Currency Report Card – September 2023

07 September 2023

Forecasts

September 2023

Three month forecast returns

Most bullish	Most bearish
BRL	GBP
INR	SEK
USD	CHF

Source: RBC Capital Markets

12 month forecast returns

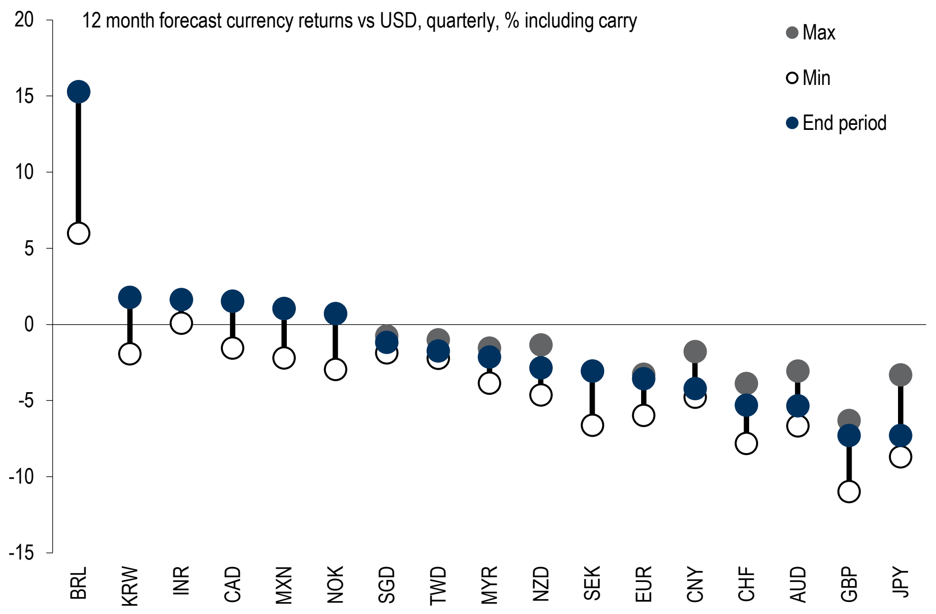
Most bullish	Most bearish
BRL	JPY
KRW	GBP
INR	AUD

Source: RBC Capital Markets

Key forecast revisions this month include:

We have pushed out the timing of the peak in USD to H1 2024 (prior: end-2023).

BRL outperformance; JPY, GBP, AUD underperformance



Source: RBC Capital Markets

Global FX Strategy

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US Dollar

Elsa Lignos

1-3 Month Outlook – A material shift in positioning

As we head into the last month of Q3, DXY has broken to a new 6m high, matching levels last seen in early March before regional bank troubles led to the US curve to bull flatten, bringing USD down with it. We put it down to two drivers: (1) while US data have slowed and our US ESI has turned negative/EMI just entering negative territory (Figure 1), the picture looks worse elsewhere (see pg 4); (2) bonds and equities have both weakened, and as seen in 2022, that creates a positive environment for USD. In the very short-term, we have left most of our end-Q3 forecasts unchanged, as the USD move went in our direction. Since USD troughed in mid-July, we think there has been a sizeable shift in positioning (Figure 2), taking markets from net short USD in most pairs to now net long USD across all G10 and almost all of EM. MXN and BRL are the only two exceptions, though short USD/MXN and short USD/BRL positions have been more than halved on our metrics. The outlook from here feels particularly data-dependent. First up is August CPI on September 13. Headline inflation is seen ticking back up but markets will be focusing on the core and if the m/m rate remains at or below 0.2%, we may start to see some more cuts filtering back into the curve for 2024, keeping a lid on further USD gains. On the flipside, a large upside surprise in inflation would raise prospects of one more hike from the Fed. There is almost nothing in the price for the 20 Sep meeting, and we know the Fed doesn't like to surprise, but November is still in play (currently sitting around 50/50 for one last 25bp hike). We still look for modest USD gains into year-end but with positioning having built up and 2024 cuts materially priced out, it is unlikely to be a straight line up.

6-12 Month Outlook – Extending strength into H1'24

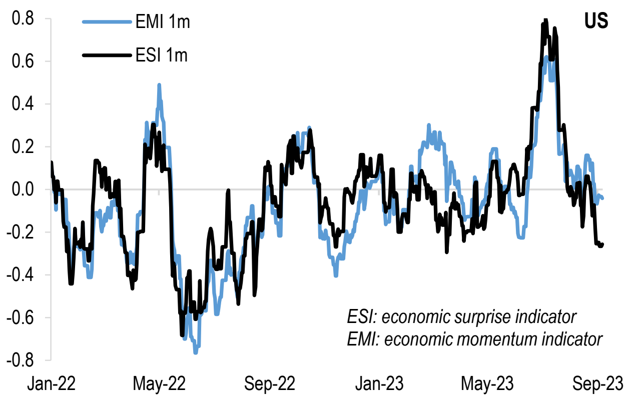
The bearish USD bias is still strong, particularly on the sell-side and we can understand where it comes from. USD looks expensive in historical terms. We have little doubt that in January 2024, short USD is likely to be one of the most popular thematic trades – as it was in Jan 2023 and 2022 and 2021 (and failed to work three years running…). But when we think about the underlying drivers for our USD view – a US economy that is more resilient than expected, a failure of bonds and equities to sustainably rally together, a slowdown in RoW growth has turned out to be deeper than thought, we couldn't see a reason for USD to start heading lower from Jan 2024. We have extended modest USD strength in our forecasts into H1 2024.

Indicators

	Current (Previous)*
Official cash rate	**5.25-5.50% (5.00-5.25%)**
Trend interest rates (10yr average)	0.9%
Bias in interest rate market	Small hikes then lower
Core PCE Inflation %Y/Y June (May)	**4.2% (4.1%)**
Inflation target	2%, on average
Budget balance % GDP FY22 (FY21)	**-5.5% (-12.3%)**
Budget balance target % GDP	-
GDP Growth % y/y Q2 S (Q4)	2.1% (2.0%)
Trend GDP %y/y	2.5%
Purchasing Power Parity Value	-
Spot	-
PPP Valuation	-
Current account balance % GDP Q1 (Q4)	**-3.4% (-3.7%)**
Trend current account balance % GDP	-2.4%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

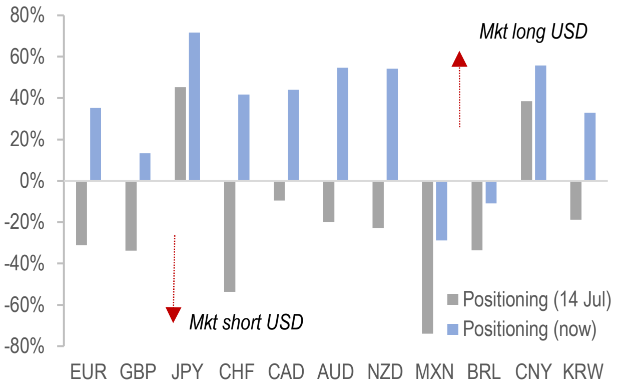
* Current is latest month, quarter or year

1. Data have slowed, but the picture is worse elsewhere



Source: RBC Capital Markets; Bloomberg

2. Seven week flip from short USD to long USD



Source: Bloomberg, RBC Capital Markets

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.09	1.07	1.04	1.03	1.02	1.05	1.08
USD/JPY	133	144	147	150	152	154	150	145
USD/CAD	1.35	1.32	1.35	1.38	1.39	1.39	1.35	1.31

Source: RBC Capital Markets estimates

Euro

Elsa Lignos

1-3 Month Outlook – Dragged down by USD strength

EUR/USD is down 5% since the mid-July high, down 2% since the start of September. The current pace of decline would get us to our year-end 1.04 target by mid-October though we would be surprised if it kept going at this speed. It has really been USD strength rather than EUR weakness. EUR is middle of the pack over that same time period, both in G10 and against a broader G10/EM universe. We expect that to continue and our near-term EUR forecasts are mixed on the crosses. The Euro area outlook is not particularly positive. In the past month data have turned lower again, confounding expectations (economic surprises in particular have plunged again). But the pass-through from that to the ECB outlook is limited which has limited the independent EUR direction. The ECB is still priced for a 50% chance of one last hike by year-end to take rates to 4%. That doesn't seem unreasonable given the concerns over inflation but we think ultimately the ECB will stay on hold, leaving EUR with hefty negative carry against USD (and CAD and others). That in turn should keep a lid on EUR over the next few quarters. We have left our near-term forecasts unchanged. Technically, the recent close below trendline support at 1.0784 has triggered a bearish trend reversal for EUR/USD, shifting the focus down to the May low at 1.0635. A rough triple bottom from February-March at 1.0516 serves as secondary support. The trend reversal suggests that rallies to resistance at 1.0786 and 1.0898 should now attract selling interest, with a daily close above 1.0945 required to nullify the bearish backdrop.

6-12 Month Outlook – Cyclical underperformance

For the first time in a while, year-end GDP forecasts for the US and Euro area are on a par – the Euro area has come down while the US has edged higher (Figure 2). But we see scope for that to continue and as discussed on the previous page, have revised down our 2024 forecasts for EUR/USD, maintaining our end-23 target of 1.04 and pencilling in 1.02 for H1-24. Meanwhile analyst consensus has come down to 1.09 for end-23 but remains stuck near 1.15 for 2024. It is tempting to call EUR/USD higher on valuation alone but as the past decade has shown, currencies can remain cheap for a very long time. Eventually that long-term bullish EUR/USD outlook will be right but it looks premature right now on cyclical drivers. Our rates team expect the ECB will be slower to cut than the Fed but we place importance on the level of rates as well as the rate of change and expect that will slow the pace of eventual EUR/USD gains.

