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Market Tone

The US dollar (USD) is strengthening into the end of Q2 and its gains are being driven by fundamentals as markets have moved to re-price a considerable amount of Fed tightening in the aftermath of the June FOMC. The outlook for relative central bank policy is dominating and currency markets are shifting away from the sentiment-driven movement that has characterized much of the price action that we've observed since the outbreak of the US / Iran conflict in early March.

Current levels reflect a combination of both fundamental and sentiment-related support resulting from the Fed's hawkish repricing and lingering geopolitical concerns. The balance of risk appears to be somewhat skewed to the downside however, as we maintain a dovish outlook for the Fed and see additional downside risks for the USD as markets re-price for an easing in geopolitical tensions following the peace deal between the US and Iran.

We see few catalysts for additional USD strength from here, and note that current levels in the DXY have been met with considerable resistance over the past year or so.

We have made no changes to our FX forecast and we remain focused on the material downside risks to the USD. Tactical considerations—Fed pricing, sentiment—suggest an exhaustion of near-term support and cyclical risks remain firmly tilted to the downside as the US economy's 'twin deficits' (trade, fiscal) erode longer-term support.

Continued on next page ...

FX Forecasts

Major Currencies		2025a	2026f	2027f	2026f				2027f			
					Q1a	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Japan	USDJPY	157	150	140	159	155	152	150	147	145	143	140
	EURUSD	1.17	1.22	1.24	1.16	1.18	1.22	1.22	1.23	1.23	1.24	1.24
Euro zone	EURJPY	184	183	174	183	183	185	183	181	178	177	174
	GBPUSD	1.35	1.37	1.39	1.32	1.34	1.36	1.37	1.38	1.38	1.39	1.39
UK	EURGBP	0.87	0.89	0.89	0.87	0.88	0.90	0.89	0.89	0.89	0.89	0.89
	USDCHF	0.79	0.76	0.77	0.80	0.78	0.76	0.76	0.76	0.76	0.77	0.77
Switzerland	EURCHF	0.93	0.93	0.95	0.92	0.92	0.93	0.93	0.94	0.94	0.95	0.95
	Americas											
Canada	USDCAD	1.37	1.33	1.30	1.39	1.35	1.34	1.33	1.32	1.32	1.30	1.30
	CADUSD	0.73	0.75	0.77	0.72	0.74	0.75	0.75	0.76	0.76	0.77	0.77
Mexico	USDMXN	18.01	18.38	19.21	17.94	18.04	18.20	18.38	18.56	18.77	18.99	19.21
	CADMXN	13.12	13.82	14.78	12.90	13.36	13.59	13.82	14.06	14.22	14.61	14.78
Brazil	USDBRL	5.47	5.15	5.25	5.18	5.06	5.10	5.15	5.18	5.20	5.23	5.25
Chile	USDCLP	901	870	870	926	900	870	870	870	870	870	870
Peru	USDPEN	3.36	3.35	3.45	3.48	3.40	3.35	3.35	3.40	3.37	3.42	3.45
Asia-Pacific												
Australia	AUDUSD	0.67	0.73	0.75	0.69	0.72	0.72	0.73	0.73	0.74	0.74	0.75
New Zealand	NZDUSD	0.58	0.64	0.66	0.57	0.62	0.64	0.64	0.65	0.65	0.66	0.66

f: forecast a: actual

CAD FX Forecasts

FX Rate	Spot 18-Jun	Canadian Dollar Cross-Currency Trends							
		26Q1a	26Q2f	26Q3f	26Q4f	27Q1f	27Q2f	27Q3f	27Q4f
AUDCAD	0.99	0.96	0.97	0.96	0.97	0.96	0.98	0.96	0.98
CADJPY	114	114	115	113	113	111	110	110	108
EURCAD	1.62	1.61	1.59	1.63	1.62	1.62	1.62	1.61	1.61
USDCAD	1.41	1.39	1.35	1.34	1.33	1.32	1.32	1.30	1.30

Market Tone

Fed Chair Warsh's first meeting delivered a hold that was hawkishly interpreted by markets while offering little in terms of guidance. The Chair communicated a forceful commitment to price stability while also announcing the creation of several task forces to evaluate the Fed's communication, its balance sheet, data sources and measurement, productivity, and the central bank's inflation framework.

All of these areas offer the potential for a lower policy path, as we consider the conventional policy response to balance sheet normalization and declining measures of narrower (trimmed-mean, median) measures of inflation.

