Currency Report Card – November 2023

09 November 2023

Forecasts

November 2023

Three month forecast returns

Most bullish	Most bearish
INR	GBP
USD	SEK
CAD	KRW

Source: RBC Capital Markets

12 month forecast returns

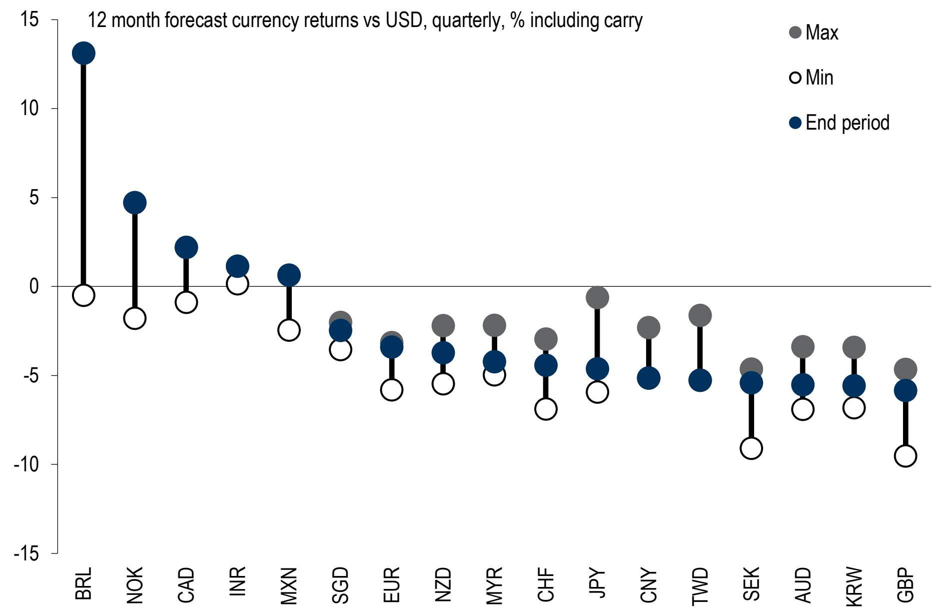
Most bullish	Most bearish
BRL	GBP
NOK	KRW
CAD	AUD

Source: RBC Capital Markets

Key forecast revisions this month include:

We have only made short-term forecast revisions to Scandis and Asia EM this month.

BRL outperformance; GBP, KRW, AUD underperformance



Source: RBC Capital Markets

Global FX Strategy

RBC Europe Limited
Global Head of FX Strategy
Elsa Lignos

Chief Currency Strategist
Adam Cole

RBC Capital Markets LLC
Vice President
Daria Parkhomenko, CFA

RBC Dominion Securities Inc.
Technical Strategist
George Davis, CMT

Royal Bank of Canada – Singapore Branch
Asia FX Strategist
Alvin T. Tan

Table of contents

US Dollar

Elsa Lignos

1-3 Month Outlook – Narrative shift or not?

There is no denying something shifted for USD in early November. We spent two weeks seeing clients across the US/Canada in mid/late October and it was hard to find a USD bear. Now we hear more people talking about a narrative shift – the Treasury's quarterly refinancing announcement (Nov 1) squashed fears of another large pick-up in long bond issuance. The FOMC statement and press conference later that same day acknowledged the impact that the sharp rise in back-end yields has had on tightening financial conditions. Some signs of softer data (ISM, NFP) were the cherry on the cake. So far the move has been limited. DXY had a quick 2% correction from the Nov 1 high to the Nov 6 low but has struggled to follow through. Now both equities and bonds have stalled, reducing the cross-asset USD-sell signal (the twin bond/equity rally is the most powerful driver for USD lower). It leaves USD in limbo, awaiting the next data release for direction. October CPI is shaping up to be as important as it was last year – does it confirm the market expectation for ongoing disinflation (and reinforce the feeling for some that 'the Fed is done', cuts are not far) or does it call into question the extra cut now priced for 2024? We're still in the camp looking for USD to recover. Bonds and equities rallying can create a big short-term headwind for USD, but if that persists, it would also unwind a lot of the tightening that the Fed felt was doing its job. It's hard to change our USD view without confirmation that US data are really slowing. So far, we have not seen enough to make that call, noting USD bears have been calling the slowdown for over a year. We have left our 1-3 month forecasts unchanged. The main risk is still positioning. Figure 1 shows our estimates of where that sits after the early November squeeze and clearly there is room for a further unwind. But we also need a catalyst. Failing that, USD remains a high carry currency in G10, which makes sense to hold in range-bound markets.

6-12 Month Outlook – No change to H1 view

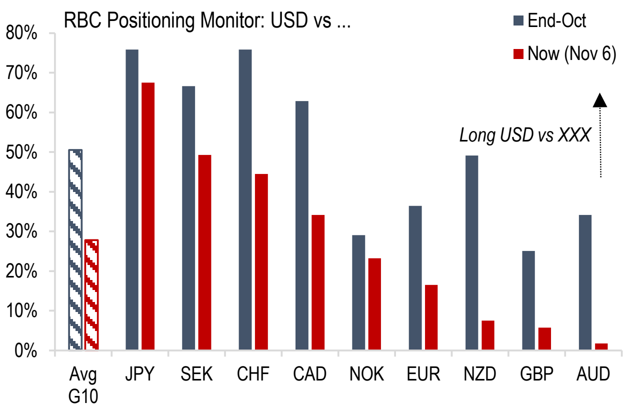
We have little doubt that in January 2024, short USD is likely to be one of the most popular thematic trades – as it has been for the last three years. US data slowed but are already bouncing (Figure 2), and in relative terms, the rest of the world still looks worse (see next page). As noted above, the twin bond/equity rally has run out of steam and it's hard to rely on it for USD lower. Eventually the US deficits may well weigh on the currency but as long as the private sector remains in surplus, we think it is premature to try to factor it in. Our long-term forecasts are also unchanged.

Indicators

	Current (Previous)*
Official cash rate	**5.25-5.50% (5.00-5.25%)**
Trend interest rates (10yr average)	1.2%
Bias in interest rate market	Small hikes then lower
Core PCE Inflation %Y/Y Sep (Aug)	**3.7% (3.8%)**
Inflation target	2%, on average
Budget balance % GDP FY22 (FY21)	**-5.5% (-12.3%)**
Budget balance target % GDP	-
GDP Growth % y/y Q3 A (Q2)	4.9% (2.1%)
Trend GDP %y/y	2.6%
Purchasing Power Parity Value	-
Spot	-
PPP Valuation	-
Current account balance % GDP Q2 (Q1)	**-3.2% (-3.4%)**
Trend current account balance % GDP	-2.4%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

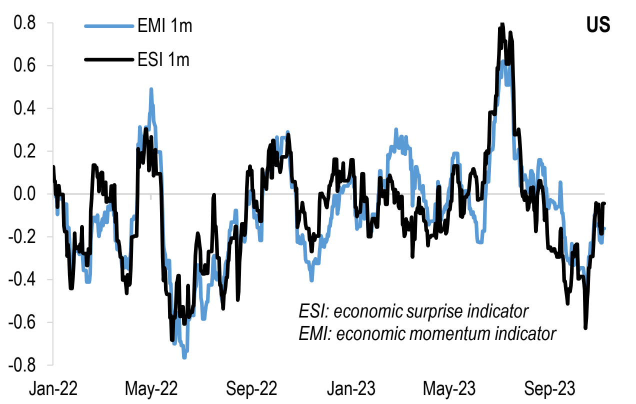
* Current is latest month, quarter or year

1. USD longs scaled back albeit balance still long



Source: RBC Capital Markets

2. Higher frequency US ESI/EMI has started to bounce



Source: Bloomberg, RBC Capital Markets

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.09	1.06	1.04	1.03	1.02	1.05	1.08
USD/JPY	133	144	149	150	152	154	150	145
USD/CAD	1.35	1.32	1.36	1.38	1.39	1.39	1.35	1.31

Source: RBC Capital Markets estimates

Euro

Elsa Lignos

1-3 Month Outlook – Year-end risk on forecasts

EUR bearishness feels pretty well-entrenched. Even as some investors turn bearish USD (see prev. page), EUR is typically the 'least favourite' long on the other side. The growth dynamic continues to run in the US's favour. By now it's consensus that US growth is going to come in well above the Euro area for 2023 (1.8% gap) but the gap for 2024 is also edging higher (0.3ppt, up from 0.1 last month and 0.3 in the Euro area's favour at its peak). We have looked before at what matters more, the gap itself or the change in the gap, and found much stronger evidence for the former than the latter (see *Total FX*, 13 May 2021). We still see EUR/USD grinding lower over the short/medium term but that is not specific to EUR. What could turn markets less bearish on EUR? There is some marginally positive news coming from an unexpected source. While tension in the Middle East and the ongoing war in Ukraine are known risks (though perhaps underpriced in some areas), there is a potential silver lining from Panama. With water levels in the Gatun Lake (required to operate the locks) at their lowest level since records began, Panama has restricted crossing. Many of the slots for LNG transits are likely to go to long-term contracts while spot cargos get bumped by container ships. That means more cargoes stay in the Atlantic, supporting European LNG supply. Outside the marginally positive, we see EUR's best hope for a rally coming from a material slowdown in US data. Clients mostly disagree with us that EUR could rally in the event of a global recession and we agree it wouldn't be the norm historically – but if we head into a risk off regime with markets holding long USD for carry and short EUR for funding, the impact should be to send EUR/USD higher. Right now that is a tail risk rather than a central scenario and we have left our forecasts unchanged for EUR/USD to retest and break the lows in H1 2024. Technically, a break of resistance at 1.0769 would extend the corrective rally in EUR/USD, exposing 1.0862/1.0945. A break below trendline support at 1.0570 would signal an end to the correction.

6-12 Month Outlook – Waiting for cyclical turn

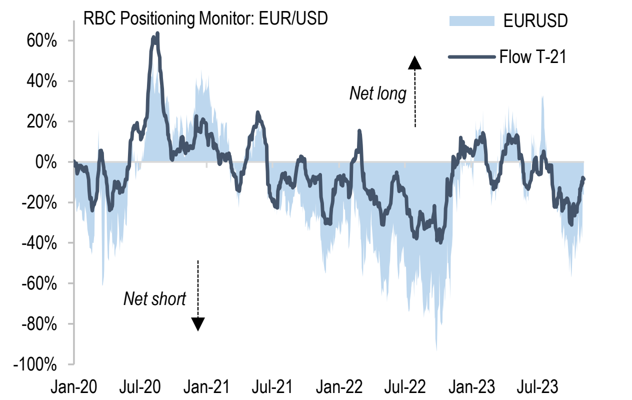
Sellside analyst consensus keeps drifting lower for EUR/USD next year (1.15 to 1.13 now 1.11) but still well above spot. Eventually that long-term bullish EUR/USD outlook will be right but we still think it looks premature right on cyclical drivers. If rates remain higher for longer but the US retains its yield advantage, we expect EUR/USD will remain "cheap" on long-term valuation metrics for the whole of 2024 as well. Our long-term forecasts are unchanged.

