

Liquid Insight

Summer strength in G10 FX

Key takeaways

- USD has maintained strength despite current disinflationary outlook, as markets debate the potential for another Fed hike.
- Our EUR-USD forecasts remains 1.05 for end-23 and 1.15 for end-2024, although we do look for short-term end-Q3 at 1.08.
- We have also recently made a number of G10 FX forecast changes, with higher USD-JPY, lower Dollar Bloc, and revised Scandies.

By John Shin, Athanasios Vamvakidis and Alex Cohen

Chart of the day: we expect near-term USD strength, but medium term reversion lower

Our end-year EUR-USD forecast remains 1.05, but 1.15 for end-2024



Source: Federal Reserve Board, Bloomberg and BofA Global Research

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Still looking for USD upside to the end of the year

USD has continued to stay on the stronger side as the US outlook has remained robust amid disinflation over the past couple of quarters. Indeed, at the recent Jackson Hole Conference, Fed Chairman Powell delivered balanced comments, but markets saw a slightly hawkish tone, consistent with our US Economics team's expectations for a 25bp rate hike in November and 75bp cuts in 2024 (see the report [US Watch: Jackson Hole: A Rorschach test, 25 August 2023](#)). As summer approaches the end, we remain modestly positive for USD near-term, with both our continued end-year EUR-USD forecast of 1.05, as well as making a number of recent USD-positive FX forecast changes, such as higher USD-JPY and lower Dollar Bloc, although we also still see medium-term downside (see the Chart of the Day, and the report [World at a Glance: Summer Strength, 23 August 2023](#)).

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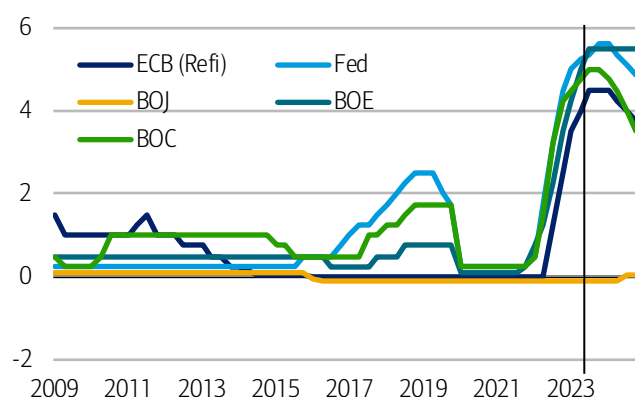
USD: all about resilience with US economic outperformance

Since depreciating to its YTD lows on back of disinflationary signals in July, the USD has strengthened. The USD's rebound has been driven by a confluence of inter-related factors, including: ongoing signs of relative US economic resilience, weak data in China, supply driven rise in US Treasury yields, increased inflation re-acceleration risks on back of rising commodity prices, and a modest and nascent turn lower in equities. ([FX Watch: The USD's road trip 16 August 2023](#)).

This U.S. resiliency amid tightening Fed policy (Exhibit 1) suggests that the neutral policy rate may ultimately be higher than previously thought. This should be USD supportive, as US economic strength suggests the Fed can maintain a policy stance that is "higher for longer" than is currently priced. And if inflation proves sticky, as we anticipate, then upward pressure on the pricing of the Fed's path should persist. While sovereign nominal yields have been rising globally, keeping these rate differentials contained, real yield differentials have been widening more so in favor of the USD.

Exhibit 1: G5 Central Bank Policy Rates to end 2024

Our US Economics team expects 75bp of cuts next year

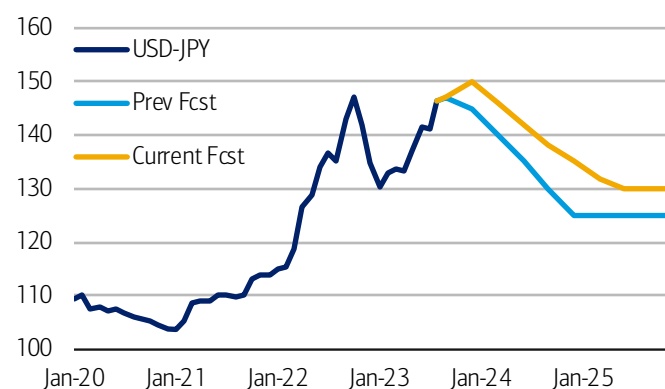


Source: Bloomberg and BofA Global Research

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Exhibit 2: Recent USD-JPY forecast revisions to the upside

Our end-2023 USD-JPY forecast is now 150



Source: Bloomberg and BofA Global Research

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EUR: short-term downside risks, more downside by year-end

Conversely, EUR is down since its July peak, back in the range we have seen most of this year, and we remain bearish. Eurozone data has been very weak recently, particularly in Germany. Weak growth and sticky core inflation in the Eurozone point to higher hard-landing risks and lower r^* (natural rate of interest) than in the US (see [Growth-inflation trade-off and FX 16 August 2023](#)).

China data has been well below expectations during reopening, and our Asia FX team sees such weakness reflected in the currency such that they would expect upside risks to USD-CNY unless a credible fiscal package is delivered (see [Asia FI & FX Strategy Watch: Asia FX Monthly – August 2023, 24 August 2023](#)). We would expect this softness from China to affect the European economy negatively through direct and indirect channels.

