Currency Report Card – February 2024

02 February 2024

Forecasts

February 2024

Three month forecast returns

Most bullish	Most bearish
JPY	CHF
GBP	KRW
CAD	MYR

Source: RBC Capital Markets

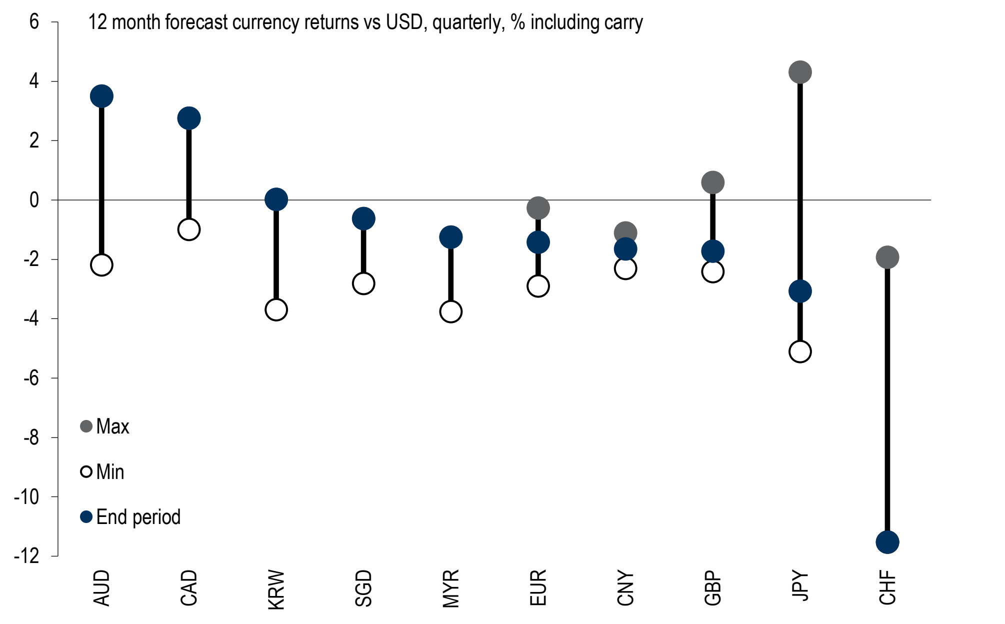
12 month forecast returns

Most bullish	Most bearish
AUD	CHF
CAD	JPY
KRW	GBP

Source: RBC Capital Markets

Forecast revisions: We have flattened the peak in our USD forecasts for G10 and Asia EM and extended our forecasts through end-2025.

AUD, CAD, KRW outperformance; CHF, JPY, GBP underperformance



Source: RBC Capital Markets

Global FX Strategy

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US Dollar

Elsa Lignos

1-3 Month Outlook – Cut coming but not quite yet

A lot has changed since our last *Currency Report Card* in early November. At the time market narrative on USD had started to shift but we were waiting on data to confirm. Since then, we have had three CPI/PCE prints, all showing much clearer signs of disinflation. After a four-month period where inflation had stalled above 3% and was drifting higher, the Oct data (published in Nov) saw a sharp drop and Nov/Dec reinforced that. Headline PCE (the Fed's target measure) hit 2.6%y/y. That paved the way for the Fed's pivot in December and the sharp unwind in USD longs seen through year-end. We entered the year with a growing bearish USD consensus, but as always things are never so simple. So far USD is the best-performing currency YTD and the January FOMC meeting followed by a stellar jobs report, reinforced our view that a March start to the cutting cycle is highly unlikely. Where do we go from here? We have flattened the peak in our USD forecasts to reflect the faster path of disinflation but unless/until we see signs of US data slowing, we expect USD positioning to stay net long. RBC's long-standing forecast has been for cuts to start in June. We wouldn't rule out a May start but key is that the Fed is in no rush. Markets have moved our way, from ~75% chance of a March cut a month ago to ~20% now and that has helped drive an unwind in USD shorts (Figure 1). That has probably run its course for now so we look for USD to range-trade for the next 1-3 months with a bias to end H1 at the stronger USD-end of the range (EUR/USD 1.06). To turn USD around, we think we'd need to see a material slowdown and/or much deeper banking stress than anything seen so far. For USD to break higher, we'd need to see reacceleration in inflation and/or a bigger non-US risk off shock (escalating conflict in the Middle East).

6-12 Month Outlook – Election dominates

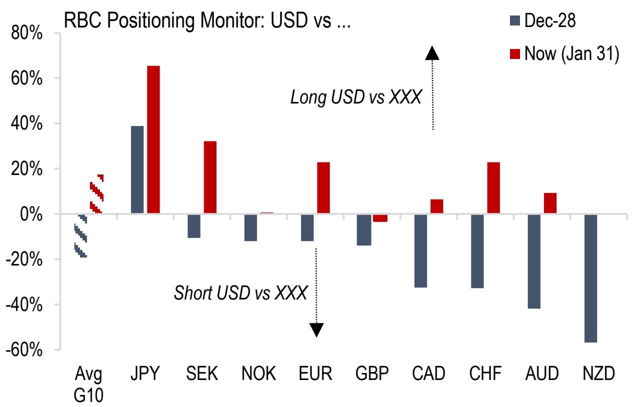
The election dominates the 6-12m outlook but client (and internal) views are mixed on what it could mean for USD. Most investors expect a Trump victory would be USD positive (more tariffs and 'America first') but there is a strong minority arguing it could be negative, if not initially then more so in the longer-term, through a combination of excessive deficit spending and a President pushing for a more dovish Fed. Polls show the election is a coin toss and for all the investor focus on the event, we suspect even that may not be enough to break USD out. Eventually we look for USD to trade lower against the majors, but that is more a story of portfolio hedging flows (see EUR page).

Indicators

	Current (Previous)*
Official cash rate	**5.25-5.50% (5.00-5.25%)**
Trend interest rates (10yr average)	1.5%
Bias in interest rate market	Lower
Core PCE Inflation %Y/Y Dec (Nov)	**2.9% (3.2%)**
Inflation target	2%, on average
Budget balance % GDP FY22 (FY21)	**-5.5% (-12.3%)**
Budget balance target % GDP	-
GDP Growth % y/y Q4 A (Q3)	3.3% (2.0%)
Trend GDP %y/y	2.6%
Purchasing Power Parity Value	**-**
Spot	-
PPP Valuation	-
Current account balance % GDP Q3 (Q2)	**-3.1% (-3.4%)**
Trend current account balance % GDP	-2.4%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Negative

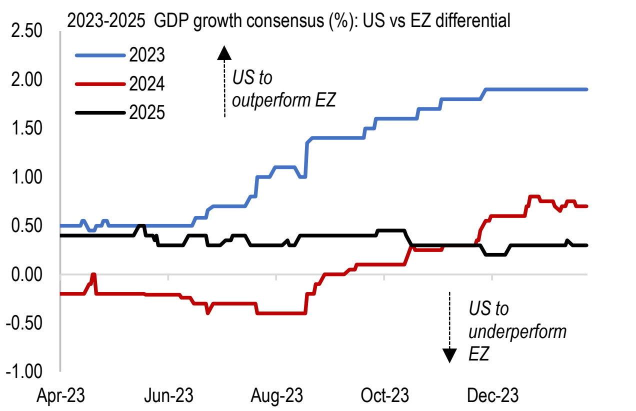
* Current is latest month, quarter or year

