FX Viewpoint

G10 FX: 24 Charts for 2024

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G10 FX Strategy
Global

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Key takeaways

- We share 24 key G10 FX charts as we start '24, covering: f'casts, positioning, valuation, individual ccys, vol, quant & techs
- Key takeaways: we see the USD depreciating broadly, beyond consensus by year-end; FX vol to rise from subdued '23 levels
- Most G10 undervalued vs USD, amid modest positioning. Fed cuts and risk appetite should pave the way for USD downside

G10 Currencies: Our favored charts

A picture tells a thousand words- for each currency, we present some of our favored charts of key drivers for the year ahead.

FX & CB Forecasts: Reduced US carry advantage & USD depreciation

Amid the expected global easing cycle, we forecast central bank policy rate differentials (vs. fed funds) to narrow (i.e. less advantage to the USD) for all currencies except CAD and NZD in 2024. We see USD underperforming most consensus forecasts (ex-JPY and NZD), as Fed cuts should matter more for FX.

Valuation & Positioning: USD still overvalued

By any measure, the USD remains mostly overvalued vs the G10. Once global rates start to come down, currencies can move in the direction of equilibrium. Nevertheless, FX positioning is not extreme, and USD in particular remains neutral according to our data.

FX Volatility: Poised to rise from 2023 levels

Coming off from a low 2023 base, we expect FX vol to spike higher in 2024 on start of Fed cutting cycle and US election risk.

FX Quant: Europe-based investors have not sold the USD

FX was driven predominantly by rates factor and monetary policy in 2023, with diverging time zone patterns. 2023 USD selloff largely occurred in US trading hours; USD could fall more in 2024 on European-hour supply.

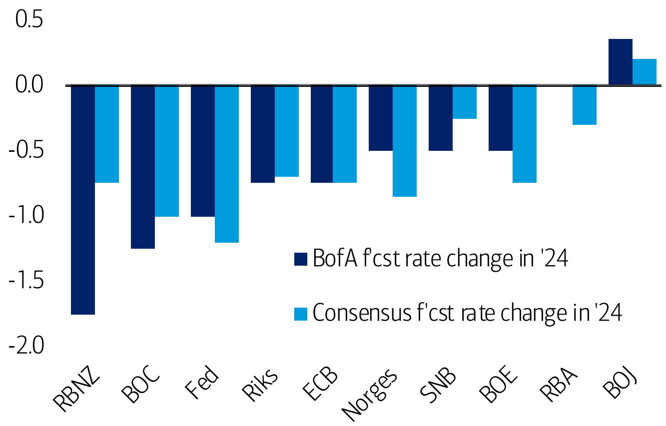
Technicals: DXY trend sideways- to- lower

DXY wave C down to at as much as 97.50. Bonds vs BBDXY: Classic Elliott wave trend of 5 down and now 3 up. We think bond prices outperform the BBDXY index which favors yields lower and USD weaker.

FX and central bank forecasts

Chart 1: BofA vs. consensus forecast policy rate changes in 2024 (ppt)

We forecast Fed cuts only to be exceeded by BOC and RBNZ in 2024. Fed, BoE, and Norges to disappoint consensus expectations



Source: BofA Global Research; Bloomberg

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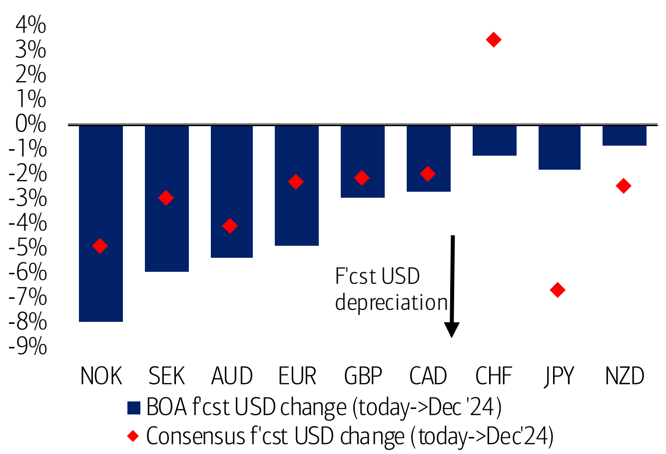
- Amid the expected global easing cycle, we forecast central bank policy rate differentials (vs. fed funds) to narrow (i.e. less advantage to the USD) for all currencies except CAD and NZD in 2024. (Chart 1)
- These forecasts are either in-line with, or less than consensus for most in the G10. The main exceptions are for the Fed, Norges bank and BoE, where we expect fewer rate cuts than the consensus.