Indicators

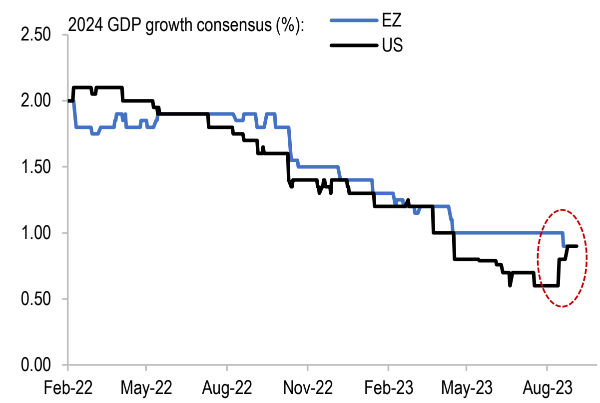
	Current (Previous)*
Official cash rate (ECB main refi rate)	**4.25% (4.00%)**
Trend interest rates 10y average	0.31%
Bias in interest rate market	Slight hiking
HICP core Inflation %Y/Y Aug P (Jul)	**5.3% (5.5%)**
Inflation target	2.0% (symmetric)
Budget balance % GDP 2022 (2021)	**-3.6% (-5.3%)**
Budget balance target % GDP	3% of GDP-Unless special circumstances
GDP Growth %Y/Y Q2 (Q1)	**0.5% (1.1%)**
Trend GDP %y/y	1.5%
Purchasing Power Parity Value Jul	**1.2665**
Spot end-Aug	1.0843
PPP Valuation	EUR/USD is undervalued
Current account % GDP Q1 (Q4)	-0.2% (-0.7%)
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 data turning lower again

Source: Bloomberg, RBC Capital Markets

2. EZ growth forecasts still too optimistic



Source: Bloomberg, RBC Capital Markets

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.09	1.07	1.04	1.03	1.02	1.05	1.08
EUR/JPY	144	157	157	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 still trending up

After grinding steadily higher through August, USD/JPY pushed on to a new 10 month high close to 148 in early-September, before repeated verbal intervention by MoF capped it, temporarily, in our view. Part of the move is explained by general USD direction, but JPY is also lower against most other G10 currencies over the last month. As Figure 1 shows, RBC is one of only three forecasters (of 50) in Bloomberg's survey that thinks the trend higher in USD/JPY continues in the remainder of the year and one of only five that has an end-year forecast above the forward curve. Our main reason for being outside the consensus is the weight we give to CB policy outside Japan, compared to the role of the BoJ, in driving domestic flow (see below).

Independent of the domestic flow, a further reason to doubt the consensus for JPY gains is the reemergence of a theme that has been absent for most of the last 15 years – carry as a viable G10 strategy. When G10 rates were last as dispersed as they are now, the JPY carry trade was the dominant market strategy. We are unlikely to revisit that world, but at the very least it is hard for us to join the bullish-JPY consensus. In the very near-term, the risk of intervention has clearly risen (our model puts it around a 20% probability) which may temporarily cap USD/JPY, but it will not stop the longer-term trend higher. We have not changed our end-year USD/JPY forecast of 150, though we have extended the rally into the first half of 2024 and pushed the peak to a new cycle high (154), in line with similar moves in other USD spot rates.

6-12 Month Outlook – Trend JPY weakness

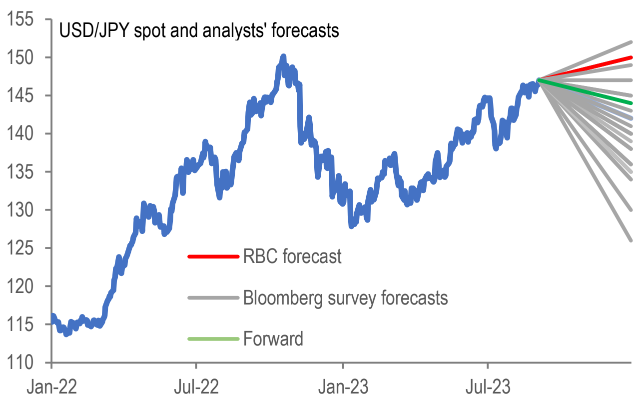
It is the balance between foreign and domestic investor flow that will be the longer-term driver of JPY. While in the short-term, there may be further bouts of selling as USD/JPY shorts are reestablished or international yields rise, in the longer-term, we think domestic investor flow will dominate. 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.

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 Jul (Jun)	**3.1% (3.3%)**
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)	**2.1% (1.9%)**
Trend GDP %Y/Y	1.0%
Purchasing Power Parity Value Jul	**81.34**
Spot end-Aug	145.54
PPP Valuation	USD/JPY is overvalued
Current a/c balance % GDP Q2 (Q1)	2.7% (2.3%)
Trend current account balance % GDP	2.8%
Moody's Foreign Currency Rating	**A1**
Outlook	Stable

* Current is latest month, quarter or year

1. Almost all forecasters are bearish USD/JPY



Source: RBC Capital Markets, Bloomberg

2. JGB yield rise modest so far

Source: RBC Capital Markets, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/JPY	133	144	147	150	152	154	150	145
EUR/JPY	144	157	157	156	157	157	158	157
CAD/JPY	98	109	109	109	109	111	111	111

Source: RBC Capital Markets estimates

Sterling

Adam Cole

1-3 Month Outlook – Policy credibility questioned

EUR/GBP has spent the last three months trapped in a 0.85-0.87 range. Although GBP/USD has seen bigger moves, they have largely reflected USD direction and GBP has done little independently. This has been frustrating for many (ourselves included) looking for GBP underperformance. There are still clearly doubts on the credibility of UK policy. Gilts yield 120bp over the average of USTs and bunds – similar to the spread during Truss's brief period as PM – but unlike that period, this has not been accompanied by GBP weakness. It is nonetheless true that GBP has been underperforming what we would have expected, given the widening of yield spreads in the UK's favour (Figure 1). The "wedge" between rates spreads and the currency is still there, but unlike in 2022 it has built without the currency going down. Going forward, we still see the risks for GBP are skewed to the downside, though are most likely to play out through markets moving to discount a lower peak in rates (currently 50bp above Bank Rate) and, more importantly, the start of the easing cycle. Just because GBP has not benefitted from rising rate expectations, it does not follow that it will be similarly immune to markets starting to discount cuts. On most measures the stance of policy in the UK is already extremely tight (fiscal and monetary; see Figure 2 for the latter) and unlike the US, SONIA forwards plateau rather than peaking. As the evidence that tight policy is biting spreads from the housing market to the broader economy expect this to change, carrying GBP lower.

6-12 Month Outlook – Medium-term weakness

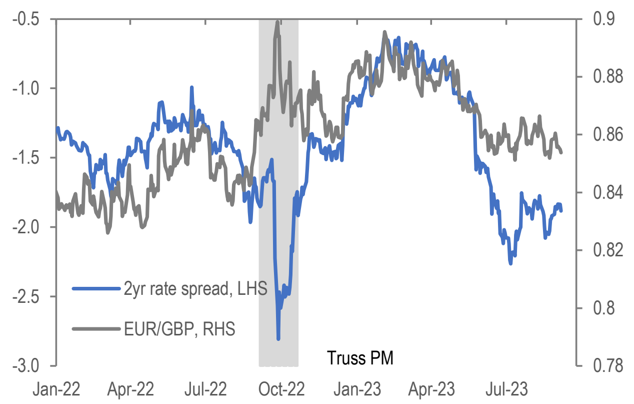
The UK's financial imbalances pre-date September's "fiscal event" and the triple deficits the UK was already running look very similar to those the US ran in the early-2000s. The current account deficit is trending at around 5% of GDP (though recent data have been blighted by very large recording errors) 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 "requires" a relative cheapening of UK assets via the currency. We expect grinding GBP underperformance to continue into the medium-term.

Indicators

	Current (Previous)*
Official cash rate	**5.25% (5.0%)**
Trend interest rates 10y average	3.3%
Bias in interest rate market	Higher
CPI Inflation %Y/Y Jul (Jun)	**6.8% (7.9%)**
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)	**0.4% (0.3%)**
Trend GDP %Y/Y	1.5%
Purchasing Power Parity Value Jul	**1.3462**
Spot end-Aug	1.2673
PPP Valuation	GBP/USD is undervalued
Current a/c balance % GDP Q1 (Q4)	-2.1% (-3.8%)
Trend current account balance % GDP	-3.9%
Moody's Foreign Currency Rating	**Aa1**
Outlook	Stable

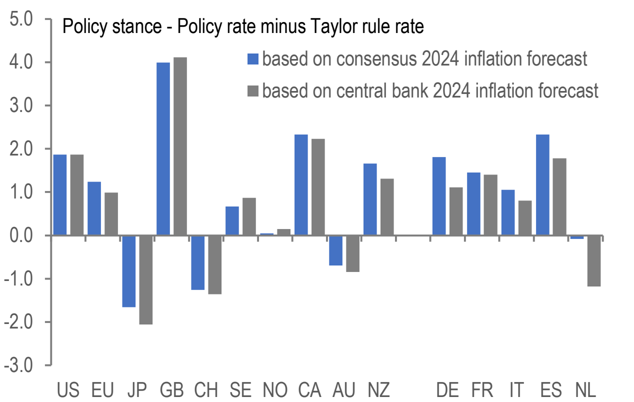
* Current is latest month, quarter or year

1. GBP "cheap" to rate spreads



Source: RBC Capital Markets, Bloomberg

2. UK policy very restrictive



Source: RBC Capital Markets, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
GBP/USD	1.23	1.27	1.23	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	181	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 – Maybe no hike but CB support

EUR/CHF has not moved much in the past month, hovering above 0.9500. FX reserves have declined again (Figure 1) dropping below CHF700bn for the first time since mid-2017, though the pace of decline slowed in August (-0.5% from -3.7% last month). Valuation effects mask some of the decline as we estimate the actual decline was closer to 1% (particularly as the value of USD reserves rose in CHF terms). We still see the SNB's focus "on selling foreign currency" keeping CHF supported over the medium-term. Selling FX reserves and maintaining currency strength acts as a natural cap on inflation and we expect the SNB to continue using this opportunity to normalise its balance sheet.

