61	0.63	0.63	0.65	0.65

f: forecast a: actual

CAD FX Forecasts

Canadian Dollar Cross-Currency Trends

FX Rate	Spot 13-Jun	24Q1a	24Q2f	24Q3f	24Q4f	25Q1f	25Q2f	25Q3f	25Q4f
AUDCAD	0.91	0.88	0.91	0.94	0.92	0.94	0.92	0.95	0.94
CADJPY	114.4	111.8	108.7	108.7	110.3	108.2	109.8	106.1	107.7
EURCAD	1.48	1.46	1.48	1.48	1.48	1.49	1.47	1.52	1.50
USDCAD	1.37	1.35	1.38	1.38	1.36	1.34	1.32	1.32	1.30

Market Tone

As markets have reined back Fed rate cut expectations, expectations for lower rates beyond North America have moderated as well. Inflation is proving somewhat sticky elsewhere, growth momentum is improving moderately and central bankers have tacitly acknowledged that slower rate cuts in the US may affect their own pace of easing. Short-term interest rate differentials which were moving strongly in the USD's favour earlier this year have moderated. With interest rates unlikely to move higher in the US now, it appears that yield support for the USD peaked in the spring. High for longer US rates means a high—but not necessarily higher—for longer USD. Absent other drivers, the USD bull run has likely peaked.

We continue to anticipate some moderation in USD strength in H2 as the Fed gets closer to easing interest rates and markets look ahead to 2025 when the US economy's growth advantage is likely to narrow. Clearly, however, there are risks to the outlook. Geo-political tensions remain evident. Although shipping and freight costs continue to rise as a result of Red Sea tensions, these risks appear manageable for markets at this point. Note that oil prices recently fell to their lowest since February. Heightened volatility in other asset markets could affect the USD's performance. Equity markets are nearing the time of the year that is typically associated with a period of softness. And, of course, the US presidential election is likely to figure as a factor for investors into H2 when candidate Trump's trade policies may come under greater scrutiny.

The Canadian dollar (CAD) is soft and, following the Bank of Canada (BoC) initiating its easing cycle this month, it looks poised to remain soft. The start of the rate cut cycle came a little earlier than we had expected and the dovish tone of the policy statement suggests that further rate cuts will follow fairly quickly. We now anticipate a further three 25bps cuts from the BoC over the next three policy decisions for a total of 100bps of cuts this year. Therefore, we have adjusted our forecast for the CAD lower and expect USDCAD to trade at 1.38 in the next few months before edging a little higher to 1.36 at year-end when the Fed easing cycle should be underway.

In Europe, the Swiss National Bank (SNB), Riksbank and European Central Bank (ECB) have all initiated their own easing cycles now. The ECB's decision was well-telegraphed by rate setters and was easily digested by the euro (EUR). The decision to cut rates was not unanimous (there was one dissenter) and expectations for quick, additional easing were firmly dampened by a cautious outlook from President Lagarde. Data released just after the rate decision showing a pickup in worker compensation in Q1 (to 5.1% Y/Y) might explain policymakers' reticence about providing clearer guidance on rates. Higher wage growth risks stoking second round inflation pressures. Further ECB easing may have to wait for signs that wage pressures are clearly moderating which suggests September at the earliest. The outlook for somewhat slower (than expected) rate cuts should provide the EUR with some support against the prevailing strength of the USD on EURUSD dips back to the 1.07 zone.

Sterling (GBP) took UK Prime Minister Sunak's decision to call a snap election for July 4th in its stride. A general election was due by early 2025. An earlier election amounts to a tacit admission that key concerns for voters (health, education, immigration) are not going to improve for the ruling Conservative party in the next few months. The Conservatives were at a significant disadvantage in the opinion polls before the election call and early campaigning has made a bad situation worse for them. Labour appears to be heading for a "landslide" win. After 14 years of sometimes crass and reckless Tory leadership, markets are at ease with the prospect of a Labour win. Brexit is a low-priority consideration for UK voters right now but a Labour government could forge a reset of UK relations with Europe which would be a mild positive for the GBP in the medium term.

Recent elections in India (where PM Modi's BJP lost its majority) and Mexico, where AMLO's anointed successor Claudia Sheinbaum and the Morena party gained more support than expected, injected volatility and uncertainty into local markets. Mexican peso (MXN) volatility was amplified by carry trades getting squeezed out as investors dumped the MXN in response to the election results. Strong gains for AMLO's Morena appear to have paved the way for constitutional reforms. Elevated US interest rates are helping keep regional Latam currencies on the defensive overall but the MXN's sharp fall in early June leaves it an underperformer versus its Pacific Alliance peers after a sustained period of outperformance.