Indicators

	Current (Previous)*
Official cash rate (ECB main refi rate)	**4.50% (4.25%)**
Trend interest rates 10y average	0.31%
Bias in interest rate market	Easing
HICP core Inflation %Y/Y Oct P (Sep)	**4.2% (4.5%)**
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 Q3 A (Q2)	**0.1% (0.2%)**
Trend GDP %y/y	1.5%
Purchasing Power Parity Value Sep	**1.2636**
Spot end-Oct	1.0575
PPP Valuation	EUR/USD is undervalued
Current account % GDP Q2 (Q1)	0.2% (-0.4%)
Trend current account balance % GDP	2.2%
Moody's Foreign Currency Rating	**Aaa (Germany)**
Outlook	Stable

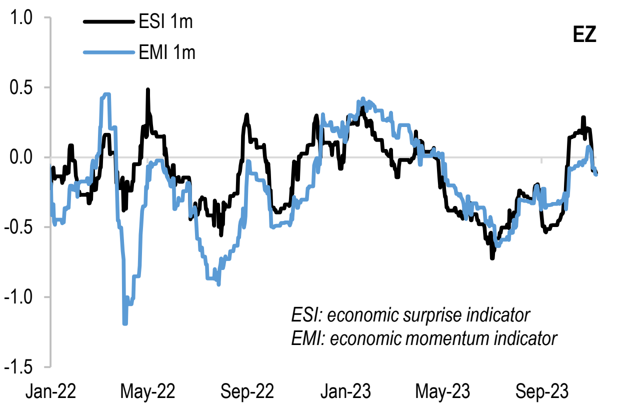
* Current is latest month, quarter or year

1. Market scaling back short EUR/USD positioning



Source: RBC Capital Markets

2. Euro area ESI/EMI briefly turned positive, now dipping



Source: RBC Capital Markets, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.09	1.06	1.04	1.03	1.02	1.05	1.08
EUR/JPY	144	157	158	156	157	157	158	157
EUR/CAD	1.46	1.44	1.44	1.44	1.43	1.42	1.42	1.41

Source: RBC Capital Markets estimates

Japanese Yen

Adam Cole

1-3 Month Outlook – USD/JPY momentum regained

Despite a series of developments in the last few weeks – another surprise tweak to the BoJ's YCC policy on October 31, a decidedly dovish shift in central bank rhetoric outside Japan and resulting fall in international yields and even a material fall in global equity prices in October – it did not take long for USD/JPY to push back above 150, again frustrating the JPY bulls that make up more than 90% of sell-side analysts. For us, the strength of downward pressure on JPY is driven by the *levels* of global yields, with small changes making little difference to the big picture flows on the part of local investors in Japan. As Figure 1 shows, recent developments have left every bond market in G10 yielding more than JGBs in unhedged terms (horizontal axis). Add a currency hedge, however, and every G10 market yields less than JGBs to a JPY-based investor (vertical axis). After huge liquidation flows in 2022, Japanese investors have been fairly consistent net buyers of foreign bonds in 2023 and, as the chart suggests, the bulk of this flow is likely to have been unhedged and so involve JPY selling. As we have consistently pointed out, however, it is the flow related to existing bond holdings that matters more. With forward CB rate expectations under new downward pressure (at least for now), we are again seeing assertions that peak rates (outside Japan) should be associated with peak USD/JPY. As Figure 2 shows, however, it would take far deeper rate cuts than currently discounted for hedging existing portfolios to start making sense.

6-12 Month Outlook – Trend JPY weakness

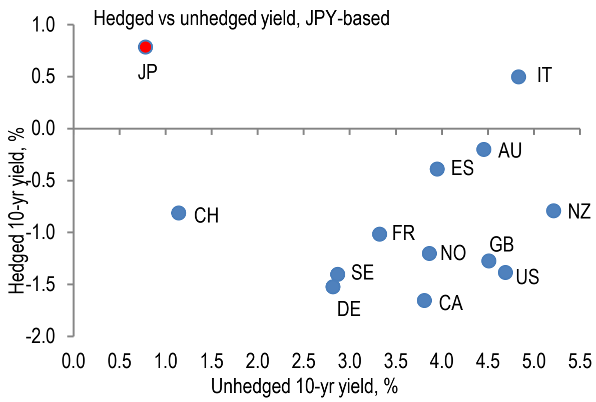
It is the balance between foreign and domestic investor flow that will be the longer-term driver of JPY. While in the short-term, there may be further bouts of selling as USD/JPY shorts are reestablished or international yields fall, in the longer-term, we think domestic investor flow will dominate. This is being driven primarily by the end of a 20-year paradigm in terms of the cost of hedging. The cost of hedging most foreign assets now far exceeds the yield on those assets and as a result, Japanese investors are removing the hedges on bonds that are already owned (JPY-negative). At some point hedge ratios will hit desired levels and the JPY selling will abate, but early indications from the Lifers' accounts for March suggest we are not there yet, and history has shown they are slow-moving and reactive rather than preemptive.

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 Sep (Aug)	**2.8% (3.1%)**
Inflation target	2.0%
Budget balance % GDP FY21 (FY20)	**-6.4% (-9.5%)**
Budget balance target % GDP	n/a
GDP Growth %Y/Y Q2 (Q1)	**1.7% (1.8%)**
Trend GDP %Y/Y	1.0%
Purchasing Power Parity Value Sep	**81.33**
Spot end-Oct	151.68
PPP Valuation	USD/JPY is overvalued
Current a/c balance % GDP Q2 (Q1)	3.9% (2.8%)
Trend current account balance % GDP	2.8%
Moody's Foreign Currency Rating	**A1**
Outlook	Stable

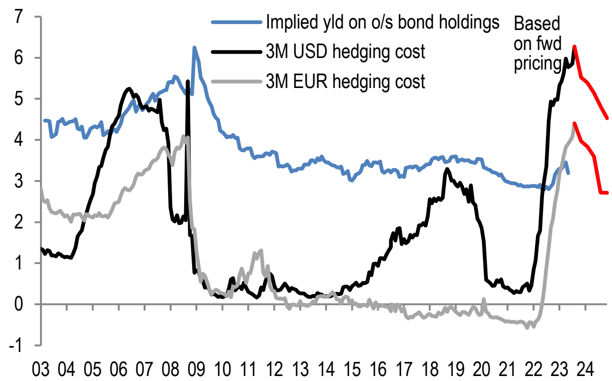
* Current is latest month, quarter or year

1. Current hedged foreign bonds unattractive



Source: RBC Capital Markets, Bloomberg

2. For FX, stock of holdings matters more



Source: RBC Capital Markets, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/JPY	133	144	149	150	152	154	150	145
EUR/JPY	144	157	158	156	157	157	158	157
CAD/JPY	98	109	110	109	109	111	111	111

Source: RBC Capital Markets estimates

Sterling

Adam Cole

1-3 Month Outlook – Narrower risk premium

GBP was a middling G10 performer in October and was essentially flat against both USD and EUR. This came against a background, however, where UK front end rates fell more than was the case in either the US or Eurozone, so a flat performance for GBP implies a continued narrowing of the risk premium that GBP started carrying in the early summer (Figure 1). Forwards now price UK rates being at their peak, though the profile of cuts is shallow (65bp over the next year). We therefore see two downside risks for GBP. Firstly, the pace of forward rate cuts starts to accelerate, given the tightness of policy in the UK. Secondly, the risk premium apparent in Figure 1 starts to increase again, most likely driven by renewed upward pressure on inflation with new questions arising on the credibility of UK policy.

6-12 Month Outlook – Medium-term weakness

The UK's financial imbalances pre-date last year's "fiscal event" and the triple deficits the UK was already running look very similar to those the US ran in the early-2000s. The current account deficit is trending at around 4% of GDP (though recent data have been blighted by very large recording errors) and although it has been readily financed through equity sales, the outperformance of UK equities in 2022 was driven by GBP weakness. On the OECD's estimates, the structural budget deficit is 6% of GDP. The fact that the budget and current deficits are similar in magnitude reflects the UK's lack of domestic private savings, unlike other DM countries that run similar sized budget deficits (Japan, Italy). Our longer-term expectations for GBP have to include the risk that attracting the foreign inflows the UK will need "requires" a relative cheapening of UK assets via the currency. The widespread view that GBP is historically "cheap" is not supported by measures of the real exchange rate, with the UK's persistently poor productivity performance and relatively high wage growth offsetting most of the weakness of the nominal exchange rate in recent years. We expect grinding GBP underperformance to continue into the medium-term.

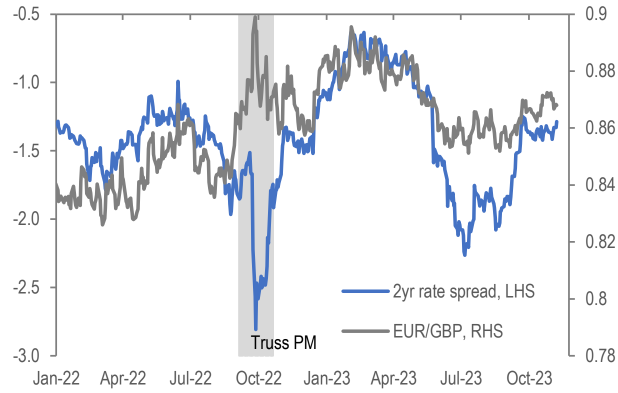
We are fielding more-and-more questions on the next election in the UK (due by December 2024, though more likely slightly earlier). There is little uncertainty on the outcome of the election itself (Betfair price 87% probability of Labour being the largest party), but there is some risk that markets assume a more constructive attitude to Europe will drive some GBP upside under Labour. It is probably too soon to start positioning for this, however.

