Global FX weekly

Destination unknown

19 January 2024

FX Research
Global

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The View

G10: Complacent markets have finally started to price risks. Data, central banks, geopolitics the main drivers. We have been expecting correction, but baseline remains.

EM: Pain trade sell-off in EM FX trade offers opportunities. Stay short CNH against long EM carry, long BRL vs. short MXN.

G10 Themes

What if no central bank cuts rates this year? Unrealistic, but aggressive cuts markets are pricing at other extreme. Positive for USD, EUR, CHF vs. NOK, AUD, JPY.

USD. Off to good start. Mixed data, similar CB pricing, balanced Fed comments, geopolitics. USD depreciation an H2 story, scope for 2-way risk near-term.

ECB Preview: No change, but more pushback against market pricing early cuts. We stick to our call for first cut in June. EUR positive, but no sustained impact.

JPY risks for 2024: Capital outflows, politics, excess net JGB supply, JGB downgrade (tail-risk), BoJ behind the curve. Implications: higher vol, negative for JPY & JGB.

BoJ Preview: On hold, to exit NIRP+YCC April-July. Cautious BoJ policy normalization will not drive JPY higher. JPY driven by global factors and seasonality in 1Q24.

BoC Preview: Recent data and hawkish bias suggest BoC on hold. Rate cuts to start in June, 5 cuts in 2024. 1.34-1.35 near-term fair value for USDCAD, 1.30 by yea-end.

Norges Bank preview: No further hikes. First cut 3Q24. Economy stagnating but price pressures higher than elsewhere. Non-event for NOK. Stay constructive in 2024.

EM Themes

EM FX: More idiosyncratic now vs 2010-19. PC1 explains 61% of variance (71% in 2010-19). PC1+PC2 explain 75% (83% before).

Sell USD/KRW: The strong KOSPI and KRW sell-off is overdone relative to fundamentals. We sell 3M USDKRW at 1332 for a reconvergence with global trends.

Short COP: We open a short COP against LatAm currencies. We open the trade at an index value of 100 with a target of 92 and stop of 104.

VOL

Hedging Q1 USD bounce: Consensus short USD for 2024. Hedge with cheap 3m USD risk reversals vs cyclical G10. CAD & SEK most vulnerable. Calendar spreads preferred.

Our medium-term views

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Exhibit 1: Our medium-term views
G10 and EM FX medium-term views

G10	We are bearish USD, looking for EURUSD at 1.15 by end-2024. In our base case, the US economy starts recoupling with the rest of the world, US disinflation continues, and the Fed cuts rates, supporting risk sentiment and pushing the USD lower from an overvalued level. But risks abound: in our main risk scenarios the USD softens less than we expect, or even strengthens. We expect a stronger EUR and GBP next year mostly vs USD—we remain bearish on both Euro area and UK growth, seeing both EURUSD and cable driven by the US recoupling. On JPY, we remain more cautious than consensus, primarily on carry—we expect USDJPY it to fall to 142 by end-2024. We expect high-beta G10 FX to perform well but have some reservations on NZD and SEK. We expect EURCHF modestly higher in line with the symmetric SNB stance.
EM	Our client conversations suggest investors are lacking in directional EM FX conviction and leaning more towards relative value trades. In Asia, our preference in relative value FX is for short CNH against long SGD and INR, where positive carry is enhanced, and volatility contained by MAS and RBI intervention. In Latam, we favor long BRL against short MXN based on valuations, acknowledging that market positioning is long both currencies against short USD. In EMEA, we are long PLN/CZK on hawkish monetary policy in Poland relative to Czech.

Source: BofA Global Research

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Our key forecasts

Exhibit 2: Key BofA G10 and EM FX forecasts
Forecasts as of 18-Jan-2024

(EOP)	YE 2021	YE 2022	YE 2023	1Q24	2Q24	3Q24	YE 2024	YE 2025
EUR/USD	1.14	1.07	1.10	1.07	1.10	1.15	1.15	1.20
USD/JPY	115	131	141	145	143	142	142	136
GBP/USD	1.35	1.21	1.27	1.23	1.26	1.31	1.31	1.40
AUD/USD	0.73	0.68	7.00	0.66	0.68	0.71	0.71	0.71
USD/CNY	6.36	6.90	7.10	7.55	7.40	7.10	6.90	6.70
USD/BRL	5.58	5.29	4.92	5.00	4.95	4.85	4.75	5.00
USD/INR	74.34	82.74	83.21	83.00	82.50	82.00	82.00	81.00
USD/ZAR	15.94	17.04	18.36	18.60	18.50	17.70	17.80	18.40

Source: BofA Global Research. Forecasts as of 18-Jan-2024.

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What we particularly like right now

Exhibit 3: Our latest G10 and EM FX trade recommendations
What we particularly like right now

G10	
Buy 3m GBP/SEK ratio call spread	Carry & our BoE v Riksbank outlook vs that priced are key reasons. Trade could also benefit from worsened risk sentiment
Buy 3m EUR/CHF ratio call spread	SNB symmetric reaction function implies intervention to weaken CHF or (more likely) less FX sales to taper balance sheet
Buy EUR/USD	We are bearish USD in 2024 on the start of Fed rate cutting cycle and normalization of the overvalued USD
Buy 4m EUR/GBP vol swap	EURGBP implied is at a historical low and should rise on diverging EZ-UK economic and fiscal outlooks
EM	
Long USD/COP	We open a short COP vs LatAm currencies. We open the trade at an index value of 100 with a target of 92 and stop of 104.
Short USD/KRW	We sell USDRW 3m outright at 1332 to play for a reconvergence with global trends.
Short CNH/long narrow CFETS	Short CNH against CFETS as we expect PBOC to lean against trade-weighted appreciation

For complete list of open trades, and those closed over the past 12 months, please see here

G10 Central Bank calls

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Exhibit 4: G10 Central Bank calls
ECB, BoJ, BoC and Norges Bank are meeting next week

Country	Next Meeting	BofA	Consensus	Prior	Narrative
US	31-Jan	5.25-5.50%	5.25-5.50%	5.25-5.50%	We look for four25bp cuts (Mar, Jun, Sep, and Dec) this year, and another 100bp of cuts next year. Our projection is for fewer rate cuts than financial markets currently expect: we have shifted in the direction of lower recession risk while maintaining a forecast for inflation that is stickier than market expects. On QT, we expect the Fed to cut the monthly UST redemption cap by $15bn/m starting in Mar with QT ending in July.
Eurozone	25-Jan	4.00%	4.00%	4.00%	We expect quarterly cuts in 2024 from June, one cut per meeting in 2025 until the depo is at 2%, and then more in 2026. We still think the ECB prefers to do too much rather than too little (in contrast to the Fed) which, to us, means the risk of faster cuts in 2H24 is higher than the risk of cuts before June. We still expect the operational framework review to bring an adjustment in the minimum reserve ratio to 2-3% and the ECB to stick to the pre-announced plan to reduce PEPP reinvestments by half in 2H24 and stop fully thereafter.
Japan	23-Jan	-0.10%	-0.10%	-0.10%	We pushed back our expected window for the likely timing of BoJ policy adjustments to Apr-Jul '24, and make April our baseline for NIRP+YCC removal. There are no changes to our view that the rise in Japan's underlying inflation will be sustained. We keep unchanged our forecast that the exit from NIRP/YCC will be followed by 25bp hikes in Oct-Dec '24 and Apr-Jun '25, to take BoJ policy rate to 0.5% by mid-2025. We also keep intact our view that QT will be delayed until 2025, despite the recent reduction in BoJ bond purchases.
UK	1-Feb	5.25%	5.25%	5.25%	We expect the BoE on hold at 5.25% until Aug-24 and a cutting cycle of 25bp per quarter from there. The UK will be the last of the major central banks to start the cutting cycle and is likely to move slower, at least vs the ECB. We see a risk that the BoE cuts rates 25bp per meeting when it starts in August of this year. We think that would have short legs if it were to materialise: faster cuts in 2024 would likely need to be followed by, likely, a long pause down the line or, under some circumstances, even some small reversal of the move.
Canada	24-Jan	5.00%	5.00%	5.00%	We expect five rate cuts in 2024 and another 3 in 2025
Australia	6-Feb	4.35%	4.35%	4.35%	We expect no rate cuts in 2024 and the cash rate at 3.50 by YE 25
New Zealand	28-Feb	5.50%	-	5.50%	We expect seven rate cuts in 2024 and another 3 in 2025
Switzerland	21-Mar	1.75%	-	1.75%	We expect the SNB to start cutting later (September 2024) and less (quarterly to 0.5% by September 2025) than the ECB, with the risk of cutting even less. We now expect a more symmetric than before approach toward CHF.
Norway	25-Jan	4.50%	4.50%	4.50%	Norges done with hikes but to remain cautious. We continue to look for two rate cuts in 2024, starting in 3Q, and another five in 2024. Symmetric risks.
Sweden	1-Feb	4.00%	4.00%	4.00%	We look for three rate cuts in 2024 and another 5 in 2024, similarly to the ECB, Downside risks to this path.

Source: BofA Global Research, Bloomberg consensus forecasts as of 18-Jan-2024.

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The view

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Markets finally started to price risks

We have been arguing consistently that the market has been ignoring risks for this year and that just pricing some of them was likely at some point, even if eventually they do not materialize. We have been particularly concerned about the aggressive central banks rate cuts that markets have been pricing, primarily because data remains solid in most cases, labor markets are stretched, headline inflation is increasing on the back of strong base effects from the drop in energy prices last year and core inflation remains sticky.