1. Swing from net short USD at year-end to net long now



Source: RBC Capital Markets

2. It is now consensus that US growth will outperform



Source: Bloomberg, RBC Capital Markets

Forecasts

	2024				2025			
	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.06	1.06	1.08	1.10	1.12	1.15	1.18
USD/JPY	140	145	150	145	143	141	138	135
USD/CAD	1.34	1.36	1.33	1.31	1.31	1.30	1.30	1.29

Source: RBC Capital Markets estimates

Euro

Elsa Lignos

1-3 Month Outlook – EZ bearishness is consensus

In the past week, EUR/USD has traded above/below 1.0827 every single day. The significance of that level is that it's the average spot rate over the past 12 months. That sums up why investors struggle to get excited about FX and G10 in particular at the moment. Aggregate positioning across G10 is at multi-year lows. Within that, a bias for short EUR has emerged particularly on crosses. It is now consensus that the Euro area is most at risk of recession (Figure 1). We have long been EUR bears and thought it was mad when the US was perceived to be most at risk last summer, but we also can't help feeling the EUR bearishness is pretty well priced by now. For sure there are plenty of downside risks for European growth/EUR (war in the Middle East, disrupted shipping via the Red Sea, cyclical weakness in China, a structural shift in China away from EZ exports, a deep slowdown in core European manufacturing). But the hurdle for some upside surprises is also pretty low. Our European economists note that as inflation comes down, with unemployment at historic lows, real incomes are rising and domestic demand is likely to improve. A ceasefire reduces the 'war premium' being carried by EUR. Positioning is already short EUR so further losses need more catalysts. That could come from (1) even weaker EZ data, (2) problems in European banks, (3) escalating conflict in the Middle East, (4) Trump gaining in the polls and upping the trade war rhetoric. But with the Fed edging towards cuts and the ECB likely to lag its pace in our view, we have revised up our expected trough in EUR/USD to 1.06.

6-12 Month Outlook – Watch hedging flows

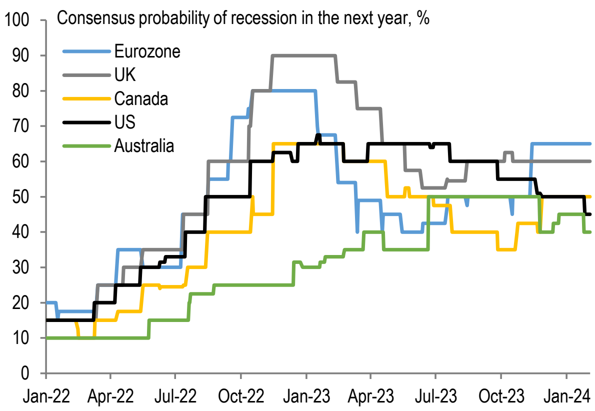
We think EUR's best hope for a rally comes from a US slowdown. Clients mostly disagree with us. But one key impact of deeper Fed cuts would be to converge the cost of carry for USD and EUR. A narrowing in hedging costs, of the sort we saw in 2020, could lead to a material move higher in EUR/USD. We have penciled that in for 2025 though the timing is highly uncertain. European investors now hold over EUR5trn of US portfolio assets so shifts in hedge ratios can dwarf other flows. On the political side, investors tend to think Trump is EUR-negative as the US is the EZ's largest external export market, but it is dwarfed by intra-EZ trade. Biden's policies have already had an EZ-negative impact, with the IRA redirecting investment flows to the US. Trump is seen at risk of pulling the US out of NATO which has a negative impact on European security but a positive impact on defence spending. The political effect is ambiguous, so we have focused on hedging flows to drive our forecasts.

Indicators

	Current (Previous)*
Official cash rate (ECB main refi rate)	**4.50% (4.50%)**
Trend interest rates 10y average	0.5%
Bias in interest rate market	Easing
HICP core Inflation %Y/Y Jan P (Dec)	**3.3% (3.4%)**
Inflation target	2.0% (symmetric)
Budget balance % GDP 2022 (2021)	**-3.6% (-5.3%)**
Budget balance target % GDP	3% of GDP-Unless special circumstances
GDP Growth %Y/Y Q4 A (Q3)	**0.1% (0.0%)**
Trend GDP %y/y	1.4%
Purchasing Power Parity Value Dec	**1.2626**
Spot end-Jan	1.0818
PPP Valuation	EUR/USD is undervalued
Current account % GDP Q3 (Q2)	1.24% (0.25%)
Trend current account balance % GDP	2.2%
Moody's Foreign Currency Rating	**Aaa (Germany)**
Outlook	Stable

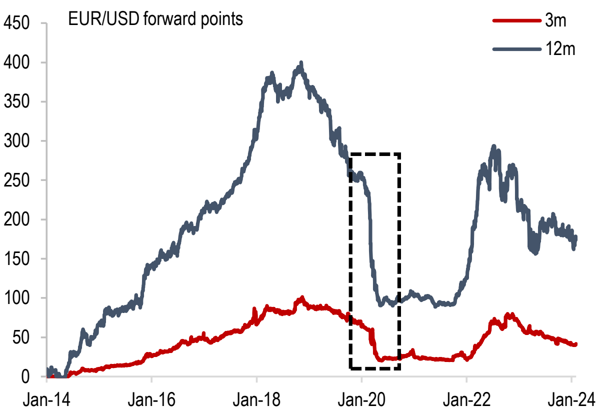
* Current is latest month, quarter or year

1. Euro area seen most at risk of recession



Source: RBC Capital Markets, Bloomberg

2. As fwd points collapsed in 2020, EUR/USD rallied hard



Source: RBC Capital Markets, Haver Analytics

Forecasts

	2024				2025			
	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.06	1.06	1.08	1.10	1.12	1.15	1.18
EUR/JPY	151	154	159	157	157	158	159	159
EUR/CAD	1.45	1.44	1.41	1.41	1.44	1.46	1.49	1.52

Source: RBC Capital Markets estimates

Japanese Yen

1-3 Month Outlook – Gearing up for BoJ hike, but…

It is hard to put down thoughts on USD/JPY without reference to the loss of our friend and colleague. Adam's off-consensus calls on JPY stretched back over a decade and time and again were proven right.

Heading into 2024, USD/JPY is once again on the front foot. The Fed's reluctance to cut rates prematurely, along with signs of stronger than expected momentum in US economic data leaves us unable to jump on board the still bearish JPY consensus. Analysts have been revising up their end-2024 forecasts, from a consensus of 120 in mid-2023, to 136 now. But they are unwilling to abandon the constant expectation that a sizeable sell-off in USD/JPY is just around the corner. A large New Year's Day earthquake in western Japan shook confidence in calls for BoJ tightening but the minutes from the BoJ's December meeting show the central bank is actively mulling "the timing of the exit… and the appropriate pace… thereafter". Markets are priced for a 10bp hike by June and a full 25bp by end-2024. For sure that is a sea change from the perspective of the BoJ, which last raised rates pre-GFC and even then only to 0.5%. But the real sea change is the same one we have highlighted for a long time (Figure 1). Even as and when the Fed cuts rates, and even if it keeps pace with the forward curve (which is faster than our US rates team anticipates), the gap between the cost of hedging and the yield on Japan's foreign stock of assets will remain higher than it has been at any point in the last two decades (Figure 1). For EUR/JPY that may not be quite so clear cut and it is possible we could see some EUR/JPY hedges being selectively put on. But USD assets are a far bigger share of Japan's portfolio (Figure 2). The main risk for USD/JPY is positioning – it is one of the most popular longs and has rapidly rebuilt since the start of the year (see Fig 1, pg3). We think we could see a repeat of early 2023, where investors cut longs or get short anticipating action from the BoJ but the reality turns out to be a disappointment, and that dip is a buying opportunity for USD/JPY.