Indicators

	Current (Previous)*
Official cash rate	**5.25% (5.0%)**
Trend interest rates 10y average	3.3%
Bias in interest rate market	Flat then lower
CPI Inflation %Y/Y Sep (Aug)	**6.7% (6.7%)**
Inflation target (HICP)	2.0%
Budget balance % GDP FY21 (FY20)	**-7.6% (-12.6%)**
Budget balance target % GDP	Budget surplus as soon as possible
GDP Growth %Y/Y Q2 (Q1)	**0.5% (0.5%)**
Trend GDP %Y/Y	1.5%
Purchasing Power Parity Value Sep	**1.3422**
Spot end-Oct	1.2153
PPP Valuation	GBP/USD is undervalued
Current a/c balance % GDP Q1 (Q4)	-1.8% (-1.8%)
Trend current account balance % GDP	-3.9%
Moody's Foreign Currency Rating	**Aa1**
Outlook	Stable

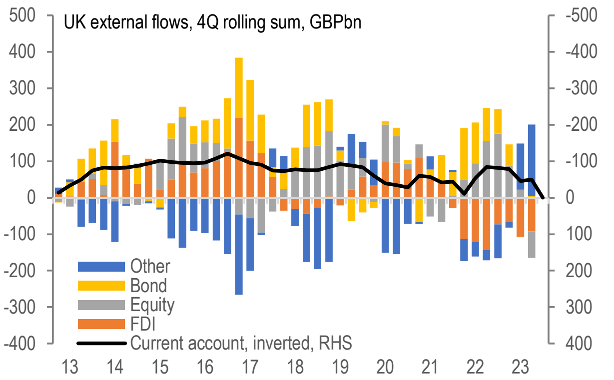
* Current is latest month, quarter or year

1. GBP's risk premium has reduced



Source: RBC Capital Markets, Bloomberg

2. Long-term risk from funding needs



Source: RBC Capital Markets, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
GBP/USD	1.23	1.27	1.22	1.17	1.13	1.11	1.15	1.20
EUR/GBP	0.88	0.86	0.87	0.89	0.91	0.92	0.91	0.90
GBP/JPY	164	183	182	175	172	171	173	174
GBP/CAD	1.67	1.68	1.66	1.61	1.57	1.54	1.56	1.57

Source: RBC Capital Markets estimates

Swiss Franc

Elsa Lignos

1-3 Month Outlook – SNB done on rates but not on reserves

CHF is a middle of the pack performer over the past month. There is one more SNB meeting still to come before the end of the year (December 14) but by now markets have fully come around to the expectation that the SNB is done hiking rates. Cuts start creeping into the curve next year (one cut by September, one more cut by Q1 2025) but at a slower pace than other central banks, reflecting the lower starting point. Where does that leave the currency? CHF is still the best-performing G10 currency in spot terms YTD, though slips to third place on total returns. The SNB continues to shrink its balance sheet. Reserves were down 3% in October (though part of that will be valuation effect of the underlying assets which will reverse in November). But stripping away a guesstimate for mark-to-market, we think the SNB is still actively selling foreign reserves. We're not yet back to Feb 2017 levels in reserves, and while the SNB has not said how far it wants to go in the unwind, the time looks opportune for this process to run further, keeping CHF supported and helping guide inflation back towards target.

Technically in USD/CHF, pullbacks to support at 0.8888 and 0.8745 are expected to attract buying interest in USD/CHF for another attempt to rally. A daily close above 0.9074 would add to bullish price momentum in this regard, with the breakout favouring a re-test of 0.9225 followed by 0.9342.

6-12 Month Outlook – Still a classic haven

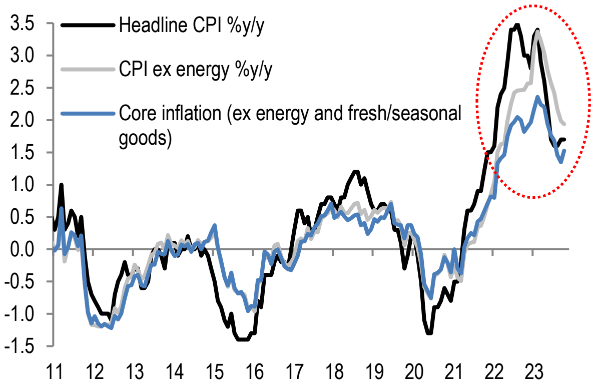
The more time that passes, the more recession risk rises. Stronger household balance sheets and solid income growth may keep consumption firmer than one might expect given the general speed of central bank tightening in the last two years, but eventually it will hit. We wrote on pg 4, that EUR might do better than history suggests in the next risk off shock, particularly if it's driven by a global slowdown which would have to mean a US slowdown. Arguing in favour of that is short market positioning and use as a funding currency. Both of those arguments could be made for CHF. We do get the sense, it's not the most popular funder despite its relatively low yield. But as Figure 2 shows, positioning is short and we would expect CHF to do best in a risk off scenario.

Indicators

	Current (Previous)*
Official cash rate	**1.75% (1.50%)**
Trend interest rates average	-0.2%
Bias in interest rate market	Easing
CPI Inflation %Y/Y Oct (Sep)	**1.7% (1.7%)**
Inflation target	less than 2.0%
Budget balance % GDP 2021 (2020)	**-0.5% (-3.1%)**
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Y/Y Q2 (Q1)	**0.5% (1.5%)**
Trend GDP %Y/Y	1.9%
EUR Purchasing Power Parity Value Sep	**1.0597**
EUR/CHF spot end-Oct	0.9627
EUR/CHF PPP Valuation	EUR/CHF is undervalued
Current a/c balance % GDP Q2 (Q1)	9.82% (9.17%)
Trend current account balance % GDP	6.8%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

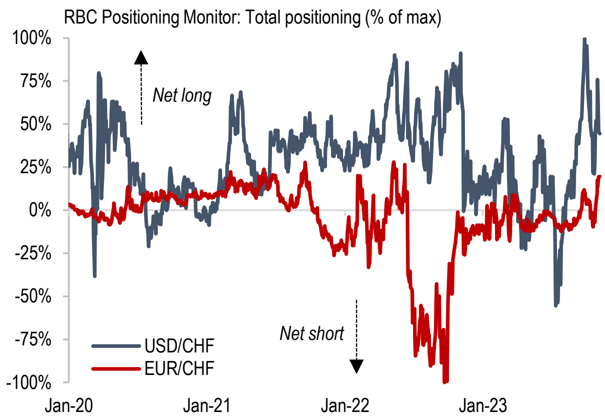
* Current is latest month, quarter or year

1. Will core inflation keep trending lower?



Source: Bloomberg, RBC Capital Markets

2. Market net short CHF, against USD and against EUR



Source: Bloomberg, RBC Capital Markets

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CHF	0.92	0.90	0.92	0.91	0.91	0.92	0.89	0.86
EUR/CHF	0.99	0.98	0.97	0.95	0.94	0.94	0.93	0.93
CHF/JPY	145	161	163	164	167	167	169	168
CAD/CHF	0.68	0.68	0.67	0.66	0.66	0.66	0.66	0.66

Source: RBC Capital Markets estimates

Swedish Krona & Norwegian Krone

Elsa Lignos

Swedish Krona – Faster than it should be

Seven weeks into the Riksbank's programme to hedge FX reserves "to reduce currency risk", and with four weeks of published data, the pace of SEK buying appears to be faster than it should be. The published data don't yet capture the late October SEK sell-off (due on Nov 10) or the early November recovery. But it is fair to say the programme appears to be having limited impact in changing the market's direction of travel on SEK. The Riksbank meets again in late November, with markets discounting a 50% chance of one more hike. But whether or not that is delivered, taking base rates to 4.25%, we expect markets will continue to favour SEK as a funding currency, unless something fundamentally changes to shift markets away from G10 carry as a theme. On our metrics, positioning is a lot less crowded in short SEK than it was a month ago. In the last three weeks, the net flows have been SEK buying as part of those EUR/SEK and USD/SEK longs got stopped out (Figure 1). But so far both pairs have been unable to break out of the past few months' ranges and as long as EUR/SEK holds above the 200dma, we suspect momentum investors will feel comfortable holding onto EUR/SEK longs.

Norwegian Krone – Fortunes tied to crude

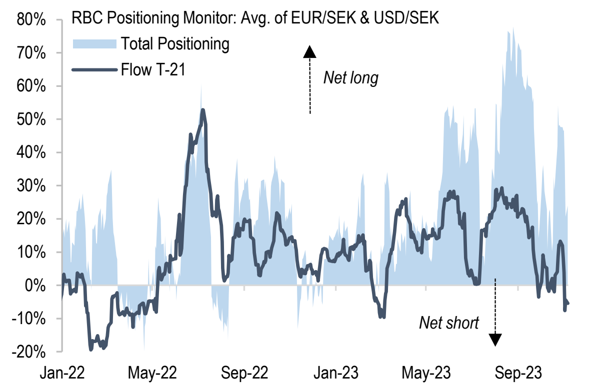
NOK remains highly leveraged to energy prices. While that sounds obvious, it is particularly strong right now. Figure 2 shows a 3m rolling correlation for EUR/NOK to 'typical' drivers – 2y rate differentials, crude, and S&P, as a proxy for general risk appetite. NOK's underperformance through October and early November, closely mirrors the very sharp sell-off in crude (Brent from $97/bl to $80, -18% in six weeks). The move in crude has caught many out, given high geopolitical risk, firm physical markets and low storage levels. Our commodity analysts expect a bounce-back in Brent to average $90 in Q4'23/Q1'24. That should support NOK though it has been a painful trade this year. Norges Bank left the deposit rate at 4.25% as expected this month, still indicating a probable hike in December though Oct CPI is due as we go to press and will be important input for that decision. Core inflation is trending lower but remains high. NOK weakness argues against turning prematurely dovish, even if rate differentials appear to matter less to NOK right now. We have adjusted our short-term forecasts but find it hard to buy into much more NOK weakness from here. Short NOK is a relatively crowded CTA trade and we suspect 12.00 will offer decent resistance for any topside moves.