Most of the Fed's peer central banks are constrained by single mandates, with a primary focus on headline measures of inflation that have been impacted by the rapid rise in energy costs. Single-mandate, inflation-targeting central banks will maintain a hawkish bias in both their guidance and their policy execution as they push back against the risk of second round inflationary pressures. The divergence in policy rate paths remains a core pillar of our fundamental outlook. Narrowing interest rate differentials have been a critical driver of the broad weakening in the USD from its 2022 peak, and we expect this trend to continue into the end of our forecast horizon.

Growth trends in the US are worrisome, as consumer sentiment remains weak, and forward-looking indices like the Atlanta Fed's GDPNow suggest a material softening into the second half of 2026. Recent growth has also been relatively narrow, and much of it has been powered by significant AI-lead investment spending related to data centres. The US housing market remains incredibly weak, reflecting poor sentiment among homebuilders and ongoing homebuyer-related headwinds tied to the recent rise in mortgage rates.

Scotiabank's central bank forecasts remain directionally unchanged. The Fed is expected to deliver 50bps of easing with one 25bp cut in Q4 2026 and another in Q1 2027. The terminal rate remains at 3.25%.

The Canadian dollar (CAD) has suffered through the latter half of Q2, weakening to fresh 2026 lows on the back of a material widening in US-Canada yield spreads. The BoC's cautious hawkishness has offered a minor headwind, especially when contrasted with the material shift in the Fed's outlook.

The balance of risk favours CAD strength from current levels as market sentiment and positioning largely incorporate many of the downside risks while offering little to those looking for a recovery. The medium-term chart continues to be one of retracement, as the CAD recovers from its late 2025/early 2025 decline. Our fair value CAD estimate continues to hover above spot levels, suggesting some pressures unrelated to fundamentals.

The Bank of Canada forecast was most recently adjusted for timing. The BoC's terminal rate is unchanged at 3.25%. We have maintained our bearish USDCAD forecast with a Q4 2026 target at 1.33, extending to 1.30 by Q4 2027.

The EUR's performance has been dull, owing to its flat one-year range with movement largely centred around 1.15. The retreat from the multi-year January high above 1.20 has been frustrating but also relatively muted, suggesting persistent EUR support in the face of shorter-term headwinds.

The fundamental support has been important, reflecting an ECB that has adopted a much more decidedly hawkish tone and actually delivered the first hike among the G4 (Fed, ECB, BoE, BoJ) central banks since the start of the crisis. This has been followed by the BoJ, delivering the next hike—its first since early 2025—in mid-June. The JPY's muted reaction suggests a desire from market participants for a more forceful commitment to price stability. The yen continues to trade at relatively weak levels, and markets remain concerned about the possibility of official currency management (intervention).

Sterling's (GBP) prospects remain solid, despite near-term political risks related to the Labour party's leadership. PM Starmer's government has been continually buffeted by recurring political issues, opening up the potential for a leadership challenge. The BoE's hawkish stance has softened somewhat, but the central bank is still expected to deliver 50bps in the back half of 2026. Fiscal concerns have softened and key officials have sought to reinforce the government's commitment to self-imposed fiscal rules.

The Australian dollar's (AUD) performance has been notable, delivering fresh multi-year highs on the back of a clear retracement of the decline from 2021. We recently made a modest upward adjustment to the AUD forecast, reflecting earlier than expected gains. For Latam FX, the MXN's performance has been impressive, delivering 4+% gains over the course of Q2. Markets appear reassured by President Sheinbaum's approach to USMCA negotiations. The PEN's modest gain has masked considerable volatility related to the 2026 Presidential Election, whose June runoff has failed to deliver a clear winner at the time of printing.

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Federal Reserve and Bank of Canada Monetary Policy Outlook

FEDERAL RESERVE—WARSH JUST TOLD YOU NOT TO PRE-JUDGE!

As Chair Warsh embarks on a fresh mission to reinvent the operational framework surrounding the conduct of US monetary policy, we counsel clients to expect high volatility, but also greater patience than presently priced for future moves.

Markets are largely pricing a hike by the September FOMC despite 50–50 hold-hike divisions. There are several reasons why we think this may be worth receiving in OIS and hence being careful toward dollar strength.

One major reason is that Warsh was careful to emphasize that he didn't wish to pre-judge the outcome of what five taskforces will report back on starting in the Fall and probably concluding by year-end. To hike as soon as September would pre-judge their guidance and recommendations.

