Scotiabank.

GLOBAL ECONOMICS & FX STRATEGY

FOREIGN EXCHANGE OUTLOOK

April 18, 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

Mario Guerrero, Deputy Head Economist
Scotiabank Peru
+51.1.211.6000 Ext. 16557
mario.guerrero@scotiabank.com.pe

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

FOLLOW US ON TWITTER
@Scotiabankfx
@ScotiabankEconomics

Contents

Market Tone

The US dollar (USD) remains very firm, gaining against most of its major currency peers as slow progress on inflation drove a significant repricing of market expectations for Federal Reserve (Fed) rate cuts this year. In early February, swaps reflected around 150bps of easing expected by the Fed this year. But market expectations have repriced significantly after higher-than-expected US inflation data in January, February and again in March. Fed officials appeared to be looking through the January and February data but the persistence in price pressures is getting harder to dismiss as a "bump in the road" on the way to price stability. Indeed, our own forecasts now anticipate 50bps of Fed rate cuts this year versus 100bps of cuts in our last forecast round. A high for longer Fed likely means a strong for longer USD. Factors driving exchange rates in the coming months are likely to revolve mainly around interest rate policy but also valuation and domestic politics.

Even a cursory glance at the overall performance of currencies so far this year shows that interest rates and interest rate expectations are shaping FX performance significantly. The Mexican peso (MXN) was a top performer overall in 2023 and has only recently lost ground to trade flat against the "king dollar" so far this year. The Banxico initiated its first rate cut of the cycle in March, but the benchmark rate remains elevated (11%) and (nominal and real) yields are still attractive for investors.

Continued on next page …

FX Forecasts

		2023	2024f	2025f	2024f				2025f			
Major Currencies					Q1a	Q2	Q3	Q4	Q1	Q2	Q3	Q4
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	1.33	1.30	1.35	1.36	1.36	1.33	1.32	1.32	1.30	1.30
	CADUSD	0.76	0.75	0.77	0.74	0.74	0.74	0.75	0.76	0.76	0.77	0.77
Mexico	USDMXN	16.97	18.20	19.50	16.56	17.60	17.90	18.20	18.50	18.80	19.25	19.50
	CADMXN	12.80	13.68	15.00	12.23	12.94	13.16	13.68	14.02	14.24	14.81	15.00
Brazil	USDBRL	4.86	4.97	5.07	5.01	5.00	4.99	4.97	4.96	4.98	5.03	5.07
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	3.70	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 18-Apr	24Q1a	24Q2f	24Q3f	24Q4f	25Q1f	25Q2f	25Q3f	25Q4f
AUDCAD	0.89	0.88	0.90	0.92	0.90	0.92	0.92	0.94	0.94
CADJPY	112.3	111.8	110.3	110.3	112.8	109.8	109.8	107.7	107.7
EURCAD	1.47	1.46	1.46	1.46	1.45	1.47	1.47	1.50	1.50
USDCAD	1.38	1.35	1.36	1.36	1.33	1.32	1.32	1.30	1.30

April 18, 2024

Market Tone

The Chilean peso (CLP) is the weakest major currency in year-to-date terms, down more than 10%, as the Banco Central de Chile (BCCh) pursues its aggressive rate cut policy.

Meanwhile, the pound (GBP) is the best performing G10 currency so far this year outside the USD. Markets have been pricing in a shallower and slower round of rate cuts for the UK this year relative to most of the GBP's peers, providing the pound with some support. At the foot of the year-to-date performance table sit the yen (JPY) and the Swiss franc (CHF). The Bank of Japan (BoJ) lifted its benchmark rate to zero, or a little above, from -0.1% in March. This was the BoJ's first rate tightening in 17 years. At zero, however, yield spreads are still widely disadvantageous for the weak JPY. The Swiss National Bank (SNB) became the first G10 central bank to relax monetary policy when it cut its already low policy rate 25bps to 1.50% in March, driving CHF losses against other major currencies.