To a large extent, the market correction that has taken place so far this year reflects the pricing of some of these risks. The data in G10 has been mixed but still not consistent with a landing. Fed speakers have not necessarily pushed against market pricing for a rate cut in March, but have argued for gradual easing, including Waller this week. ECB speakers have consistently and strongly pushed against market pricing of early cuts, with surprising unanimity from both hawks and doves. The IMF sent a strong message that the fight against inflation was not over yet. Oil prices have increased following the developments in the Red Sea. The latter has also increased the market focus on geopolitical risks. And Trump's victory in Iowa reminded markets of the US elections this fall.

The focus next week turns to central bank meetings, including BoJ, ECB, BoC and Norges. As we discuss in this report, we expect all of them to be on hold and we will focus on their communication. We see caution as their main message, but this is not something new. The markets have only now started to listen.

Our view remains that central bank rate cuts, in soft landing, and US recoupling will eventually be positive for risk and negative for the USD. However, we have been warning of a choppy path, as we started the year with the markets priced to perfection. Our EURUSD forecast for Q1 is 1.07, strengthening to 1.15 only in h2, as the easing cycle gets going. We believe this is a year to sell USD rallies, but we also expect that we will get such rallies, particularly in h1. Beyond the USD, we are bullish AUD, NOK and GBP and bearish CHF and SEK.

We will change our view and turn bullish USD if: 1/ Inflation is even stickier that we expect and no central bank cuts rates this year; 2/ New energy shocks lead to stagflation; 3/ US growth remains as strong as last year—no landing; 4/ Hard landing triggers risk-off. We have been arguing that the market has been complacent about such risks, but we don't expect them to materialize in our baseline.

A note on the US elections, particularly ahead of the New Hampshire primary next week. As we have argued before, some of the Trump policies are positive for the USD, including tax cuts and tariffs. However, concerns about future pressure on the Fed can be USD negative. For now, we expect the first to dominate and the US elections to be a positive risk for the USD this year. The Iowa caucus was a wake-up call for markets, but the US election tends to become a market theme after Labor Day. We don't expect a sustained market impact in the meantime. Data, central banks, and geopolitics are more important market drivers for now, in our view.

EM FX – Pain trades and who-dunnit?

The January sell-off in emerging market currencies is sustaining and confounding the market consensus that the USD would be weak in 2024. Indeed, the working assumption going into this year is that a Fed easing cycle would favor EM carry, characterized by high carry to volatility ratios – see Exhibit 5. Moreover, positioning indicators, such as the z-score of 3-month 25-delta risk reversals, suggest investors are already long and vulnerable - Exhibit 6. Understanding the causes of this EM FX sell-off will help in guiding an effective counter strategy against this pain trade.

The first, obvious, candidate is that markets were pricing-in too much Fed easing over the next year. Subsequent stronger than expected US data and Fed officials pushing back on the market's pricing, provides a tactical explanation for the USD bounce.

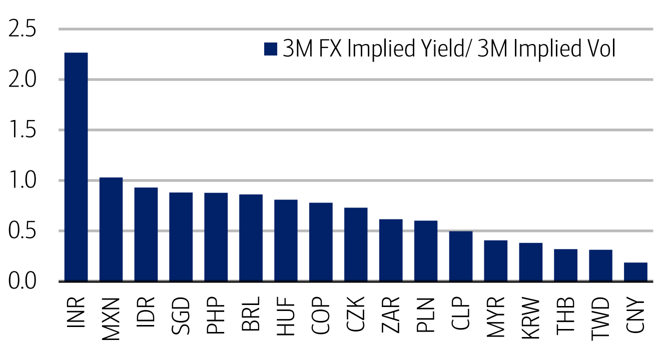
If this hypothesis is correct, the market's current repricing to 144bps of easing over the next 12-months, may offer a re-entry point for EM FX carry trades such as long BRL and high beta longs like KRW. This is motivated that our view for a 100bps over 12-months is appropriate and that the market may price in an additional 25bps as a margin-of-error and weight of receiver positioning to pre-empt the easing cycle.

The second candidate for USD strength is China's weak economic data, notably property sales, and deflation in asset prices. This is depressing EM equity markets and growth expectations. Unlike the re-pricing of Fed expectations, this China factor is more structural in nature and favors short CNH against long EM crosses liker INR or SGD.

The third and final explanation for the recent rebound in USD strength, especially against CNY and MXN, may be related to the market's reassessment of a potential Trump presidency and the return of greater trade protectionism. This factor is more event-driven and harder to position for.

However, the underperformance of MXN was evident over the past week and favors our own long BRL/short MXN positioning. The selling pressure on CNY is less evident as the PBoC continues to fix CNY stronger than market expectations at the daily fixings. Consequently, we favor USD 3M call, CNH put spreads as represented by our existing year-ahead trade with 7.30/7.50 strikes.

Exhibit 5: 3M forward FX Sharpe Ratio based on implied yield & vol
INR and MXN offer most attractive carry to risk



Source: BofA Global Research, Bloomberg

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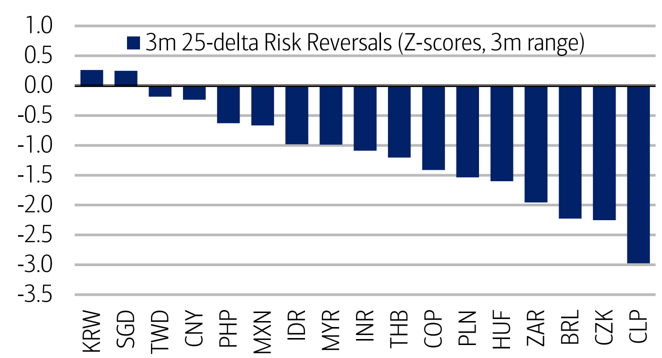
Exhibit 6: 3M 25-delta risk reversal skews reveal a long bias.
The majority of EM FX has below average upside skew risk premiums



Source: BofA Global Research, Bloomberg

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Thinking the unthinkable: what if no central bank cuts rates this year?

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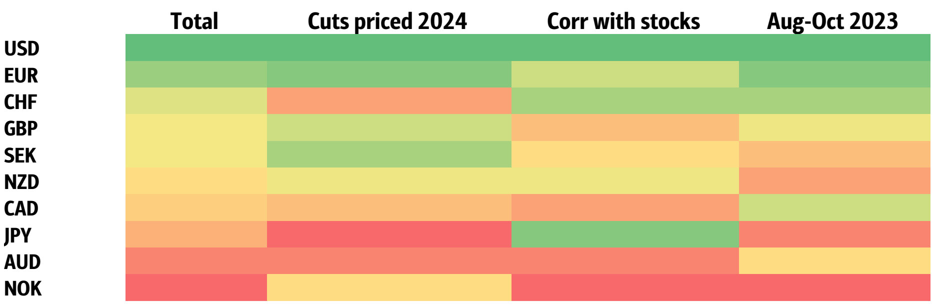
Please see full report for details: Thinking the unthinkable: what if no central bank cuts rates this year? 16 January 2024

For the sake of the argument

The most important discussion in the market as the new year has started is not if, but when and how fast G10 central banks will start to cut policy rates. Even if a scenario of central banks staying on hold this year may seem completely unrealistic to the consensus, it is still worth considering its market implications in our view, as we are puzzled by the aggressive market pricing of rate cuts this year.

As a contrarian exercise, we rank G10 currencies in a scenario of no rate cuts according to: market pricing, correlation with equities, and market reaction during Aug-Oct last year when the market priced out rate cuts. The results in Exhibit 7 suggest that USD, EUR and CHF will perform the best against NOK, AUD and JPY. We may see a similar market reaction if rate cuts come later or slower than market pricing, with the size and duration of the impact depending on the difference. The results are also relevant if the market starts to differentiate more according to the latest inflation dynamics. We remain bearish on the US this year, but see a choppy path.

Exhibit 7: G10 FX performance ranking in scenario of no central bank rate cuts in 2024
USD, EUR, CHF to perform the best against NOK, AUD, JPY if no G10 central bank cuts rates this year



Source: BofA Global Research. Note: Equally weighted ranking of three forces driving G10 FX in scenario of no central bank rate cuts this year. The total reflects the sum of the three rankings. Green for positive FX impact, red for negative FX impact, yellow for neutral FX impact. See Exhibits 1-3 for detailed data. Colors use Excel conditional format.

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USD: Defying gravity

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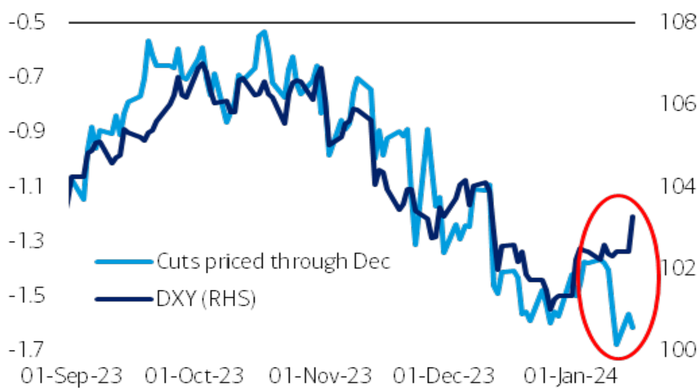
Please see full report for details: USD: Defying gravity 17 January 2024

USD off to a hot start

Despite greater pricing for Fed cuts to start the year, the USD has rallied against all G10 currencies. We see several reasons for this, including: the exuberant "pricing to perfection" of a soft landing scenario and the possibility that any cuts priced for a harder landing scenario are not USD negative; a mixed reading of recent US labor and inflation data; recent Fed communication striking a more balanced tone than the December FOMC; the fact that other central banks are similarly (albeit more modestly) being priced for faster/deeper easing in 2024; and ongoing geopolitical concerns.