Data from Japan's Ministry of Finance indicated the authorities spent a record USD62bn supporting the yen (JPY) through late April and into May. Some of that intervention appears to have been financed by the sale US Treasury securities held by the Bank of Japan (BoJ). The JPY remains soft but the aggressive support for the currency and the potential for the BoJ to make further, modest adjustments to monetary policy should help stabilize the JPY around the recent low (160).

Shaun Osborne, Canada 416.945.4538

June 13, 2024

Federal Reserve and Bank of Canada Monetary Policy Outlook

FEDERAL RESERVE—SEPTEMBER IS 'LIVE'

Scotiabank Economics continues to expect the Federal Reserve to stay on hold until September when we think the Committee could deliver a first rate cut. We expect 50bps of cuts this year, with the next one at the December meeting. At present, we think that the policy rate will be gradually reduced to 3.5% by the end of 2025.

A lot has to go right for the FOMC to feel comfortable easing by the September meeting. Nascent evidence of a sharp softening of inflationary pressure arrived in the May CPI report when core CPI landed at just 0.16% m/m SA along with soft core services inflation and further improvement in terms of a falling breadth of price increases. This will probably translate into a very soft core PCE reading at the end of June. There are three more CPI and three more core PCE readings before the September decision which probably explains why 8 on the Committee think -50bps of cuts are possible this year while 7 think -25bps. It will all come down to watching the nearer term data.

BANK OF CANADA—100BPS OF CUTS THIS YEAR

Scotiabank Economics increased its forecast easing this year to 100bps from 75bps after the latest Bank of Canada announcement. Our best estimate at this point is that the BoC will be on a path toward a 3¼% policy rate trough by next summer, thereby maintaining a mildly restrictive stance relative to our estimated neutral rate. The Canada curve is getting richly priced for this expectation.

Since this time last year, we were forecasting a 25bps cut at this June's meeting but pushed that out to Q3 earlier this year. We did that because the economy is tracking materially better than the BoC feared at the start of the year, and because in early May Governor Macklem said he wanted 'months' of additional evidence before deciding to cut.

Nevertheless, when he violated his own forward guidance and cut a few weeks later it was clear that Macklem had seen enough evidence and was in a bigger hurry to jump in ahead of the Federal Reserve. This was not narrative changing for us as opposed to a forecast tweak given Macklem's new stance. We remain concerned about how the economy and inflation risk will evolve as further easing unfolds.

Derek Holt, Canada 416.863.7707

North America

USD

USD Holds Firm, Upside Limited **Current spot 1,264.74**

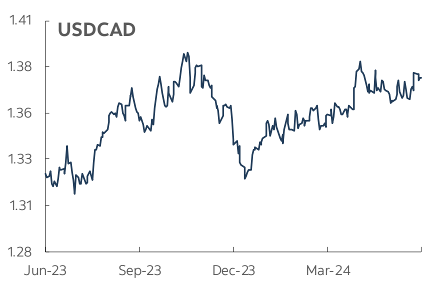
Source: Bloomberg.

USD—A strong for longer USD remains a key feature of the FX markets. US economic data trends have slowed somewhat in the past few weeks while yields have slipped back from early spring highs, prompting investors to pare back their exposure to the USD. But whenever the USD appears to be vulnerable to a more sustained push lower, something seems to come along and revive its fortunes—like the latest Non-farm payrolls data. While scope for losses seems limited at the moment, potential for gains is also perhaps limited as US short rates settle into a well-defined range between 4–5%. The USD remains very "rich" in broad effective terms and we still anticipate some, modest weakness emerging later in the year once the Fed starts to ease rates.

Shaun Osborne, Canada 416.945.4538

USDCAD

CAD Remains Soft as BoC Cuts **Current spot 1.3578**



Source: Bloomberg.

USDCAD—The CAD had traded softly over the past month. It just can't seem to hold a bid, despite improving commodity prices and slightly firmer terms of trade. The BoC's dovish rate cut in June won't help matters, with policymakers signalling a willingness to ease even as the Fed remains sidelined. Wider short-term spreads will keep the CAD on the defensive for now, though spot losses may hold around the recent lows (1.3850/1.39 or USc 72). The "good" news for the CAD is that market positioning data suggest traders are already aggressively short the CAD which likely means that fresh, negative drivers may be needed to extend the CAD's decline. We forecast USDCAD holding around 1.38 over Q2/Q3 and easing modestly to 1.36 in Q4.

Scotia Forecasts	Q2-24	1.38	Q3-24	1.38	Q4-24	1.36	Q1-25	1.34

Shaun Osborne, Canada 416.945.4538

USDMXN

Peso Battered by Political Risk **Current spot 18.6232**

Source: Bloomberg.