The SNB meets again later this month for its third quarterly meeting of the year. The forward curve is discounting a 40% chance of a hike which seems high to us. But we would expect any dip in CHF to be an opportunity to reposition. Our favourite CHF trade this year has been long CHF/JPY and one which we think has a bit further to run. On positioning, the market remains neutral EUR/CHF but has built up long USD/CHF (+42%), echoing the build-up of USD longs across the board. We noted before there could be some interest in using CHF as a funding currency, but our carry barometer shows EUR typically beats CHF as a funder.

Technically, the bullish channel breakout above 0.8828 in USD/CHF favours additional gains, with 0.9017 and the May high at 0.9148 serving as the next resistance levels of note. If the channel breakout is valid, then pullbacks to support at 0.8808 and 0.8699 should attract buying interest, with a return below a double bottom at 0.8556 required to reassert the prior downtrend.

6-12 Month Outlook – Will we see 2024 recession?

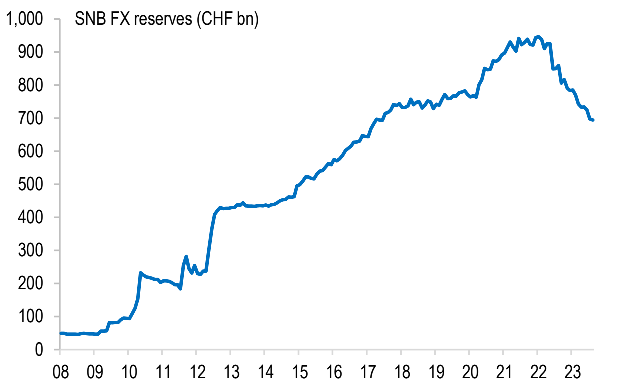
We see further CHF gains into 2024 as global recession risk rises. But if the recession turns out to be shallow and rate cuts from other central banks are mild, CHF outperformance should be limited. The largest downside risk for CHF was an upside growth surprise from China, but every month that looks less and less likely. It leaves us with a grinding profile for CHF, unlikely to change until/unless we see an unexpected external shock. We still hear valuation being cited occasionally as a reason to sell CHF. But as Figure 2 shows, it is hard to take PPP seriously for CHF when USD/CHF has not traded above 'fair value' in 40 years.

Indicators

	Current (Previous)*
Official cash rate	**1.75% (1.50%)**
Trend interest rates average	-0.4%
Bias in interest rate market	Small hikes
CPI Inflation %Y/Y Aug (Jul)	**1.6% (1.6%)**
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 Jul	**1.0658**
EUR/CHF spot end-Aug	0.9579
EUR/CHF PPP Valuation	EUR/CHF is undervalued
Current a/c balance % GDP Q1 (Q4)	9.45% (10.20%)
Trend current account balance % GDP	6.8%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

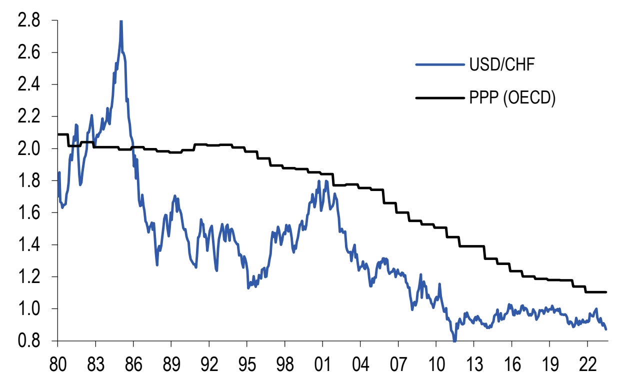
* Current is latest month, quarter or year

1. Reserve reduction continues – back to mid-2017 levels



Source: Bloomberg, RBC Capital Markets, SNB

2. Valuation not a reason to sell CHF



Source: Bloomberg, RBC Capital Markets

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CHF	0.92	0.90	0.89	0.91	0.91	0.92	0.89	0.86
EUR/CHF	0.99	0.98	0.95	0.95	0.94	0.94	0.93	0.93
CHF/JPY	145	161	166	164	167	167	169	168
CAD/CHF	0.68	0.68	0.66	0.66	0.66	0.66	0.66	0.66

Source: RBC Capital Markets estimates

Swedish Krona & Norwegian Krone

Elsa Lignos

Swedish Krona – New high in sight

We noted last month that SEK's gains in July didn't seem sustainable and sure enough EUR/SEK has reverted to its path of 2023 underperformance. The Riksbank is not comfortable with the weakness, arguing "it risks contributing to continued high inflationary pressures." Floden links it to "trend-following behaviour, concern regarding the Swedish property sector, the geopolitical situation and the image of Sweden, as well as the expectation that the Riksbank will raise the interest rate less than other countries," none of which in his opinion can justify the extent of SEK depreciation. We have some sympathy but given the Riksbank is not in a position to hike a lot and squash SEK's position as a funding currency, there is not much they can do to reverse it. Floden himself acknowledges that FX intervention is "typically costly and not very effective". We expect EUR/SEK to keep grinding higher and have pencilled in a new high of 12.10 in H1 2024. Positioning remains a risk factor as it is clearly crowded. Our monitor shows how SEK shorts have ballooned in the past month (Figure 1). But while that may cause short sharp squeezes of the type we saw in July, it is not the basis for a sustained turnaround in SEK. We think that has to come from an improved economic outlook and narrowing of the carry gap between SEK and others. Technically, EUR/SEK is in a long-term uptrend, with support at 11.7950 and 11.6261. The pair has to close below an ascending channel base at 11.5251 in order to nullify the uptrend.

Norwegian Krone – EUR/NOK topping out

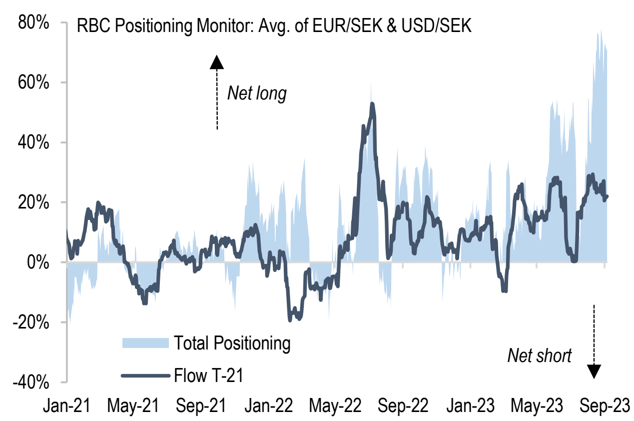
NOK underperformed again in August, weakening more than its usual drivers would suggest. Our model shows after finally unwinding some of its negative residual in July, NOK reverted to its pattern of 2023, with the 2.6% rise in EUR/NOK at odds with moves in S&P, crude and rate differentials. NOK's move lower coincided with CPI data though it didn't change the outlook, and Norges Bank's August meeting signalled another hike is on the way. A build-up in USD/NOK longs is perhaps partly to blame, though USD longs were building everywhere. Nevertheless we look for residual NOK weakness to unwind going forward, as it did in July. Crude should offer support – our commodities team look for Brent to average $91/bbl in the final quarter of the year as physical balances are the tightest they have been in 12 months and OPEC+ continues to restrict supply. We remain moderately constructive on NOK.