Indicators - Sweden

	Current (Previous)*
Official cash rate	**4.0% (3.75%)**
Trend interest rates 10y average	0.14%
Bias in interest rate market	Small hikes, then cuts
CPIF Inflation %Y/Y Sep (Aug)	**4.0% (4.7%)**
Inflation target (UND1X)	2.0%
Budget balance % GDP 2022 (2021)	**1.1% (0.0%)**
Budget balance target % GDP	Cyclical avg. surplus of 1%
GDP Growth %Y/Y Q2 (Q1)	**-1.0% (1.0%)**
Trend GDP %Y/Y	2.0%
EUR Purchasing Power Parity Value Sep	**9.4039**
Spot end-Oct	11.8207
PPP Valuation	EUR/SEK is overvalued
Current a/c balance % GDP Q2 (Q1)	5.0% (4.9%)
Trend current account balance % GDP	4.3%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

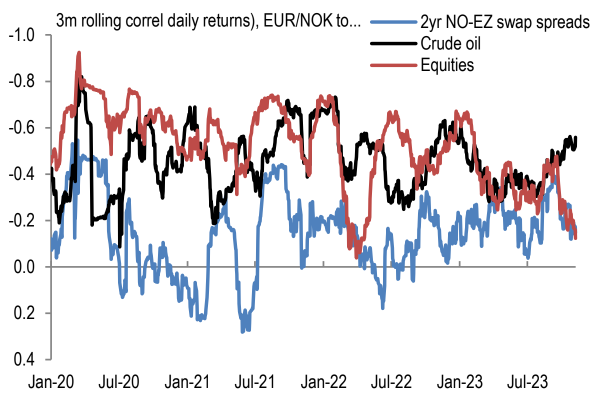
* Current is latest month, quarter or year

1. Market remains short SEK, but flows shifting to long



Source: RBC Capital Markets

2. EUR/NOK's correlation w/ crude oil has increased



Source: RBC Capital Markets, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/SEK	11.28	11.78	11.54	11.80	12.10	12.00	11.90	11.80
EUR/NOK	11.35	11.71	11.31	11.80	11.50	11.20	11.10	11.00
NOK/SEK	0.99	1.01	1.02	1.00	1.05	1.07	1.07	1.07
CAD/SEK	7.70	8.15	8.04	8.22	8.45	8.46	8.40	8.34

Source: RBC Capital Markets estimates

Canadian Dollar

Daria Parkhomenko

1-3 Month Outlook – Use pullbacks to buy USD/CAD

In October, USD/CAD extended its uptrend, but unlike the prior two months' rallies, the move was not solely driven by USD direction. Rather, it was a combination of a mildly higher USD, lower US equities, wider 2Y US-CA rate spreads, and lower crude oil prices. This environment left CAD a mixed performer in G10. As November gets underway, USD/CAD has pulled back from the new YTD highs (1.3899) reached on November 1 due to a brief rally in US bonds and equities and the resulting broad-based USD weakness.

Our bias remains to use pullbacks in USD/CAD as a buying opportunity, with USD direction likely to be the key driver of CAD vs USD and on the crosses. That means CAD's short-term performance hinges on US CPI on November 14. With markets still long USD/CAD, this suggests more space for the positioning to flush out, if US CPI surprises to the downside. Thus, we think the asymmetric near-term risk is likely for a further pullback in USD/CAD. But given our broader view for a recovery in USD and the precarious geopolitical situation, we prefer to buy USD/CAD on such pullbacks. Our USD/CAD profile is unchanged, but we are not ruling out that there is risk of the pair overshooting 1.40, especially if USD/CAD doesn't see relief post US CPI.

In October, the BoC held the policy rate again at 5.00%, amid "clearer signs that monetary policy is moderating spending and relieving price pressures". The BoC retained a hiking bias, with the meeting showing more of a concern about the inflation outlook but also a more dovish growth outlook. Although rate cuts are a long way off, a couple of BoC officials recently made rate cut timing comments (Macklem: "don't need to wait until it's back to 2 per cent"). This alongside softer GDP and jobs data in Canada contributed to US-CA 2Y rate spreads widening over the past month or so. We think that if the current signs that prior BoC rate increases are feeding through into softer growth dynamics and an easing in the labor market continue, then that should allow the BoC to remain patient on the wage and core inflation fronts. We expect the BoC to hold into H1 2024 (mkt: cum. -20bps).

6-12 Month Outlook – Profile unchanged

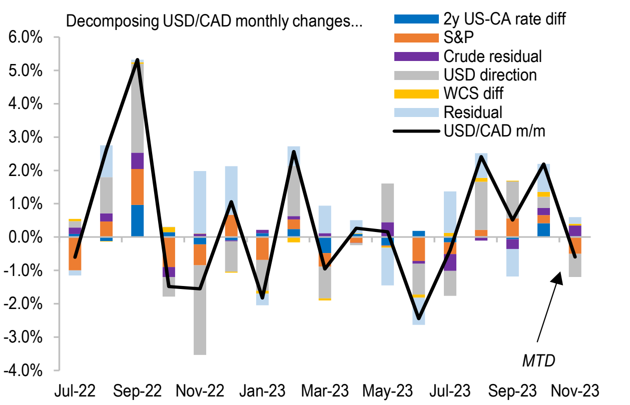
We are keeping our profile unchanged for USD/CAD to mildly move higher into H1 2024, followed by a decline in H2 2024 on the assumption of an eventual turn lower in USD (see pg. 3). RBC Economics expects a prolonged BoC hold, with rate cuts to begin in Q3 2024, compared to a central scenario for the Fed to start easing in June next year.

Indicators

	Current (Previous)*
Official cash rate	**5.00% (5.00%)**
Trend interest rates 10y average	1.3%
Bias in interest rate market	Flat, then easing
Core CPI Inflation (Trim) %Y/Y Sep (Aug)	**3.7% (3.9%)**
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 Q2 (Q1)	**-0.2% (2.6%)**
Trend GDP %Q/Q	2.1%
Purchasing Power Parity value Sep	**1.2156**
Spot end-Oct	1.3875
PPP valuation	USD/CAD is overvalued
Current account balance % GDP Q2 (Q1)	**-1.0% (-0.6%)**
Trend current account balance % GDP	-2.2%
Moody's foreign currency rating	**Aaa**
Outlook	Stable

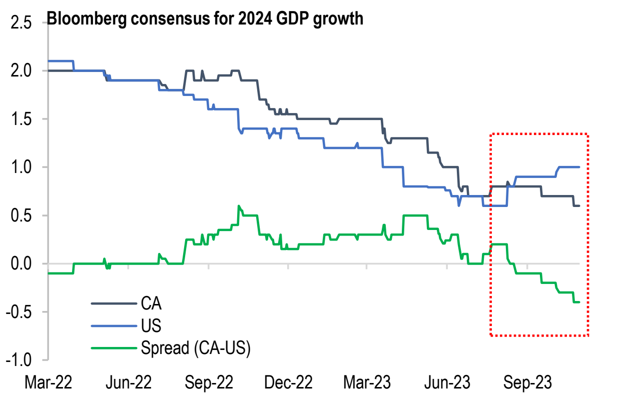
* Current is latest month, quarter or year

1. Weaker USD behind the recent pullback in USD/CAD



Source: Bloomberg, RBC Capital Markets; Latest reading as of 08 Nov 2023

2. Mkt is now expecting the US to outperform CA in 2024



Source: RBC Capital Markets; Latest reading as of 08 Nov 2023

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CAD	1.35	1.32	1.36	1.38	1.39	1.39	1.35	1.31
EUR/CAD	1.46	1.44	1.44	1.44	1.43	1.42	1.42	1.41
CAD/JPY	98.3	109.0	110.0	108.7	109.3	110.8	111.1	110.7

Source: RBC Capital Markets estimates

Australian Dollar

Adam Cole

1-3 Month Outlook – Mild underperformer

AUD was only a mid-pack performer in October, falling against generally strong USD, but gaining against the other commodity currencies. This middling performance is slightly surprising, given the rise in relative rate expectations in particular. AU was the only G10 where 2yr rates rose, against a background of generally softening central bank expectations everywhere else. Lower equity prices and a generally firm USD partly explain AUD's lack-lustre performance, though there is still a large negative residual on our model's decomposition of the return in the month (Figure 1). Arguably, the relative rise in AU 2yr yields in October was the market moving to discount the rate hike that the RBA delivered at its November 7 meeting. Even this, however, was not sufficient to drive AUD higher. At the same time as delivering a 25bp hike, the RBA raised the hurdle for further hikes going forward. While they technically retained a hiking bias, the reluctance is clear from, "*Whether further tightening of monetary policy is required to ensure that inflation returns to target in a reasonable timeframe will depend upon the data and the evolving assessment of risks.*" Following the meeting, forward rates attach around a 50% probability to one further hike in the cycle, though our economists note that elevated inflation risk may demand additional hikes. This would be consistent with the stance of policy, which on our measures, is only mildly restrictive in Australia. We are leaving our forecasts unchanged this month, which imply AUD is a mild underperformer within G10.

6-12 Month Outlook – Worsening valuations

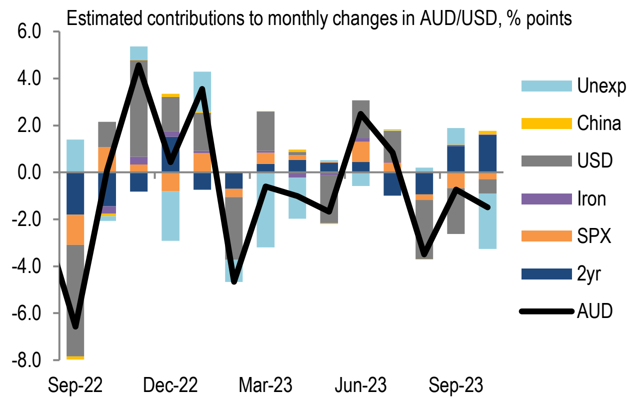
Longer-term concerns on valuation still stand. While the RBA looks for improving productivity to offset the sharp increases in wages, there are limited signs of that so far, leaving unit labour costs on an upward trajectory. ULCs are a key driver of long-term valuation and in theory, rising ULCs in the long-term requires a lower nominal exchange rate to maintain competitiveness. Valuation rarely works as a trading strategy in FX and we have evidence from a number of other countries that a currency's fair value can go down in RULC terms without any mechanism for it to correct (see *Chart of the Day*, 7 June 2023). Nevertheless, from a longer-term perspective that reinforces our view that AUD/USD is likely to grind lower over time.

