Liquid Insight

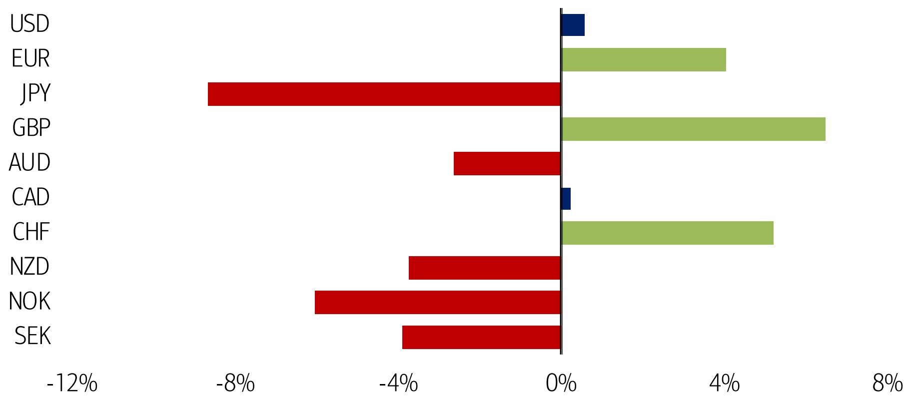
G10 FX RV to end the year

Key takeaways

- Looking beyond the USD, several G10 crosses have had outsized year-to-date moves in the FX market.
- We focus on EUR/AUD, CHF/JPY, and GBP/SEK; discuss drivers of the rallies and catalysts for these crosses to reverse lower.
- As well as risks to our outlooks for rest of the year.

By Howard Du & Vadim Iaralov

Chart of the Day: Year-to-date returns for G10 FX trade weighted indices
European majors gained the most in 2023; JPY and G10 high-betas depreciated the most



Source: BofA Global Research, Bloomberg

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Catalysts for G10 RV retracements

Year-to-date in the G10 FX space, European majors (EUR, GBP, and CHF) have led in gains while the high-betas (AUD, NZD, NOK, and SEK) and JPY have lagged behind (Chart of the Day). Amid choppy price actions for the USD, crosses like EUR/AUD, CHF/JPY, and GBP/SEK have all seen outsized rallies in 2023, respectively up by around 7%, 18% and 10% vs beginning of the year spot levels. We discuss drivers of the rallies, catalysts and risks to for the rallies to retrace lower. We find compelling reasons for the year-to-date EUR/AUD and GBP/SEK rallies to see retracements in Q4 2023, while the CHF/JPY reversal may come later in 2024.

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Rates and Currencies Research
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RV: Relative Value
TWI: trade weighted index
REER: real effective exchange rate
PMI: Purchasing Managers' Index
ECB: European Central Bank
BoJ: Bank of Japan
BoE: Bank of England

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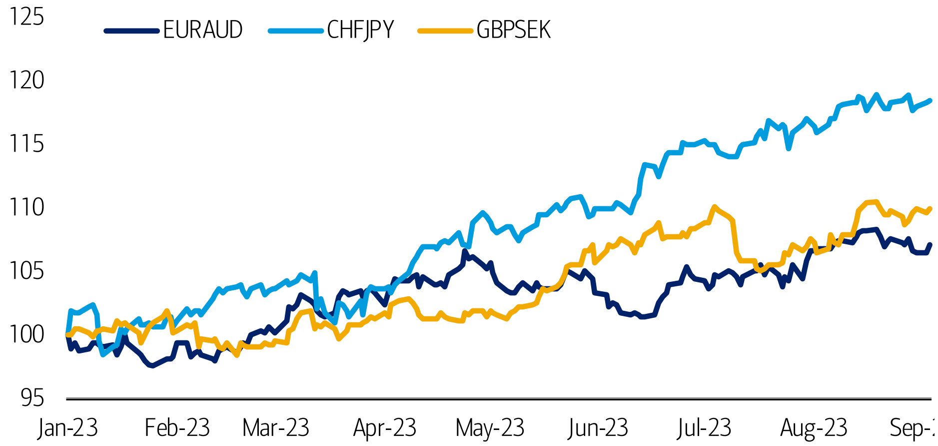
Looking beyond the USD in 2023

Amid a tug-of-war between bears and bulls, the USD has moved in a choppy range in 2023. Our team maintains the view that USD still has short-term upside risks but should sell off more significantly in 2024 (see the report FX Viewpoint: 03 August 2023). Looking beyond the USD, European majors gained the most in G10 while JPY and the high-betas lagged (Chart of the Day). As a result, several G10 crosses have had sizable moves. In this note, we examine year-to-date rallies for EUR/AUD, CHF/JPY and GBP/SEK (Exhibit 1) and discuss the catalysts that would trigger reversals for these crosses.