Our currency forecasts have been adjusted to reflect the outlook a further period of USD dominance this year as Fed policy remains tight relative to many of its major peers. Broadly, however, history does suggest the USD tends to soften once the Fed easing cycle gets underway and investors move out of the US currency to other, higher yielding assets. A mildly weaker USD may yet emerge later this year. Our forecasts anticipate some convergence in growth trends across the major economies moving into 2025 which may be more of a burden for the USD.

In addition to interest rate policy, valuation may become more of a factor for markets in the coming months. In broad terms, the USD looks relatively rich, or expensive, versus its major currency peers. In real effective terms, the USD has risen by around 30% in the past 10 years. This prompts us to think that longer run risks for the USD are tilted to the downside. In contrast, the JPY looks exceptionally weak in nominal and real effective terms. The JPY's real effective exchange rate index reached a record low in Q1. The Japanese authorities are increasingly attentive to yen weakness, with USDJPY trading to new, multi-year highs (the highest since 1990). Comments from officials suggest a high state of alert among monetary officials. Intervention is a major risk if the JPY appears poised to weaken further.

The Canadian dollar (CAD) has lost significant ground in real effective terms in recent years and it also looks relatively cheap against the USD. Soft growth trends late last year and the domestic clamour for relief from tighter Bank of Canada (BoC) monetary policy have weighed on CAD sentiment. Interest rate spreads versus the US have widened, pinning the CAD back to the 1.38 area so where it may stay for now. Domestic growth trends have rebounded sharply in Q1 and the economy appears to be operating on a much stronger level than the BoC expected as recently as January. A sharp pickup in growth will leave policymakers in no rush to cut rates just yet. Our BoC rate call is unchanged (75bps of cuts this year, starting in Q3) but that does mean slightly more BoC easing now relative to the Fed this year versus slightly less in our previous outlook. That outlook is now more or less fully reflected in US/Canada spreads, meaning that while the CAD may not weaken that much more, it will not be able to regain much ground while rate differentials remain so averse.

The GBP remains cheap-looking in our opinion, with GBPUSD stuck on a 1.2- handle. The pound recovered well from the exceptional volatility and uncertainty that descended on UK markets and the political scene in 2022 but a more significant rebound has been limited by broader USD strength and slow UK growth. Growth trends are improving and sticky inflation may yet delay Bank of England (BoE) rate cuts until later this year which may provide the GBP with some support. The domestic political backdrop may add to short-term uncertainty in the pound, with a general election now looking likely in Q4. But the outcome could bolster its longer-term prospects. After fourteen years of Conservative party rule, polls suggest that Labour is heading for a landslide victory. A reset of the UK's relationship with Europe could develop under Labour which would be modestly supportive of the GBP at least in the longer run, particularly against the EUR.

The UK election is not the only vote on the market's radar. The Mexican presidential election will be held in June (polls point to a win for AMLO's heir apparent Sheinbaum) and the political cycle is turning quickly in the US. Investors are likely to become more sensitive to polling trends in the presidential election as the race heats up after the summer. The prospect of another Trump term may lift expectations for a stronger USD—largely because candidate Trump has suggested broad tariffs on imports to the US could be part of his trade policy. Trade tensions could bolster risk aversion and add to demand for the USD. The CAD and MXN, with significant trade ties to the US, would be particularly sensitive to impediments to trade.

There are risks to the assumption of a stronger USD under a Trump presidency, however. Currency policy was somewhat muddled in the first Trump term. At one point, officials were apparently considering whether to intervene to curb USD strength (when the DXY was about 8% lower than it is right now). And there have been reports that Team Trump is considering a weak dollar policy to help rebalance global trade in a second Trump term. Foreign investors, especially those affected by tariff measures, might also be cautious about the potential fiscal/monetary policy mix in another Trump term and demand a higher premium for holding US assets, including the USD.

Shaun Osborne, Canada 416.945.4538

North America

USD

Strong for Longer **Current spot 1,261.66**

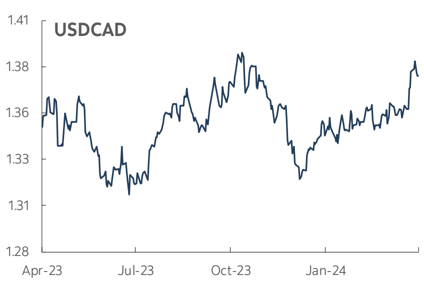
Source: Bloomberg.