Indicators

	Current (Previous)*
Official cash rate	**4.35% (4.10%)**
Trend interest rates 10y average	1.6%
Bias in interest rate market	Small hikes
CPI Inflation %y/y Sep (Aug)	**5.6% (5.2%)**
CPI Inflation target range %Y/Y	2.0-3.0%
Budget balance % GDP FY22/21	**-1.4%/-6.4%**
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Y/Y Q2 (Q1)	**2.3% (2.6%)**
Trend GDP %Y/Y	2.8%
Purchasing Power Parity Value Q3	**0.7331**
Spot end-Oct	0.6337
PPP Valuation	AUD/USD is undervalued
Current account balance % GDP Q2 (Q1)	**1.2% (1.4%)**
Trend current account balance % GDP	-1.4%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

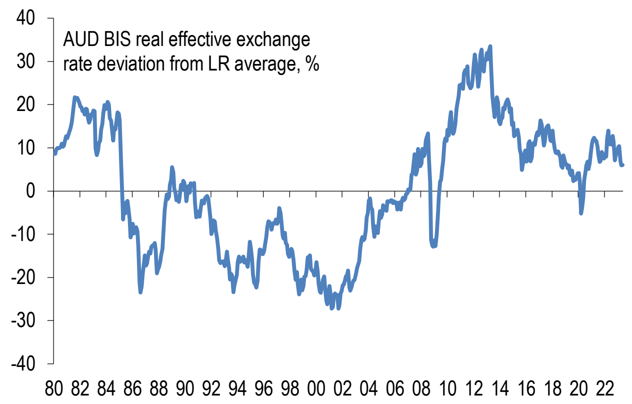
* Current is latest month, quarter or year

1. AUD "should" have rallied in October



Source: RBC Capital Markets, Bloomberg

2. AUD close to "fair value"



Source: RBC Capital Markets, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
AUD/USD	0.67	0.67	0.64	0.62	0.61	0.60	0.61	0.62
EUR/AUD	1.62	1.64	1.64	1.68	1.69	1.70	1.72	1.74
AUD/NZD	1.07	1.09	1.07	1.07	1.07	1.07	1.07	1.07
AUD/CAD	0.90	0.88	0.87	0.86	0.85	0.83	0.82	0.81

Source: RBC Capital Markets estimates

New Zealand Dollar

Adam Cole

1-3 Month Outlook – Rate cuts mispriced

NZD was the second worst performing G10 currency in October (after NOK). To some degree, NZD's poor performance reflected relative rate dynamics, with 2yr yields falling almost everywhere in G10, but NZ being amongst the biggest falls. In turn, this was driven by the undershoot on Q3 inflation that that saw headline inflation fall to a two year low. Within the detail, however, there remains very little evidence that *domestic* inflation pressure has started to moderate (proxied by non-tradeable prices). Similarly, the labour market remains robust, with the recent Q3 data showing the unemployment rate up only slightly from the lows and still below pre-COVID levels and employment still trending higher.

At the time of the last RBNZ MPS (August), the projections showed a prolonged plateau for the OCR, with a small chance of a further hike in the cycle and the first cuts only starting (at a very gradual pace) in early-2025. Given the tightness of the labour market and still high domestic inflation pressure it is hard to see RBNZ saying anything much different to this when it updates the forecasts in the forthcoming MPS (November 29). As in many markets, the forward curve diverges hugely from this with rates starting to drift lower early next year and the first full rate cut 50% discounted by mid-2024. Expect RBNZ to push back against market pricing and our central scenario is that markets move back to pricing something like the "higher for longer" profile that prevailed until recently.

If this is the case, we return to the point that has driven our view of moderate NZD outperformance this year. Irrespective of the rate dynamic, wide rate spreads (Figure 2) and relatively low volatility should support carry as a driver of FX returns and this is a positive background for NZD on a relative basis.

6-12 Month Outlook – Is the current acct a problem?

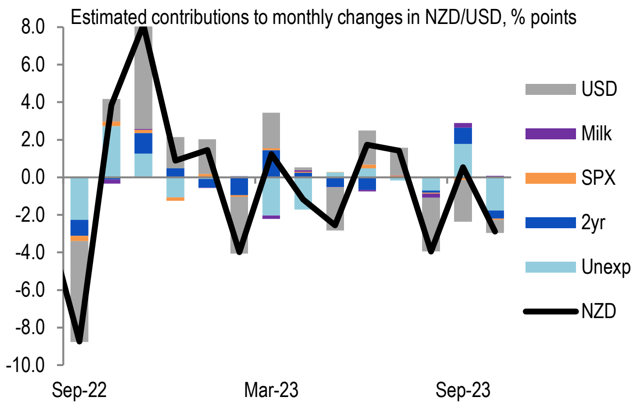
We have looked into NZ's huge c/a deficit and argued that a large part of it was down to post-COVID timing mismatches in spending. The closure of NZ's only refinery in April last year didn't help but the deficit is already improving faster than expected (-8.5% to -7.5% in Q2, cons -8.0%). We expect the current account to continue to recover through 2024.

Indicators – New Zealand Dollar

	Current (Previous)*
Official cash rate	**5.50% (5.25%)**
Trend interest rates 10y average	2.1%
Bias in interest rate market	Small hikes then cutting
CPI Inflation %y/y Q3 (Q2)	**5.6% (6.0%)**
CPI Inflation target range %Y/Y	2.0-3.0%
Budget balance % GDP 2021 (2020)	**-4.1% (-5.3%)**
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Y/Y Q2 (Q1)	**1.8% (2.2%)**
Trend GDP %Y/Y	2.8%
Purchasing Power Parity Value Q3	**0.6496**
Spot end-Oct	0.5825
PPP Valuation	NZD/USD is undervalued
Current account balance % GDP Q2 (Q1)	**-7.5% (-8.2%)**
Trend current account balance % GDP	-2.9%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

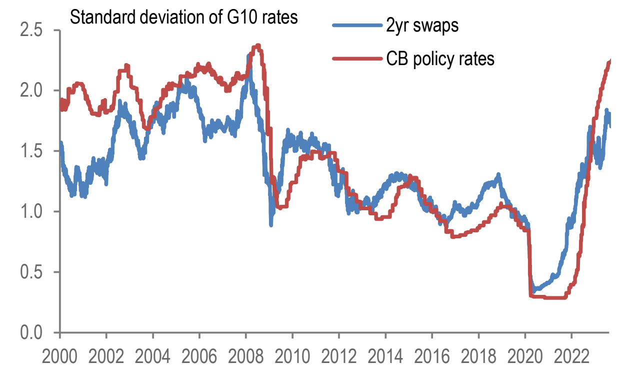
* Current is latest month, quarter or year

1. NZD "should" also have rallied in October



Source: Bloomberg, RBC Capital Markets

2. Divergent policy should leave carry performing



Source: RBC Capital Markets, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
NZD/USD	0.63	0.61	0.60	0.58	0.57	0.56	0.57	0.58
EUR/NZD	1.73	1.78	1.76	1.79	1.81	1.82	1.84	1.86
AUD/NZD	1.07	1.09	1.07	1.07	1.07	1.07	1.07	1.07
NZD/CAD	0.85	0.81	0.81	0.80	0.79	0.78	0.77	0.76

Source: RBC Capital Markets estimates

Chinese Yuan

Alvin T. Tan

1-3 Month Outlook – Ongoing economic malaise

China's growth slowdown has stabilised with support from a variety of targeted stimulus measures. The year's GDP growth target of "around 5%" looks achievable, but the economy remains frail with the moribund real estate and construction sectors exerting a huge drag. Net exports have been another drag.

Housing prices in Tier-1 cities have revived to some extent, but there is a considerable overhang of housing inventory in lower tier cities that is likely to take a long while to clear. Falling housing prices have dampened consumer sentiment and activity. The economy will require additional policy support.

In this light, further RRR and/or interest rate cuts are also expected before year-end. Nonetheless, USD/CNY has been effectively pegged around 7.30 for the past couple of months through persistently below-expectations USD/CNY reference rates. Given the general appreciation of the USD during that period, the trade-weighted CFETS Index has risen as a result.

The containment of CNY weakness has thus been cross-purposes to the PBOC's easy monetary policy path. Moreover, the USD continues to possess a significant carry premium over CNY. The current measures to restrain USD/CNY around 7.30 is consequently likely to be abandoned sooner than later.

6-12 Month Outlook – More monetary easing needed

China's multi-year property and construction boom has turned to bust, and policymakers are unwilling to reflate it. The fallout is likely to last for years. This is exacerbating caution among households and firms, who have suffered financially through the pandemic, and undermining domestic demand.

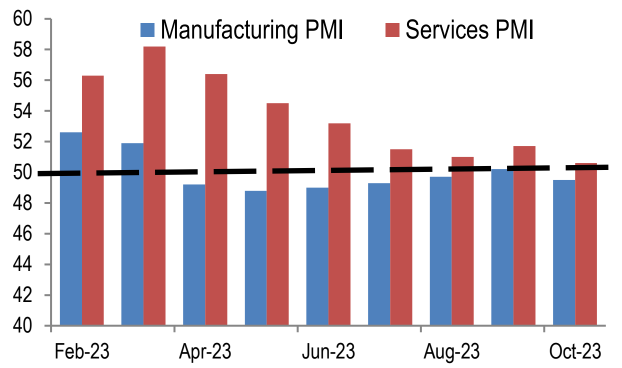
Weak domestic demand and exports are headwinds for the yuan. Beijing continues to evince an aversion to large-scale fiscal stimulus. Hence, the need for easier monetary policy to support the economy, and further currency depreciation will help in this regard.

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)	**-0.2% (0.0%)**
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)	6.3% (4.5%)
Trend GDP %y/y	5.0%
Purchasing Power Parity Value Sep	**6.8558**
Spot end-Oct	7.3165
PPP valuation	USD/CNY is overvalued
Current account balance % GDP last (prev)	**2.2% (2.2%)**
Trend current account balance % GDP	1.6%
Moody's Foreign Currency Rating	**A1**
Outlook	Stable

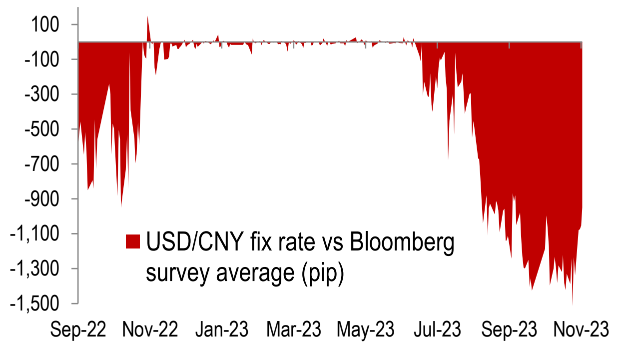
* Current is latest month, quarter or year

1. Growth slowdown has stabilised



Source: RBC Capital Markets; Bloomberg

2. Large & persistent below-expectations USD/CNY fixes



Source: RBC Capital Markets; Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CNY	6.87	7.25	7.30	7.40	7.45	7.50	7.45	7.35
EUR/CNY	7.45	7.91	7.72	7.70	7.67	7.65	7.82	7.94
CNY/JPY	19.3	19.9	20.5	20.3	20.4	20.5	20.1	19.7
CAD/CNY	5.09	5.48	5.38	5.36	5.36	5.40	5.52	5.61

Source: RBC Capital Markets estimates

Indian Rupee

Alvin T. Tan

1-3 Month Outlook – Tightly-held stability

India's economic dataflow continues to demonstrate robust strength. The October composite PMI reading of 58.4 suggests solid growth momentum into the fourth quarter. On the flipside, the perennial trade deficit remains extremely wide.