Chart 2: Implied USD move through YE 2024 based on BofA and consensus forecasts

We are more bearish USD vs most of G10 except JPY and NZD



Source: BofA Global Research; Bloomberg

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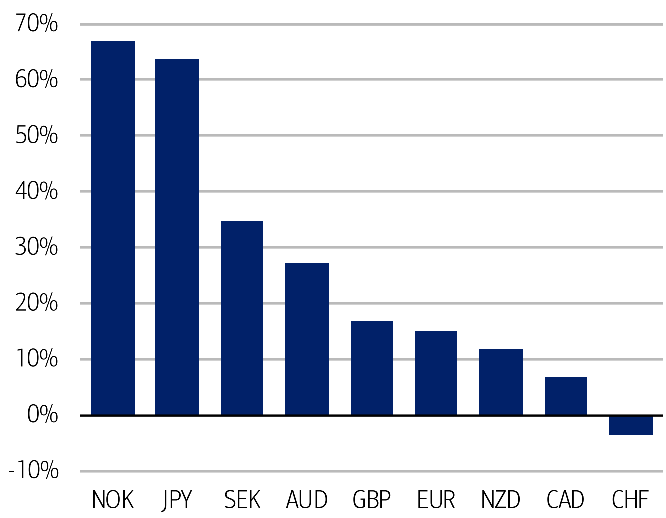
- Nevertheless, most of our G10 FX forecasts through YE 2024 reflect a more bearish USD view compared to consensus, with notable exceptions of USDJPY and NZDUSD. (Chart 2)
- Ongoing disinflation and eventual US growth recoupling towards the rest of the world should allow the USD to eventually underperform, bringing currencies back towards equilibrium.
- For more, see: World at a Glance: Kickoff for the new year 04 January 2024

Valuation & Positioning

Chart 3: Misalignment from equilibrium, USD G10 crosses, based on BEER model (positive for overvalued USD)

NOK, JPY most undervalued, CHF, USD most overvalued in G10



Source: BofA Global Research

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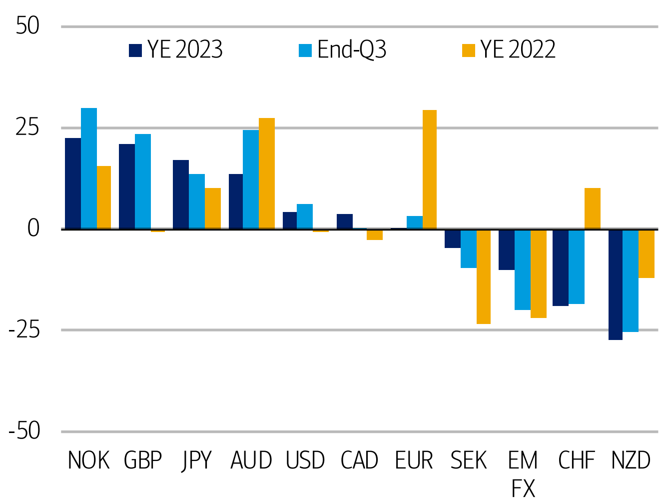
- The USD remains overvalued vs. all G10 currencies, except the CHF. JPY and NOK remain the most misaligned using the Behavioral Equilibrium Exchange Rate (BEER) model. (Chart 3)
- As noted above, we believe currencies can begin to move towards fair-value once central banks begin to normalize monetary policy.
- This is broadly consistent with other exchange rate models, including our dynamic factor model for FX.

Chart 4: FX positioning at end-2023

BofA investors are roughly neutral on USD, long rest of G10, and short EM FX



Source: BofA Securities. Weekly data through Dec 29. +50 (-50) represents max long (short) positioning level vs history. Ranking based on equal weights for HF and RM.

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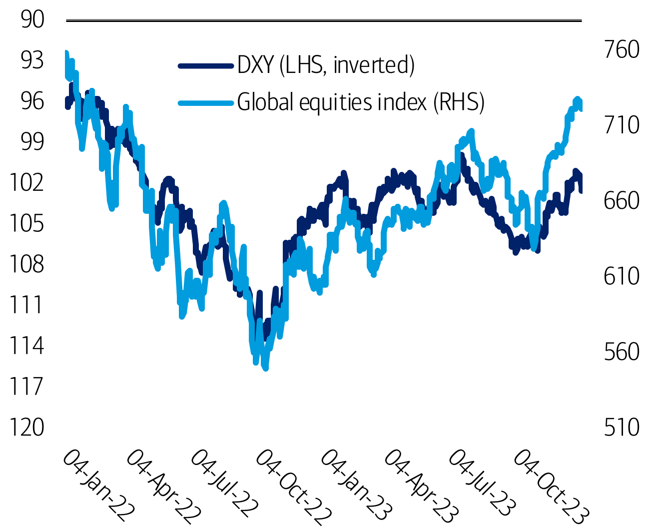
- Despite the USD's overvaluation and consensus expectations for depreciation in 2024, our proprietary flow data suggests investors are positioned roughly neutral on USD and short EM FX (Chart 4).
- No G10 FX positions appear particularly stretched, but not all are light either: BofA investors remain long NOK, GBP, JPY, and AUD, and short NZD and CHF.
- For more detailed look at positioning, see our most recent publication: Liquid Cross Border Flows: USD breather 08 January 2024

G10 Currencies

USD

Chart 5: DXY and global equities

Recent USD weakness consistent with risk rally and could have more to go



Source: Bloomberg and BofA Global Research.