Those taskforces will leave no stone unturned. One will look at Fed communications including the future of the projections, dot plot and press conferences. Another will opine on balance sheet management goals. A third will seek to expand upon and modernize the data toolkit. A fourth will delve into productivity and jobs including how AI and other tech may impact the labour market. A fifth will re-examine the inflation framework—excluding the sacrosanct 2% target—particularly on issues like the best measures.

As Warsh has previously indicated, his preference leans toward trimmed mean PCE that remains trending lower than traditional core PCE. He may argue that today is more about a relative price shock than generalized inflation and monetary policy should look through the former.

How the FOMC judges the state of the labour market depends upon annual benchmarking revisions just before the September FOMC, how hiring holds up into further weakness for household incomes and a plunging saving rate, and what the taskforce says about how rapid tech innovation and jobs.

And while the FOMC would say they conduct independent monetary policy, the current political climate would invite Congressional attacks should they rush hikes before mid-term elections on November 7th. Go ahead, poke the bear.

BANK OF CANADA—BIG BROTHER WENT OFF TO COLLEGE

Our forecast remains in favour of rate hikes beginning toward year-end and continuing into next year. Cumulative tightening of 75bps over 2026Q4 and 2027Q1 remains our baseline.

Our hike view extends to last November and hence pre-dated the Iran war and the concomitant shock to commodity prices. That's an important first point in that the decline in commodity prices of late does not change our view that the economy would gradually re-emerge from an underlying soft patch on core inflation. We are seeing nascent signs of this already with the average of trimmed mean and weighted median CPI over 2% m/m SAAR over the past two months.

We're sceptical that the US-Iran MOU will be durable which could maintain a geopolitical premium across commodity prices. Energy is off the peaks but still expected to remain well above pre-war levels with passthrough still assumed.

We forecast slack to narrow as the economy rebounds with the help of negative real rates due to passive easing, ongoing fiscal supports and the beneficial effects of commodities. Soaring import and producer prices pose material passthrough risk into consumer prices. Productivity-adjusted wages keep rising. So do inventories. Overall cost pressures represented by these factors are accompanied by the costs of trade diversion in light of US protectionism to find new suppliers, new markets, new products and rejigged production. Inflation expectations are above target.

And the BoC's Big Brother has gone off to college, blowing the BoC's cover. As Chair Warsh embarks on an uncertain agenda marked by the creation of five taskforces to report back by year-end the market has assumed a more hawkish FOMC outcome that is punishing USDCAD. At over 1.41, the currency is beginning to test the BoC's tolerances in the context of other sources of imported price pressures and at the widest policy rate differential in decades.

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North America

USD

USD Stronger for Longer on Fed

Current spot 1216.14



Source: Bloomberg.

USD—The USD is heading into the end of Q2 on a firm note. Higher short-term rates and wider front-end spreads have added to USD support, the more so following the latest FOMC which lifted market expectations for Fed rate hikes in the coming months. But the apparent end to the Iran conflict and the prospect of lower energy prices is already weighing on inflation expectations and tighter policy in the early days of a reformist Fed chair look unlikely. Broader dollar gains look stretched and markets are already quite long the USD but strength will persist while markets anticipate a tightening being the Fed’s next move. We think structural challenges (debt/deficits) remain medium-term constraints on dollar gains as well.

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USDCAD

CAD Soft on Wider US/Canada Spreads

Current spot 1.4140



Source: Bloomberg.

USDCAD—The CAD retains a generally weak undertone following the significant widening in front-end US/Canada spreads through May and June. We think early-year data overstate the softness of the Canadian economy and there is little incentive for the BoC to adjust already-accommodative policy. Any relief from spreads will have to come from the US side of the equation for now—but that looks unlikely in the short run. Trade uncertainty is a drag on CAD sentiment, but a protracted USMCA review period is largely factored in. The CAD will underperform relative to our end-Q2 forecast (1.35) but we continue to feel that USD gains through 1.40/1.41 are unsustainable in the medium-term.

Scotia Forecasts

Q2-26	1.35	Q3-26	1.34	Q4-26	1.33	Q1-27	1.32
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USDMXN

MXN Resilient but Softness Lies Ahead

Current spot 17.3740



Source: Bloomberg.