Indicators - Sweden

	Current (Previous)*
Official cash rate	**3.75% (3.50%)**
Trend interest rates 10y average	0.14%
Bias in interest rate market	Slight hiking
CPIF Inflation %Y/Y Jul (Jun)	**6.4% (6.4%)**
Inflation target (UND1X)	2.0%
Budget balance % GDP 2022 (2021)	**0.8% (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.%
EUR Purchasing Power Parity Value Jul	**9.4305**
Spot end-Aug	11.8803
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

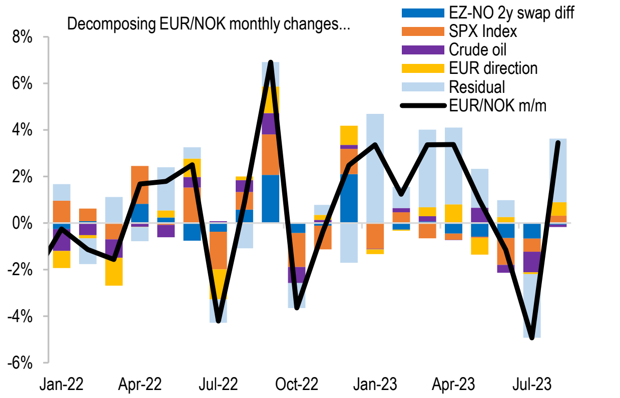
* Current is latest month, quarter or year

1. Extended SEK shorts vs EUR & USD



Source: RBC Capital Markets

2. NOK "too weak" again in August…



Source: RBC Capital Markets, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/SEK	11.28	11.78	11.90	12.00	12.10	12.00	11.90	11.80
EUR/NOK	11.35	11.71	11.40	11.30	11.20	11.20	11.10	11.00
NOK/SEK	0.99	1.01	1.04	1.06	1.08	1.07	1.07	1.07
CAD/SEK	7.70	8.15	8.24	8.36	8.45	8.46	8.40	8.34

Source: RBC Capital Markets estimates

Canadian Dollar

Daria Parkhomenko

1-3 Month Outlook – BoC likely finished hiking rates

After reaching the YTD bottom of 1.3093 on July 14, USD/CAD has traded higher due to a stronger USD and has broken above the 1.30/1.35 range earlier than we had expected. On the G10-crosses, CAD has been a mixed performer since the start of H2: (a) in July, USD weakness resulted in CAD's underperformance, and then (b) since August, although USD strength has caused CAD to outperform its main peers (SEK, AUD, NZD, NOK), that has been insufficient to turn CAD into a top performer in G10 (ex-USD). Our CAD model (Figure 1) shows there was a decent 'unexplained portion' that pushed USD/CAD higher in August. We think this may have been a function of positioning – at the end of July, the RBC Positioning Monitor showed that markets were more 'long' CAD (vs USD) than most other G10 pairs. Since then, CAD has seen the largest increase in net short positioning vs USD, potentially explaining CAD's mixed performance since August.

In the near-term, we think the backdrop will remain choppy, with US data and their impact on USD the key driver of USD/CAD. This will determine whether USD/CAD is able to sustain a move above the double top at 1.3668 in the near-term or the pair may see some relief. Given our view for modest USD gains into year-end and into H1 2024, we prefer to use pullbacks in USD/CAD as a buying opportunity in the coming months – our end-2023 target is unchanged at 1.38. We see the BoC on hold for the rest of this year (mkt: +12bps), as our economists see the softer growth environment continuing in the coming quarters, with RBC expecting growth to contract 0.5% q/q ann. in Q3 vs the BoC's July MPR projection of +1.5%. At the September meeting, the BoC held the policy rate at 5.0%, attributing it to signs that "excess demand in the economy is easing" and due to "the lagged effects of monetary policy". The BoC also stated that it is "prepared to increase the policy interest rate further if needed", citing concerns "about the persistence of underlying inflationary pressures". There are two labor and two CPI prints and one monthly GDP report ahead of the October 25th meeting.

6-12 Month Outlook – Later peak in USD/CAD

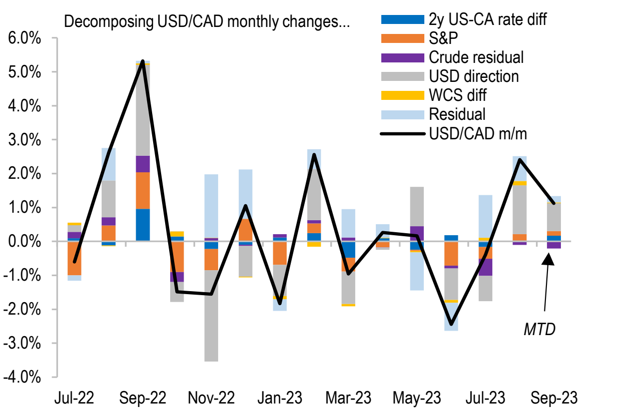
Given we have slightly raised and pushed out the timing for the peak in USD into H1 2024 (see pg. 3), we now also expect further modest USD gains to result in USD/CAD peaking at 1.39 in H1 next year (prior: 1.38 end-2023). We expect a prolonged hold from the BoC, with a base case that rate cuts will begin in Q3'24, compared to our central scenario for the Fed to start easing in Q2'24.

Indicators

	Current (Previous)*
Official cash rate	**5.00% (5.00%)**
Trend interest rates 10y average	1.2%
Bias in interest rate market	Small hikes in the ST
Core CPI Inflation (Trim) %Y/Y Jul (Jul)	**3.6% (3.7%)**
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 Jul	**1.2205**
Spot end-Aug	1.3508
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

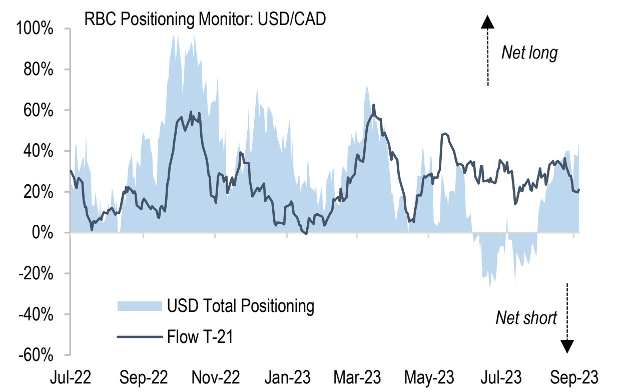
* Current is latest month, quarter or year

1. USD/CAD's rally in Aug and MTD due to USD strength



Source: Bloomberg, RBC Capital Markets; Latest reading as of 06 Sep 2023

2. Positioning is long USD/CAD albeit not yet extended



Source: RBC Capital Markets; Latest reading as of 05 Sep 2023

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CAD	1.35	1.32	1.35	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	108.9	108.7	109.3	110.8	111.1	110.7

Source: RBC Capital Markets estimates

Australian Dollar

Adam Cole

1-3 Month Outlook – Revising the trough lower

After a 3% fall over the last month, AUD/USD is currently trading around the lows for almost a year. In August, however, little of this weakness was down to AUD-specific factors. AUD was right in the middle of the G10 pack for monthly performance and most of the weakness in AUD/USD was simply the counterpart of a general rally in USD (grey bars in Figure 1). Although dominated by USD moves, domestic factors (dark blue bars) have been negative for AUD in the last couple of months and this remains the case in our forecasts. Forward rates continue to price the risk of a resumption of the RBA hiking cycle, though the premium for this is diminishing and likely to continue diminishing if the important Q2 CPI data (October 25) mirror the surprising softness seen in the monthly releases recently.

Rate spreads may further depress AUD/USD from the US side if markets continue to push expected Fed easing further into the future. Disappointing news from China remains a downside risk for AUD, both terms of the softness of incoming activity data and the reluctance of the authorities to respond to this with significant fiscal support for fear of reigniting the property market. We have made some revisions to the AUD/USD forecast this month and now see the trough at 0.60 in mid-2024, coinciding with the peak we tentatively predict for the broad USD. This leaves AUD as an underperformer within G10, AUD/NZD notably falling through the bottom of the 1.07-1.10 range that has held for the last three months.

6-12 Month Outlook – Worsening valuations

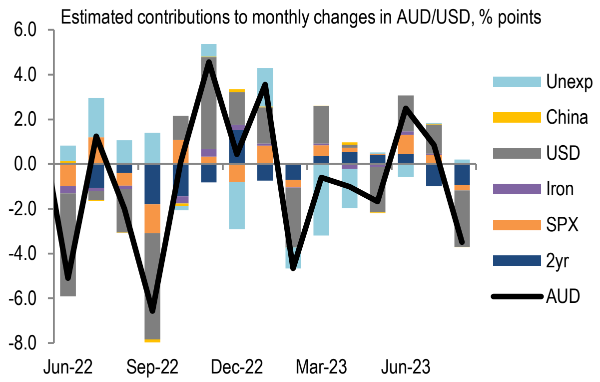
We discussed worsening valuation last month and the concerns still stand. While the RBA looks for improving productivity to offset the sharp increases in wages, there are limited signs of that so far, leaving unit labour costs on an upward trajectory. ULCs are a key driver of long-term valuation and 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	**4.10% (4.10%)**
Trend interest rates 10y average	1.6%
Bias in interest rate market	Small hikes
CPI Inflation %y/y Jul (Jun)	**4.9% (5.4%)**
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)	**2.1% (2.4%)**
Trend GDP %Y/Y	2.8%
Purchasing Power Parity Value Jun	**0.7392**
Spot end-Jul	0.6717
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

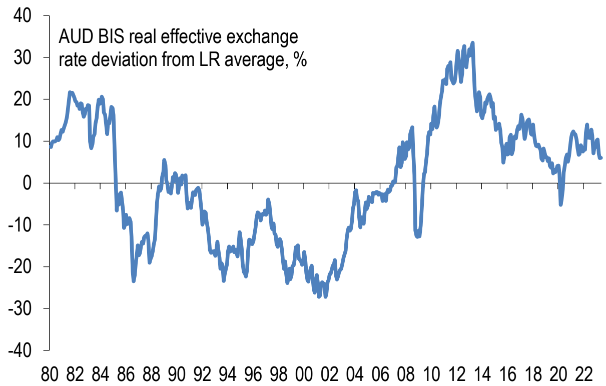
* Current is latest month, quarter or year

1. August losses reflect USD direction and rate spreads



Source: RBC Capital Markets, Bloomberg

2. AUD close to LT fair value



Source: RBC Capital Markets, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
AUD/USD	0.67	0.67	0.63	0.62	0.61	0.60	0.61	0.62
EUR/AUD	1.62	1.64	1.70	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	0.85	0.86	0.85	0.83	0.82	0.81

Source: RBC Capital Markets estimates

New Zealand Dollar

Adam Cole

1-3 Month Outlook – Mildly positive outlook

NZD/USD traded steadily lower through August and early-September and is currently around a 10 month low. As with AUD/USD, however, little of this is down to domestic developments, with the general strength of USD accounting for most of the weakness (grey bars in Figure 1). Domestic developments have been quite neutral in recent weeks. RBNZ left rates unchanged at 5.5% at the August policy announcement, as was universally expected. The forward guidance was slightly more hawkish with the peak rate now incorporating the risk of a further hike (peak 5.59% from 5.50 previously) and the first cuts pushed out to 2025 from 2024 previously. Forward rates pricing is very close to this, with a small risk of a further hike and rates falling only slightly earlier than the RBNZ's guidance suggests (around October 2024). Unless there is a major turn in incoming CPI or labour market data (Q2 for both due in late-October) The rate expectations dynamic looks like remaining very neutral for NZD in the near-term. Although markets have at times prematurely looked for cuts in NZ, we note that despite the highly proactive tightening cycle from RBNZ, policy is only moderately to the tight side of neutral (see Figure 2 on page 6).