While we see the USD depreciating broadly this year, it could still take some time, and our forecasts call for greater moves in H2. Current Fed pricing is excessive, but a normalized inflation environment and eventual rates cuts should still allow for greater FX valuation adjustments to finally occur, even as most other central banks are also cutting. But until we get even more signs that inflation is comfortably pointing towards central bank targets, the timing and pace of USD depreciation can remain less certain.

Exhibit 8: DXY and Fed cuts priced through Dec 2024
While dovish Fed pricing has continued this year, the USD has rallied



Source: BofA Global Research; Bloomberg

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ECB Preview: One more pushback

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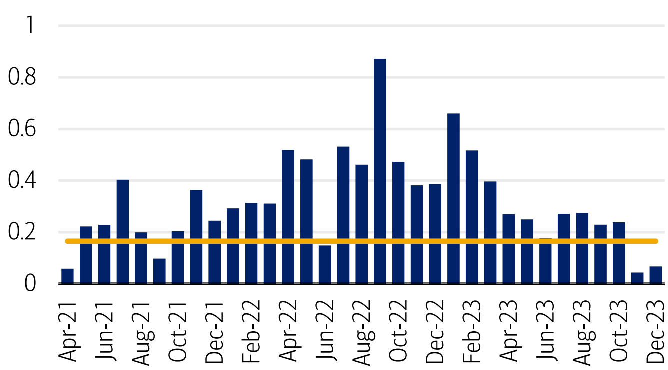
We expect no changes to policy or communication, but additional pushback on market pricing for early cuts in the ECB meeting next week. The ECB considers current market pricing of early cuts as a risk to inflation converging to its target. Wage and profit developments are key inputs for the next ECB move. We stick to our call of a first cut in June but disinflation points to risk of faster policy easing thereafter.

Despite strong ECB pushback, including by various ECB officials in Davos this week, the market continues pricing early and fast cuts. The market is now pricing 19bp for April, although this is much lower than 30bps earlier this week. The market is pricing 136bp of cuts by year-end, compared with our call for 75bp. Despite some adjustment this week, it is still surprising why the market is still pricing so much, but it may have more to do with Fed pricing. All ECB speakers so far this year, both hawks and doves, have delivered the same message of later rate cuts and we stick to our view.

If our call turns out to be right for Fed cut in March and ECB cut in June, EURUSD should find some support, keeping everything else constant. However, we believe that the Fed and overall risk sentiment matters more for FX. Even if the Fed starts earlier, if they deliver less cuts than the size that the market is currently pricing, it will be hard for the EUR to sustain a rally in h1, even if by the end of the year EURUSD is higher, as indeed we expect.

We could argue for some positive EUR risks for the meeting this week and the ECB pushback against market pricing. However, this message is not new and markets have so far ignored it. Therefore, we would not expect a sustained EUR impact. We believe that US data, the Fed, energy prices, geopolitics and overall risk sentiment matter more for EURUSD for now.

Exhibit 9: Core inflation, mom% bottom-up seasonally adjusted
Monthly SA rate suggests job on inflation is almost done



Source: BofA Global Research, Eurostat

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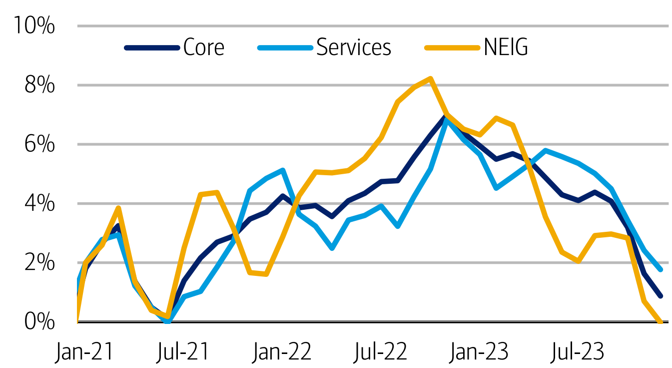
Exhibit 10: Inflation momentum
Clear downward momentum in inflation



Source: BofA Global Research, Eurostat

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JPY: 5 risks for 2024

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For more details, please see full report: Japan risks for 2024 18 January 2024.

Capital outflow, politics, JGB supply, JGB rating, BoJ

As 2024 has started, we identify Japan's idiosyncratic risks, which could impact asset pricing and volatility.

1. Acceleration in capital outflow: Japan's structural outflow could accelerate, putting the consensus USD/JPY short trade at risk.

2. Increased political risk on falling approval ratings: Depressed approval ratings of the LDP (Liberal Democratic Party) administration could lead to (internal) regime change, raising political and policy uncertainty.

3. Excess JGB supply: A combination of an increase in JGB net supply and weak JGB demand leaves the rates market vulnerable to a shock.

4. Tail-risk of a JGB downgrade: High level of outstanding public debt and fiscal deficit and renewed political uncertainty keeps tail-risk of JGB downgrade in place.

5. BoJ falling behind the curve: There are several alternative scenarios for the BoJ's policy path in 2024. But in each case, the BoJ is likely to be cautious, resulting in prolonged negative rates and policy behind the curve.

Market implications: higher vol and yen & JGB weakening risk in 2H24

These risk factors could lead to increased market volatility and are directionally negative for the yen and mostly negative for JGB. Timing-wise, these risks may rise from 2Q24 onward while near-term risks are more dominated by global factors and fiscal year-end seasonality.

Our JPY forecast remains bearish against the consensus (we expect USD/JPY at 142 at year-end vs Bloomberg consensus of 135). We are comfortable with our near-term outlook (145 at March-end) as the policy convergence theme would likely cap USD/JPY upside and exporter hedging could also weigh on the pair. That said, we think risks for the JPY still tilt to the downside, especially for 2H24 and 2025.

In the rates space, JGBs, especially in the superlong sector, may be supported by investor demand before fiscal year-end in March. However, we expect the 10yr JGB yield to rise to above 1% by year-end, reflecting the gradual normalization in BoJ policy and increased expectations that inflation will be sustained. Overall, the risk factors that we discussed above support our view that risks to consensus forecasts for JGBs are tilted to the downside (higher rates).

BoJ preview

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BoJ unlikely to boost JPY

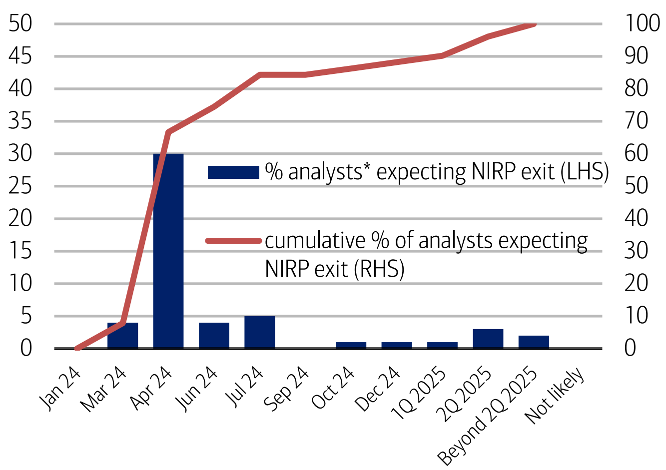
Our economists' base case is that the BoJ will exit from NIRP+YCC in April-July '24. Contingent on a soft landing in the US economy, they expect the BoJ to then proceed with two additional 25bp hikes in Oct-Dec '24 and Apr-Jun '25, to take the policy rate to 0.5% by mid-2025 (see our report, Japan Watch: BoJ Watch: Eyes on April 11 January 2024).

Against this base line, both positive and negative surprises would lead to a cautious BoJ as the BoJ is likely to take extra caution in case of a negative economic shock while it would still not rush to tighten policy in case of a positive shock (see our report, Liquid Insight: Japan risks for 2024 18 January 2024).

Thus, we do not expect the BoJ's policy normalization to drive JPY higher this year. Without significant new information on the economy and inflation, the January MPM is unlikely to be the primary driver of JPY in the near-term either. Instead, JPY would be driven by global factors and seasonality in 1Q24.

Our JPY forecast remains bearish against the consensus (we expect USD/JPY at 142 at year-end vs Bloomberg consensus of 135). We are comfortable with our near-term outlook (145 at March-end) as the policy convergence theme would likely cap USD/JPY upside and exporter hedging could also weigh on the pair. That said, we think risks for the JPY still tilt to the downside, especially for 2H24 and 2025.