USDMXN—Despite elevated volatility stemming from the Middle East conflict, ongoing USMCA renegotiation noise, US–Mexico political frictions, and Moody’s downgrade of Mexico’s long-term sovereign debt rating, the Mexican peso has demonstrated notable resilience. The currency has remained firm—trading below 17.50 pesos per USD—supported by broad USD weakness and the peso’s high liquidity. This performance is particularly striking given that underlying macroeconomic fundamentals, such as subdued economic growth, a fragile fiscal position, and persistent inflationary pressures, do not appear to fully justify such strength. Looking ahead, we anticipate a gradual depreciation of the MXN by end-2026.

Scotia Forecasts

Q2-26	18.04	Q3-26	18.20	Q4-26	18.38	Q1-27	18.56
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Rodolfo Mitchell, Mexico +52.55.3977.4556

Major Currencies

EURUSD

EUR Drifts to Low End of Trading Range

Current spot 1.1470



Source: Bloomberg.

EURUSD—EUR sentiment has been buffeted by risk aversion and a generally firmer USD in response to rising US interest rates. EZ-US short-term spreads narrowed steadily over the past year, proving essential support for the EUR. Wider spreads since March have undercut the appeal of the EUR. Meanwhile, a mild tightening in ECB policy has lifted concerns that prematurely raising rates may cause economic harm to the still-fragile Eurozone economy. The rotation from US equities to European stocks, which was a feature of the EUR’s stronger Q1 performance, has also reversed in Q2. EUR losses have driven spot back to the lower end of the trading range in place since mid-2025, giving bargain hunters a chance to re-enter EUR longs at attractive levels.

Scotia Forecasts

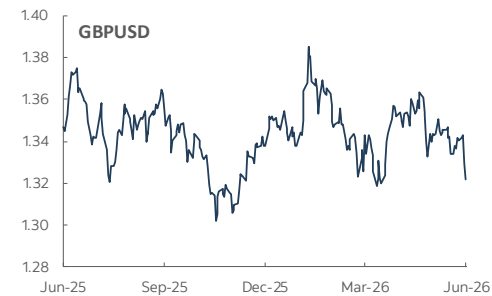
Q2-26	1.18	Q3-26	1.22	Q4-26	1.22	Q1-27	1.23
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GBPUSD

GBP Soft as Political Speculation Swirls

Current spot 1.3230



Source: Bloomberg.

GBPUSD—The pound is trading towards the low end of the past year’s range amid neutral momentum as investors mull fading BoE tightening prospects, the Fed policy outlook and speculation about PM Starmer’s future. Specifically, markets worry about the risk of fiscal slippage if Starmer were to lose a leadership challenge. So far, international investors appear sanguine. Data show eight consecutive months of net foreign inflows into UK government bonds, with totals running well above average. But the “revolving door” at Number 10 over the past few years is a poor look for a large, developed economy and any tilt to the left in the ruling Labour party will register on GBP sentiment, making our Q4 forecast of 1.37 difficult to achieve.

Scotia Forecasts

Q2-26	1.34	Q3-26	1.36	Q4-26	1.37	Q1-27	1.38
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USDCHF

CHF Gives Up Haven-Related Gain

Current spot 0.8040



Source: Bloomberg.

USDCHF—The CHF benefitted from haven demand in the early days of the Strait of Hormuz crisis, driving EURCHF back to the 0.90 level, the strongest CHF level since its 2015 surge following the scrapping of the 1.20 peg versus the EUR. But rising oil prices and the ECB’s response to rising inflation risks prompted a rebound in the cross and some broader underperformance in the CHF, driving EURCHF back to 0.92, as the Swiss National Bank is expected to hold its policy rate at zero for the foreseeable future amid still very low domestic inflation. We expect the CHF to soften moderately on the cross over the balance of the year, with EURCHF ending 2026 at 0.93.

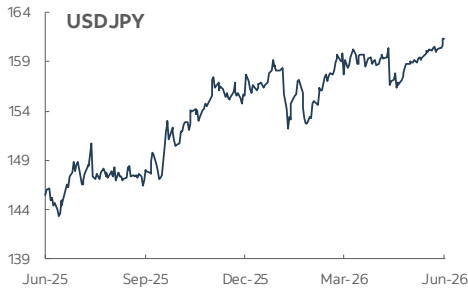
Scotia Forecasts

Q2-26	0.78	Q3-26	0.76	Q4-26	0.76	Q1-27	0.76
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Major Currencies (continued...)