We still see some scope for a degree of NZD outperformance, however, as a result of NZD's yield advantage over most other G10 currencies and the rising role of carry in driving G10 FX. With G10 rate dispersion now back to pre-GFC levels (Figure 2) and with FX volatility still historically low, we expect rates in levels terms to play and increasing role in driving FX. As with AUD, we have made some changes to the NZD/USD forecast this month, moving the trough to mid-2024. The forecast low of 0.56, however, leaves NZD outperforming AUD.

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

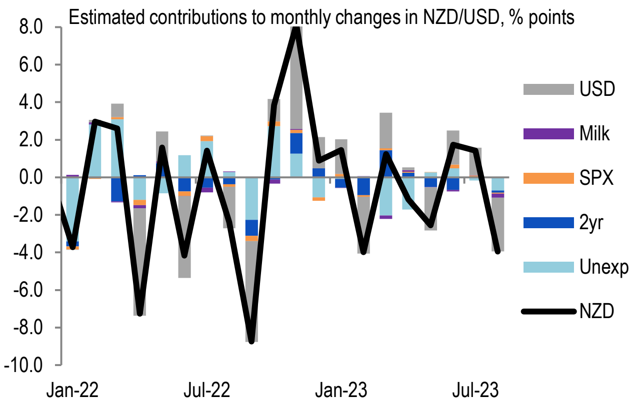
In recent quarters, NZ's current account deficit has ballooned from 1% of GDP in late 2020 to 8.5% of GDP in the year to Q1. Is that a longer-term problem for NZD? The answer might be yes if the current account is structural in nature and NZ struggles to attract funding for it. But digging into the details, we think a lot of it is down to post-COVID spending normalisation. Tourism imports have skyrocketed while exports have yet to return to pre-pandemic levels. We expect the current account to continue to recover through 2023.

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 Q2 (Q1)	**6.0% (6.7%)**
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 Q1 (Q4)	**2.2% (2.3%)**
Trend GDP %Y/Y	2.8%
Purchasing Power Parity Value Q2	**0.5967**
Spot end-Aug	0.6209
PPP Valuation	NZD/USD is overvalued
Current account balance % GDP Q1 (Q4)	**-8.5% (-9.0%)**
Trend current account balance % GDP	-2.9%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

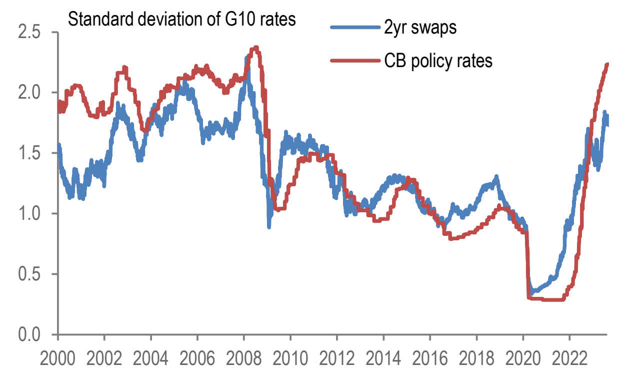
* Current is latest month, quarter or year

1. Stronger USD accounts for most of August weakness



Source: Bloomberg, RBNZ; RBC Capital Markets

2. Rate dispersion back to pre-GFC levels



Source: RBC Capital Markets, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
NZD/USD	0.63	0.61	0.59	0.58	0.57	0.56	0.57	0.58
EUR/NZD	1.73	1.78	1.81	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	0.80	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 growth drag

China's economy weakened into the third quarter. The government is pushing various targeted stimulus measures that together might just be enough to maintain the year's growth at 5%, but a decisive economic turnaround is unlikely given the paucity of sizeable fiscal-driven stimulus.

The moribund property and construction sectors have become a major drag for the economy. Mortgage rates for the overwhelming majority of outstanding mortgages are being cut, and additional supportive housing market measures are widely expected. Further RRR and interest rate cuts are also expected. But it is debatable if these by themselves will adequately counteract the fundamental lack of demand by households and firms.

Net foreign portfolio outflows have petered out, but exports growth have stumbled this year too. Persistently below-expectations USD/CNY fixes have returned as the PBOC leans against the yuan's depreciation trend, as has tightened funding for the offshore CNH. These will not change the fundamental driver of yuan weakness, namely the downside risks to the economy, though it should slow down the pace.

Beijing appears to retain an abiding wariness over debt-fueled fiscal stimulus. This suggests additional need for monetary policy easing, including through the exchange rate channel. The trade-weighted CFETS Index is expected to continue to slide over time. Moreover, the USD continues to possess a significant carry premium over CNY.

6-12 Month Outlook – Growing economic gloom

China's multi-year property and construction boom has ended definitively, and policymakers are unwilling to reflate it. This is exacerbating caution among households and firms, who have suffered financially through the pandemic, and undermining domestic demand. Monetary policy alone is unlikely to be effective in turning the situation around, but looser policy including currency depreciation will help.

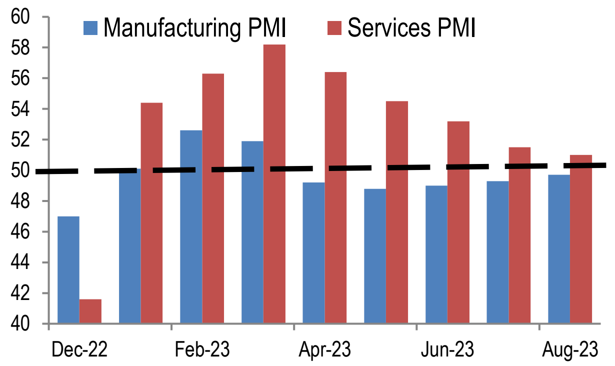
Weak domestic demand and exports are headwinds for the yuan. On the other hand, greater economic weakness is also likely to spur more stimulus measures. However, the lack of transparency makes it difficult to understand policymakers' key considerations and reaction function, and thereby the probability of significant stimulus.

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% (0.0%)**
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 Jul	**6.8983**
Spot end-Aug	7.2589
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

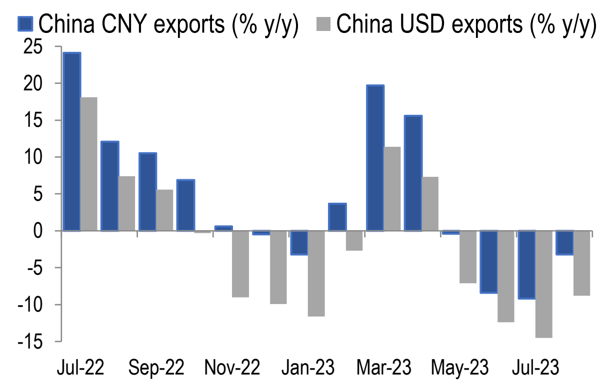
* Current is latest month, quarter or year

1. Faltering post-Covid economic rebound



Source: RBC Capital Markets; Bloomberg

2. Exports downturn exacerbating weak domestic demand



Source: RBC Capital Markets; Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CNY	6.87	7.25	7.34	7.40	7.45	7.50	7.40	7.35
EUR/CNY	7.45	7.91	7.85	7.70	7.67	7.65	7.77	7.94
CNY/JPY	19.3	19.9	20.0	20.3	20.4	20.5	20.3	19.7
CAD/CNY	5.09	5.48	5.44	5.36	5.36	5.40	5.48	5.61

Source: RBC Capital Markets estimates

Indian Rupee

Alvin T. Tan

1-3 Month Outlook – Renewed growth vigour

India's economic dataflow has demonstrated surprising strength lately. The August composite PMI of 60.9 suggests solid growth momentum through the third quarter. The perennial trade deficit has also improved over the past year, though still large. At the same time, there has been sustained portfolio capital inflows into India's equity market for most of this year.

India's benchmark Nifty and Sensex equity indices both hit their record highs in late July, and have been consolidating. Foreign investor sentiment has been consequently bullish, and capital inflows have supported the rupee though it is tailing off lately. Sliding cross-asset volatility is also raising the rupee's appeal as a carry currency.

On the other hand, waning core inflation pressures should keep the RBI on its policy pause setting. Furthermore, USD/INR spot has largely traded within an 81/83 range in the past eleven months, with help from the RBI. Upside risks, however, are escalating amid the broad USD revival and higher oil prices.

Thus, the rupee's outlook is turning bearish, even as it remains relatively bullish within the EM Asia FX universe. The currency has evinced low correlations to other Asian currencies in recent months, 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.