Exhibit 11: Consensus expectations of BoJ NIRP exit (BBG survey)
~85% of analysts expect the BoJ to have exited NIRP by the July MPM



Source: BofA Global Research, Bloomberg BoJ Policy survey
Note: Based on the results of Bloomberg's BoJ Policy survey of analysts conducted between 10-15 January 2024 (N=51).
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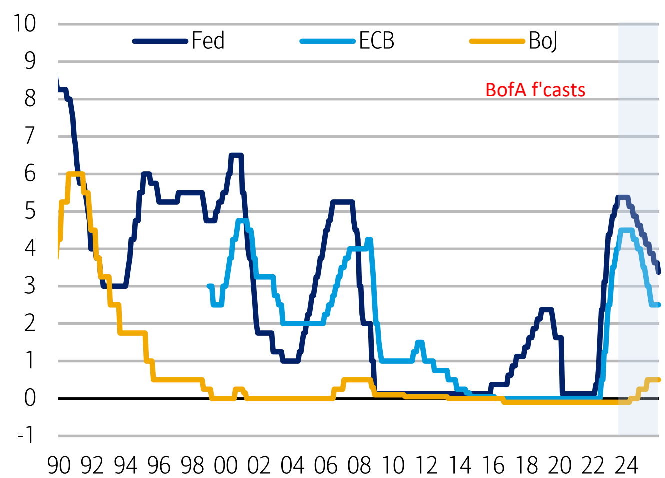
Exhibit 12: Big 3 central bank policy rates and BofA forecasts
BoJ normalization is expected to proceed very gradually



Source: BofA Global Research, BIS
BofA GLOBAL RESEARCH

BoC Preview

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Investors pared back on BoC rate cut pricing after recent Canada economic data
Into the new year, rates market has pared back on the pricing for BoC rate cuts for 2024 after recent data releases for Canada. Month-to-date, wage growth at 5.7% YoY remained high (Exhibit 13 and see Canada Watch: 05 January 2024), core CPI at 3.65% YoY remained sticky (Canada Watch: 16 January 2024), and inflation expectations (both consumer and business) from the Q4 '23 BoC Business Outlook Survey have been slow to trend down. Rates market was pricing more than 6 BoC rate cuts for 2024 at one point last month, but the pricing has since pared back to 4 cuts for the year.

Recent economic data confirms our view the BoC is unlikely to cut rates at this meeting, particularly given the BoC has also been relatively more hawkish than other major G10 central banks (Exhibit 14). Our economists expect BoC rate cuts to start in June 2024 and we expect 5 rate cuts for 2024 (Canada Viewpoint: 04 December 2023).

Exhibit 13: Wage data continues to rise in Canada and appears to be misaligned with achieving 2% inflation target
Average hourly wage for Canadian permanent workers YoY

Source: BofA Global Research, Bloomberg
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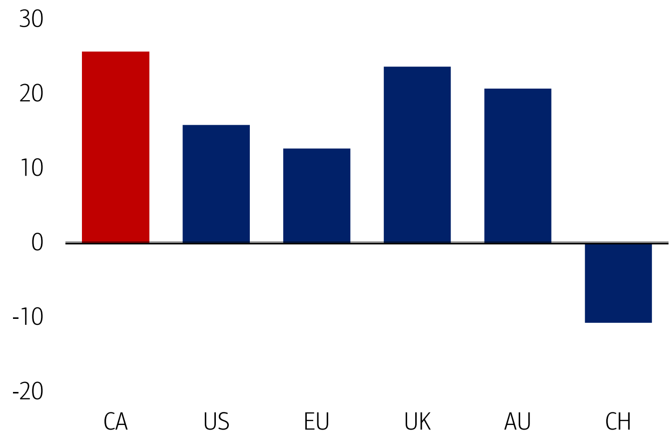
Exhibit 14: BoC has been one of the more hawkish central banks among major G10 countries
Q4 2023 average central bank speeches hawk-dove score



Source: BofA Global Research, Bloomberg. A higher score corresponds to more hawkish central bank communication; a lower score corresponds to more dovish central bank communication.
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Still see 1.34-1.35 as near-term fair value range for USDCAD
We continue to estimate 1.34-1.35 as the near-term fair value range for USDCAD. But should an equity risk-off shock materialize or growth data for Canada surprise to the downside, the pair could face short-term upside risks (FX Viewpoint: 16 January 2024). For the year as a whole, we hold a more constructive view on CAD vs the USD and see the pair falling to 1.30 by end of the year, mainly driven by bearish USD forces that are likely to play out later in 2024 (FX Viewpoint: 05 January 2024).

Norges Bank preview: the wait begins

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See full report for details: Norges Bank preview: now the wait begins 17 January 2024

Data supports a longish hold

Taking onboard the recent data, we mark-to-market our 2023/24 growth forecast to 1.0%/0.4% (-10bp both years). The Norwegian economy is stagnating – growth will likely stay very close to zero for the coming months, with clear risks of negative prints. While consumers are clearly feeling the pain of higher interest rates and sustained inflation, we still don't see any sharp recessionary momentum at play. Credit flows are slowing in an orderly way and even the housing sector remains resilient (especially vs Sweden).

On the inflation side, things are moving (slowly) in the right direction, with the stronger NOK likely helping down the road. But price pressures remain high overall. Wage growth is robust across sectors and the labour market's normalization appears to be slow. Domestic core goods prices look sticky, and rents are still rising fast. It will take time for underlying inflation to normalize. We continue to expect CPI-ATE to print >3% y/y at year-end.

We don't expect further rate hikes. But a resilient domestic economy and still-too-timid improvements on the inflation front will probably keep Norges Bank's policy rate stuck at 4.5% over 1H24.

But Norges projections are likely too hawkish

Norges Bank's December projections would imply one first full cut in 4Q24. While we agree that inflation is likely to remain more persistent than in the rest of DM Europe, we think their hawkish forecasts are likely to be surprised to the downside over time. We expect CPI-ATE to average around 4% this year vs 4.8% in the latest Norges forecast.

With the ECB and the Fed likely embarking on cutting cycles in 1H24, and underlying inflation likely to show some meaningful progress over 2Q/3Q, we see Norges Bank moving slightly faster than they currently project. Our baseline is for two cuts this year - we pencil-in a first cut in the September meeting.

NOK: constructive, more faith in the crosses near term

The upcoming Norges meeting will likely be a non-event for NOK. We are constructive on NOK for 2024, counting on (1) soft US landing & softer USD, (2) supported oil prices, (3) a relatively hawkish Norges Bank, and (4) more favourable petroleum-related NOK flows. But near term we are cautious, with the market pricing more & faster Fed rate cuts vs our base case, and a relative Norges stance close to our base case. We look for EURNOK &USDNOK slightly higher near term but at 10.90 and 9.48 at year-end, and we expect NOKSEK to gradually move toward 1.02 in the next months.

EM FX has become more idiosyncratic since COVID

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Full Report: EM FX has become more idiosyncratic since COVID 17 January 2024

PCA confirms structural shifts in EM FX after COVID

We run a principal component analysis (PCA) on major EM FX pairs against the USD. We use monthly frequency data and run PCA for: 1) January 2010-December 2019, and 2) January 2020-December 2023. For more details on methodology, see the Appendix. There have been a few notable structural changes in EM FX: 1) EM currencies have become more idiosyncratic and the first PC now explains the lower variation than pre-COVID, driven mainly by BRL and MXN; 2) the correlation sign between commodity prices and the first PC has changed; 3) global growth has become less important for EM FX after COVID. However, the broader dollar remains the main driver of EM FX and its first principal component.

EM FX is more idiosyncratic now than pre-COVID…

The first PC explains only 60% of the EM FX variance since COVID. It used to capture as much as 71% before the shock (see Chart of the day). Moreover, the average correlation between individual currency pairs and the first PC was 81% before COVID and only 67% after (Exhibit 15 - Exhibit 16).

Exhibit 15: 2010-19: correlation of EM FX pairs to principal components
Many EM currencies were driven primarily by PC1, a proxy for global factors

	PC1	PC 2	PC 3
BRL	0.96	-0.16	-0.03
CLP	0.97	-0.03	-0.01
CNY	0.52	0.16	0.78
COP	0.97	-0.09	0.13
CZK	0.9	0.2	-0.29
HUF	0.96	-0.01	-0.13
INR	0.89	-0.3	-0.26
IDR	0.94	-0.26	-0.16
ILS	0.12	0.81	-0.38
KRW	0.43	0.65	0.43
MYR	0.97	-0.03	0.09
MXN	0.95	-0.16	0.13
PEN	0.96	-0.04	0.12
PHP	0.84	-0.29	0.38
PLN	0.94	0.14	-0.12
SGD	0.82	0.41	0.27
ZAR	0.96	-0.15	-0.16
TWD	0.6	0.69	-0.04
THB	0.67	0.41	-0.33
TRY	0.82	-0.39	0.27

Source: Bloomberg, Haver, MATLAB, BofA Global Research; the table shows correlation of USDXXX with principal components

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Exhibit 16: 2020-23: correlation of EM FX pairs to principal components
EM FX has become more idiosyncratic after COVID driven by BRL and MXN

	PC1	PC2	PC3
BRL	-0.27	0.12	0.59
CLP	0.85	0.25	0.28
CNY	0.76	0.29	-0.53
COP	0.79	-0.17	0.33
CZK	0.49	0.83	0.16
HUF	0.89	0.05	0.32
INR	0.93	-0.29	-0.05
IDR	0.84	0.06	-0.03
ILS	0.76	0.04	-0.58
KRW	0.97	0.03	0.07
MYR	0.96	-0.07	-0.11
MXN	-0.47	0.76	0.33
PEN	0.17	-0.5	0.77
PHP	0.97	-0.15	0.06
PLN	0.81	0.15	0.45
SGD	0.32	0.88	0.19
ZAR	0.84	0.1	-0.28
TWD	0.9	0.11	-0.38
THB	0.91	-0.12	0.32
TRY	0.85	-0.44	-0.09

Source: Bloomberg, Haver, MATLAB, BofA Global Research; the table shows correlation of USDXXX with principal components

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…driven primarily by BRL and MXN

The more idiosyncratic nature of EM FX performance is most evident in the performance of the Brazilian real and Mexican peso. which had almost a perfect correlation (0.96 and 0.95, respectively) with the first PC before COVID. However, in January 2020-December 2023, the correlation dropped to -0.27 and -0.47. If we exclude BRL and MXN, the average correlation between an EM FX pair and the first principal component has not changed much. The change was most likely driven by the significant tightening of monetary policy as well as high real rates and carry in Brazil and Mexico, which resulted in a divergent performance of these currency pairs from the rest of EM FX.