6-12 Month Outlook – Long JPY doesn't pay

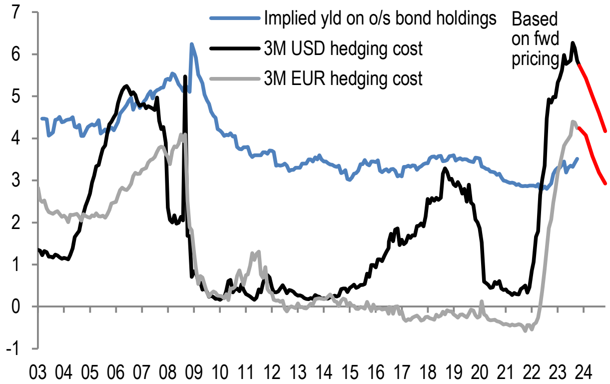
It is the balance between foreign and domestic investor flow that will be the longer-term driver of JPY. While in the short-term, there may be further bouts of selling as USD/JPY shorts are reestablished or international yields fall, in the longer-term, we think domestic investor flow will dominate. Hedge ratios are getting closer to historic lows but Lifers' accounts for October suggest we are not there yet.

Indicators

	Current (Previous)*
Official cash rate	**-0.1% (-0.1%)**
Trend interest rates 10y average	0.15%
Bias in interest rate market	Rising
CPI Inflation %Y/Y Jan (Dec)	**2.6% (2.8%)**
Inflation target	2.0%
Budget balance % GDP 2021 (2020)	**-6.2% (-9.1%)**
Budget balance target % GDP	n/a
GDP Growth %Y/Y Q3 (Q2)	**1.5% (2.2%)**
Trend GDP %Y/Y	0.7%
Purchasing Power Parity Value Dec	**82.81**
Spot end-Jan	146.92
PPP Valuation	USD/JPY is overvalued
Current a/c balance % GDP Q3 (Q2)	2.9% (2.0%)
Trend current account balance % GDP	2.8%
Moody's Foreign Currency Rating	**A1**
Outlook	Stable

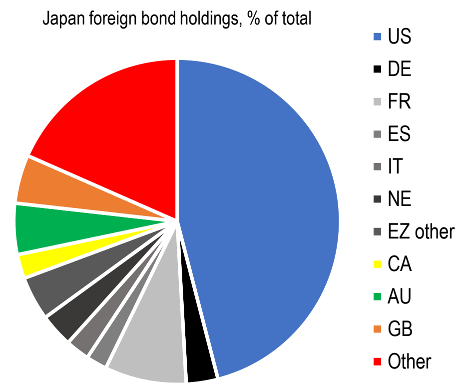
* Current is latest month, quarter or year

1. 200bps of Fed cuts are not enough; for ECB it might be



Source: RBC Capital Markets, Bloomberg

2. US bonds still dominate Japan's stock of foreign assets



Source: RBC Capital Markets, Haver Analytics

Forecasts

	2024				2025			
	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/JPY	140	145	150	145	143	141	138	135
EUR/JPY	151	154	159	157	157	158	159	159
CAD/JPY	104	107	113	111	110	108	107	105

Source: RBC Capital Markets estimates

Sterling

Daria Parkhomenko

1-3 Month Outlook – GBP recoupling with rates

GBP continued its winning streak into the first month of the year, outperforming most of G10, except for USD, on the back of the UK's 2Y swap rate rising by more than most other G10 economies. Unlike GBP's decoupling from UK rate prospects in October 2022 and Q3 2023 when markets had questioned the credibility of UK policies, Figure 1 shows that the "wedge" between the currency and rates has narrowed.

The BoE held its first meeting for the year on February 1. It removed its hiking bias and shifted to a more neutral stance, with Governor Bailey stating in the press conference that "the key question has moved from how restrictive do we need to be to how long do we need to retain this position for". The voting split showed a more dovish shift, with one member switching vote from a hike to no change and one from no change to a cut. Following the shift in the MPC's rhetoric, our economists now expect the BoE to start cutting rates in August and lower the policy rate by a total of 100bps to 4.25% by the of 2024. Although the magnitude is similar to markets pricing -97bps by year-end, this would still mean the BoE will start cutting rates later than the Fed and the ECB (RBC expects both to start in June). The BoE's more gradual shift to rate cuts than peers removes a reason to sell GBP. Although GBP may further benefit from decent carry in the near-term, we don't yet see a catalyst to drive an outright GBP-bullish view on a longer-run horizon. Hence, our profile shows a relatively flat EUR/GBP profile in 2024.

6-12 Month Outlook – Elections, fiscal dynamics

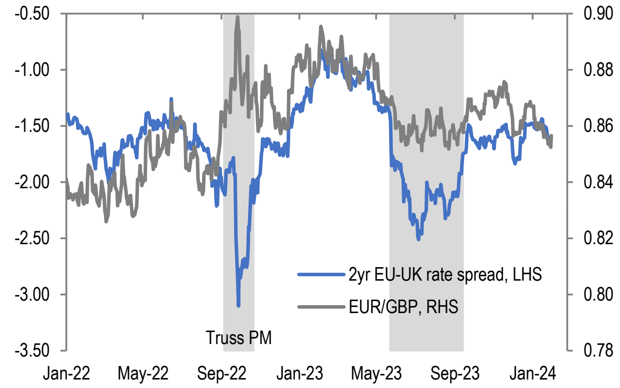
UK elections are due within the next 12 months, with 28 January 2025 as the latest possible date. Labour is widely expected to be the largest party in Parliament. Although there is risk that markets may view a more constructive UK attitude to Europe will lend support to GBP under Labour, the factors that would cause material GBP upside, such as single market or customs union membership, do not appear to be in play for the UK on any kind of investable horizon. On fiscal, no matter what the makeup of the new government will be, the new administration will inherit a constrained fiscal environment, where the spending profile is already tight and demand for public services is increasing. Any deterioration in policy credibility would leave GBP vulnerable, with the UK becoming more dependent on large inflows of short-term capital (blue bars in Figure 2) to fund its current account deficit.