6-12 Month Outlook – Mediocre real yields

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.

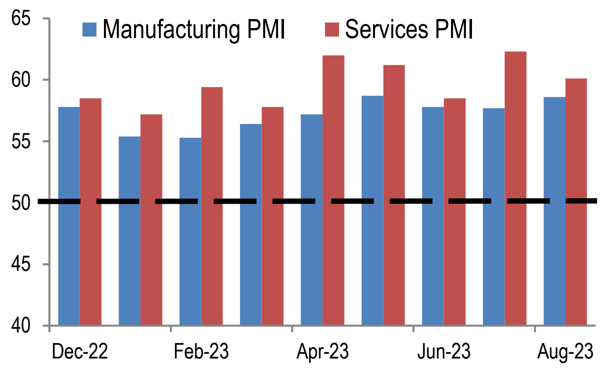
The public debt is large relative to GDP, but is almost entirely denominated in rupee. Moreover, global index inclusion hopes for Indian government may finally be realised over the next year. This is a key potential positive factor for the rupee in the medium-term, though the chances are not high in the foreseeable horizon.

Indicators

	Current (Previous)*
RBI policy repo rate	**6.50%**
Trend interest rates (10yr average)	6.25%
Bias in interest rate market	Lower
CPI Inflation %Y/Y last (prev)	**7.4% (4.9%)**
Inflation target	4% +/- 2%
Budget balance % GDP last (prev)	**-6.4% (-6.8%)**
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 Jul	**82.51**
Spot end-Aug	82.79
PPP valuation	USD/INR is close to PPP
Current account balance % GDP last (prev)	**-2.0% (-2.4%)**
Trend current account balance % GDP	-1.4%
Moody's Foreign Currency Rating	**Baa3**
Outlook	Negative

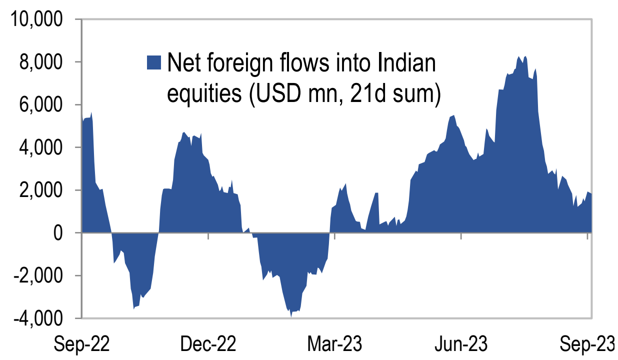
* Current is latest month, quarter or year

1. Surprising strength in the economy lately



Source: RBC Capital Markets; Bloomberg

2. Sustained portfolio inflows into local equities



Source: RBC Capital Markets; Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/INR	82.1	82.1	83.3	83.5	83.5	83.6	83.3	83.0
EUR/INR	89.0	89.6	89.1	86.8	86.0	85.3	87.5	89.6
INR/JPY	1.62	1.76	1.76	1.80	1.82	1.84	1.80	1.75
CAD/INR	61	62	62	61	60	60	62	63

Source: RBC Capital Markets estimates

South Korean Won

Alvin T. Tan

1-3 Month Outlook – Buffeted by global tides

South Korea's trade-dependent economy remains buffeted by the negative macro headwinds emanating from Fed tightening, China's slowdown, and the exports downturn. The BOK's tightening cycle has undercut domestic demand, but it has also ended with inflation turning lower.

The trade balance has been driven into a rare deficit over the past year, though it has improved in recent months. The related and ongoing global semiconductor slump is another negative factor on exports. Indications of a bottoming exports downturn need to be balanced against China's weakening economy, given that it is Korea's chief trading partner by far.

The Korean won's outlook has arguably become more balanced in recent months from more positive overall risk sentiment, the AI-driven tech rally and associated capital inflows into Korean semiconductor stocks. The resilient US economy should also help prevent external demand from souring too badly.

The won meanwhile continues to demonstrate a heightened sensitivity to external macro factors. USD/KRW, for example, evinces the highest persistent "USD beta" among the major Asia EM currencies, averaging +0.95 in the past two years. Moreover, persistent weakness in the neighbouring JPY and CNY currencies are also dragging on the won.

6-12 Month Outlook – Cheap amid deep uncertainties

The won's persistent weakness in 2021 and 2022 has made 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, albeit still less than the US dollar.

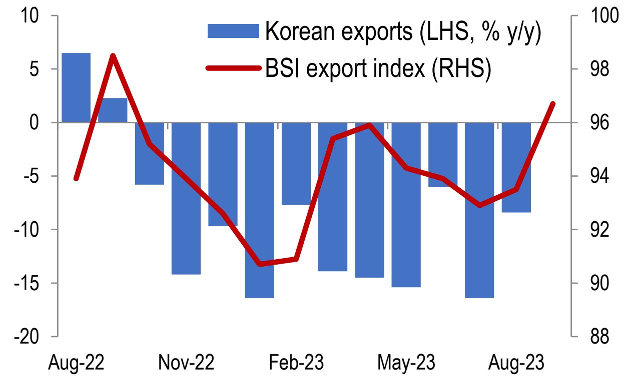
The months ahead promise a more favorable outlook for the won as existing macro headwinds fade in time. The semiconductor cycle in particular is anticipated to start turning soon. However, this needs to be balanced against deep uncertainties about the state of external demand, given the economy's heavy 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	Lower
CPI Inflation %Y/Y last (prev)	**3.4% (2.3%)**
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)	0.9% (0.9%)
Trend GDP %y/y	2.5%
Purchasing Power Parity Value Jul	**1047**
Spot end-Aug	1323
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

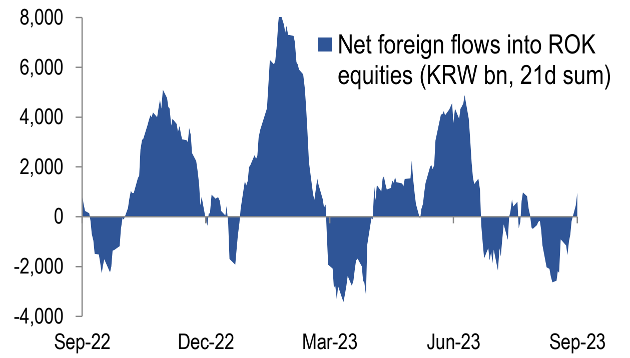
* Current is latest month, quarter or year

1. Exports slump not fully turning yet



Source: RBC Capital Markets; Bloomberg

2. Mixed foreign equity flows in recent months



Source: RBC Capital Markets; Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/KRW	1306	1316	1335	1345	1350	1330	1290	1260
EUR/KRW	1416	1436	1428	1399	1391	1357	1355	1361
JPY/KRW	9.8	9.1	9.1	9.0	8.9	8.6	8.6	8.7
CAD/KRW	967	994	989	975	971	957	956	962

Source: RBC Capital Markets estimates

Taiwanese Dollar & Singapore Dollar

Alvin T. Tan

Taiwan Dollar – Tied to CNY

Similar to South Korea, Taiwan is suffering through a deep exports slump. The island continues to run a very sizeable external surplus, but the local tech-driven stock market has seen less net portfolio flows than Korea. Part of this might be due to investors' growing wariness of geopolitical risks.

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 a wide margin, and the two currencies tend to be highly correlated. Moreover, TWD is not as attractive as KRW on valuation grounds, and the carry it offers is mediocre.

Cross-strait tensions have cooled somewhat in recent months. The upcoming competitive presidential election in January will likely see the mainland refrain from actions that would provoke Taiwan's electorate. That said, the near-term outlook for TWD is mixed-to-poor, and it will probably continue to lag the Asian FX complex.

Singapore Dollar – Supported by existing policy settings

Singapore's growth momentum and inflation pressures have decelerated. The MAS tightening cycle has thus ended as growth concerns take centre stage. The trade-weighted SGD's appreciation has already slowed noticeably this year.

However, the current estimated 1.5% annualised appreciation path of the trade-weighted exchange rate has and should continue to support further gradual gains. The large current account surplus also offers robust fundamental support. Singapore is also highly attractive as a major fund management and family office centre in the region. Finally, the relative outlook for SGD has brightened with the renminbi on a likely medium-term depreciation path, certainly for the trade-weighted SGD.

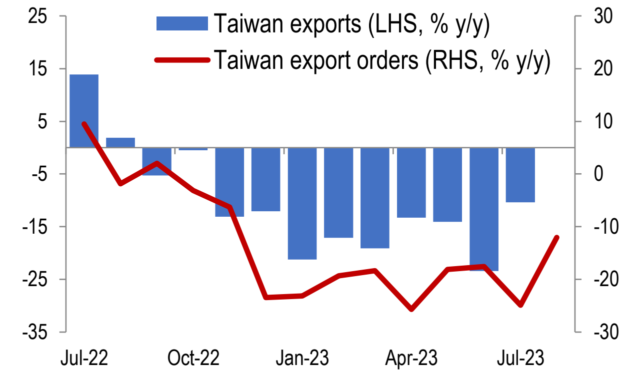
The currency should continue to perform among the upper half of Asian currencies through the rest of the year. SGD's outlook hence is cautiously optimistic. On the flipside, the SGD has become richly valued following its cumulative gains over the past few years.