USDMXN—The aftermath of the presidential elections has been a rollercoaster. It seems that AMLO will be able to modify the constitution before his term ends and the investor community has shown concern over the lack of counterweights for the new administration and the fiscal outlook. Since then, the MXN has depreciated around 10.20% and political headlines remain the main drive for volatility, which is at maximum levels since 2020. Recently, Banxico said that they would be ready to intervene in the exchange market. But the MXN is no longer the king of carry trade and, in the short term, the local political agenda will likely continue taking its toll on the MXN. Later, it will be the US election's turn.

Scotia Forecasts	Q2-24	18.70	Q3-24	18.80	Q4-24	18.90	Q1-25	19.50

Luisa Valle, Mexico +52.55.5123.1725

Major Currencies

EURUSD

EUR Holds Range After Cautious ECB Cut **Current spot 1.0769**

Source: Bloomberg.

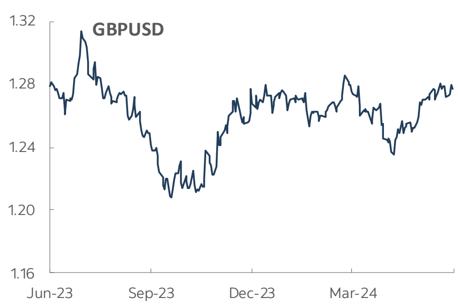
EURUSD—The ECB's cautious rate cut in June suggests the widely anticipated easing process will be a slow process amid sticky service inflation and high wage growth. June's European Parliament elections reflected an expected tilt to the right but the centrist majority remained intact. France's snap election call added to EUR uncertainty but the far-right National Rally seems unlikely to win a majority in parliament. Voting trends reflect populist focus on hot-button issues, such as immigration, rather than the European Union or the EUR which remain popular among participating countries. The elections may have little lasting impact on the EUR. We forecast EURUSD holding around 1.07 over the summer and rising slightly to 1.09 in Q4.

Scotia Forecasts	Q2-24	1.07	Q3-24	1.07	Q4-24	1.09	Q1-25	1.11

Shaun Osborne, Canada 416.945.4538

GBPUSD

Resilient GBP Ignores Election **Current spot 1.2766**



Source: Bloomberg.

GBPUSD—The GBP is unchanged against the USD in year-to-date terms. The GBP's resilience reflects the fact that UK rate cut expectations have been pared back aggressively since the start of the year. BoE policymakers have hinted that rate cuts are near, but the data UK points such as core prices and wages, are not co-operating. Diverging monetary policy between the BoE and ECB is driving EURGBP lower, with the cross trading at its lowest level since August 2022. Meanwhile, Sterling has been unfazed by PM Sunak's decision to call a snap election for July 4th.

Scotia Forecasts	Q2-24	1.25	Q3-24	1.25	Q4-24	1.27	Q1-25	1.29

Shaun Osborne, Canada 416.945.4538

USDCHF

CHF Choppy on Uncertain SNB Outlook **Current spot 0.8956**

Source: Bloomberg.

USDCHF—The CHF has been choppy in the past few weeks. Expectations around the potential for follow-up easing from the SNB after March's surprise rate cut have been volatile amid on target inflation data but stronger-than-expected growth. The June 20th decision is a virtual toss-up from a market pricing point of view, with swaps indicating a 50% chance of a 25bps cut in the SNB's 1.50% key rate this month at writing. The CHF fell to its lowest against the EUR in a little over a year in late May before rising sharply on the back of comments from SNB Chairman Jordan who remarked that the weak exchange rate was a likely source of inflation. A hold this month is possible but lower rates are likely to emerge sooner or later, keeping the CHF tone defensive.

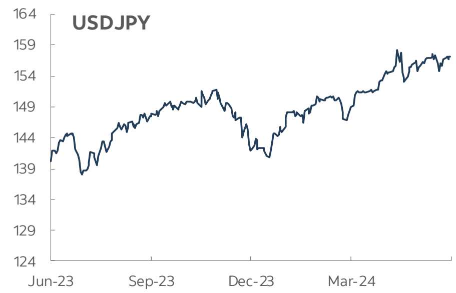
Scotia Forecasts	Q2-24	0.89	Q3-24	0.92	Q4-24	0.90	Q1-25	0.91

Shaun Osborne, Canada 416.945.4538

Major Currencies *(continued…)*

USDJPY

Intervention, Spreads Help Steady JPY **Current spot 157.16**



Source: Bloomberg.