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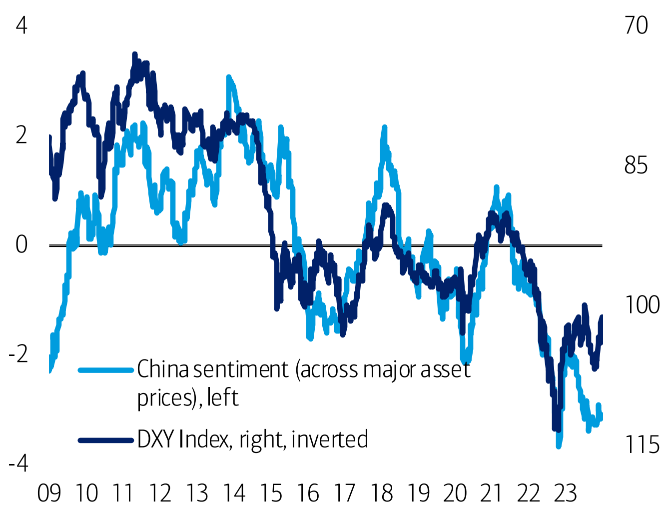
- In addition to the impact of a lower interest rate outlook, the USD has recently depreciated alongside the rally in risk assets. (Chart 5)
- This poses further downside risks, should these inter-related trends continue.
- For more, see: [Liquid Insight: Kickoff for the new year in G10 FX 08 January 2024]

Chart 6: Chart: China reflation sentiment vs. DXY (inverted)

China sentiment remains depressed - a recovery would reinforce USD downtrend



Source: Bloomberg, China sentiment = first PCA component across HSCEI, 10y CGB, CNY, iron ore, high yield credit

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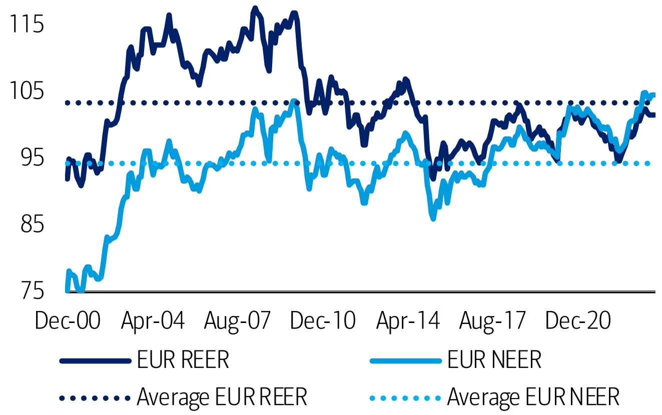
- Meanwhile, the USD has broadly benefited from weak China sentiment over the past few years. (Chart 6)
- A recovery in China (from near-peak pessimism) could be another catalyst for USD downside this year.
- Our recent FX & Rates Sentiment Survey suggests investors are mildly constructive on China growth. [FX and Rates Sentiment Survey: Hung jury 12 January 2024]

EUR

Chart 7: EUR REER AND NEER

EUR slightly below long-term average in real effective terms; historically strong in nominal effective terms



Source: BofA Global Research; Bloomberg; BIS

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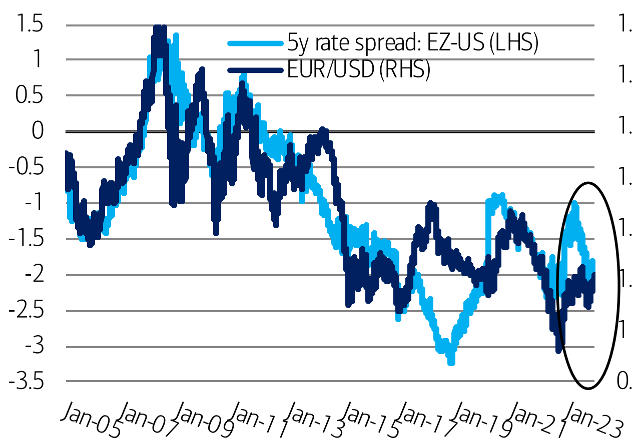
- While the EUR still trades near historically weak levels vis-à-vis the USD, this is not the case on a broader scale.
- The Euro Real Effective Exchange rate (REER) is currently trading quite close to its long-term average, while it's Nominal Effective Exchange Rate (NEER) is near all-time highs.