Indicators

	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)	**2.5% (1.9%)**
Inflation target	None
Budget balance % GDP last (prev)	**1.2% (1.4%)**
Budget balance trend % GDP	0.0%
GDP Growth % y/y last (prev)	1.4% (-3.3%)
Trend GDP %y/y	3.2%
Purchasing Power Parity Value Jul	**25.40**
Spot end-Aug	31.88
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

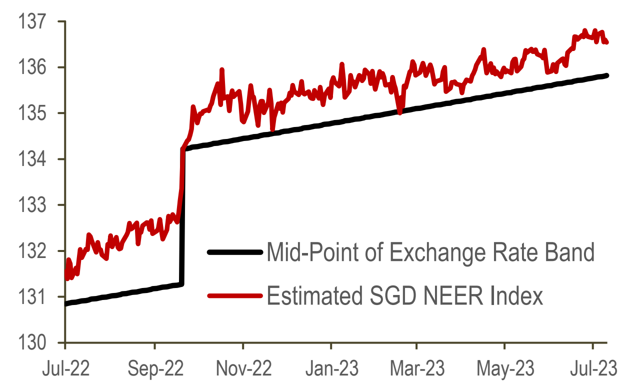
* Current is latest month, quarter or year

1. Extended bottoming process in Taiwan exports



Source: RBC Capital Markets; Bloomberg

2. SGD NEER uptrend supported by MAS' policy settings



Source: RBC Capital Markets

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/SGD	1.33	1.35	1.36	1.37	1.38	1.37	1.36	1.34
EUR/SGD	1.44	1.48	1.46	1.42	1.42	1.40	1.43	1.45
SGD/JPY	99.8	106.7	108.1	109.5	110.1	112.4	110.3	108.2
CAD/SGD	0.98	1.02	1.01	0.99	0.99	0.99	1.01	1.02

Source: RBC Capital Markets estimates

Malaysia Ringgit

Alvin T. Tan

1-3 Month Outlook – Positive factors in short supply

The bloom from Malaysia's economic recovery has faded. The country's manufacturing PMI has been running consistently below the 50 level for a whole year. Malaysia's exports too have joined the regional slump. It also has the largest trade exposure to China among the major ASEAN economies, and this has been a drag for the ringgit.

The recent bounce in the prices of key commodity exports of oil & gas and palm oil have lent some stability to MYR in the past month, but downside risks still predominate. The incumbent coalition government remains fragile after last month's bundle of state elections. This makes it challenging to undertake needed structural reforms to reduce the persistent fiscal deficit and boost potential growth.

The local equity market is among the worst performing in Asia-Pacific year-to-date, and MYR has been bedeviled by net foreign equity portfolio outflows for much of the past year. Bond yields are relatively mediocre too. Without an exciting growth story, Malaysian financial assets will struggle to generate significant interest from global investors.

The government's pledge to reduce subsidies, which are a huge fiscal drain, has also been slow to materialise. On the other hand, government revenues remain highly dependent on crude oil's price, and that has helpfully risen back above the current budget's assumed US$80/bbl price lately.

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.

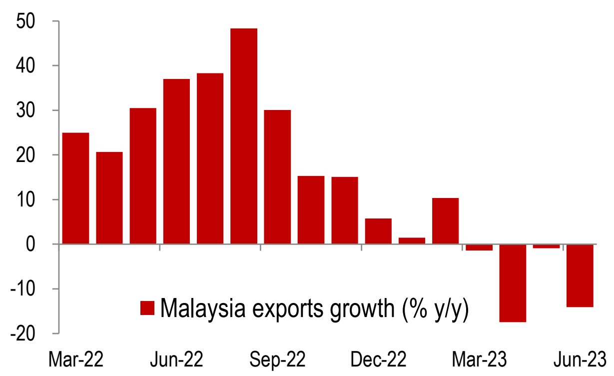
On the flipside, the country's fiscal challenges will keep investors cautious. Malaysia's interest rates continue to lag US ones and those of several of its Asian peers. Finally, it is difficult to foresee a significant improvement in the local political situation.

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)	**2.0% (2.4%)**
Inflation target	None
Budget balance % GDP last (prev)	**-5.8% (-6.4%)**
Budget balance trend % GDP	-4.2%
GDP Growth % y/y last (prev)	2.9% (5.6%)
Trend GDP %y/y	4.0%
Purchasing Power Parity Value Jul	**2.94**
Spot end-Aug	4.64
PPP valuation	USD/MYR is overvalued
Current acct bal % GDP last (prev)	**3.0% (2.8%)**
Trend current acct balance % GDP	3.7%
Moody's Foreign Currency Rating	**A3**
Outlook	Stable

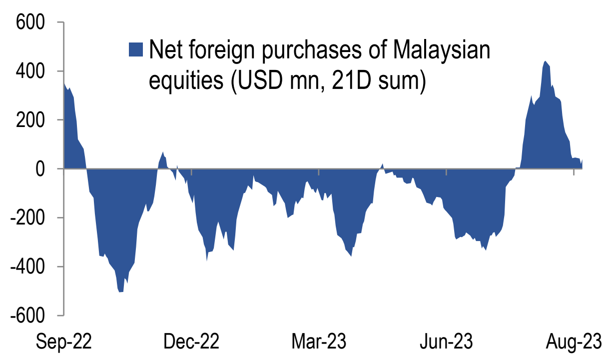
* Current is latest month, quarter or year

1. Exports have joined the regional slump



Source: RBC Capital Markets; Bloomberg

2. Equity outflows predominated for much of the past year



Source: RBC Capital Markets; Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/MYR	4.41	4.67	4.68	4.73	4.76	4.80	4.70	4.60
EUR/MYR	4.78	5.09	5.01	4.92	4.90	4.90	4.94	4.97
MYR/JPY	30.1	30.9	31.4	31.7	31.9	32.1	31.9	31.5
CAD/MYR	3.26	3.52	3.47	3.43	3.42	3.45	3.48	3.51

Source: RBC Capital Markets estimates

Brazilian Real

Daria Parkhomenko

1-3 Month Outlook – BCB to maintain pace of cuts

Since August, BRL has been one of the worst performers in EM, with USD/BRL attempting to break the 5.00 threshold (unsuccessfully). Although part of this can be attributed to the external backdrop (China's growth concerns, a stronger USD), the bulk of BRL's relative underperformance came in early August when the BCB cut rates by more than expected and the market initially turned skeptical about the BCB not accelerating rate cuts in future meetings (despite repeated hawkish messages from the BCB).

We expect the BCB to continue to cut rates in 50bp increments for the rest of this year, bringing the policy rate to 11.75% (mkt: ~-160bps by YE). We cannot rule out a faster pace of cuts (e.g. in early Sep, FinMin Haddad stated that it is time to cut by 75bp), but we think this would require further improvement in inflation and inflation expectations anchoring around the BCB's inflation target, and contingent on the fiscal proceedings. Given the current dynamics, this risk of acceleration is more likely a story for early 2024, as the terms of two members, who had voted for a smaller cut of 25bps in August, expire in December. Brazil's level of rates should still lend support to BRL in the near-term, with 150bp of cuts for the rest of this year more than fully priced and this magnitude of rate cuts to still leave Brazil's real policy rate as one of the highest in LatAm/CEEMEA in the coming months. Additionally, more of Brazil's peers are starting to cut rates.

We have shaded up our end-Q3 target to 4.90 (prior 4.75) amid the more difficult external backdrop and rising domestic fiscal uncertainty.

6-12 Month Outlook – Fiscal commitment

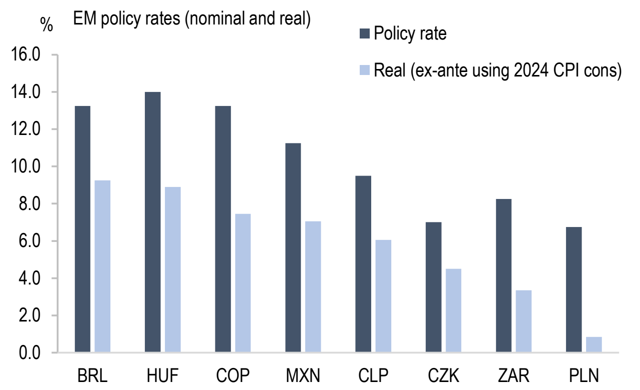
The government's commitment & ability to rein in the fiscal finances is key for USD/BRL's path. The lower house has passed the new fiscal plan, with only part of the Senate's changes. The government has also sent the 2024 budget bill to Congress, with a target to eliminate the primary deficit next year, and the government counting on BRL 168.5bn in extra revenues to achieve this. President Lula has also made changes to the cabinet, with the aim of bolstering support in Congress. Attention will now turn to any progress or lack thereof in Congress passing the necessary measures to raise more revenues and developments in the tax reform. Although signs of disagreement in Congress make us more cautious and we are ready to reassess depending on the fiscal process ahead, we are keeping next year's target at 4.50 until further information.