At the same time, the planned inclusion of Indian bonds into the JPM GBI-EM index starting next June has boosted investor sentiment on both local bonds and the rupee. This development is particularly helpful because there has been net foreign capital outflows from local equities lately.

Waning core inflation pressures should keep the RBI on its policy pause setting. Although the USD/INR pair has not been immune to the USD advance, the rupee has been relatively stable among the Asia FX complex, with RBI interventions providing a major assist. The currency's relatively high carry has also been helpful.

More importantly, the rupee has evinced low correlations to other Asian currencies this year, and continues to march to its own tune. This has added to the INR's appeal among regional currencies at a time of CNY weakness. Thus, the rupee's outlook might not be bullish in an absolute sense, but it is relatively bullish within the EM Asia FX universe.

6-12 Month Outlook – Index inclusion

Indian bonds offer among the highest nominal yields among Asian EM currencies, but real yields are paltry due to high domestic inflation. India historically runs a higher inflation rate than the rest of the world. On top of this, the structural fiscal and trade deficits are likely to remain sizeable. These are hurdles for the rupee in a fundamental and relative sense over the longer term.

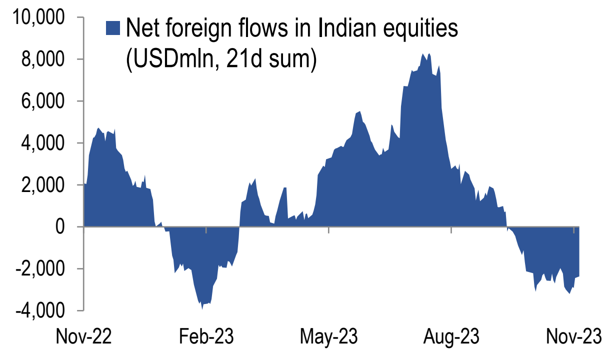
The public debt is large relative to GDP, but is almost entirely denominated in rupee. India's inclusion in the JPM GBI-EM is expected to spur $20-40bn of portfolio inflows in coming years, providing a tailwind for the rupee. The development is also likely to increase speculation of additional index inclusion going forward. This is a key potential positive factor for the rupee in the medium-term.

Indicators

	Current (Previous)*
RBI policy repo rate	**6.50%**
Trend interest rates (10yr average)	6.25%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	**5.0% (6.8%)**
Inflation target	4% +/- 2%
Budget balance % GDP last (prev)	**-6.6% (-6.4%)**
Budget balance trend % GDP	-4.4%
GDP Growth % y/y last (prev)	7.8% (6.1%)
Trend GDP %y/y	5.0%
Purchasing Power Parity Value Aug	**82.35**
Spot end-Oct	83.26
PPP valuation	USD/INR is overvalued
Current account balance % GDP last (prev)	**-1.7% (-2.0%)**
Trend current account balance % GDP	-1.4%
Moody's Foreign Currency Rating	**Baa3**
Outlook	Negative

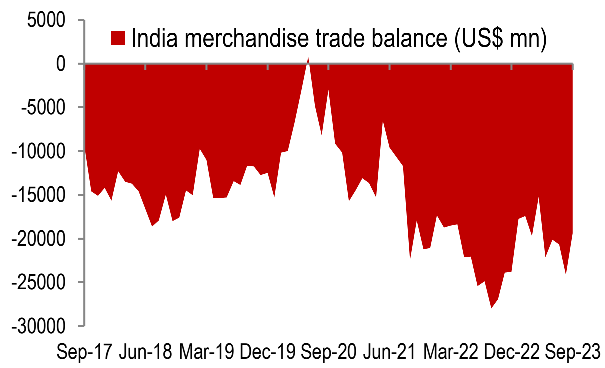
* Current is latest month, quarter or year

1. Outflows from local equities lately



Source: RBC Capital Markets; Bloomberg

2. Persistent external balance deficit



Source: RBC Capital Markets; Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/INR	82.2	82.0	83.0	83.4	83.5	83.6	83.3	83.0
EUR/INR	89.1	89.5	87.8	86.7	86.0	85.3	87.5	89.6
INR/JPY	1.62	1.76	1.80	1.80	1.82	1.84	1.80	1.75
CAD/INR	61	62	61	60	60	60	62	63

Source: RBC Capital Markets estimates

South Korean Won

Alvin T. Tan

1-3 Month Outlook – Exports slump has turned

The outlook for South Korea's trade-dependent economy is brightening. The Fed has reached its terminal interest rate, and the exports slump appears to have finally turned. China's economy also seems to be stabilising, and China is Korea's chief trading partner by far.

The trade balance has been in a persistent surplus since June, while October printed the first year-on-year positive exports growth figure since September 2022. Semiconductors are a mainstay of the Korean economy, and major global semiconductor firms have recently raised their outlook for the industry. The blunting of the global bond selloff lately also helps the won, given its traditional heightened sensitivity to external macro factors.

Indications of a turn in the exports and semiconductor cycles, however, need to be balanced against China's ongoing economic malaise. Net portfolio flows into local equities have also been mixed-to-negative since the summer.

Furthermore, the US dollar retains a large carry advantage. Persistent downside pressures on the neighbouring JPY and CNY currencies are also a drag on the won. The best that can be said is that the won is likely to outperform among the Asia FX complex, especially if risk assets rally into year-end.

6-12 Month Outlook – Cheap amid uncertainties

The won's persistent weakness in 2021 and 2022 has rendered it among the cheapest of the major Asian currencies. BOK rate hikes over that period also mean that the won now offers a decent carry among the Asia FX complex, albeit still less than the US dollar.

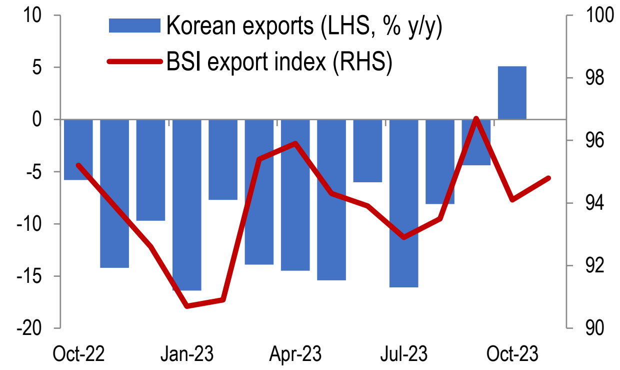
The months ahead promise a more favorable outlook for the won as existing macro headwinds fade in time. The semiconductor cycle in particular is anticipated to start turning soon. However, this needs to be balanced against deep uncertainties about the state of global demand next year, given the Korean economy's heavy export-dependence, plus the US dollar's resilience.

Indicators

	Current (Previous)*
BOK Base Rate	**3.50%**
Trend interest rates (10yr average)	1.68%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	**3.8% (3.7%)**
Inflation target	2.0%
Budget balance % GDP last (prev)	**0.2% (-0.8%)**
Budget balance trend % GDP	1.3%
GDP Growth % y/y last (prev)	1.4% (0.9%)
Trend GDP %y/y	2.5%
Purchasing Power Parity Value Sep	**1057**
Spot end-Oct	1351
PPP valuation	USD/KRW is overvalued
Current acct balance % GDP last (prev)	**0.4% (0.6%)**
Trend current acct. balance % GDP	5.0%
Moody's Foreign Currency Rating	**Aa2**
Outlook	Stable

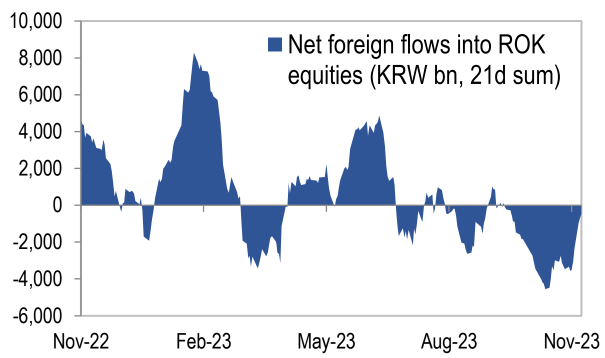
* Current is latest month, quarter or year

1. Exports growth is finally rebounding



Source: RBC Capital Markets; Bloomberg

2. Mixed/negative foreign equity flows in recent months



Source: RBC Capital Markets; Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/KRW	1302	1318	1348	1350	1390	1380	1365	1350
EUR/KRW	1411	1438	1425	1404	1432	1408	1433	1458
JPY/KRW	9.8	9.1	9.0	9.0	9.1	9.0	9.1	9.3
CAD/KRW	963	995	993	978	999	993	1011	1031

Source: RBC Capital Markets estimates

Taiwanese Dollar & Singapore Dollar

Alvin T. Tan

Taiwan Dollar – Tied to CNY risks

Taiwan has been heavily affected by the regional exports slump, which are showing tentative signs of a rebound. However, the local stock market has seen persistent net portfolio outflows since the summer. Part of this might be due to investors' growing concern with geopolitical risks. The upcoming January election will be closely watched as it would have significant medium-term implications for cross-strait relations.

Among Asia EM currencies, the TWD is also the most affected by the renminbi's broad weakness. Mainland China is Taiwan's largest trade partner by far, and the two currencies tend to be highly correlated. The upside risks to USD/CNY in coming months consequently imply upside risks to USD/TWD too.

Moreover, TWD is not as attractive as KRW on valuation grounds, and the carry it offers is also lacking. The near-term outlook for TWD is therefore mixed-to-poor, and it will probably continue to lag the Asia FX complex.

Singapore Dollar – Supported by existing policy settings

Singapore's growth momentum and inflation pressures have decelerated. The MAS tightening cycle has consequently ended. The trade-weighted SGD's appreciation has already slowed noticeably this year.