Exhibit 1: EUR/AUD, CHF/JPY, and GBP/SEK year-to-date cumulative returns in 2023
All 3 crosses saw sizable gains in 2023



Source: BofA Global Research, Bloomberg. Normalized to Jan 3 2023 = 100

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Lower EUR/AUD on ECB pause and better global growth outlook

Year-to-date, EUR/AUD has gained around 7%; magnitude of the rally ranks at 88th percentile over the past 20 years. We believe the rally was driven by three reasons:

1. High expectation of ECB rate hikes since the hawkish meeting in December 2022 (Europe Economic Weekly: 16 December 2022) had supported the EUR for most of this year.

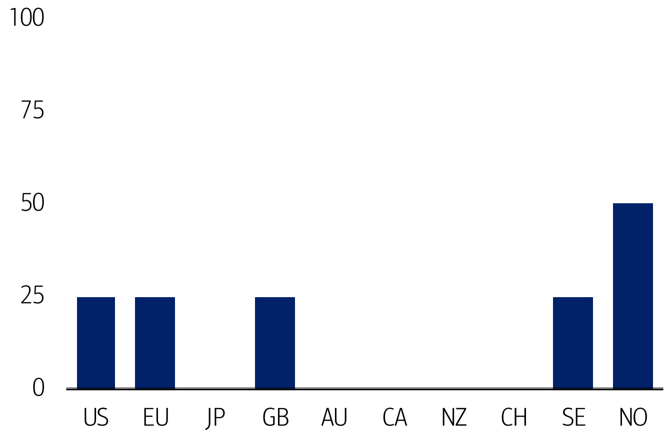
2. Economists' forecast of a weak global growth backdrop for majority of H1 2023 weighed on G10 high-beta currencies including the AUD.

3. Bearish China sentiment since Q2 put further pressure on AUD and NZD in G10.

Looking ahead, all 3 drivers have either played out or may reverse course, in our view. Global central banks are broadly at the end of the current rate hike cycle (Exhibit 2), and our economists expect at most one more rate hike by the ECB (Europe Economic Weekly: 11 August 2023). Market pricing of further ECB rate hikes has also pared back recently due to weak Eurozone PMIs. With consensus view looking past the regional bank shock and converging to a US soft landing scenario, economists have gradually raised the global growth outlook for 2023 to 2.7 from 2.1 at start of the year (Exhibit 3). Finally, economic surprise index has been rising for China since mid-July, and our economists expect China sentiment to further improve in the near term on the back of more active policymaker responses (China Watch: 28 August 2023). With all three bullish EUR/AUD drivers fading or reversing course, the pair could retrace some of the year-to-date gains, in our view. Risk would be lack of coordinated stimulus measures from China by October.

Exhibit 2: We expect majority of G10 central banks will have at most one more rate hike to go

BofA economists' projection of future G10 central bank rate hike



Source: BofA Global Research, Bloomberg

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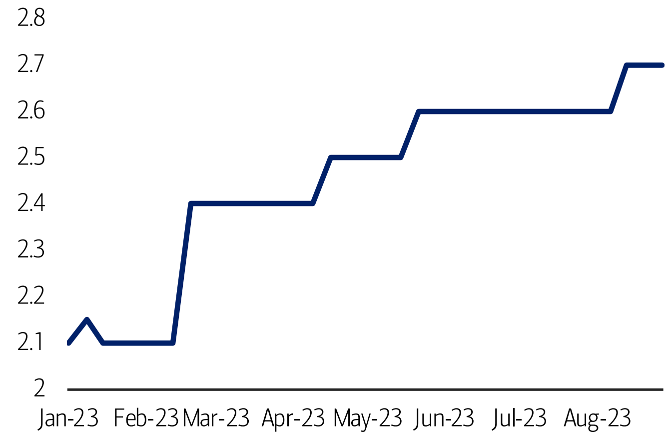
Exhibit 3: Economists have gradually raised global growth outlook as the year progressed