Meanwhile, energy prices have started to rise again, weighing on the Eurozone's terms of trade given strong reliance on energy imports. We expect one more ECB hike, but markets have already priced it. Recent ECB speakers have sounded dovish. Real rate differentials point to a weaker EUR.

Forecasts: slight EUR-USD revision to Q3., otherwise EUR-USD the same

We have adjusted our Q3 EUR-USD forecast from 1.05 to 1.08, mainly marking-to-market as we enter September. (see [Global FX Weekly: High rates until 2% at the end of the tunnel, 18 August 2023](#)) Our EUR-USD forecast is otherwise the same, with an end-year forecast of 1.05, but with softening to the end of the 2024 with a forecast of 1.15. Broadly, we maintain our view that the USD should be supported this year as US growth

resilience allows the Fed to maintain restrictive policy amid inflation reacceleration risks. Valuation should bring the USD back towards equilibrium starting in 2024.

...but revisions elsewhere, including USD-JPY profile higher...

We do have a variety elsewhere of revisions for G10 FX, particularly in terms of raising our overall USD-JPY profile after Q3, with an end-year forecast now of 150, continuing to reflect policy differentials (Chart 2).

We also modestly lowered our Dollar Bloc forecasts (see Exhibit 3). In Canada, our USD-CAD outlook is slightly higher, with an end-year forecast of 1.32, compared to 1.30. For Antipodean FX, we generally lower our profile, especially given the importance of the struggling outlook for China. Our forecast profiles for both AUD-USD and NZD-USD are lower.

We also revised our EUR-Scandies forecasts, raising our profiles for both EUR-SEK and EUR-NOK.

Risks: all about the data

Data dependent central banks keep the FX market susceptible to the latest major prints. A logical key example will be the upcoming US payroll report out on Friday 1-September, where our US Economics team expects a gain of 175K in jobs, and the unemployment rate to stick at a low level of 3.5% (see [Morning Market Tidbits: August employment preview, 24 August 2023](#)).

Should US growth begin to soften, or should disinflationary impulses increase, the market will re-focus on sooner rate cuts from the Fed. Conversely, resurgent inflation could pose over-tightening risks globally, introducing greater “hard landing” risks. China also poses several 2-way risks, as further economic malaise will have global growth implications, while the prospect for fiscal easing could engender greater risk appetite.

Ultimately our key thesis remains that we need some landing of the economy, meaning higher unemployment, to get inflation all the way down, close to the target. The timing and details of such landing compared with the rest of G10 are key risks for the EUR path forward.

Exhibit 3: G10 FX Forecasts

Our end-year EUR-USD forecast remains 1.05, although we have made a number of forecast revisions elsewhere

	Spot	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
G3											
EUR-USD	1.08	1.08	1.05	1.07	1.10	1.15	1.15	1.16	1.17	1.18	1.20
USD-JPY	146	147	150	146	142	138	135	132	130	130	130
EUR-JPY	158	159	158	156	156	159	155	153	152	153	156
Dollar Bloc											
USD-CAD	1.36	1.33	1.32	1.32	1.30	1.28	1.26	1.26	1.26	1.26	1.26
AUD-USD	0.64	0.63	0.64	0.66	0.68	0.71	0.71	0.71	0.71	0.71	0.71
NZD-USD	0.59	0.59	0.59	0.60	0.62	0.64	0.64	0.64	0.64	0.64	0.64
Europe											
EUR-GBP	0.86	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
GBP-USD	1.26	1.27	1.24	1.26	1.29	1.35	1.35	1.36	1.38	1.39	1.41
EUR-CHF	0.96	0.98	0.98	0.99	0.99	1.00	1.00	1.02	1.02	1.05	1.05
USD-CHF	0.88	0.91	0.93	0.93	0.90	0.87	0.87	0.88	0.87	0.89	0.88
EUR-SEK	11.93	12.00	11.70	11.40	11.20	11.00	10.70	10.60	10.50	10.30	10.20
USD-SEK	11.06	11.11	11.14	10.65	10.18	9.57	9.30	9.14	8.97	8.73	8.50
EUR-NOK	11.54	11.30	11.00	10.80	10.70	10.50	10.30	10.20	10.10	10.00	9.90
USD-NOK	10.70	10.46	10.48	10.09	9.73	9.13	8.96	8.79	8.63	8.47	8.25

Forecast as of Aug-27-2023. Spot exchange rate as of Aug-27-2023. The left of the currency pair is the denominator of the exchange rate. **Source:** BofA Global Research

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Notable Rates and FX Research

- **Global Rates, FX & EM Year Ahead 2023 – [Year Ahead 2023: Pivot ≠ Peak](#)**, 20 Nov 2022
- [High rates until 2% at the end of the tunnel](#) **Global FX Weekly**, 18 Aug 2023
- [R*s be our guide](#) **Global Rates Weekly**, 11 Aug 2023
- [Support for USD vs. GBP, CHF, CAD; EM interventions](#), **Liquid Cross Border Flows**, 21 August 2023

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