However, the estimated 1.5% annualised appreciation path of the trade-weighted exchange rate 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. The large current account surplus also offers robust fundamental support.

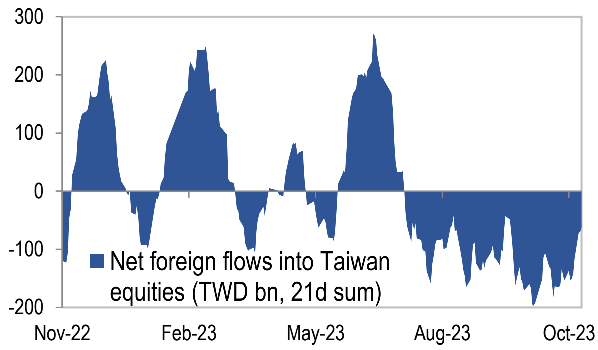
The SGD has been a middling performer among Asian currencies this year so far, whether measured year-to-date or in each quarter. It is less affected by China's slowdown that the likes of TWD or KRW, but also more impacted than the likes of INR. The SGD's implied carry is also decidedly in the middle of its regional peers. It is difficult to see this middling performance shifting abruptly in the final quarter of the year.

Indicators – Taiwan

	Current (Previous)*
CBC discount rate	**1.875%**
Trend interest rates (10yr average)	1.51%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	**3.0% (2.9%)**
Inflation target	None
Budget balance % GDP last (prev)	**1.2% (1.4%)**
Budget balance trend % GDP	0.0%
GDP Growth % y/y last (prev)	2.3% (1.4%)
Trend GDP %y/y	3.2%
Purchasing Power Parity Value Sep	**25.55**
Spot end-Oct	32.40
PPP valuation	USD/TWD is overvalued
Current account balance % GDP last (prev)	**11.9% (12.1%)**
Trend current account balance % GDP	12.1%
Moody's Foreign Currency Rating	**Aa3**
Outlook	Positive

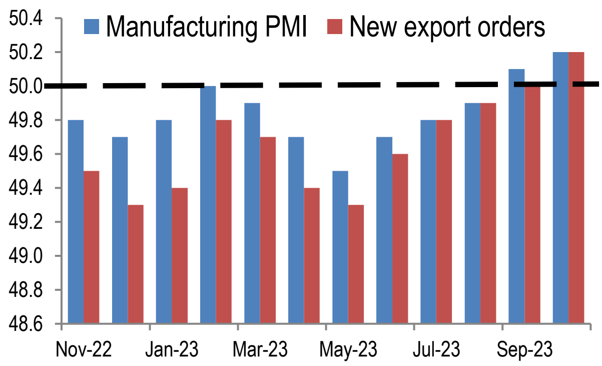
* Current is latest month, quarter or year

1. Persistent outflows from Taiwan equities since June



Source: RBC Capital Markets; Bloomberg

2. Singapore's PMI new exports orders sub-index has gradually risen back above the 50.0 threshold



Source: RBC Capital Markets; Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/TWD	30.49	31.15	32.24	32.50	32.70	33.00	32.80	32.60
EUR/TWD	33.04	33.99	34.09	33.80	33.68	33.66	34.44	35.21
TWD/JPY	4.4	4.6	4.6	4.6	4.6	4.7	4.6	4.4
CAD/TWD	22.56	23.53	23.75	23.55	23.51	23.74	24.30	24.89

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 more than a year, and has dipped further in recent months. It also has the largest trade exposure to China among the major ASEAN economies.

On top of these fundamental drags, MYR has been bedeviled by net foreign equity portfolio outflows for much of the past year. Local bond yields are relatively mediocre too. The prices of key commodity exports of oil & gas and palm oil have also trended lower in recent weeks.

Without an exciting growth story, Malaysia's financial assets will struggle to generate significant interest from global investors. The incumbent coalition government remains fragile, 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 rationalise 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 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 the cheapest Asian currency 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.

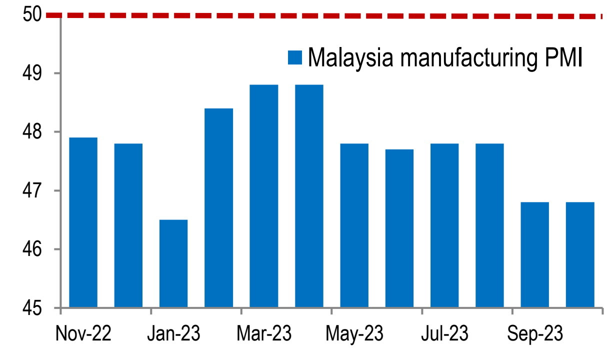
On the flipside, the country's fiscal challenges will keep investors cautious. Malaysia's interest rates continue to lag US ones and those of several of its Asian peers. Finally, it is difficult to foresee a significant improvement in the domestic political situation.

Indicators

	Current (Previous)*
BNM official overnight rate	**3.00%**
Trend interest rates (10yr average)	2.80%
Bias in interest rate market	Flat
CPI Inflation %Y/Y last (prev)	**1.9% (2.0%)**
Inflation target	None
Budget balance % GDP last (prev)	**-5.2% (-5.1%)**
Budget balance trend % GDP	-4.2%
GDP Growth % y/y last (prev)	3.3% (2.9%)
Trend GDP %y/y	4.0%
Purchasing Power Parity Value Sep	**2.9324**
Spot end-Oct	4.7635
PPP valuation	USD/MYR is overvalued
Current acct bal % GDP last (prev)	**3.3% (3.0%)**
Trend current acct balance % GDP	3.7%
Moody's Foreign Currency Rating	**A3**
Outlook	Stable

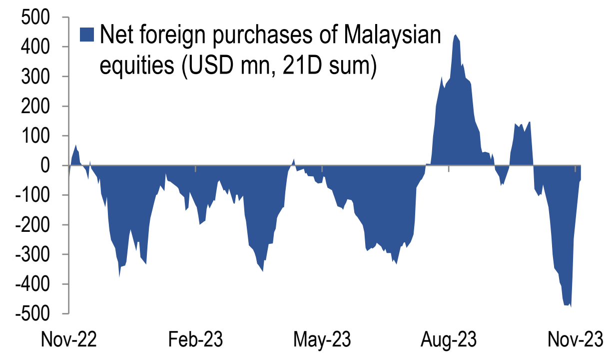
* Current is latest month, quarter or year

1. Drawn-out weakness in manufacturing sector



Source: RBC Capital Markets; Bloomberg

2. Equity outflows predominated for most of the past year



Source: RBC Capital Markets; Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/MYR	4.42	4.67	4.70	4.76	4.80	4.82	4.75	4.60
EUR/MYR	4.79	5.09	4.96	4.95	4.94	4.92	4.99	4.97
MYR/JPY	30.1	30.9	31.8	31.5	31.7	32.0	31.6	31.5
CAD/MYR	3.27	3.52	3.46	3.45	3.45	3.47	3.52	3.51

Source: RBC Capital Markets estimates

Brazilian Real

Daria Parkhomenko

1-3 Month Outlook – Focus on 2024 fiscal target

For most of October, USD/BRL traded above the 5.00 level. Although the external backdrop was an important driver, concerns about the fiscal outlook caused BRL to end the month as a mixed performer in EM (more below). With November underway, relief in USD has taken USD/BRL back below 5.00 and BRL towards the top of the EM leaderboard.

Domestically, the BCB delivered the third consecutive 50bp rate cut on November 1, taking the Selic rate to 12.25%. The statement kept its forward guidance that, “If the scenario evolves as expected, the Committee members unanimously anticipate further reductions of the same magnitude in the next meetings”. However, the BCB was more cautious about the global environment, stating that it is “adverse” and “requires attention and caution”. The minutes also showed more concern about the fiscal outlook, with the committee noting that there is not only fiscal uncertainty about “the execution of targets”, but “uncertainty increased about the target itself for the fiscal balance, which led to an increased risk premium”. Having said that, Governor Campos Neto suggested on November 7 that the BCB is likely to maintain the 50bp increment rate cuts at the next two meetings (almost fully priced by mkt). On the fiscal front, since the end of October, market concerns have picked up about Lula’s administration potentially changing its zero primary deficit target for 2024. Thus far, Finance Minister Haddad has been able to avert a change to the target, which is positive, but this topic bears watching.

In all, we are keeping a constructive view on BRL amid the still high real rates – this is conditional on the fiscal target remaining unchanged. We have also kept our USD/BRL profile unchanged this month, with the fiscal story posing an upside risk to our profile while weaker than expected US CPI on November 14th would pose a downside risk.

6-12 Month Outlook – Fiscal commitment

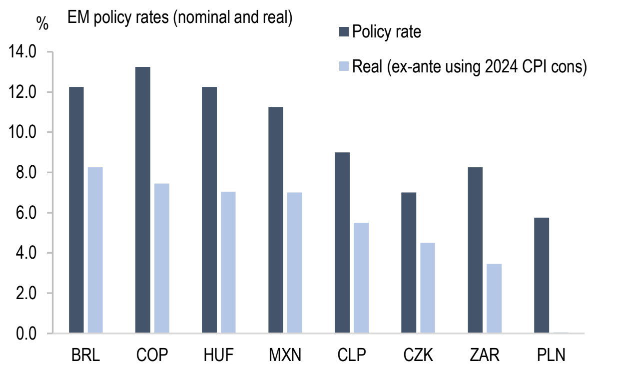
The government’s commitment and ability to rein in the fiscal finances is key for USD/BRL’s longer-run trajectory. Specifically, the focus will be on whether the government changes its target of zeroing the primary deficit next year and the government’s progress (or lack thereof) in Congress passing the necessary measures to raise more revenues. We continue to stand ready to reassess our long-run target of 4.50 if the fiscal process faces more significant delays/lack of progress or a change in the 2024 target.