Evolution of Bloomberg consensus 2023 global growth forecast



Source: BofA Global Research, Bloomberg

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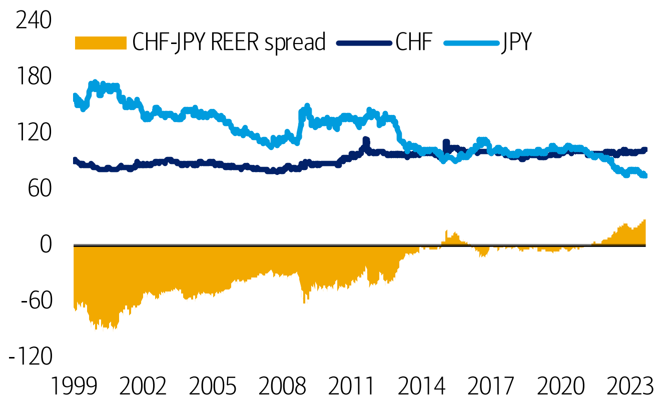
Catalysts for CHF/JPY to normalize lower from a historical peak

Year-to-date, CHF/JPY has gained around 18%; magnitude of the rally ranks at 97th percentile over the past 20 years and CHF/JPY spot has appreciated to a historical peak. In real terms, the CHF-JPY REER differential is also at the historically widest level. We have been arguing for carry as a bearish JPY factor in 2023 (FX Watch: 08 August 2023). But looking at yields across G10 currencies, carry should not have mattered nearly as much for CHF/JPY as for other JPY-crosses (Exhibit 5).

We have also been flagging CHF overvaluation throughout the year (FX Viewpoint: 21 June 2023). But as noted in Diverging time zone trends for the USD (09 August 2023), bulk of the year-to-date CHF/JPY rally had occurred during Asia trading sessions. Asia-based investors are using short JPY positions to fund longs for another low-yielding currency like the CHF. Asia hour flow would need to reverse in order for CHF/JPY to fall from a historical peak, in our view. We see this as more likely to happen in 2024, given our economists believe the BoJ is unlikely to implement further monetary policy changes for the next several meetings (FX Watch: 08 August 2023). Risk is more BoJ monetary policy shifts still happening this year, earlier than our economists' view.

Exhibit 4: CHF REER is close to the highest and JPY REER is around the lowest level since 1999
CHF vs JPY REER



Source: BofA Global Research, Bloomberg

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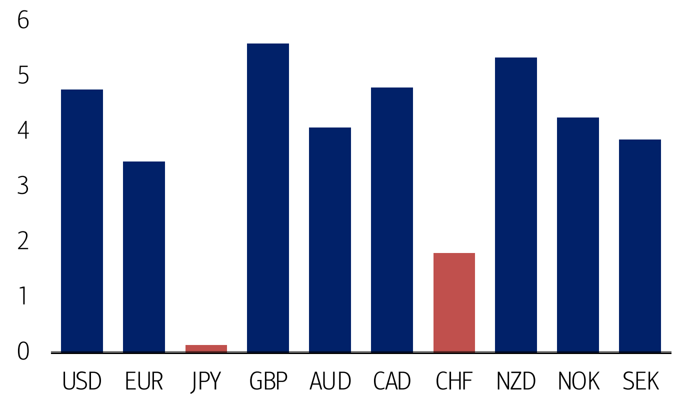
Exhibit 5: Carry is not nearly as supportive of higher CHFJPY as other JPY-crosses
2y G10 yields: JPY and CHF have the lowest yields in G10