Indicators

	Current (Previous)*
Official cash rate	**5.25% (5.25%)**
Trend interest rates 10y average	~1.0%
Bias in interest rate market	Easing
CPI Inflation %Y/Y Dec (Nov)	**4.0% (3.9%)**
Inflation target (HICP)	2.0%
Budget balance % GDP 2022 (2021)	**-4.7% (-7.9%)**
Budget balance target % GDP	Budget surplus as soon as possible
GDP Growth %Y/Y Q3 (Q2)	**-0.1% (0.0%)**
Trend GDP %Y/Y	0.5%
Purchasing Power Parity Value Dec	**1.3383**
Spot end-Jan	1.2688
PPP Valuation	GBP/USD is undervalued
Current a/c balance sa % GDP Q3 (Q2)	-2.5% (-3.5%)
Trend current account balance % GDP	-3.9%
Moody's Foreign Currency Rating	**Aa1**
Outlook	Stable

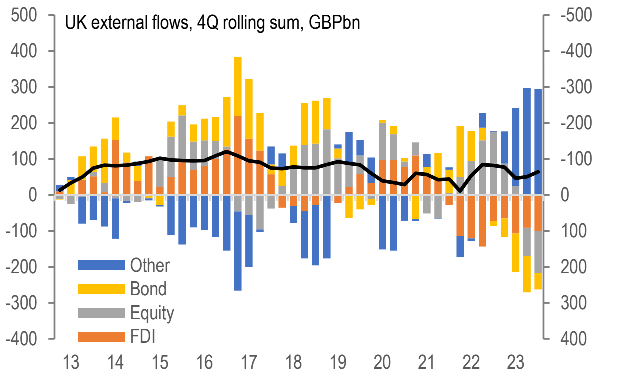
* Current is latest month, quarter or year

1. GBP's risk premium has fallen



Source: RBC Capital Markets, Bloomberg

2. UK increasingly dependent on short-term capital inflows



Source: RBC Capital Markets, Haver Analytics

Forecasts

	2024				2025			
	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
GBP/USD	1.27	1.25	1.23	1.24	1.24	1.23	1.24	1.26
EUR/GBP	0.85	0.85	0.86	0.87	0.89	0.91	0.93	0.94
GBP/JPY	178	181	185	180	177	174	171	169
GBP/CAD	1.70	1.70	1.64	1.63	1.61	1.60	1.60	1.62

Source: RBC Capital Markets estimates

Swiss Franc

Elsa Lignos

1-3 Month Outlook – A lesser-watched Dec pivot

While the Fed's pivot grabbed the headlines in December, the SNB also performed a pivot. For us it shifted the balance of risks from higher CHF to lower CHF. Long CHF/JPY was one of our favourite trades last year – the key driver was two contrasting central banks. In particular, the SNB spent all of 2022 and 2023 reducing its balance sheet by actively selling reserves/buying CHF. In December, it dropped the line from its statement that "In the current environment, the focus is on selling foreign currency." While it still says it is "willing to be active in the foreign exchange market as necessary", we think the SNB's judgment is that it is not currently necessary. Inflation has rapidly converged to target (Figure 1) and the SNB's updated conditional forecast from its December meeting shows inflation at or below its 2% target for the entire forecast horizon. In fact the below-target forecast for 2025 and 2026 suggests cuts are coming, though that is also priced by the market. The scale of cuts looks less aggressive than those priced for other central banks (-67bps by end-2024 and another -17bps by end-2025) and may leave CHF as a choice funding currency for periods when carry is in vogue.

Technically a daily close above nearby resistance at 0.8677 in USD/CHF would trigger a bullish medium-term trend reversal, that would favour an extension toward 0.8728 and 0.8821. But prices will have to pierce a more important descending channel top at 0.8909 in order to derail the broader downtrend that has been in place since November 2022. Initial support is located at 0.8551, followed by 0.8456 and the December low at 0.8333.

6-12 Month Outlook – Do hedging arguments apply to CHF?

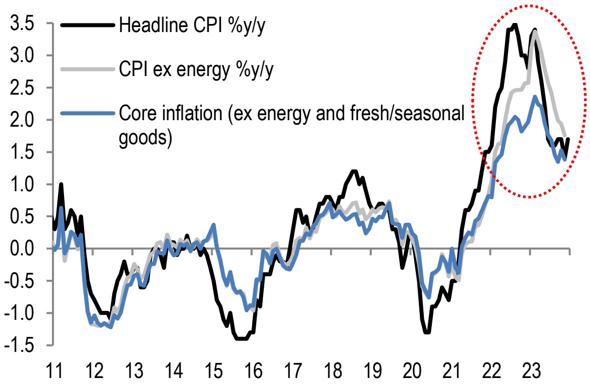
The SNB has lagged all other central banks bar the BoJ in the tightening cycle, so it is fair to ask whether cuts elsewhere could lead CHF higher. The argument would be similar to that laid out on page 4 for EUR. As the Fed and others cut rates, it becomes more cost-effective for CHF-based investors to put on hedges (i.e. sell USD/CHF, EUR/CHF, etc.) The problem at the moment for CHF is that it looks less likely other central banks will come down to Swiss levels, unless we hit a deeper slowdown than anything we have seen so far. We have penciled in a rise in EUR/CHF in 2025 which leaves USD/CHF more rangebound.

Indicators

	Current (Previous)*
Official cash rate	**1.75% (1.75%)**
Trend interest rates average	-0.09%
Bias in interest rate market	Easing
CPI Inflation %Y/Y Dec (Nov)	**1.7% (1.4%)**
Inflation target	less than 2.0%
Budget balance % GDP 2022 (2021)	**1.2% (-0.3%)**
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Y/Y Q3 (Q2)	**0.3% (0.3%)**
Trend GDP %Y/Y	1.8%
EUR Purchasing Power Parity Value Dec	**1.0648**
EUR/CHF spot end-Jan	0.9319
EUR/CHF PPP Valuation	EUR/CHF is undervalued
Current a/c balance % GDP Q3 (Q2)	8.33% (8.86%)
Trend current account balance % GDP	6.5%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

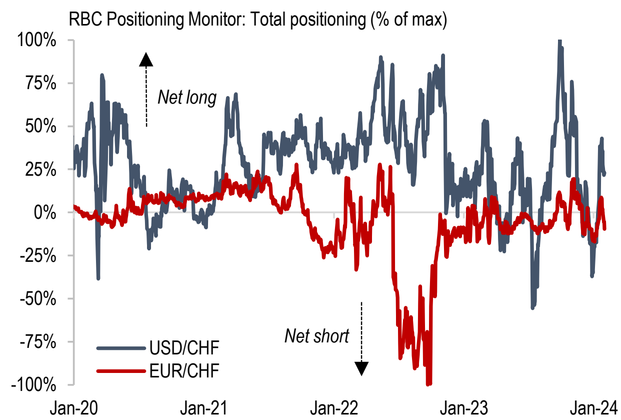
* Current is latest month, quarter or year

1. Headline and core inflation is back at 2% target



Source: Bloomberg, RBC Capital Markets

2. Market short CHF vs USD and flat against EUR



Source: RBC Capital Markets

Forecasts

	2024				2025			
	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CHF	0.87	0.90	0.92	0.91	0.91	0.91	0.90	0.89
EUR/CHF	0.94	0.96	0.97	0.99	1.00	1.02	1.03	1.05
CHF/JPY	161	161	164	159	157	155	153	152
CAD/CHF	0.65	0.66	0.69	0.70	0.70	0.70	0.69	0.69

Source: RBC Capital Markets estimates

Canadian Dollar

Daria Parkhomenko

1-3 Month Outlook – USD/CAD range-bound

CAD ended January down ~1.4% vs USD due to broad-based USD strength, however, the currency was one of the main outperformers on the crosses on the back of its 'mini-dollar' status and CA 2Y swap rates seeing one of the larger rises in G10 YTD. In our year-ahead piece, we had written that we expected USD direction to remain the main determinant of USD/CAD's path amid a central scenario that the US bond/equity relationship is likely to be inconsistent (i.e. similar to H1 2023). Given this and our USD view, we thought the pair would be range-bound. Our view since that piece has not changed. Unless the geopolitical situation in the Middle East escalates to the point where it carries a more material impact on markets through a traditional risk-off shock, the onus is likely on either a sustainable twin selloff or twin rally in US bonds & equities to take USD/CAD outside of its range-trading. We have penciled in 1.34 & 1.36 as the point forecasts for end-Q1 & end-Q2 on the marginally stronger USD embedded into our forecasts for H1 2024, but we want to emphasize that our base case is for USD/CAD to be range-bound (~1.3100-1.3600).