Indicators

	Current (Previous)*
Official policy rate	12.25 (12.75)
Trend interest rates (10yr average)	9.4
Bias in interest rate market	Easing
CPI Inflation %Y/Y Sep (Aug)	5.19 (4.61)
Inflation target (2023)	3.25%
Budget balance % GDP Q2 (Q1)	-7.7 (-4.9)
Budget balance % GDP (10y avg)	-6.6
GDP Growth % y/y Q2 (Q1)	3.4 (4.0)
Trend GDP %y/y	0.5
Purchasing Power Parity Value Sep	3.6079
Spot end-Oct	5.0378
PPP Valuation	USD/BRL is overvalued
Current account balance % GDP Q2 (Q1)	-2.7 (-2.7)
Trend current acct balance % GDP (10y avg)	-2.7
Moody's Foreign Currency Rating	Ba2
Outlook	Stable

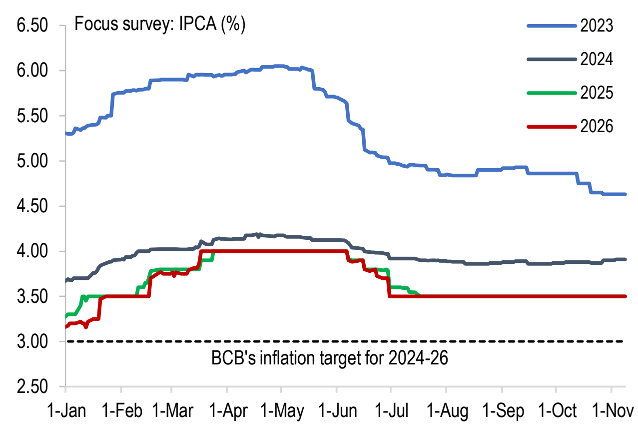
* Current is latest month, quarter, or year

1. BCB rate cuts have not yet eroded Brazil’s high real rate



Source: RBC Capital Markets, Bloomberg

2. Market analysts’ inflation expectations still above target



Source: RBC Capital Markets; BCB, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/BRL	5.06	4.79	5.03	5.00	4.90	4.75	4.50	4.50
EUR/BRL	5.49	5.22	5.32	5.20	5.05	4.85	4.73	4.86
BRL/JPY	26.2	30.1	29.7	30.0	31.0	32.4	33.3	32.2
CAD/BRL	3.75	3.62	3.71	3.62	3.52	3.42	3.33	3.44

Source: RBC Capital Markets estimates

Mexican Peso

Daria Parkhomenko

1-3 Month Outlook – Focus on Banxico's guidance

In October, MXN's losing streak continued as the uncertain external backdrop kept MXN on the backfoot, and USD/MXN broke above the 200-dma, reaching the highest levels since March 2023. In early November, USD/MXN retraced towards the bottom of the recent range amid USD weakness, with the RBC Positioning Monitor showing that markets have flipped back to the net short USD/MXN levels seen earlier this year.

As we go to press, USD/MXN has spiked higher, partly on the back of Banxico's rate meeting. The central bank kept its overnight rate at 11.25% (as expected). The surprise was Banxico making a dovish change to its forward guidance. The prior statement noted that the policy rate is likely to be held "for an extended period" and this has been changed to "for some time". This suggests Banxico is getting closer to starting its easing cycle (likely in H1 2024). Although USD/MXN has spiked higher, Mexico still has a high real policy rate, and this means once the initial negative MXN reaction passes, the level of the real rate should still lend support to MXN on an RV basis in the near-term, if the external backdrop stabilizes. Our end-2023 target remains at 18.00, but we recognize that if the next US CPI print surprises to the downside, USD/MXN may fall to 17.00.

6-12 Month Outlook – Erosion of outperformance?

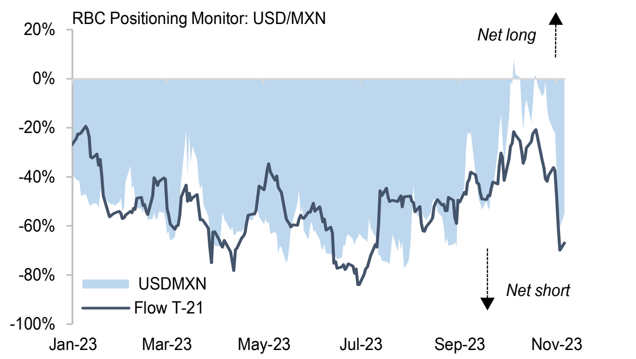
Under our base case, US rates will remain high for longer, and we expect a mild US growth slowdown into next year. As the recession takes hold, this may temper flows into Mexico (e.g. remittances) and weigh on Mexico's economy due to the strong linkages. We recently found that data have yet to show more significant evidence supporting the anecdotal stories about nearshoring, even if there are some positive signs of Mexico's share in US goods imports rising (see *Total FX*, 26 Oct 2023). Mexico's government issued a decree in October that will provide tax incentives to encourage nearshoring in ten export-oriented sectors. Deputy FinMin Gabriel Yorio stated last month that this decree may result in USD 18.5bn in additional investment in Mexico. This would be supportive of MXN, but the extent of the US slowdown may impact FDI flows into Mexico, as the largest portion of flows comes from the US. Then, volatility may increase as idiosyncratic risks rise ahead of the 2024 elections in Mexico and the US. In all, these factors may eat into the currency's outperformance from this year.

Indicators

	Current (Previous)*
Official cash rate (%)	11.25 (11.25)
Trend interest rates (10yr average)	5.96
Bias in interest rate market	Flat, then cuts
Core CPI Inflation %Y/Y Oct (Sep)	5.50 (5.76)
Inflation target	3%
Budget balance % GDP 2022 (2021)	-3.62 (-2.85)
Budget balance target % GDP	-2.2
GDP Growth % y/y Q3 P (Q2)	3.3 (3.6)
Trend GDP %y/y	1.5
Purchasing Power Parity Value Oct	16.3774
Spot end-Oct	18.0483
PPP Valuation	USD/MXN is overvalued
Current account balance % GDP Q2 (Q1)	-1.18 (-1.61)
Trend current acct balance % GDP (10y avg)	-1.1
Moody's Foreign Currency Rating	Baa2
Outlook	Stable

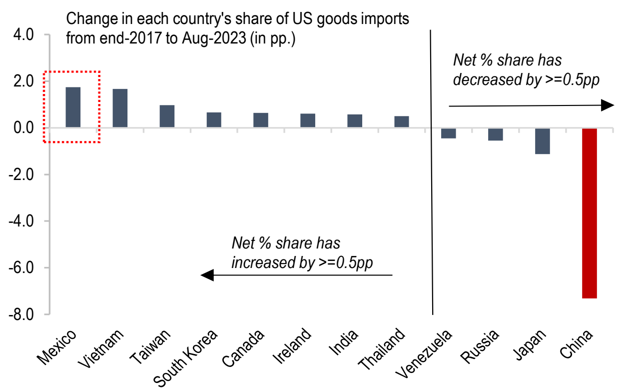
* Current is latest month, quarter, or year

1. Market flips back to net short USD/MXN



Source: RBC Capital Markets

2. MX is not the only winner of China's declining mkt share



Source: RBC Capital Markets; Haver Analytics

Forecasts

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
USD/MXN	18.05	17.12	17.42	18.00	18.50	18.50	18.50	18.50
EUR/MXN	19.56	18.68	18.42	18.72	19.06	18.87	19.43	19.98
MXN/JPY	7.36	8.43	8.57	8.33	8.22	8.32	8.11	7.84
CAD/MXN	13.35	12.93	12.83	13.04	13.30	13.31	13.70	14.12

Source: RBC Capital Markets estimates

Forecasts

Spot forecasts

	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.09	1.06	1.04	1.03	1.02	1.05	1.08
USD/JPY	133	144	149	150	152	154	150	145
GBP/USD	1.23	1.27	1.22	1.17	1.13	1.11	1.15	1.20
USD/CHF	0.92	0.90	0.92	0.91	0.91	0.92	0.89	0.86
USD/SEK	10.40	10.80	10.91	11.35	11.75	11.76	11.33	10.93
USD/NOK	10.47	10.74	10.70	11.35	11.17	10.98	10.57	10.19
USD/CAD	1.35	1.32	1.36	1.38	1.39	1.39	1.35	1.31
AUD/USD	0.67	0.67	0.64	0.62	0.61	0.60	0.61	0.62
NZD/USD	0.63	0.61	0.60	0.58	0.57	0.56	0.57	0.58
USD/CNY	6.87	7.25	7.30	7.40	7.45	7.50	7.45	7.35
USD/KRW	1302	1318	1348	1350	1390	1380	1365	1350
USD/INR	82.18	82.04	83.04	83.40	83.50	83.60	83.30	83.00
USD/TWD	30.49	31.15	32.24	32.50	32.70	33.00	32.80	32.60
USD/SGD	1.33	1.35	1.37	1.38	1.39	1.39	1.37	1.36
USD/MYR	4.42	4.67	4.70	4.76	4.80	4.82	4.75	4.60
USD/HKD	7.85	7.84	7.83	7.84	7.84	7.83	7.83	7.82
USD/MXN	18.05	17.12	17.42	18.00	18.50	18.50	18.50	18.50
USD/BRL	5.06	4.79	5.03	5.00	4.90	4.75	4.50	4.50

Source: RBC Capital Markets estimates

EUR Crosses

	2023				2024			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.09	1.06	1.04	1.03	1.02	1.05	1.08
EUR/JPY	144	157	158	156	157	157	158	157
EUR/GBP	0.88	0.86	0.87	0.89	0.91	0.92	0.91	0.90
EUR/CHF	0.99	0.98	0.97	0.95	0.94	0.94	0.93	0.93
EUR/SEK	11.28	11.78	11.54	11.80	12.10	12.00	11.90	11.80
EUR/NOK	11.35	11.71	11.31	11.80	11.50	11.20	11.10	11.00
EUR/CAD	1.46	1.44	1.44	1.44	1.43	1.42	1.42	1.41
EUR/AUD	1.62	1.64	1.64	1.68	1.69	1.70	1.72	1.74
EUR/NZD	1.73	1.78	1.76	1.79	1.81	1.82	1.84	1.86
EUR/CNY	7.45	7.91	7.72	7.70	7.67	7.65	7.82	7.94
EUR/KRW	1411	1438	1425	1404	1432	1408	1433	1458
EUR/INR	89.07	89.50	87.80	86.74	86.01	85.27	87.47	89.64
EUR/TWD	33.04	33.99	34.09	33.80	33.68	33.66	34.44	35.21
EUR/SGD	1.44	1.48	1.44	1.44	1.43	1.42	1.44	1.47
EUR/MYR	4.79	5.09	4.96	4.95	4.94	4.92	4.99	4.97
EUR/HKD	8.51	8.55	8.28	8.15	8.08	7.99	8.22	8.45
EUR/MXN	19.56	18.68	18.42	18.72	19.06	18.87	19.43	19.98
EUR/BRL	5.49	5.22	5.32	5.20	5.05	4.85	4.73	4.86

Source: RBC Capital Markets estimates

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