Best RV trade – long BRL/MXN
Our favorite EM RV trade is long BRL/MXN (current: 3.51, open: 3.52). Risks are fiscal slippage in Brazil and strong inflows into Mexico due to nearshoring. Idiosyncratic nature of MXN and BRL performance after COVID allows us to focus on local fundamentals. We find BRL is vastly undervalued and MXN slightly overvalued. For the original report, please see LatAm FI & FX Strategy Viewpoint: Buy BRL/MXN – 2024 Macro Outlook Favors Brazil Over Mexico 28 November 2023.

Commodity prices have changed the correlation sign with the first PC
Another big difference between the pre- and post-COVID periods is the change in the correlation sign between commodity prices (oil and metals) and the first PC. If higher commodity prices were associated with a weaker USD and stronger EM FX before COVID, the correlation sign changed to the opposite one in 2020-23. This is especially true for oil, as it has become highly correlated with US terms-of-trade

PC1 = DXY+ core rates now; before COVID: PC1 = DXY + global growth + rates
DXY is still the main driver of the first PC now – as it was before COVID. However, other drivers have altered. Before COVID, global nominal growth (in particular, EM export volumes and oil prices), together with US real rates, also had a strong correlation with the first component, but after COVID US and Eurozone rates became much more important drivers of the first PC.

Cointegration analysis: PC1 is DXY + US real rates in both periods
Cointegration analysis suggests that PC1 is driven by DXY and US real rates for both periods under consideration. Simple correlation analysis might be misleading since our principal components and most explanatory variables are not stationary. The first PC has strong cointegration with DXY for both periods. Moreover, PC1 is cointegrated with the US 5y5y real rate in 2010-19 and with 10y real rate (albeit weakly) in 2020-23.

PC2 = US rates + credit spreads now; 2010-19: same factors + global growth
The key drivers of the second PC have not changed much since COVID. Before the shock, nominal global growth (mainly), as well as US rates and US BAA credit spreads (to a much lesser extent), were strongly correlated with the second PC.

Cointegration: PC2 is global growth + 5y breakeven (mainly) in 2010-19…
In 2010-19, PC2 was strongly cointegrated with EM exports (a good proxy for nominal global growth) and weakly so with US BAA 10y credit spreads and US 5y breakevens. This highlights that global nominal growth was an important driver of EM FX.

…and US credit spreads + US rates and VIX after COVID
However, in 2020-23, US BAA 10y credit spreads, the VIX index and, to some extent, US 5y breakevens became cointegrated with the second PC. Global nominal or real growth, and commodity prices are no longer cointegrated with PC2, highlighting the shifting relationship between global growth and EM FX.

PC3 mainly reflects idiosyncratic factors, in our view
There is no cointegration between PC3 and any of explanatory variables suggesting that it most likely reflects idiosyncratic factors. However, there are some changes in corelation trends. Since COVID, commodity prices (the EM export price) and nominal EM exports (which is a proxy for nominal global growth) have had the highest correlation with the third principal component. These variables are much less correlated with the first and second PC, suggesting commodity prices and global nominal growth are less important for EM DX now than in 2010-19. Before COVID, the third PC was strongly correlated with USDCNY, highlighting the importance of China.

Selling USDKRW on spike

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Strong sell-off in Korean equities in 2024

Despite the impressive rally we saw in the second half of December 2023, the KOSPI gave up the entirety of its December 2023 gains in the first three weeks of January 2024. The strong USD rally of this week pushed KOSPI lower to 2440 and USDKRW to 1,340, reconverging to the recent highs reached in late-October 2023 (at 1,360).

Domestically, Korea's export sector is performing quite well, led by a sharp rise in semiconductor exports, resulting in rising industrial production and manufacturing PMIs (see: Korea Watch: Monthly chart book #5: Mixed recovery in Nov-Dec; property sector rebound halted 16 January 2024). Internationally, we see recent divergence between the pricing of Fed cuts and the general path of the USD (Liquid Insight: USD: Defying gravity 17 January 2024). Although our G10 FX team warns that significant USD weakness would likely come in 2H24, we are not expecting a trend of USD strength in 1H24, unless the market pricing for Fed cuts begins to reduce from here.

Both those factors lead us to believe the recent decline in the Korean Won has been too aggressive and we like to fade the move by selling USDKRW 3-month outright (entry: 1332, target: 1292, stop: 1352). Primary risks to the trade include the market pricing in for significantly less Fed cuts and the materialization of geopolitical risks from the Middle East, resulting in a global risk-off reaction.

SOX performance to remain intact and we expect equity inflows to return

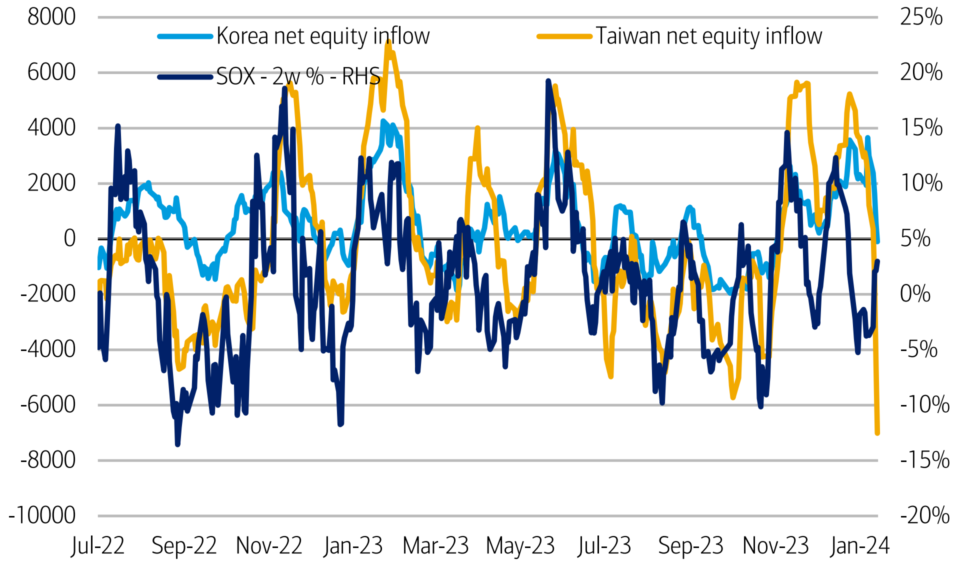
One of the key reasons why we think valuation of the Korean Won is stretched (too low) is the recent divergence between the SOX Index and KOSPI reaction, either in terms of net foreign flows or the reaction of USDKRW. Exhibit 17 shows the medium-term relationship between net equity flows to Korea and Taiwan and the performance of the SOX Index. We saw the in past week, there is a marked divergence between the performance of the SOX index and the net equity inflows into Korea and Taiwan. The divergence may partially be attributed to regional factors, as such as the outcome of Taiwan election which occurred over the past weekend. We think this divergence is temporary and net inflows into Korean and Taiwan equities should reconverge with the performance of the semi index at the global level.

Selling USDKRW on spike

Recent divergence between SOX and net equity inflows and USDKRW. Exhibit 17 shows the medium-term performance of the Korean Won and the SOX Index. Similar to the trends shown in Exhibit 17, we currently see a divergence between the performance of Korean FX and the SOX Index, which is partially driven by the net equity outflows shown earlier. Both these charts tell us, in the past three days, the performance of net inflows into Korean equities, and USDKRW, is not reacting to its typical principal driver: the SOX Index. As such, tactically, we expect reconvergence with the performance of the SOX Index, resulting in stronger equity inflows and a lower USDKRW.

Exhibit 17: Net equity flow to Korea and Taiwan (2wma, US$ Mn) and the SOX Index

Over the medium terms, net inflows into Korean and Taiwanese equities track the movement of the SOX index



Source: Bloomberg

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Sell COP – Petro risk premium is gone and monetary easing will be largest in LatAm

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Full Report: EM Alpha: Sell COP – Petro risk premium is gone and monetary easing will be largest in LatAm 16 January 2024

We recommend selling COP 3M forwards against a basket of LatAm currencies. We use an equal-weighted basket of BRL, CLP, MXN and PEN as the long side of the trade. We open the trade at an index value of 100 with a target of 92 and a stop of 104. Over a three-month period, the historical volatility of the trade is 6% (12% annualized) and the carry is -0.9% (-3.7% annualized). Risks to the trade are hawkish central bank surprises, stronger domestic growth, rising oil prices and further policy moderation.