Domestically, in January, the BoC's characterization of underlying inflation erred on the hawkish side, however, the market latched onto the softening rhetoric about policy direction. The shift reinforced the market's view that the BoC is finished hiking rates and moving towards cuts. The decision statement removed the hiking bias ("prepared to raise the policy rate further if needed"), and even though Governor Macklem noted that they are not ruling out further rate increases "If new developments push inflation higher", he also flagged that "discussion about future policy is shifting from whether monetary policy is restrictive enough to how long to maintain the current restrictive stance". We expect the BoC to start reducing rates in June and deliver a total of 100bps of cuts this year. Given our view is close in line with market expectations for -92bps, this leaves the onus on the broader USD to drive USD/CAD.

6-12 Month Outlook – Not breaking the range yet

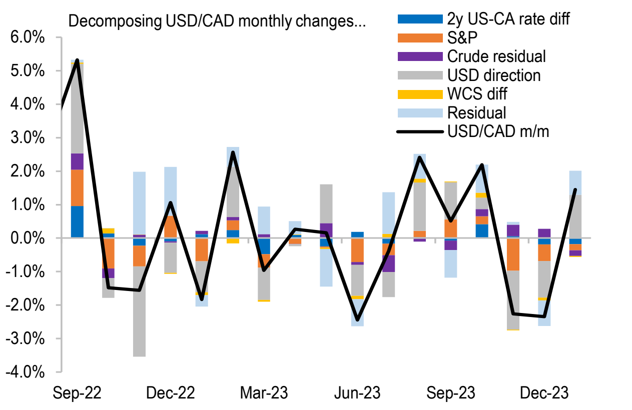
In our last edition of this report, we had 1.3100 as the end-2024 forecast. We think this is still a fair target. This would keep USD/CAD within the range we cited above, but with a bias that CAD performs well on the crosses. If CBs are making "adjustment" cuts instead of substantial ones due to significant growth concerns, then global CBs reducing rates in H2 2024 and a potential turn in the global business cycle may benefit CAD, given CAD is likely to be one of the main candidates for the market expressing a view on global growth. US elections may present some volatility in H2.

Indicators

	Current (Previous)*
Official cash rate	**5.00% (5.00%)**
Trend interest rates 10y average	1.4%
Bias in interest rate market	Easing
Core CPI Inflation (Trim) %Y/Y Dec (Nov)	**3.7% (3.5%)**
CPI inflation target range %Y/Y	1-3%
Budget balance % GDP FY22 (FY21)	**-c3.2% (-12.5%)**
Budget balance target % GDP	Declining over the business cycle
GDP growth %Q/Q saar Q3 (Q2)	**-1.1% (1.4%)**
Trend GDP %Q/Q	2.1%
Purchasing Power Parity value Dec	**1.2189**
Spot end-Jan	1.3435
PPP valuation	USD/CAD is overvalued
Current account balance % GDP Q3 (Q2)	**-0.9% (-1.1%)**
Trend current account balance % GDP	-2.1%
Moody's foreign currency rating	**Aaa**
Outlook	Stable

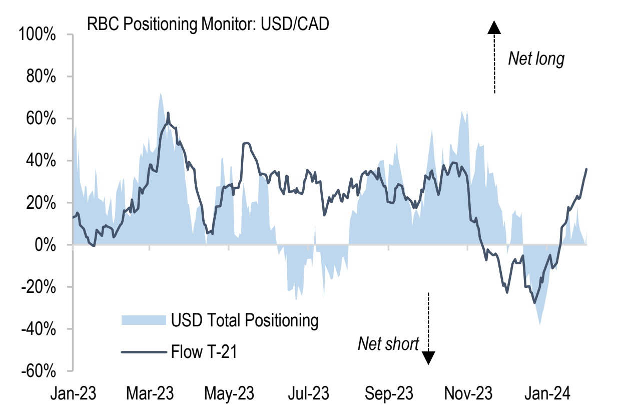
* Current is latest month, quarter or year

1. Stronger USD behind the January rally in USD/CAD



Source: Bloomberg, RBC Capital Markets

2. Markets are pretty neutral USD/CAD



Source: RBC Capital Markets

Forecasts

	2024				2025			
	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CAD	1.34	1.36	1.33	1.31	1.31	1.30	1.30	1.29
EUR/CAD	1.45	1.44	1.41	1.41	1.44	1.46	1.49	1.52
CAD/JPY	104.5	106.6	112.8	110.7	109.6	108.5	106.6	104.7

Source: RBC Capital Markets estimates

Australian Dollar

Alvin T. Tan

1-3 Month Outlook – Resilient economy & currency

Australia's domestic demand has cooled following the RBA's policy tightening cycle but remains relatively resilient. More importantly, inflation pressures have turned the corner, and the Q4 CPI data appears to be tracking below the RBA's forecasts. This leads to our expectation of 50bp RBA rate cuts this year, all in Q4 2024. In this light, the RBA is expected to lag both the Fed and ECB in the timing of its first rate cut and the quantum of cuts.

Moreover, Australia's trade with China has risen significantly over the past year amid improving diplomatic ties. It has consequently not been affected too negatively by China's economic malaise. Iron ore prices too have climbed to near cycle highs in January. With the downside risks to China's economy contained for the time being, additional major headwinds to AUD from this aspect is unlikely.

The Aussie dollar retains a clear negative correlation to the MSCI World Index, indicating that it remains a relatively pro-risk currency. However, this has generally been advantageous because of the persistent bull market in global equities and largely lower volatility across global markets.

Without a major sustained risk-off shock, the Aussie dollar is expected to stay resilient. China's growth difficulties have not had much negative impact on either Australia's economy or currency. It is difficult to see it trend significantly in either direction, but AUD/USD should continue to face mild downside pressure until the Fed starts to cut rates in earnest.

6-12 Month Outlook – Potential upside if China's recovery firms up

Australia's external balance has improved structurally in recent years, turning it into a persistent current account surplus country. It is also no longer a "high carry" currency relative to other major currencies. Nonetheless, AUD continues to be sensitive to global risk sentiment, and it is difficult to see this changing within the year.

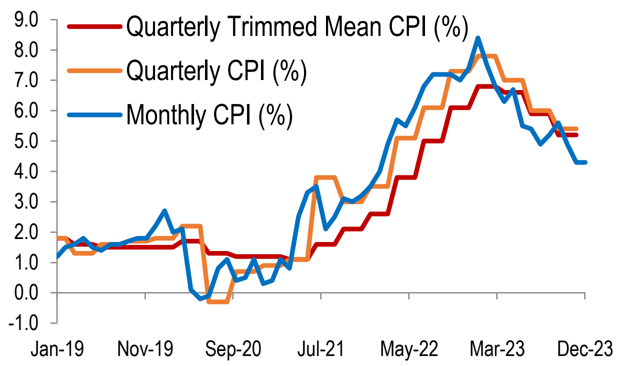
There is a potential strong upside risk for AUD if China's economy recovers more strongly, with corresponding growth in its imports from Australia, but this is unlikely to be a baseline scenario.