Indicators

	Current (Previous)*
Official policy rate	13.25 (13.75)
Trend interest rates (10yr average)	9.3
Bias in interest rate market	Easing
CPI Inflation %Y/Y Jul (Jun)	3.99 (3.16)
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 Jul	3.6348
Spot end-Aug	4.9553
PPP Valuation	USD/BRL is overvalued
Current account balance % GDP Q2 (Q1)	-2.6 (-2.7)
Trend current acct balance % GDP (10y avg)	-2.8
Moody's Foreign Currency Rating	Ba2
Outlook	Stable

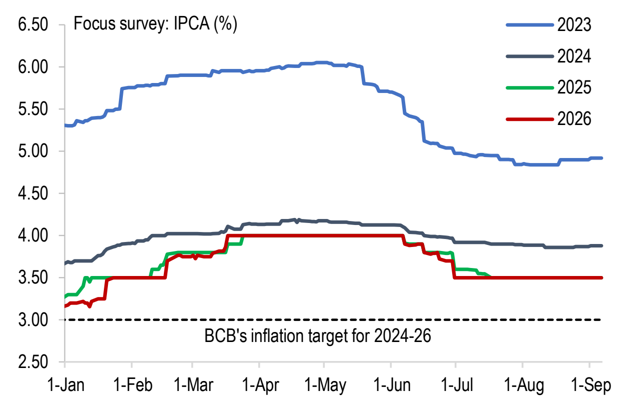
* Current is latest month, quarter, or year

1. Brazil still has a high real policy rate



Source: RBC Capital Markets, Bloomberg; Note: HUF uses 1d deposit rate

2. Market analysts' inflation expectations still above target



Source: RBC Capital Markets; BCB, Bloomberg

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/BRL	5.06	4.79	4.90	4.75	4.50	4.50	4.50	4.50
EUR/BRL	5.49	5.22	5.24	4.94	4.64	4.59	4.73	4.86
BRL/JPY	26.2	30.1	30.0	31.6	33.8	34.2	33.3	32.2
CAD/BRL	3.75	3.61	3.63	3.44	3.24	3.24	3.33	3.44

Source: RBC Capital Markets estimates

Mexican Peso

Daria Parkhomenko

1-3 Month Outlook – MXN has not yet lost its 'shine'

MXN was one of the top performers in H1 this year. MXN was also the outperformer in July/most of August, but the currency has fallen down the ranks post Banxico's press release on August 31 (more below). We think there are two key factors that had lent support to MXN (pre-Aug 31): (a) Banxico's hawkish 'hold' bias vs its LatAm peers who have started to ease rates (BCCh & BCB) and (b) the market re-adjusting its expectations for Fed rate cuts (SFRZ3Z4) next year amid US data showing resiliency. In the short-term, we still think MXN can perform well vs its EM peers, albeit some caution is warranted. We think the recent knee-jerk reaction in USD/MXN in response to Banxico gradually reducing its currency hedging program will be temporary (the program was introduced in Feb 2017, with Banxico holding additional MXN-settled NDF auctions in 2020 and continuously rolling the NDF positions). With widespread views that MXN was becoming overvalued, it is not surprising the market interpreted the announcement as Banxico's signal that MXN may have run too far. But at some point, the program would have been reduced and it makes sense to do it at a time when there is lower volatility and MXN is strong. More importantly, the factors that have contributed to MXN's strength won't go away on the back of this announcement: (a) wide interest rate differentials between Mexico & the US, (b) remittances, and (c) nearshoring. On (a), Banxico reiterated in August that it will hold rates "at its current level for an extended period", with no signs that rate cuts are imminent and then Governor Rodriguez later confirming on August 30 that easing is "still not on the table" (mkt: -6bps next 3m). On (b)/(c), these factors are more likely to be a function of the US economy and the overall global growth backdrop. Thus, despite the recent spike higher, we think there is space for USD/MXN to trade back down to our end-Q3 target of 17.00 (unchanged) in the near-term.

6-12 Month Outlook – More idiosyncratic risk

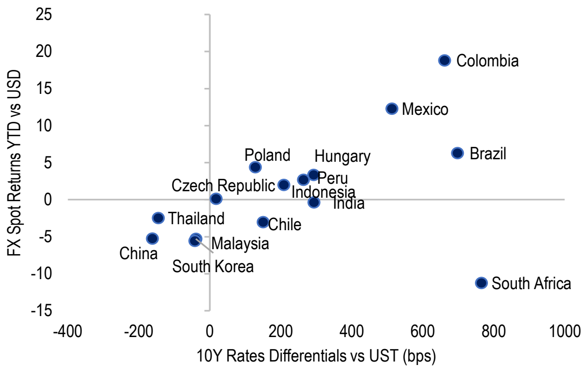
Our longer-run forecasts for USD/MXN have an upward bias. We are assuming that Banxico may begin to cut rates in early 2024, which will narrow the rate spreads between Mexico and the US. Then, volatility may increase as idiosyncratic risks rise ahead of the 2024 elections in Mexico and the US. The risk is that the move higher in USD/MXN may take longer to materialize amid the US economy's resilience supporting flows into Mexico (e.g. remittances) and Mexico's economy.

Indicators

	Current (Previous)*
Official cash rate (%)	11.25 (11.25)
Trend interest rates (10yr average)	5.77
Bias in interest rate market	Close neutral ST, then cuts
Core CPI Inflation %Y/Y Jul (Jun)	6.64 (6.89)
Inflation target	3%
Budget balance % GDP Q4 (Q3)	-3.75 (-2.85)
Budget balance target % GDP	-2.2
GDP Growth % y/y Q2 (Q1)	3.6 (3.8)
Trend GDP %y/y	1.5
Purchasing Power Parity Value Jul	16.3655
Spot end-Aug	17.0378
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

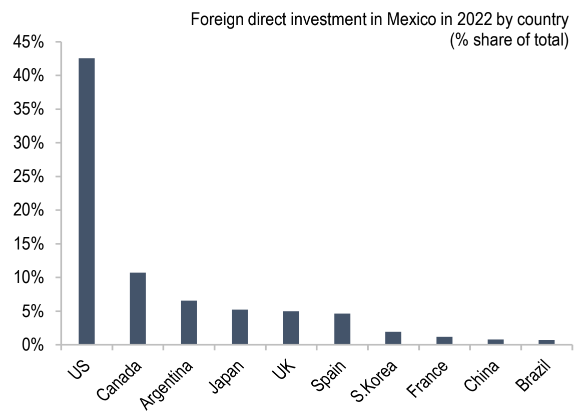
* Current is latest month, quarter, or year

1. MXN has been supported by wide MX-US rate diff



Source: RBC Capital Markets, Bloomberg

2. The US is the main source of FDI in Mexico



Source: RBC Capital Markets, Haver

Forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/MXN	18.05	17.12	17.00	18.00	18.50	18.50	18.50	18.50
EUR/MXN	19.56	18.68	18.19	18.72	19.06	18.87	19.43	19.98
MXN/JPY	7.36	8.43	8.65	8.33	8.22	8.32	8.11	7.84
CAD/MXN	13.35	12.93	12.59	13.04	13.30	13.31	13.70	14.12

Source: RBC Capital Markets estimates

Forecasts

Spot forecasts

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.09	1.07	1.04	1.03	1.02	1.05	1.08
USD/JPY	133	144	147	150	152	154	150	145
GBP/USD	1.23	1.27	1.23	1.17	1.13	1.11	1.15	1.20
USD/CHF	0.92	0.90	0.89	0.91	0.91	0.92	0.89	0.86
USD/SEK	10.40	10.80	11.12	11.54	11.75	11.76	11.33	10.93
USD/NOK	10.47	10.74	10.65	10.87	10.87	10.98	10.57	10.19
USD/CAD	1.35	1.32	1.35	1.38	1.39	1.39	1.35	1.31
AUD/USD	0.67	0.67	0.63	0.62	0.61	0.60	0.61	0.62
NZD/USD	0.63	0.61	0.59	0.58	0.57	0.56	0.57	0.58
USD/CNY	6.87	7.25	7.34	7.40	7.45	7.50	7.40	7.35
USD/KRW	1306	1316	1335	1345	1350	1330	1290	1260
USD/INR	82.12	82.10	83.30	83.50	83.50	83.60	83.30	83.00
USD/TWD	30.49	31.15	32.00	32.20	32.30	32.30	32.00	31.70
USD/SGD	1.33	1.35	1.36	1.37	1.38	1.37	1.36	1.34
USD/MYR	4.41	4.67	4.68	4.73	4.76	4.80	4.70	4.60
USD/HKD	7.85	7.84	7.84	7.84	7.84	7.83	7.82	7.82
USD/MXN	18.05	17.12	17.00	18.00	18.50	18.50	18.50	18.50
USD/BRL	5.06	4.79	4.90	4.75	4.50	4.50	4.50	4.50

Source: RBC Capital Markets estimates

EUR Crosses

	2023				2024			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
EUR/USD	1.08	1.09	1.07	1.04	1.03	1.02	1.05	1.08
EUR/JPY	144	157	157	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	0.95	0.95	0.94	0.94	0.93	0.93
EUR/SEK	11.28	11.78	11.90	12.00	12.10	12.00	11.90	11.80
EUR/NOK	11.35	11.71	11.40	11.30	11.20	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	1.70	1.68	1.69	1.70	1.72	1.74
EUR/NZD	1.73	1.78	1.81	1.79	1.81	1.82	1.84	1.86
EUR/CNY	7.45	7.91	7.85	7.70	7.67	7.65	7.77	7.94
EUR/KRW	1416	1436	1428	1399	1391	1357	1355	1361
EUR/INR	89.01	89.56	89.13	86.84	86.01	85.27	87.47	89.64
EUR/TWD	33.04	33.99	34.24	33.49	33.27	32.95	33.60	34.24
EUR/SGD	1.44	1.48	1.46	1.42	1.42	1.40	1.43	1.45
EUR/MYR	4.78	5.09	5.01	4.92	4.90	4.90	4.94	4.97
EUR/HKD	8.51	8.55	8.39	8.15	8.08	7.99	8.21	8.45
EUR/MXN	19.56	18.68	18.19	18.72	19.06	18.87	19.43	19.98
EUR/BRL	5.49	5.22	5.24	4.94	4.64	4.59	4.73	4.86

Source: RBC Capital Markets estimates

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