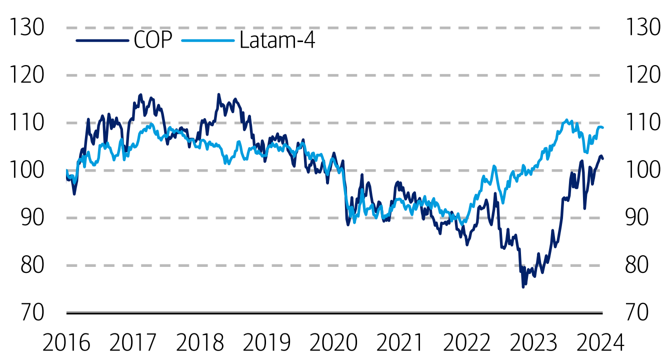
The Colombian peso outperformed all major world currencies strengthening by more than 20% in 2023, almost fully eliminating the risk premium built in 2022 due to President Petro's election (see Exhibit 18). Moreover, while the exchange rate is now in line with other EM currencies, it looks expensive relative to Colombia's local bond spreads (see Exhibit 19).

We believe Colombia's exchange rate should incorporate a larger risk premium. Macro fundamentals and crowded positioning will drive COP to underperform other LatAm currencies. Colombia's central bank will cut interest rates by more than the other central banks this year, reducing the favorable carry of the Colombian peso. And economic growth is also slowing down in Colombia by more than other economies in the region.

Colombia's monetary easing will be the largest.
All major regional central banks will ease monetary policy this year as inflation continues to decline, but Colombia's rate cuts will be the most aggressive. Over the next 12 months, markets are pricing 475bp of rate cuts in Colombia, 410bp in Chile, 245bp in Brazil, 210bp in Mexico and 150bp in Peru (see Exhibit 20).

We expect Colombia's central bank to surprise markets in an even more dovish direction: we forecast a terminal rate of 6% by 2025 relative to the 7% priced by markets. We do not expect similarly sized dovish surprises in the other regional economies. In Brazil and Mexico our terminal rates are only around 25bp lower than the market pricing, while in Chile we expect a terminal rate of around 100bp higher than the market.

Exhibit 18: COP's valuation back in line with rest of LatAm
Real effective exchange rates, rebased 2016 = 100. Latam-4 is equal-weighted average of BRL, CLP, MXN and PEN



Source: Haver Analytics

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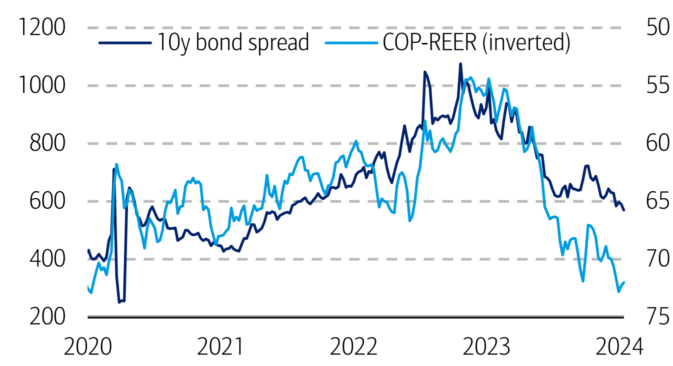
Exhibit 19: COP is expensive to TES bonds
Colombian peso looks expensive to ten-year TES bond yield spreads to US treasuries



Source: Haver Analytics

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Colombia's economy is underperforming

This week November's industrial production and retail sales data will be released, followed by the monthly economic activity index. Another round of negative numbers should put downward pressure on the Colombian peso by building expectations of faster interest rate cuts.

Minimum wage increases well above productivity

Petro's administration decided in the end to increase the minimum wage by 12%, slightly below the 13% consensus expectation. This likely removes one barrier for the central bank to perhaps accelerate the rate cut cycle.

Yet the 12% increase is still well above levels justified by productivity gains. Labor productivity contracted by 3% in 2023 given last year increases in real GDP and employment. Since headline inflation was 9.3% in 2023, an increase of around 6.5% in the minimum wage would have been consistent with productivity. The far larger increase announced by the government will reduce competitiveness and also put downward pressure on the exchange rate.

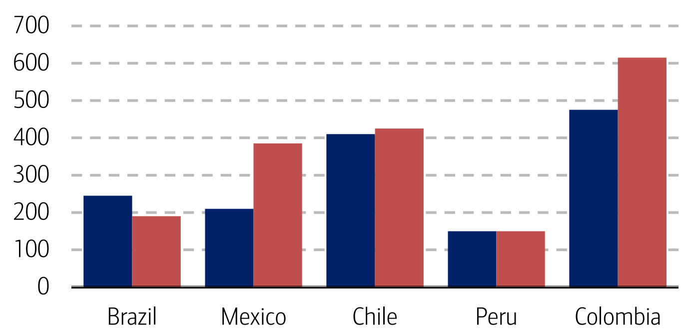
Risks: Corporate tax cuts and oil prices

In addition to a more hawkish monetary policy than priced and/or better growth than expected in Colombia relative to regional peers, 4 additional risks are worth mentioning.

First, Colombia's finance minister has recently said corporate tax rates should be cut to 30% from 35%. The proposal is likely to face resistance from the more leftist sectors of the administration, so it Is not clear it has high chances to be considered. But lower corporate taxes would be a boon to investment and so to the exchange rate.

Second, a worsening in the Middle East conflict might lead to sharply higher oil prices. The correlation between the Colombian peso and oil prices has declined in recent years, partly due to lower domestic crude oil production. And selling COP against a basket of LatAm currencies reduces the correlation further.

Exhibit 20: Colombia's central bank set to ease the most.
Cumulative rate cuts priced by end-2024 and end-2025



Source: Bloomberg

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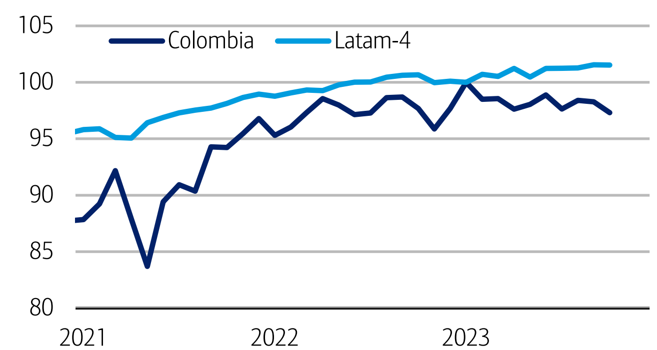
Exhibit 21: Colombia's economy is contracting.
Monthly economic activity indices, rebased January 2023 = 100



Source: Haver Analytics

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Third, Colombia's financing plan will be released in mid-February. The plan will include not only the expectations for issuance in local and external bonds during the year, but also updated 2023-end fiscal figures. We believe the market may be inclined to price a slightly lower risk premium if the data confirms a fiscal outperformance and a sharp contraction in the debt-to-GDP ratio in 2023. Finally, discussions around the pension, healthcare and labor reform will likely restart in mid-March, when the legislative session restarts. Our baseline is that the outcome will be relatively market friendly. However, while we believe this is mostly reflected in current market pricing, we think there could be scope for additional risk premium compression if these reforms are rejected.

Vol: Hedging potential USD bounce in Q1

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Please see full report for details: Hedging a potential USD bounce in Q1 16 January 2024

Bearish USD for '24 consensus and positioning is short

Bearish USD has been one of the top FX views in our 2024 Year Ahead publication (see G10 FX Year Ahead from 20 Nov '23). While we believe the USD has more room to sell off by YE '24, in the short-term the bearish USD view appears to be consensus with investors now net short. A USD bounce is a top risk for many macro investors. Here we discuss potential drivers for a near-term USD rally and ways to hedge this risk.

Scenario 1: An equity shock-driven USD rally

We believe a USD rally in Q1 is more likely driven by an equity risk-off shock than higher US yields. Our rates strategists continue to favor trading the recent range in yields with a bullish bias. They see 2yT at c.4% by year-end, with risks skewed to the downside, reflecting expectations for 4 Fed cuts in '24. In US equities, on the other hand, 4Q23 return ranks at a 94th percentile since '99. Geopolitical risks and macro events beyond the Fed may drive risk assets lower, supporting a USD rally.

Hedging scenario 1

3m 25d USD risk reversals vs cyclical G10 currencies like AUD, NZD and CAD look attractive as hedges for a scenario of an equity-driven USD rally. Since the 4Q23 USD selloff, short-dated risk reversals in these pairs have tilted to historically stretched level for USD puts. Cyclical currencies tend to weaken more vs the USD during risk-off equity selloffs and this should lead to some normalization of risk reversal for USD calls. Risks to these structures would be a resilient equity market in 1Q23.

Scenario 2: Data weakness outside of US

Negative economic data surprises outside of the US are also potential catalysts for a USD rally. Indeed, widening growth differentials between the US and rest of the world triggered the 2-months USD rally in 3Q23. We may see a repeat of this dynamic driven by weakness in overseas macro data.