Indicators

	Current (Previous)*
RBA cash rate	**4.35%**
Trend interest rates (10yr average)	1.60%
Bias in interest rate market	Lower
CPI Inflation %Y/Y last (prev)	**3.4% (4.3%)**
Inflation target	2.0-3.0%
Budget balance % GDP last (prev)	**1.6% (1.4%)**
Budget balance trend % GDP	-1.7%
GDP Growth % y/y last (prev)	2.1% (2.0%)
Trend GDP %y/y	2.4%
Purchasing Power Parity Value Dec	**0.7231**
Spot end-Jan	0.6568
PPP valuation	AUD/USD is undervalued
Current acct balance % GDP last (prev)	**1.2% (1.2%)**
Trend current account balance % GDP	-1.2%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

* Current is latest month, quarter or year

1. Inflation has turned decisively



Source: RBC Capital Markets; Bloomberg

2. Exports to China rebounded strongly in 2023

Source: RBC Capital Markets; Bloomberg

Forecasts

	2024				2025			
	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
AUD/USD	0.65	0.64	0.66	0.68	0.70	0.71	0.72	0.74
EUR/AUD	1.66	1.66	1.61	1.59	1.57	1.58	1.60	1.59
AUD/CAD	0.87	0.87	0.88	0.89	0.91	0.92	0.93	0.95

Source: RBC Capital Markets estimates

Chinese Yuan

Alvin T. Tan

1-3 Month Outlook – Ongoing economic malaise

China's economy appears set for a continuation of its "L-shape" growth trajectory in coming months. The year's GDP growth target to be unveiled in March is widely expected to repeat last year's "around 5%" target. The economy remains frail with the moribund real estate and construction sectors exerting a huge drag.

House prices in a handful of Tier-1 cities have reportedly stabilized, but there is a considerable overhang of housing inventory in lower-tier cities that is likely to take years to clear. Falling housing prices have in turn dampened consumer sentiment and activity. The economy will require additional policy support, and there has been a steady drip of targeted support measures, particularly for the property market.

In this light, further RRR and/or interest rate cuts are expected in coming months. The USD should thereby continue to provide a significant carry premium over CNY. However, the PBOC has also revealed its determination to cap USD/CNY under ~7.33 through its persistently below-expectations USD/CNY reference rates.

The PBOC's tight management of the exchange rate has helped drive down the renminbi's volatility. The currency has thus become a poor vehicle for expressing a bearish China macro view. It is difficult to see the implicit USD/CNY cap breaking in coming months without a very strong across-the-board US dollar upsurge.

6-12 Month Outlook – Determined cap on USD/CNY

China's multi-year property and construction boom has ended, and policymakers are unwilling to reflate it. The fallout is likely to last for years, and there is no easy alternative driver of the economy at hand. Although Beijing continues to evince an aversion to large-scale fiscal stimulus, targeted support measures are gradually adding up. They should be enough to keep a floor on economic growth.

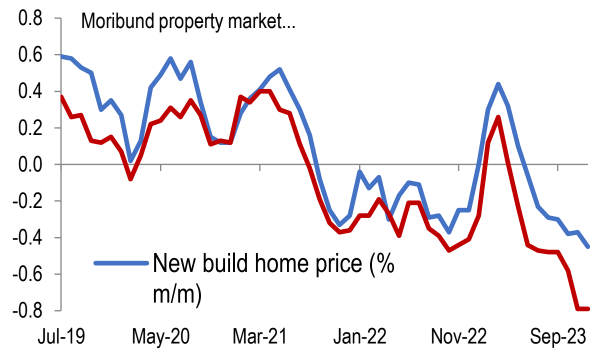
Weak domestic demand and fragile exports are headwinds for the yuan. The persistent domestic equities' bear market is also prompting foreign capital outflows. On the flipside is the apparent determination to cap upside risks in the bilateral USD/CNY exchange rate.

Indicators

	Current (Previous)*
China 1-year loan prime rate	**3.45%**
Trend interest rates (10yr average)	3.88%
Bias in interest rate market	Lower
CPI Inflation %Y/Y last (prev)	**-0.3% (-0.5%)**
Inflation target	3.0%
Budget balance % GDP last (prev)	**-4.7% (-3.8%)**
Budget balance trend % GDP	-3.1%
GDP Growth % y/y last (prev)	5.2% (4.9%)
Trend GDP %y/y	5.0%
Purchasing Power Parity Value Dec	**6.8793**
Spot end-Jan	7.1689
PPP valuation	USD/CNY is overvalued
Current acct balance % GDP last (prev)	**1.8% (2.2%)**
Trend current account balance % GDP	1.6%
Moody's Foreign Currency Rating	**A1**
Outlook	Stable

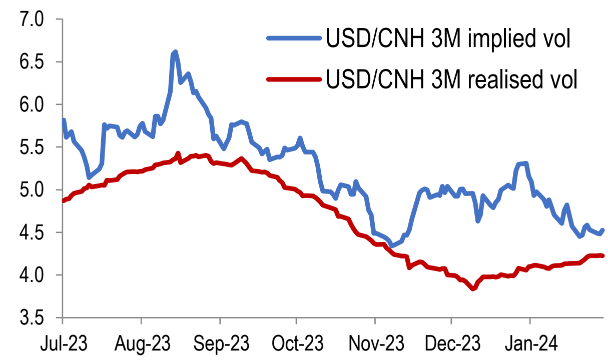
* Current is latest month, quarter or year

1. Property sector downturn is a huge growth drag



Source: RBC Capital Markets; Bloomberg

2. CNH vol dropping amid PBOC's tight management



Source: RBC Capital Markets; Bloomberg

Forecasts

	2024				2025			
	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CNY	7.22	7.25	7.20	7.10	7.00	7.00	6.90	6.80
EUR/CNY	7.80	7.69	7.63	7.67	7.70	7.84	7.94	8.02
CNY/JPY	19.4	20.0	20.8	20.4	20.4	20.1	20.0	19.9
CAD/CNY	5.39	5.33	5.41	5.42	5.36	5.38	5.33	5.27

Source: RBC Capital Markets estimates

South Korean Won

Alvin T. Tan

1-3 Month Outlook – Buffeted by cross-currents

The outlook for South Korea's trade-dependent economy is brightening, but background risks have also risen. The Bank of Korea is on an extended pause, and the exports cycle appears to have turned for the better. The trade balance has been in a persistent surplus since June 2023, and monthly exports have marked four consecutive positive year-on-year growth readings.

Semiconductors are a mainstay of the Korean economy, and the global semiconductor cycle is on an upturn, though still uneven. The turn lower in the global interest rate cycle also helps the won, given its traditional heightened sensitivity to external macro factors.

Indications of an upturn in the exports and semiconductor cycles, however, need to be balanced against China's ongoing economic malaise. There are also domestic financial stability concerns arising in the local credit market caused by a combination of elevated interest rates, high debt levels and weak property sector. Geopolitical concerns over North Korea have also risen to the fore lately amid Pyongyang's aggressive statements and weapons tests.

Furthermore, the US dollar retains a large carry advantage. Downside pressure on the neighbouring JPY and CNY currencies is also a drag on the won. Given the various cross-currents, the won is likely to underperform among the Asia FX complex in coming weeks.

6-12 Month Outlook – Cheap amid uncertainties

The won's persistent weakness in 2021 and 2022 has rendered it relatively cheap. The months ahead promise a more favorable outlook for the won as existing macro headwinds fade in time. However, a more positive cycle for the won may have to await the start of Fed rate cuts.