Chart 8: EURUSD and 5-year rate differentials

EURUSD consistent with rate differentials



Source: Bloomberg and BofA Global Research.

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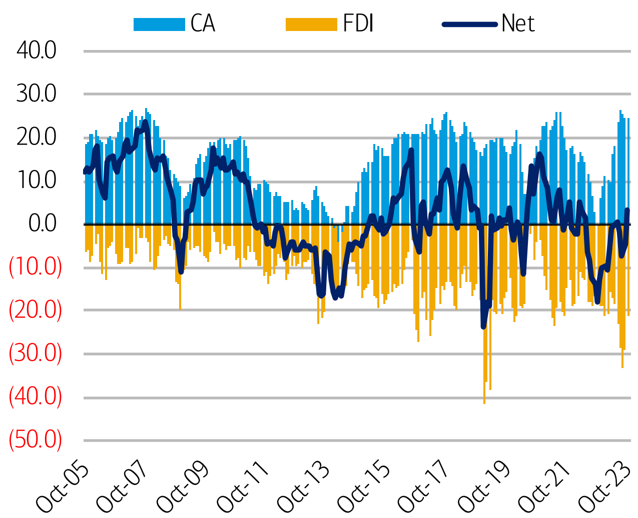
- The EUR/USD pair is also trading mostly in line with levels of interest rate differentials. (Chart 8)
- Growth convergence between the US and euro are this year should be supportive of the pair.
- For more, see: [FX Viewpoint: EUR Year Ahead: Pyrrhic Victory 15 December 2023]

JPY

Chart 9: Japan basic balance of payments (annualized rolling 3m, tn JPY)
Weak yen not enough to generate Japan's surplus



Source: BofA Global Research, Haver

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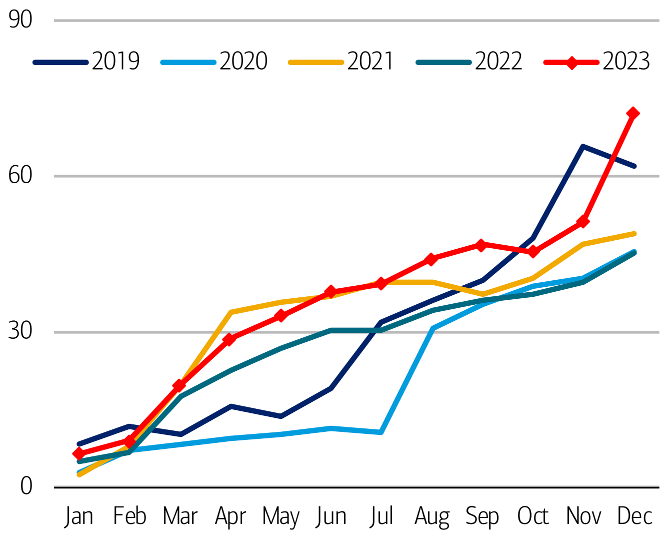
- While the rate differentials should be the primary driver of USD/JPY in the near-term, we think structural outflows from Japan will limit JPY's rebound and lead to JPY's decline beyond its cyclical rebound vs USD.
- The yen weakening has failed to generate a meaningful surplus for Japan (Chart 9)
- We have also recently pushed back our call for the BOJ to end YCC and remove NIRP from January to April (Japan Watch: BoJ Watch: Eyes on April 11 January 2024)

Chart 10: Cumulative outward M&A announcement volume* by Japanese companies by calendar year ($bn)
Japan Inc.'s outward M&A may be accelerating



Source: BofA Global Research, Bl;oomberg

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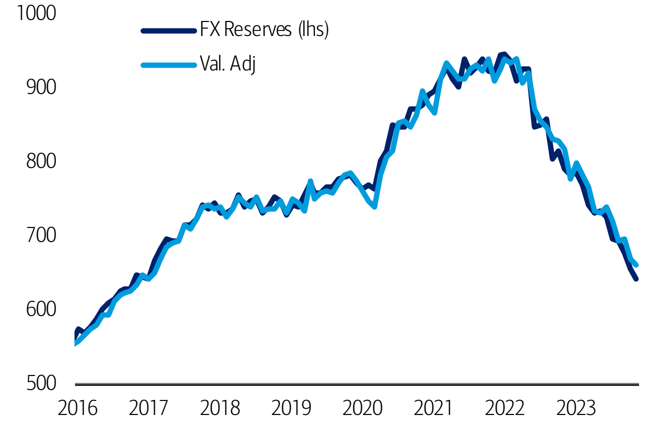
- Japan Inc.'s outward M&A announcement reaccelerated in 2H23, implying continued outward FDI (Chart 10).
- For more, see: FX Watch: Japan BoP: high carry + no BoP surplus 08 December 2023