Hedging scenario 2

We favor calendar spread structures to hedge scenarios where USD appreciates short term due to overseas macroeconomic weakness, but still sells off for 2024 as a whole in accordance with our core view. Recent data suggest that Canada and Sweden are the most vulnerable in G10. For investors that believe a USD selloff in '24 may be more backloaded, a 3m9m ATMF USD calendar put spread (own 9m USD put funded by 3m USD put) could cheapen the premium by around 50% compared an outright 9m USD put for the likes of CAD and SEK. The risk to this scenario would be resilient non-US economic data and a USD sells off earlier rather than later in '24.

Trade Recommendations G10

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Exhibit 22: Open trades G10
Current G10 FX trade recommendations. Prices as of 18-Jan-2024.

Trade Description	Open Date	Entry Price	Expiry Date	Current Price	Rationale	Risks
Buy 3m 1x1.5 GBP/SEK call spread	12-Jan-24	0.66% GBP (spot ref: 13.1008, vol refs: 7.95% and 7.47%)	12-Apr-24	13.24	Carry & our BoE v Riksbank outlook vs that priced are key reasons. Trade could also benefit from worsened risk sentiment	More dovish BoE and/or more hawkish Riksbank vs our calls and the UK budget. Positioning also presents some risks
Buy 3m 1x1.5 0.8320/0.95 EUR/CHF call spread	2-Jan-24	0.53% EUR (spot ref: 0.9320, vol refs: 5.8% and 5.25%)	3-Apr-24	0.94313	SNB symmetric reaction function implies intervention to weaken CHF or (more likely) less FX sales to taper balance sheet	SNB takes a more benign approach to CHF strength should inflation remain elevated
Buy EUR/USD	16-Nov-23	1.0859 (target 1.15, stop/loss: 1.04)	Spot trade	1.0863	The trade expresses our baseline cyclical bearish USD view for 2024 on the start of Fed rate cutting cycle and normalization of the overvalued USD	A later than expected start to the Fed rate cutting cycle
Buy 4m EUR/GBP vol swap	16-Nov-23	5.01 (target: 6.00, stop/loss: 4.50)	20-Mar-24	Accumulated 3.69% Current 2m implied vol at 4.58	EURGBP implied is at a historical low and should rise on diverging economic and fiscal outlook between EU and UK. Trade also used to diversification for the core bearish USD view for 2024	Persistent low vol regime in FX market into Q1 2024

Source: BofA Global Research

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Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
Buy 3m 1.90/1.86 GBP/AUD put spread
Sell EUR/NOK via 6m risk reversal (buy 6-month 11.35 put and sell 12.20 call)

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
Sell 1m 143.50/137.00 USD/JPY put spread

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description
Buy 1y 25-delta AUD/USD risk reversal (call strike 0.7391, put strike 0.6049)

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description
Buy CAD/MXN
Buy EUR/SEK via 3-month collar (buy 3m 11.8380 call, sell 3m 11.3143 put)

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
Buy 6m GBP/AUD put seagull (long 6m put spread with strikes at 1.94 and 1.90, short 2.05 call)

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
Sell 2m 0.89 USD/CHF put

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description
Sell 2m 25-delta OTM EUR/GBP put

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description
Buy USD/SEK via 3m collar (buy 3m 10.73 call and sell 3m 9.8960 put)

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
Buy 3m USD/CHF vol swap

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
Sell 1y 1.04 EUR/USD put
Buy NOK/SEK

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description
Enter 2m/6m USD/CAD put spread (sell 2m 1.40 put, buy 6m 1.40 put)
Buy AUD/CAD

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
Sell 3m 1.00/1.02905 EUR/CHF call spread

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description
Buy 4m USDJPY KI put with American barrier level at 131.50 and strike 128.11
Buy 3m 10.2466/10.70 USD/SEK call spread

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description
[illegible]
Buy 1m 1.00075 EURCHF call

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description
Buy 3 GBP/USD collar (sell 1.2850 call and buy 1.2000 put)

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description
Sell USD/NOK via 6m collar (buy 6m 9.0227 put and sell 6m 10.10 call)

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description
Sell EUR/CHF via 3m collar (long 0.98 put and short 1.00 call)

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
Buy 3m6m 25D USD/JPY put calendar spread (short 3m 25D OTM USDJPY put, long 6m USDJPY put; strike 132.70)

Exhibit 23: G10 FX Closed trades
Recently closed trades in G10 FX.

Trade Description
Buy AUD/NZD via 3m ATMF 1.0608/1.09 call spread

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
Sell GBP/USD via 3m 1x2 1.1107/1.0405 put spread

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
Buy NOK/SEK

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
Buy USD/JPY
Buy 3m EURGBP implied via vol swap

Exhibit 23: G10 FX Closed trades

Recently closed trades in G10 FX.

Trade Description
[illegible]

Source: BofA Global Research

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EM Alpha Trade Recommendations

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Exhibit 24: Open trades
EM Alpha Trade Recommendations

FX	Entry date	Entry level	Current level	Target	Stop	Notional	Rationale/ Time horizon	Risks
Sell COP vs LatAm FX basket	1/16/2024	100	99.5	92	104	10	Colombia's monetary easing will be the largest in LatAm going forward and its economy is slowing down more than the rest	Hawkish central bank surprises and stronger domestic growth in Colombia and rising international oil prices.
Short USDUZS using 3m NDF	1/5/2024	12,674	12,754	12,374	12,902	10	UZS to remain stable in the next 3m after 5% deval in 3Q23. Weak RUB caused August deval, but the RUB is supported now	The risk is an earlier-than-anticipated devaluation of the UZS
Short CNH, long basket	17-Nov-23	100	-	94	102	10	We expect CNH to underperform peers as PBOC will lean-in against appreciation in an effort to keep monetary conditions loose. Basket earns 8bps 3M carry	The risk to the trade is a large fiscal policy stimulus and economic recovery, ending the need for loose monetary policy and CNY appreciates aggressively in 6months.
3m USD call CNH put spread	17-Nov-23	39.8bps	-	7.30/7.55	-	10	Position for our contrarian view Q1 USD/CNY 7.55 forecast. 3.3% maximum payout for 8.5 times leverage	The risk to the trade would be an acceleration in fiscal policy stimulus, offsetting the need for further monetary stimulus and resulting in inflation and higher interest rates
Worst off 6M USD/IDR>5% OTMS, USDPHP>5% OTMS	17-Nov-23	32bps	-	Both 5%+ above spot	n/a	10	The rationale for the trade is that these are relatively small, open, current-account deficit economies vulnerable to global shocks such asa hard landing and/or geopolitical event	The risk to the trade would be the absence of a global recession and easing of global geopolitical tensions
Long BRL/MXN	11/17/2023	3.52	3.49	4.00	3.25	10	Rate differentials, the euro and US yields will favor BRL. We also find BRL undervalued and MXN overvalued. The macro outlook looks better for Brazil than Mexico.	Main risks against the trade are a larger budget deficit in Brazil given its higher debt levels and strong inflows into Mexico due to nearshoring and/or remittances.
Short USDZAR	11/15/2023	18.15	19.04	17.6	19.5	10	last support for USDZAR at 18.13 now at risk before a retest of YTD lows (17.63-17.42) and/or a lower low; USDZAR is a proxy for EM FX. Light positioning + weakening US data + dovish Fed + soft US CPI = stronger EM FX and ZAR.	The risk is sticky inflation and stronger-than-expected activity in the US.
Long USDHUF	10/12/23	363.56	349.0	382	338	10	Stronger USD + weak BoP fundamentals in Hungary + still long positioning + focus on growth in Hungary = long USDHUF.	Weaker broader dolla.
1yr USD/CNH vol swap at 6.175%	8/2/23	6.175	5.748	-	5.00	10	The rising use of CNY for cross-border trade settlement should help to cut FX risk for local corporates and reduce the inflation pass-through from imported goods.	Weaker USD environment is typically associated with lower FX volatility and a more favorable EM FX environment
Buy 6m 25-delta call option for USDTWD	8/1/2023	31.6	spot (31.58)	31.9	29.8	10	We like having a tail risk hedge to USDTWD, covering the period around Taiwan's Presidential election.	China announcing material fiscal stimulus
Short RONCZK	5/24/2023	4.77	4.97	4.53	4.92	10	RON is overvalued + current account in Romania is not improving (unlike the peers) => weaker RON; hawkish CNB => stronger CZK	The risk is crowded positioning in Czechia and delayed depreciation in Romania
Buy 1y USDHKD 7.7670/7.8500 call spread	3/29/23	Spot 7.8499	7.82	7.7670/7.8500	-	10	Forward points in HKD is very low given the outperformance of HK vs US rates following the increase in US banking sector risk	aggressive rally in US rates that significantly closes the HONIA-SOFR spread.

Source: BofA Global Research. Spot values as of January 18 2024. Bid/offer spreads accounted for in initiation and closing levels. Does not reflect tax withholdings or any investment advisory fees. Past performance is no guarantee of future results. A complete performance record is available on request. Inception date – July 4, 2016 Initiation and closing prices are priced as of trade publication. For additional discussion of baseline views, valuation and risks to open trades, please see links to detailed reports.