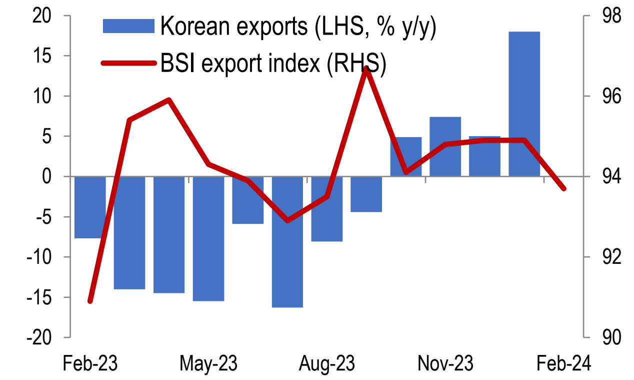
Even then, we need to be mindful of remaining deep macro uncertainties that could hinder any potential KRW uptrend. First are uncertainties about the state of global demand given the Korean economy's heavy export-dependence. Heightened geopolitical concerns in the Korean peninsula is another potential risk factor. Finally, a likely Trump candidacy and the related risk of higher US trade tariffs could also weigh on the won.

Indicators

	Current (Previous)*
BOK Base Rate	**3.50%**
Trend interest rates (10yr average)	1.68%
Bias in interest rate market	Lower
CPI Inflation %Y/Y last (prev)	**2.8% (3.2%)**
Inflation target	2.0%
Budget balance % GDP last (prev)	**-1.8% (-0.3%)**
Budget balance trend % GDP	1.3%
GDP Growth % y/y last (prev)	2.2% (1.4%)
Trend GDP %y/y	2.5%
Purchasing Power Parity Value Dec	**1058.80**
Spot end-Jan	1334.65
PPP valuation	USD/KRW is overvalued
Current acct balance % GDP last (prev)	**1.2% (0.4%)**
Trend current acct. balance % GDP	5.0%
Moody's Foreign Currency Rating	**Aa2**
Outlook	Stable

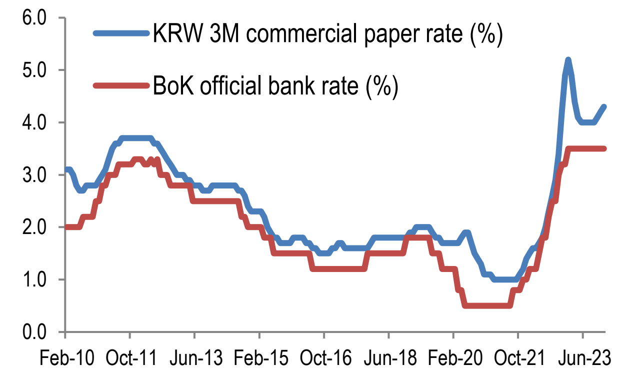
* Current is latest month, quarter or year

1. Exports growth upturn



Source: RBC Capital Markets; Bloomberg

2. Local credit market wobbles amid higher interest rates



Source: RBC Capital Markets; Bloomberg

Forecasts

	2024				2025			
	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/KRW	1340	1360	1340	1300	1280	1260	1250	1230
EUR/KRW	1447	1442	1420	1404	1408	1411	1438	1451
JPY/KRW	9.6	9.4	8.9	9.0	9.0	8.9	9.1	9.1
CAD/KRW	1000	1000	1008	992	981	969	965	953

Source: RBC Capital Markets estimates

Singapore Dollar

Alvin T. Tan

1-3 Month Outlook – Supported by existing policies

Singapore's inflation pressures have peaked, similarly with much of the world. However, inflation remains elevated, and is likely to be volatile in early 2024 from the sales tax hike and fluctuating COE prices. The situation should encourage the MAS to maintain the existing currency appreciation settings.

The apparent upturn in the regional exports cycle has also reduced the urgency of shifting to looser monetary policy. Moreover, Singapore is less exposed to China's economy compared to South Korea and Taiwan, so it has been less negatively affected.

The MAS' trade-weighted SGD index has been trading consistently above the estimated mid-point of the currency band for over two years and has actually moved closer to the band's ceiling in recent weeks. SGD's performance since mid-2023 has been in middle of the Asia FX basket, further underscoring its very consistent performance.

The estimated 1.5% annualized appreciation path of the trade-weighted SGD has and should continue to support further gradual gains in SGD against its main trading partners' currencies. The improving exports outlook has reduced downside growth risks.

That said, the bilateral USD/SGD exchange rate evinces a consistent high positive correlation to the DXY Index, so it is highly sensitive to broad US dollar direction. In this light, the range-bound USD/SGD rate is likely to remain so in coming weeks given the expected resiliency of the US dollar.

6-12 Month Outlook – Valuation getting stretched

The trade-weighted SGD's consistent appreciation in recent years has rendered it relatively expensive among Asian currencies. However, it would probably require both the start of Fed and MAS policy easing to reverse the currency's valuation. This could occur in H2 2024.

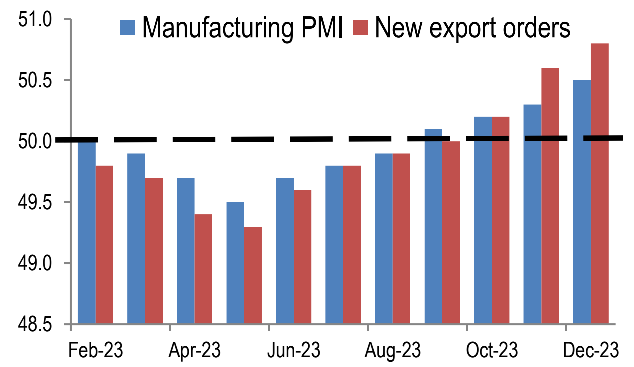
Nonetheless, the growing attractiveness of Singapore as an Asian wealth and financial hub suggests a structural tailwind for SGD. The persistently large current account surplus also offers robust fundamental support to the currency.

Indicators

	Current (Previous)*
Estimated SGD NEER annual appreciation	**1.5%**
Bias in policy expectations	Flat
CPI Inflation %Y/Y last (prev)	**3.7% (3.6%)**
Inflation target	None
Budget balance % GDP last (prev)	**-1.6% (-1.6%)**
Budget balance trend % GDP	-0.5%
GDP Growth % y/y last (prev)	2.8% (1.0%)
Trend GDP %y/y	3.2%
Purchasing Power Parity Value Dec	**1.3627**
Spot end-Jan	1.3408
PPP valuation	USD/SGD is undervalued
Current acct balance % GDP last (prev)	**18.0% (18.5%)**
Trend current account balance % GDP	17.4%
Moody's Foreign Currency Rating	**Aa3**
Outlook	Stable

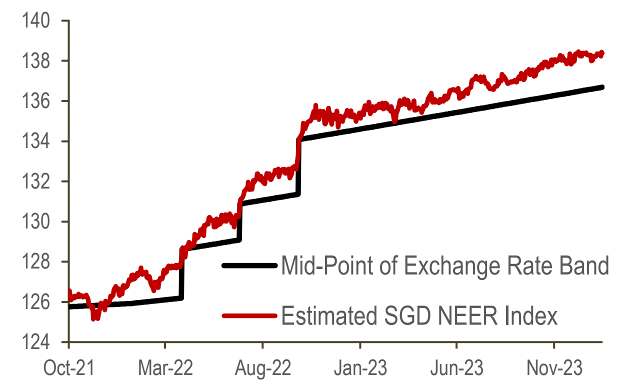
* Current is latest month, quarter or year