USD—Resilient growth and slow progress on taming inflation are combining to underpin US yields and trim Fed rate cut expectations. As a result, USD strength has proven more durable than we had expected so far this year. Our revised outlook for the Fed—fewer rate cuts this year than previously forecast—is driving a significant adjustment in our outlook for the USD in the coming quarters and we now expect USD strength to persist until late in the year. After a rapid shift in market expectations regarding the Fed outlook, the USD will be vulnerable to data which validate the potential for more significant rate cuts again—although that appears to be a low-risk probability at this point.

Shaun Osborne, Canada 416.945.4538

USDCAD

Yield Spreads Keep CAD on the Defensive **Current spot 1.3762**



Source: Bloomberg.

USDCAD—Steady CAD losses in Q1 have picked up early in Q2, against the typical run of seasonal trends which generally favour a softer USD in Q2/Q3. Wider US/Canada yield spreads are keeping the CAD tone defensive, although the 2Y cash bond spread near a 75bps premium for the USD strikes us as particularly elevated. Market sentiment is suitably CAD-bearish; short CAD positioning across speculative, hedge fund and real money traders is elevated but not excessive at this point. Modest gains in commodity prices and solid gains for stocks are mild CAD-positives but are not enough to offset the influence of yield differentials. The CAD may stay soft for now but losses beyond last year's low (1.39 or 72 USc) do not seem justified at this point.

Scotia Forecasts	Q2-24	1.36	Q3-24	1.36	Q4-24	1.33	Q1-25	1.32

Shaun Osborne, Canada 416.945.4538

USDMXN

MXN's Wings Clipped by Higher Volatility **Current spot 16.9995**

Source: Bloomberg.

USDMXN—Earlier this month, MXN reached a new high (since 2015) against the USD at 16.2616. Volatility increased slightly but remained low, contributing to the MXN's status of carry to vol king in Latam through mid-April. But the recent escalation in Middle East tensions has triggered a sell-off in risk that is particularly painful for the MXN. Due to the loaded positioning, MXN is susceptible to risk aversion events (such as the one happening at writing) that trigger exit orders from speculative positions. Banxico's monetary policy path and presidential elections on the horizon (both in Mexico and the US) are the other sources of uncertainty for the MXN in the coming months.

Scotia Forecasts	Q2-24	17.60	Q3-24	17.90	Q4-24	18.20	Q1-25	18.50

Luisa Valle, Mexico +52.55.5123.1725

April 18, 2024

Major Currencies

EURUSD

EUR Pressured by Wide Rate Differential — **Current spot 1.0664**

Source: Bloomberg.

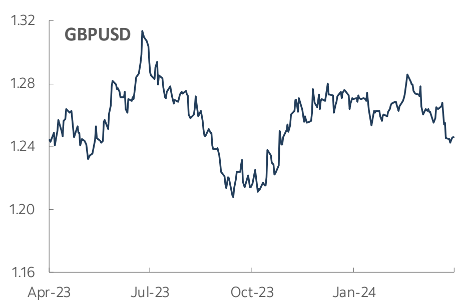
EURUSD—EURUSD's early-year losses risk extending a little more before stabilizing. Macro-economic drivers should improve somewhat for the EUR in the coming year, with the worst of the Eurozone's economic slump now behind it. But near-term trends are likely to reflect the EUR's still significant interest rate disadvantage relative to the USD. A lot of bad news—in the form of anticipated ECB easing—is already priced into the EUR at this point which may help limit losses. Chart signals are leaning negative in the short run. A drop back in the EUR to 1.05 may develop before renewed EUR buying interest emerges.

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

Uncertain BoE Outlook Underpins GBP — **Current spot 1.2450**



Source: Bloomberg.