Source: BofA Global Research, Bloomberg

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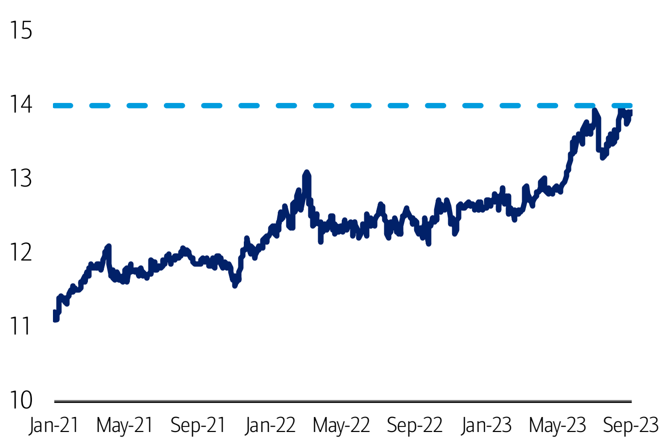
Lower GBP/SEK on spot resistance and growth outlooks

Year-to-date, GBP/SEK has gained around 10%; magnitude of the rally ranks at 97th percentile over the past 20 years. The pair touched the 14.00 level twice over the past two months, but was unable to break above this resistance (Exhibit 6). Throughout 2023, we have held a cautious outlook on SEK given concerns regarding real-estate stemmed hard landing risk for Sweden (European Viewpoint: 24 July 2023). On the other hand, relatively more resilient growth data in the UK has allowed the BoE to out-hike the Riksbank, supporting GBP.

Looking ahead, consensus forecast sees QoQ growth turning positive for Sweden from Q4 2023 onward, while QoQ growth for the UK is projected to trough to around 0% some time between Q4 2023 to Q1 2024 (Exhibit 7). Notably we also find increased investor interest to short GBP after recent UK PMI disappointment (FX Quant Insight: 28 August 2023). To the contrary, Swedish PMI appears to have troughed around May-June. With current spot still near the 14.00 resistance level, relatively better growth outlook for Sweden vs the UK may be a catalyst for GBP/SEK to retrace lower in Q4 2023, in our view. The risk is weaker than expected future growth data for Sweden and better than expected future growth data for the UK.

Exhibit 6: GBPSEK rally was rejected twice at the 14.00 resistance level
GBP/SEK spot



Source: BofA Global Research, Bloomberg

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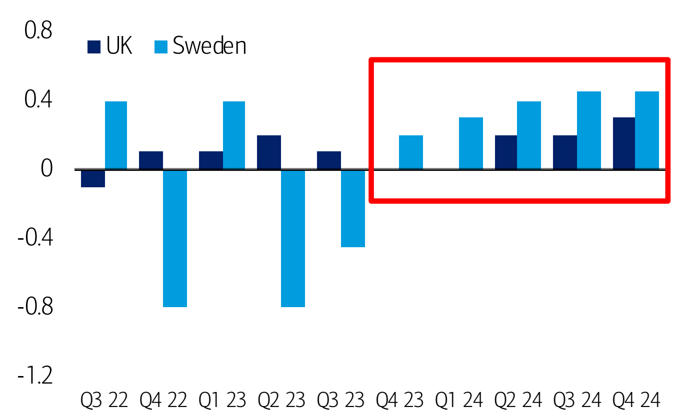
Exhibit 7: Consensus expects Sweden growth to pick up after Q3 23 and for UK growth to trough in Q4 23 and Q1 24
Actual and consensus forecast for UK vs Sweden QoQ GDP



Source: BofA Global Research, Bloomberg. Chart shows actual QoQ GDP SA up to Q2 2023 and Bloomberg consensus forecast from Q3 2023 TO Q4 2024.

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Notable Rates and FX Research

- **Global Rates, FX & EM Year Ahead 2023 –** Year Ahead 2023: Pivot ≠ Peak, 20 Nov 2022
- Little else matters **Global FX Weekly**, 1 Sep 2023
- Belabored day **Global Rates Weekly**, 1 Sep 2023
- Support for USD vs. GBP, CHF, CAD; EM interventions, **Liquid Cross Border Flows**, 21 Aug 2023

Rates, FX & EM trades for 2023

For a complete list of our open trade recommendations, as well as our trade recommendations closed over the past 12 months, see the reports below:

Global FX weekly: Little else matters 01 September 2023

Global Rates Weekly: Belabored day 01 September 2023

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