CHF

Chart 11: Swiss FX Reserves – Actual vs Val Adj. (CHFbn)

SNB have aggressively tapered the balance sheet which will slow



Source: BofA Global Research, Bloomberg

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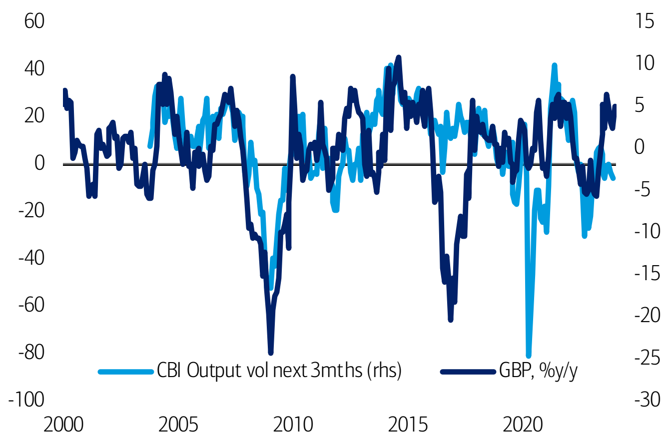
- The SNB has used its balance sheet as a tool to insulate the Swiss economy from the worst excesses of global inflation. By selling foreign assets and converting back into CHF, they have seen the FX rate as an important tool to combat inflation whilst only hiking rates by a limited amount.
- Now that inflation is back under target, the SNB is taking a more symmetric approach. It will either buy or sell CHF if conditions dictate. This makes the risks in CHF two-way. (Chart 11)
- For more, see: [FX Watch: Swiss FX Reserves: Steady 09 January 2024]

GBP

Chart 12: GBP TWI vs CBI 3mth output volumes

Carry may be supportive but GBP running into a growth slowdown



Source: BofA Global Research; Bloomberg

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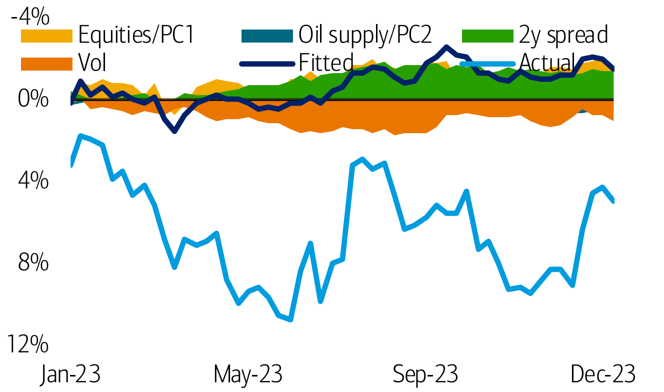
- As noted above in Chart 1, the rates market has been indiscriminate in pricing rate cuts for the major central banks, and expectations for BoE easing this year looks more aggressive than our forecasts. The pricing out of some of these cuts should enhance GBP carry credentials in 2024.
- However, the pro-cyclical nature of GBP implies that it is facing macro headwinds as growth slows. In our view, the combination of the two is likely to be steady if unspectacular GBP gains versus the funders this year. (Chart 12)

NOK

Chart 13: Fitted vs. actual NOK I-44 (inverted values)

NOK still 6-7% weaker than its recent history would suggest



Source: BofA Global Research, Bloomberg. Weekly data through Jan 5. Lower values of import-weighted krone (NOK I-44) show stronger NOK. Regression estimates are for Jan 18- Dec 22. We regress changes in (log) NOK I-44 on: proxies for (1) demand- and (2) supply-driven changes in Brent crude spot; (3) changes in Norway's 2-year trade-weighted swap spread; and (4) changes in our preferred NOK implied-vol spread measure. We find the first principal component of changes in MSCI Global, Brent crude spot, and VIX to be a good proxy for demand-driven oil-price changes, and the second principal component to be a good proxy for supply-driven oil-price changes.