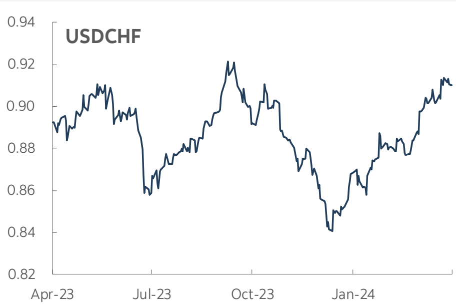
GBPUSD—The GBP remains the top-performing G10 currency so far this year, aside from the wrecking ball that is the USD. Slow progress on inflation may delay the start to the BoE easing cycle. Markets are expecting a September start to cuts, which may support GBP prospects in the short run. Longer run positives—relatively cheap UK assets, a solid improvement in the UK's external accounts position and stability in fiscal policy—are factors that may drive gains in the medium term. A general election is due by early 2025; government manoeuvring suggests a Q4 vote is likely.

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 Underperforms on Easier SNB Policy — **Current spot 0.9100**



Source: Bloomberg.

USDCHF—Easing inflation pressures and an earlier-than-expected start to the SNB's easing cycle has undercut the CHF. The central bank cut its key policy rate 25bps to 1.50% in March. Many market participants had expected a June rate ease. Sharp EURCHF gains so far this year may consolidate in the short run, but front-loading rate cuts leaves the CHF vulnerable to more losses moving forward, particularly if the JPY shows signs of rebounding and investors seek out an alternative funding vehicle for carry trades. EURCHF has already reached our end-2024 forecast (0.98) and risks are geared towards an overshoot of that target towards parity.

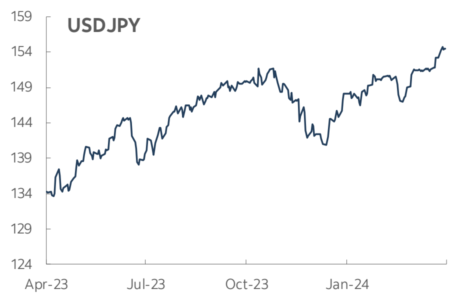
Scotia Forecasts	Q2-24	0.89	Q3-24	0.92	Q4-24	0.90	Q1-25	0.91

Shaun Osborne, Canada 416.945.4538

Major Currencies *(continued…)*

USDJPY

JPY Weak But May be Undervalued **Current spot 154.45**



Source: Bloomberg.

USDJPY—Despite the BoJ raising its benchmark policy rate for the first time in 17 years last month, the JPY remains weak, trading at its lowest since 1990 against the USD. The USD has been supported by rising US Treasury yields but JPY weakness overstates the move in rates and rate differentials. We estimate fair value to be closer to 146 currently. The Japanese authorities intervened aggressively in 2022 when USDJPY neared 152 and have stepped up verbal intervention in recent weeks in response to the currency's latest slide to—and through—that point. Investors are very short JPY and vulnerable to an intervention-driven squeeze.

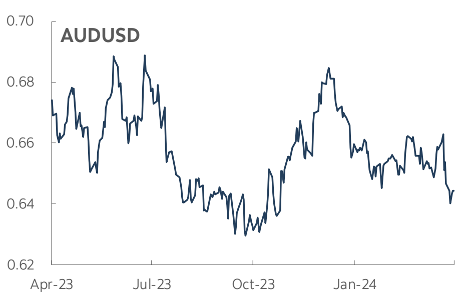
Scotia Forecasts	Q2-24	150	Q3-24	150	Q4-24	150	Q1-25	145

Shaun Osborne, Canada 416.945.4538

Australia

AUDUSD

AUD Pivots Around 0.65, Metals May Support **Current spot 0.6436**



Source: Bloomberg.

AUDUSD—The AUD continues to pivot narrowly around the 0.65 area. We anticipate some gains in the AUD in the months ahead but broader USD strength may sustain the overall range trade for a little longer. Markets are pricing in a very late start to the Reserve Bank of Australia's easing cycle, with no cuts currently anticipated until November. Rising commodity prices—especially in the metals space—are driving a sharp improvement in local terms of trade. But this development has not been fully reflected in the AUD at this point, in our opinion. Market sentiment remains bearish on the AUD but this has led to a situation where positioning appears to be excessively negative. A short squeeze could see the AUD strengthen, or outperform, briefly at least.