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Exhibit 25: Closed trades
EM Alpha Trade Recommendations

Trade description	Entry date	Entry Level	Target	Stop	Notional	Close date	Level closed
Long EURZAR	10/2/2023	20.150	21.15	19.6	10	16-Nov-23	19.7
Long INRUSD	1/18/2023	81.65	80	83	10	28-Sep-23	93.26
Short SGD/KRW	9/20/2023	974	945	990	10	28-Sep-23	969
Sell MXN/ZAR	9/25/23	1.09	1.02	1.13	10	28-Sep-23	1.04
Buy USD/PEN	5/4/23	3.72	3.8	3.68	10	28-Sep-23	3.8
Long USDHUF	9/20/2023	358.4	375	347	10	28-Sep-23	47.96
Buy ZAR/CLP	9/7/23	45.08	48.6	44	10	25-Sep-23	4.6851
Long EURPLN	5/17/2023	4.5	4.725	4.365	10	12-Sep-23	4.6851
Short USDZAR through a call spread	8/9/2023	19.06 (for USDZAR)	-	-	10	23-Aug-23	0.57
Short EURHUF	8/4/2023	391.7	372.1	403.5	10	23-Jul-23	383.4
Sell CNH/CLP	6/15/2023	111.7	108	113.6	10	4-Aug-23	118
Short EURZAR	3/1/23	19.35	18.43	22	10	27-Jul-23	19.42
Buy a 3m digital call option on USDZAR	6/20/2023	23	17	18.7	10	5-Jul-23	35.5
Lond USDILS	6/15/2023	3.58	108	113.6	10	5-Jul-23	3.73
Short USDZAR	3/23/2023	18.16	17	18.7	10	15-Jun-23	18.2
Sell MXN/CLP	5/22/23	44.85	42.00	47.00	10	15-Jun-23	46.37
Long USDPLN	3/8/2023	4.43	4.65	4.0	10	15-Jun-23	4.12
Sell USD/BRL	5/31/2023	5.08	4.85	5.2	10	13-Jun-23	4.85
Long KZT vs basket of USD and EUR via 3m NDF	5/25/2023	494.1	470	512	10	1-Jun-23	470
Sell EUR/BRL	23/Feb/23	5.43	5.20	5.80	10	18-May-23	5.34
Short PLNHUF	4/25/2023	82	77.9	84.5	10	15-May-23	81.95
Pay PHP NDF Points	3/8/2023	12	25	5	10	9-May-23	16
Long EUR/CZK	27-May-22	24.7	25.9	22.5	10	4-May-23	23.5
Sell CNH/MXN	26-Oct-22	2.72	2.50	2.90	10	24-Apr-23	2.60
SELL USDZMW VIA 9M NDF	3/6/23	22.05	20	24	10	11-Apr-23	18.53
Sell ILSCZK	3/14/2023	6.12	5.6	6.5	10	11-Apr-23	5.9
Short PLNHUF	3/17/2023	84	79.8	86.5	10	29-Mar-23	81.3
Long USDTWD 12m NDF	11/18/2022	31.17	-	29.45	10	27-Mar-23	29.37
Short USDIDR	2/16/2023	15110	14700	15400	10	8-Mar-23	15400
short ILSZAR	2/2/2023	81.65	4.74	5.14	10	13-Feb-23	4.98
Long USDILS	19-Oct-22	3.54	3.72	3.2	10	13-Feb-23	3.542
Short CZKHUF	1/18/2023	16.53	15.7	17.05	10	13-Feb-23	16.25
Long KZT vs an equal basket of USD and EUR (3m NDF)	1/16/2023	494.9	470.2	509.7	10	15-Feb-23	468
Short EURGEL (using 3m NDF)	20-Oct-22	2.714	2.94	2.53	10	1-Feb-23	2.53
Buy USDZAR	1/19/2023	17.23	17.86	16.85	10	1-Feb-23	14
Short INR vs long IDR	11/18/2022	191.9	183	188	10	18-Jan-23	184.7
Sell CAD/MXN 3m forward	29-Sep-22	15.1	14	15.5	10	18-Jan-22	14.68
Sell EUR/MXN 3m forward	29-Sep-22	20.06	19.00	21.00	10	18-Jan-22	19.72
Long USDZAR	15-Nov-22	17.3	18	16.9	10	1-Dec-22	17.6
Short EURKZT using 3m NDF	4-Oct-22	493	468.37	507.8	10	31-Oct-22	478
Short PLN/HUF	23-Sep-22	85.3	81	93	10	10-Nov-22	85
Long THB NEER	17-Jun-21	112.27	112.27	111	10	14-Oct-22	100.6
Long THB	19-Nov-21	32.60	30.0	34	10	14-Oct-22	38.08
Long 1x2 3M USD call, PHP put spread	16-Mar-22	52.975	53.5 / 54.75	-	10	14-Oct-22	53.48

Note: Bid/offer spreads accounted for in entry and closing levels. Does not reflect tax, withholdings or any investment advisory fees. Past performance is no guarantee of future results. A complete performance record is available on request. Inception date – July 4, 2016. For additional discussion on baseline views, valuation and risks to closed trades, please see links to the relevant reports. Trade recommendations are highlighted green when the closing value is greater than the entry value and red when the closing value is less than or equal to the entry value. **Source:** BofA Global Research

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World At A Glance Projections

Exhibit 26: G10 FX Forecasts
Forecasts as of 11-Jan-2024

	Spot	Mar-24	Jun-24	Sep-24	YE 2024	Mar-25	Jun-25	Sep-25	YE 2025
G3									
EUR-USD	1.10	1.07	1.10	1.15	1.15	1.16	1.17	1.18	1.20
USD-JPY	146	145	143	142	142	140	138	136.00	136
EUR-JPY	160	155	157	163	163	162	161	160.00	163
Dollar Bloc									
USD-CAD	1.34	1.35	1.34	1.32	1.30	1.30	1.30	1.30	1.30
AUD-USD	0.67	0.66	0.68	0.71	0.71	0.71	0.71	0.71	0.71
NZD-USD	0.62	0.60	0.62	0.63	0.63	0.63	0.63	0.63	0.63
Europe									
EUR-GBP	0.86	0.87	0.87	0.88	0.88	0.87	0.87	0.86	0.86
GBP-USD	1.27	1.23	1.26	1.31	1.31	1.33	1.34	1.37	1.40
EUR-CHF	0.93	0.96	0.96	0.97	0.97	0.98	0.98	0.99	1.00
USD-CHF	0.85	0.90	0.87	0.84	0.84	0.84	0.84	0.84	0.83
EUR-SEK	11.20	11.70	11.40	11.20	11.10	11.10	11.00	10.90	10.80
USD-SEK	10.22	10.93	10.36	9.74	9.65	9.57	9.40	9.24	9.00
EUR-NOK	11.33	11.60	11.30	11.00	10.90	10.90	10.80	10.70	10.60
USD-NOK	10.34	10.84	10.27	9.57	9.48	9.40	9.23	9.07	8.83

Source: BofA Global Research, Bloomberg. Note: Forecasts as of 11-Jan-2024.

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Exhibit 27: EM FX Forecasts
Forecasts as of 11-Jan-2024

	Spot	Mar-24	Jun-24	Sep-24	YE 2024	Mar-25	Jun-25	Sep-25	YE 2025
Latin America									
USD-BRL	4.89	5.00	4.95	4.85	4.75	4.78	4.82	4.90	5.00
USD-MXN	17.01	17.80	17.90	18.30	18.50	18.70	18.90	19.10	19.50
USD-CLP	916	900	880	870	875	880	885	890	900
USD-COP	3,941	4,080	4,150	4,100	3,950	3,950	4,000	4,050	4,100
USD-ARS	815	1,198	1,573	1,926	2,330	2,797	3,336	3,924	4,500
USD-PEN	3.70	3.78	3.77	3.76	3.75	3.76	3.78	3.79	3.80
Emerging Europe									
EUR-PLN	4.35	4.36	4.33	4.29	4.25	4.24	4.23	4.21	4.20
EUR-HUF	379.54	390	395	400	399	387	375	362.00	350
EUR-CZK	24.66	24.80	25.20	24.80	24.30	23.90	23.50	23.00	22.60
USD-RUB		76.00	77.00	78.00	80.00				
USD-ZAR	18.64	18.60	18.50	17.70	17.80	17.90	18.00	18.20	18.40
USD-TRY	30.01	32.00	35.00	37.00	40.00	42.00	44.00	45.00	47.00
EUR-RON	4.97	5.01	5.02	5.04	5.05	5.13	5.21	5.28	5.36
USD-ILS	3.75	3.90	3.80	3.70	3.50	3.50	3.45	3.40	3.40
Asian Bloc									
USD-KRW	1,312.80	1,300	1,260	1,250	1,230	1,210	1,190	1,170.00	1,150
USD-TWD	31.10	32.30	31.70	31.40	31.15	30.85	30.60	30.35	30.15
USD-SGD	1.33	1.34	1.33	1.29	1.26	1.25	1.24	1.23	1.22
USD-THB	35.05	35.50	35.50	35.00	34.00	33.50	33.00	32.50	32.00
USD-HKD	7.82	7.83	7.83	7.80	7.78	7.76	7.75	7.75	7.75
USD-CNY	7.16	7.55	7.40	7.10	6.90	6.90	6.80	6.80	6.70
USD-IDR	15,549	15,400	15,400	15,300	15,200	15,200	15,100	15,100	15,000
USD-PHP	55.98	56.50	56.00	55.50	55.00	54.50	54.00	53.50	53.00
USD-MYR	4.64	4.70	4.60	4.60	4.50	4.40	4.30	4.20	4.10
USD-INR	83.03	83.00	82.50	82.00	82.00	81.50	81.00	81.00	81.00

Source: BofA Global Research, Bloomberg. Note: Forecasts as of 11-Jan-2024.

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