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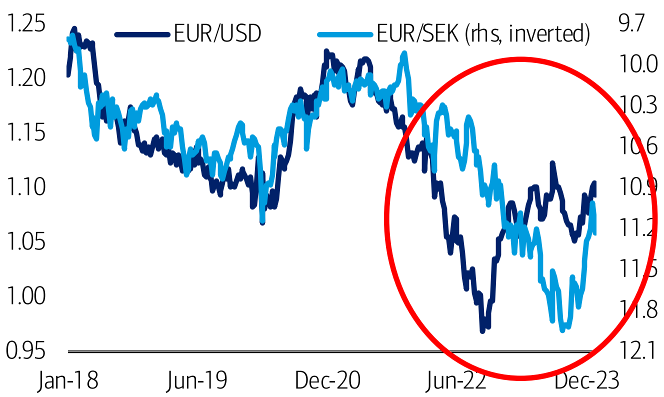
- NOK's rally in late 2023 came from a much-undervalued level based on its recent history, accounting for sentiment- and supply-driven oil-price changes, relative monetary policy, and relative implied volatility. (Chart 13)
- For more, see: FX Watch: Four reasons we like NOK 15 December 2023

SEK

Chart 14: EURUSD vs EURSEK (inverted)

EURSEK largely re-aligned itself with EURUSD in Q4



Source: Bloomberg, BofA Global Research. Weekly data through Jan 5.

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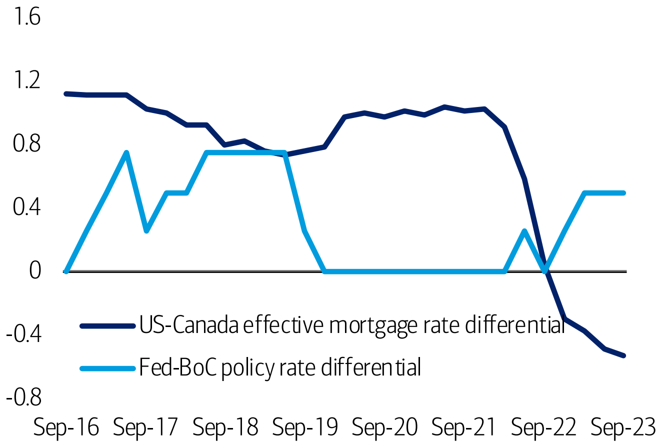
- SEK's rally in Q4 largely closed the (unusual) gap between EURUSD and EURSEK that had started emerging in late 2022. (Chart 14)
- We see scope for SEK outperform most G10 currencies this year (except NOK), and are also more constructive compared to consensus for 2024. (Chart 2)
- Near-term, however, we are tactically cautious, and have recently entered a long GBPSEK trade (FX Alpha: Buy GBPSEK 12 January 2024)

CAD

Chart 15: Monetary policy transmission takes effect faster in Canada than in US
US-Canada policy rate differential vs effective mortgage rate differential



Source: BofA Global Research, Bloomberg

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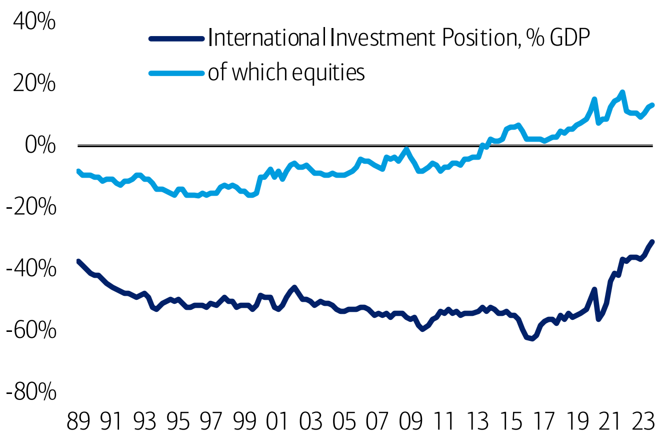
- As noted in Chart 1, we expect BoC to cut rates slightly more aggressively than Fed in 2024. (Baseline is for 5 BoC rate cuts vs 4 Fed rate cuts).
- Despite more expected BoC rate cuts, CAD can still appreciate as long as the Fed also stays in a cutting cycle. We see USD/CAD falling to 1.30 by end of 2024, mainly due to a weaker USD.
- Canadian households are squeezed by rate hikes a lot more than US households due to diverging mortgage features. (Chart 15)
- For more, see: Canada Year Ahead 2024, 04 December 2023

AUD

Chart 16: Chart: Australia's net foreign liabilities (% GDP) at lowest level in decades
... and net creditor in equities; should lower AUD risk sensitivity over time