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

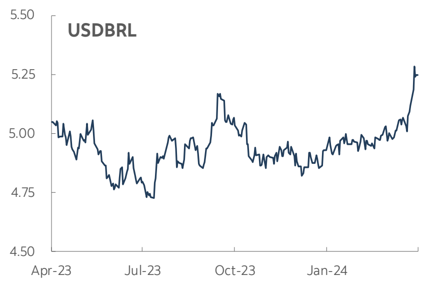
Shaun Osborne, Canada 416.945.4538

April 18, 2024

Latin America

USDBRL

BRL Slides Despite Attractive Yields **Current spot 5.2530**



Source: Bloomberg.

USDBRL—Since the last FX report (Feb 8th), BRL has depreciated 5.17%, despite its very attractive carry and relatively low volatility. Brazil's central bank even signaled in its latest monetary policy committee that it might reduce its easing pace after the next decision, due to rising uncertainty. Besides wage increases and sticky services inflation, both markets and the central bank remain concerned about the government's ability to reach its fiscal targets. In addition, external factors such as the Fed's monetary policy, risk-off events and China's economic activity remain the most relevant headwinds for the currency.

Scotia Forecasts	Q2-24	5.00	Q3-24	4.99	Q4-24	4.97	Q1-25	4.96

Luisa Valle, Mexico +52.55.5123.1725

USDCOP

COP Poised to Drop Back **Current spot 3901.38**

Source: Bloomberg.

USDCOP—After tax season and the temporary shock of the Nutresa acquisition that made the COP appreciate sharply to around COP3800 at the start of April, we expect a gradual return to levels around COP4000/4100 which reflect underlying fundamentals. A hawkish Fed and the resulting gains in the USD, plus some "noise" around political risks will take the COP above COP4000 sooner rather than later. We continue to forecast USDCOP at COP4116 at the end of the year, amid rising 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

Weak CLP Should Recover **Current spot 975.91**

Source: Bloomberg.

USDCLP—The CLP has depreciated by 2% since the last FX Outlook despite the sharp rise in copper prices (16%). CLP losses are largely explained by the appreciation of the DXY (2%). In this period, CLP depreciation has been more pronounced than most Latin American currencies, which have tended to appreciate. We continue to estimate that the current level of USDCLP is above what can be explained by the CLP's main macroeconomic determinants. This, together with the strength of the copper price, less policy 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.

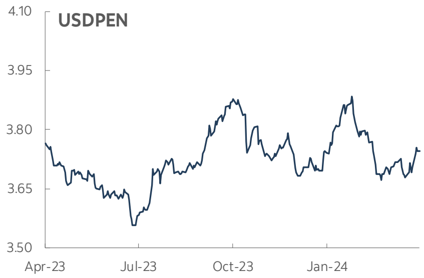
Scotia Forecasts	Q2-24	940	Q3-24	900	Q4-24	870	Q1-25	870

Aníbal Alarcón, Chile +56.2.2619.5435

Latin America *(continued…)*

USDPEN

PEN Holds Near Fair Value **Current spot 3.7466**



Source: Bloomberg.

USDPEN—USDPEN traded below 3.70 during the first half of April, due to the higher seasonal supply of dollars over the annual tax payment period. The PEN is down 1.2% in YTD terms, reflecting weaker EM currencies and a stronger USD in a context of better prospects for the US economy, and upward pressures in the US long-term interest rates. USDPEN's current level of 3.75 is important, since it is the 100-day and 50-day moving average, it is the level that we consider to be fair value, and it is our forecast for the year-end. It is also within the 3.69 – 3.81 volatility-implied range we view as the base. A push to the upper end of the range could develop if the firm trend in US long-term rates and the USD persists. However, strong gains in gold and copper prices should limit movements away from 3.75.

Scotia Forecasts	Q2-24	3.70	Q3-24	3.80	Q4-24	3.75	Q1-25	3.75

Mario Guerrero, Peru +51.1.211.6000 Ext. 16557

FOREIGN EXCHANGE STRATEGY

SCOTIABANK ECONOMICS