USDJPY—Aggressive intervention, a small increase in domestic rates and some—broad—stability in US interest rates have combined to steady the JPY. The scale of intervention undertaken in May (USD62bn) was a clear statement that the authorities were unhappy with the JPY's performance and that they were willing to act decisively to arrest the JPY's slide, particularly now that the interest rate gap between the US and Japan has steadied (and even narrowed somewhat). The JPY remains extremely weak in broad, effective terms and should improve more significantly once the Fed rate cycle turns, and yield differentials narrow further. We expect USDJPY to edge back to 150 by Q4.

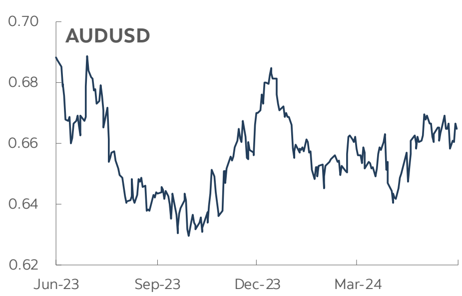
Scotia Forecasts	Q2-24	150	Q3-24	150	Q4-24	150	Q1-25	145

Shaun Osborne, Canada 416.945.4538

Australia

AUDUSD

AUD Holds Range, Focus on Metals, RBA **Current spot 0.6634**



Source: Bloomberg.

AUDUSD—We anticipate moderate gains for the AUD this year (forecast 0.68 in Q4), but the AUD has held in a broad, sideways range between 0.66/0.67 over the past month, close to the mid-point of the range so far this year. Trends in the spot rate have largely tracked the evolution in industrial metals (iron ore) in H1. Yield support may provide some additional backing for the AUD this year. RBA policymakers are making it clear that rate cuts in Europe and Canada will not influence domestic decision-making amid slow progress on inflation. Rate cuts may come only late this year and there is still talk that rates may yet need to move higher to quell prices.

Scotia Forecasts	Q2-24	0.66	Q3-24	0.68	Q4-24	0.68	Q1-25	0.70

Shaun Osborne, Canada 416.945.4538

Latin America

USDBRL

BRL Volatility Jumps on Fiscal Worries **Current spot 5.4057**

Source: Bloomberg.

USDBRL—Fiscal uncertainties have increased in Brazil and with it, its risk premium. President Lula da Silva's administration hasn't been able to reach fiscal equilibrium: high rigid spending and limited revenue growth complicate the outlook. Additionally, Brazil's central bank is no longer expected to keep easing policy; rather, the opposite (curve is pricing close to +100 bps by the end of 2024). However, Lula has said that lower interest rates will support fiscal consolidation, which is further increasing the risk premium, as traders interpret this as political pressure on the central bank to cut rates. As a result, we see little room for BRL to strengthen.

Scotia Forecasts	Q2-24	5.37	Q3-24	5.11	Q4-24	5.09	Q1-25	5.07

Luisa Valle, Mexico +52.55.5123.1725

USDCOP

Lower Rates, Fiscal Policy to Hamper COP **Current spot 4116.67**

Source: Bloomberg.

USDCOP—Carry trades have helped the COP in the short run, as BanRep's easing cycle proceeds gradually. However, recent concerns over domestic fiscal sustainability and regional weakness pushed the COP lower to near COP4000. We expect the COP will ease back to ~4100 by 2H-2024, as carry trade demand will diminish due to lower domestic rates and fiscal fears remain a factor in asset pricing. We continue to forecast COP4116 at the end of the year amid increasing volatility. In fact, our volatility models show COP100 to COP150 intraweek volatility down the road.

Scotia Forecasts	Q2-24	4078	Q3-24	4102	Q4-24	4116	Q1-25	4120

Sergio Olarte, Colombia +57.601.745.6300 Ext. 9166

USDCLP

Firmer Copper Helps Stabilize CLP **Current spot 919.50**

Source: Bloomberg.

USDCLP—Our CLP appreciation scenario has consolidated after the peso strengthened 7% since the previous FX Outlook. Gains are due in part to the strong (9%) increase in the price of copper and the global depreciation of the US dollar (2%). In this period, the CLP has outperformed most Latin American currencies and gains have come hand in hand with an unwind of bets against the peso by non-residents. This, together with the strength of the copper price, less aggressive rate cuts by the central bank and higher GDP growth projected for 2024, leads us to continue projecting an appreciation of the CLP towards 870 by the end of the year.

Scotia Forecasts	Q2-24	940	Q3-24	900	Q4-24	870	Q1-25	870

Aníbal Alarcón, Chile +56.2.2619.5435

FOREIGN EXCHANGE STRATEGY