Source: BofA Global Research; ABS

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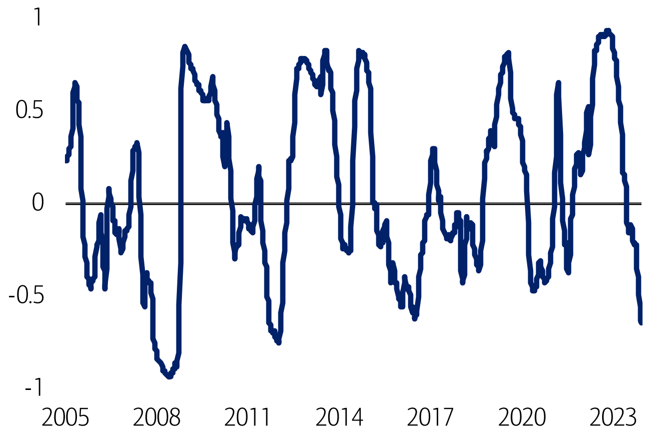
- We are constructive on AUD this year, as we see the RBA remaining on hold amid the expected broader global easing cycle (Chart 1), and China pessimism near multi-year extremes (Chart 6)
- Another factor contributing to AUD optimism is the changing structural nature of Australia's balance of payments. Among other things, Australia's Net International Investment (NIIP) position has been rising over the past several years, and rising net-foreign equity ownership should provide a buffer to downturns in global risk. (Chart 16)
- For more, see: Liquid Insight: AUD can beat its beta 09 January 2024

FX Volatility

Chart 17: FX implied vol to US real rate correlation is close to a historical low

1y rolling correlation between FX vol index and 10y US real rate



Source: BofA Global Research, Bloomberg

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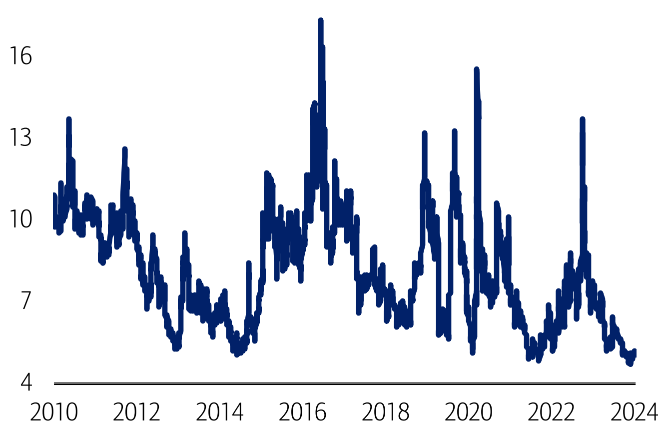
- Lack of macro trend convictions, surging volume of FX carry trades, and positive US equity sentiment has kept FX vol subdued in 2023.
- FX vol correlation to US real yield reached close to a historical low in 2023. (Chart 17)
- Coming off from a low 2023 base, we expect FX vol to spike higher in 2024 on start of Fed cutting cycle and US election risk.

Chart 18: 3m EURGBP implied vol is close to a decade low and not fully pricing March UK Budget Statement risk

3m EUR/GBP implied vol



Source: BofA Global Research, Bloomberg

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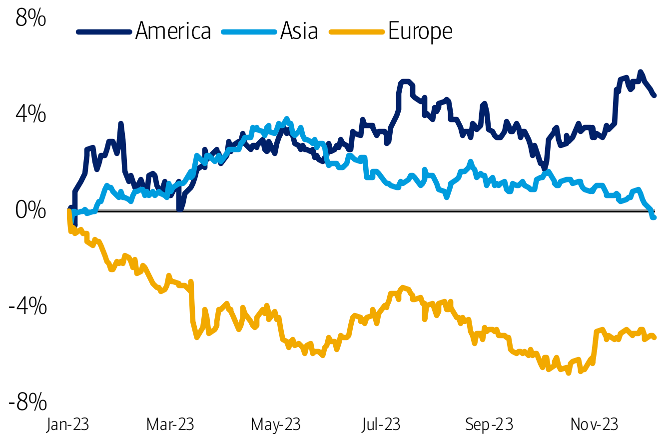
- Most specifically, we are bullish EURGBP vol in Q1 2024. Current 3m EURGBP implied vol is around a decade low due historically high correlation between EUR and GBP TWIs. (Chart 18)
- EURGBP vol should rise on diverging UK-EU macro backdrop and March UK Budget Statement risk.
- For more, see: FX Viewpoint: FX Quant/Vol Year Ahead: Volatile 2024 21 November 2023

FX Quant

Chart 19: EUR/USD rally largely occurred in America trading hours in 2023

EUR/USD 2023 cumulative return by time zone



Source: BofA Global Research, Bloomberg. We define America trading hours as 1pm to midnight UTC, Asia hours as midnight to 8am UTC, and European hours as 8am to 1pm UTC.