1. Export orders' pickup augurs well for growth outlook



Source: RBC Capital Markets; Bloomberg

2. Trade-weighted SGD continues to be supported by MAS' appreciation settings



Source: RBC Capital Markets

Forecasts

	2024				2025			
	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/SGD	1.35	1.37	1.35	1.33	1.32	1.31	1.30	1.29
EUR/SGD	1.46	1.45	1.43	1.44	1.45	1.47	1.50	1.52
SGD/JPY	103.7	105.8	111.1	109.0	108.3	107.6	106.2	104.7
CAD/SGD	1.01	1.01	1.02	1.02	1.01	1.01	1.00	1.00

Source: RBC Capital Markets estimates

Malaysia Ringgit

Alvin T. Tan

1-3 Month Outlook – Positive factors in short supply

Malaysia's economy is meandering along, with particular weakness in industrial activity as a result of the regional exports slump. The country's manufacturing PMI has been running consistently below the 50 expansion-contraction threshold for well over a year. It also has the largest trade exposure to China among the major ASEAN economies.

On top of these fundamental drags, MYR had been bedeviled by net foreign equity portfolio outflows for much of the past year, though these have turned around tentatively. Local bond yields are relatively mediocre too. The prices of key commodity exports of oil & gas and palm oil have also been range-bound for months.

Without an exciting growth story, Malaysia's financial assets will struggle to generate significant interest from global investors. Moreover, the incumbent coalition government remains fragile politically, making it challenging to undertake needed structural reforms to reduce the persistent fiscal deficit and boost the country's potential growth rate.

The government's plan to rationalize subsidies, which are a huge fiscal drain, will likely continue to be slow to be implemented. The chief positive factor for the ringgit is the potential brightening of the exports outlook. Another is Malaysia's attractiveness for foreign direct investors seeking "supply-side diversification". But in neither of these macro themes is the ringgit the top trade.

6-12 Month Outlook – Cheap valuation awaiting a catalyst

The main fundamental positive factor for the ringgit is that it is arguably cheap on a number of long-term valuation metrics. The ringgit is among the cheapest Asian currencies according to the famous "Big Mac Index" for example. Malaysia's trade balance is also expected to stay positive through 2024.

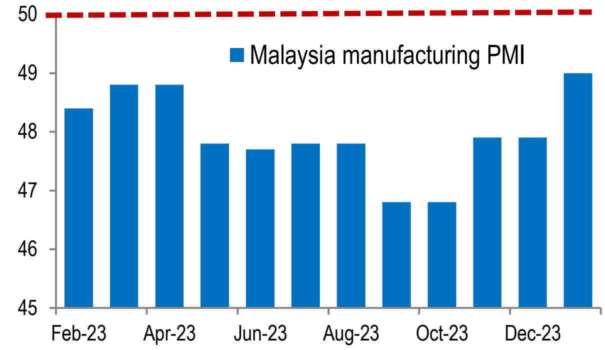
The currency, however, still awaits a catalyst to reverse its cheapness. Malaysia's interest rates continue to lag US ones and those of several of its Asian peers. Plus, there is an abiding question mark about the stability of the current coalition government.

Indicators

	Current (Previous)*
BNM official overnight rate	**3.00%**
Trend interest rates (10yr average)	2.80%
Bias in interest rate market	Lower
CPI Inflation %Y/Y last (prev)	**1.5% (1.5%)**
Inflation target	None
Budget balance % GDP last (prev)	**-5.4% (-5.2%)**
Budget balance trend % GDP	-4.2%
GDP Growth % y/y last (prev)	3.4% (3.3%)
Trend GDP %y/y	4.0%
Purchasing Power Parity Value Dec	**2.9552**
Spot end-Jan	4.7330
PPP valuation	USD/MYR is overvalued
Current acct bal % GDP last (prev)	**2.8% (3.3%)**
Trend current acct balance % GDP	3.7%
Moody's Foreign Currency Rating	**A3**
Outlook	Stable

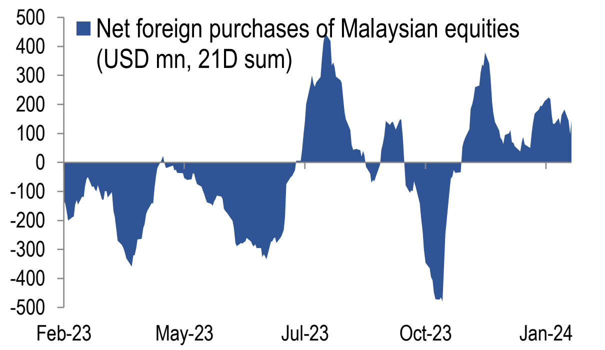
* Current is latest month, quarter or year

1. Drawn-out weakness in manufacturing activity



Source: RBC Capital Markets; Bloomberg

2. Equity outflows halted but rebound tentative



Source: RBC Capital Markets; Bloomberg

Forecasts

	2024				2025			
	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/MYR	4.75	4.80	4.80	4.65	4.50	4.50	4.40	4.30
EUR/MYR	5.13	5.09	5.09	5.02	4.95	5.04	5.06	5.07
MYR/JPY	29.5	30.2	31.3	31.2	31.8	31.3	31.4	31.4
CAD/MYR	3.54	3.53	3.61	3.55	3.45	3.46	3.40	3.33

Source: RBC Capital Markets estimates

Forecasts

Spot forecasts

	2024				2025			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.06	1.06	1.08	1.10	1.12	1.15	1.18
USD/JPY	140	145	150	145	143	141	138	135
GBP/USD	1.27	1.25	1.23	1.24	1.24	1.23	1.24	1.26
USD/CHF	0.87	0.90	0.92	0.91	0.91	0.91	0.90	0.89
USD/CAD	1.34	1.36	1.33	1.31	1.31	1.30	1.30	1.29
AUD/USD	0.65	0.64	0.66	0.68	0.70	0.71	0.72	0.74
USD/CNY	7.22	7.25	7.20	7.10	7.00	7.00	6.90	6.80
USD/KRW	1340	1360	1340	1300	1280	1260	1250	1230
USD/SGD	1.35	1.37	1.35	1.33	1.32	1.31	1.30	1.29
USD/MYR	4.75	4.80	4.80	4.65	4.50	4.50	4.40	4.30

Source: RBC Capital Markets estimates

EUR Crosses

	2024				2025			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.06	1.06	1.08	1.10	1.12	1.15	1.18
EUR/JPY	151	154	159	157	157	158	159	159
EUR/GBP	0.85	0.85	0.86	0.87	0.89	0.91	0.93	0.94
EUR/CHF	0.94	0.96	0.97	0.99	1.00	1.02	1.03	1.05
EUR/CAD	1.45	1.44	1.41	1.41	1.44	1.46	1.49	1.52
EUR/AUD	1.66	1.66	1.61	1.59	1.57	1.58	1.60	1.59
EUR/CNY	7.80	7.69	7.63	7.67	7.70	7.84	7.94	8.02
EUR/KRW	1447	1442	1420	1404	1408	1411	1438	1451
EUR/SGD	1.46	1.45	1.43	1.44	1.45	1.47	1.50	1.52
EUR/MYR	5.13	5.09	5.09	5.02	4.95	5.04	5.06	5.07

Source: RBC Capital Markets estimates

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