USDJPY
JPY Prospects Remain Bleak **Current spot 161.15**



USDJPY—The JPY is the worst-performing G10 currency in both quarter- and year-to-date terms. Sentiment has been undermined by the rise in US yields and wider US/ Japan rate differentials, alongside a negative terms-of-trade shock driven by higher energy prices. Record BoJ intervention in May and the prospect of modest policy BoJ normalization has helped steady the currency around JPY 160 per USD, the yen’s weakest since the 1990s. However, even a calmer geopolitical backdrop is unlikely to help lift yen sentiment. Instead, it may reinvigorate JPY-funded carry trades and help keep the currency on the defensive absent a material compression in US-Japan front-end spreads.

Source: Bloomberg.

Scotia Forecasts	Q2-26	155	Q3-26	152	Q4-26	150	Q1-27	147
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Australia

AUDUSD
AUD Strong on Energy and RBA **Current spot 0.7020**



AUDUSD—Rising commodity prices and a hawkish RBA have combined to lift the AUD 6% against the USD so far this year, the best return of any G10 currency. Australia’s status as a gas and coal exporter drove a positive terms of trade shock for the economy and provided the currency with some protection against the uncertainty and volatility driven by the US/Iran conflict. Technical trends are bullish, with the AUD breaking and holding above major trend resistance. This may herald more AUD gains in the medium term. We have revised up our forecast for the AUD to reach 0.73 at the end of this year and 0.75 in 2027 (versus forecasts of 0.70 and 0.72 respectively in our last update).

Source: Bloomberg.

Scotia Forecasts	Q2-26	0.72	Q3-26	0.72	Q4-26	0.73	Q1-27	0.73
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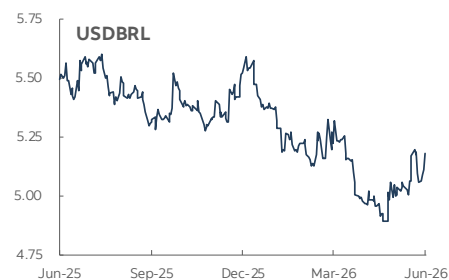
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Latin America

USDBRL

BRL Loses Some Shine on Lower Rates

Current spot 5.1700



USDBRL—The BRL lost its lofty spot as the top performer within the 32 most liquid global FX over the past month or so, but remains a solid performer at number 5 (7% YTD vs the greenback). It is also ranked 4th in carry returns among its most liquid peers. Partly behind the real's lost shine is the BCB's 50bps of rate cuts delivered since March, with DI rates anticipating about 80% odds of a final 25bp cut by August. Another factor possibly weighing on the real is election related uncertainty, with the latest CNT/MDA polls giving Lula a roughly 10–14 percentage point lead in a possible run-off presidential election.

Source: Bloomberg.

Scotia Forecasts

Q2-26	5.06	Q3-26	5.10	Q4-26	5.15	Q1-27	5.18
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Eduardo Suárez, Mexico +52.55.9179.5174

USDCLP

CLP Supported by Firm Copper

Current spot 896.80



USDCLP—Since the previous FX Outlook, the peso has appreciated by 1%, supported by higher copper prices (+6%), despite a stronger global DXY (+1%). In this context, we continue to project the CLP around 870 by end-2026, underpinned by robust copper prices and a backdrop in which the central bank has signaled that it will keep the policy rate unchanged throughout the first half of 2027. While GDP growth prospects have been revised down, we still expect strong investment growth this year and next, which should provide additional support to the CLP. Meanwhile, potentially higher USD sales by the Ministry of Finance in the local market are also likely to help anchor the peso around its long-term level over this and next year.

Source: Bloomberg.

Scotia Forecasts

Q2-26	900	Q3-26	870	Q4-26	870	Q1-27	870
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USDPEN

PEN Improves After Election

Current spot 3.3865



USDPEN—Following the volatility observed in recent weeks after the electoral period, the sol has recovered its previous levels, strengthening from around 3.52 to approximately 3.38, equivalent to a correction of about 4%. This dynamic reflects the market's internalization of the likelihood that the pro-market political party Fuerza Popular won the second round of the election. In recent days, the Central Reserve Bank of Peru (BCRP) has been intervening in both the spot and derivatives markets to prevent a sharper decline in the exchange rate, effectively establishing a short-term floor at around 3.38. This has likely been aimed at preserving export competitiveness. For now, we maintain our projection that the exchange rate will stand at around 3.35 by year-end.

Source: Bloomberg.

Scotia Forecasts

Q2-26	3.40	Q3-26	3.35	Q4-26	3.35	Q1-27	3.40
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Ricardo Avila, Peru

FOREIGN EXCHANGE STRATEGY

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