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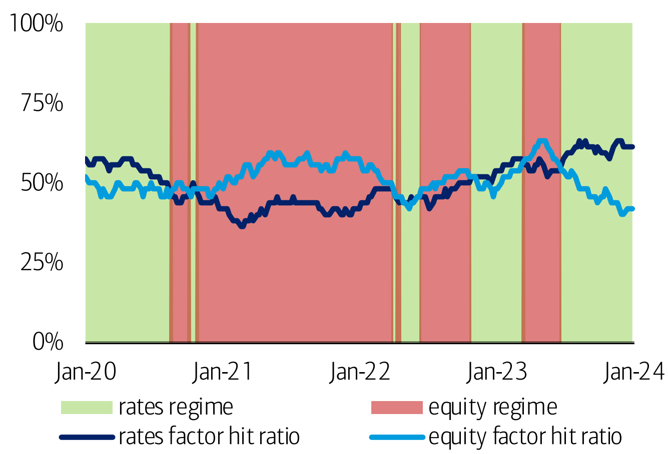
Chart 20: FX market has been trading under a rates regime for most of 2023

Rolling hit ratio between rates and equity factors in CARS model for FX



Source: BofA Global Research, Bloomberg. Period with higher hit ratio for rates factor is denoted as rates regime; period with higher hit ratio for equity factor is denoted as equity regime.

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Viewing FX through the lens of time zones

- USD selloffs in 2023 mainly took place during US trading hours.
- Europe-based investors cumulatively bought the USD vs EUR in 2023, while Asia-based investors briefly sold the USD in Q2 2023 but ended the year where they started. (Chart 19)
- Further USD selloff in 2024 would likely require more USD supply in European and Asia hours.

FX drivers that work

- The CARS model tracks realized performance of rates and equity signals in G10 FX for the following week.
- We are in a Rates Regime now. FX has been driven predominantly by rates and monetary policy in the second half of 2023. (Chart 20)
- The equity factor (a proxy for growth) had surged in 1H 2023 but has been less predictive in recent months.
- For more, see: FX Quant Insight: Look past the first week of the year 08 January 2024

Technicals

- DXY: Trend in 2024 is sideways- to- lower. Wave C down to at least 100, possibly 97.50. (Chart 21)

Chart 21: DXY – we think wave C lower within the channel is underway (Weekly Chart)
Base case year ahead view is sideways to lower in 2024. Wave C down to at least 100, possibly 97.50.

Source: BofA Global Research, Bloomberg

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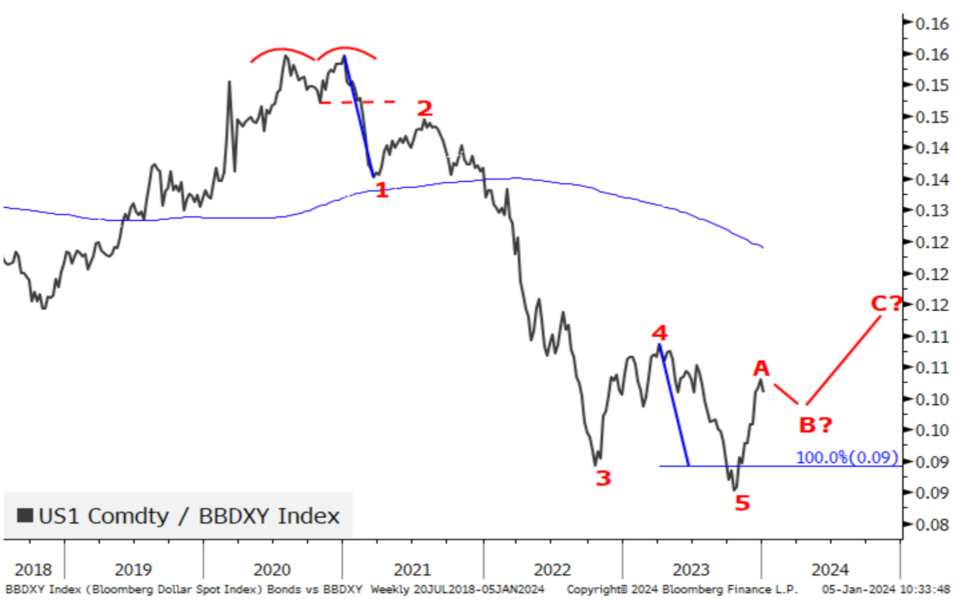
- Bonds vs BBDXY: Classic Elliott wave trend of 5 down and now 3 up (ABC). We think bond prices outperform the BBDXY index which favors yields lower and USD weaker. (Chart 22)

Chart 22: Bonds to outperform BBDXY in 2024 (Weekly Chart)
We think bond prices outperform the BBDXY index which favors yields lower and USD weaker. A classic Elliott wave trend pattern shows five waves in one direction (12345) and three in the opposite (ABC) underway.



Source: BofA Global Research, Bloomberg

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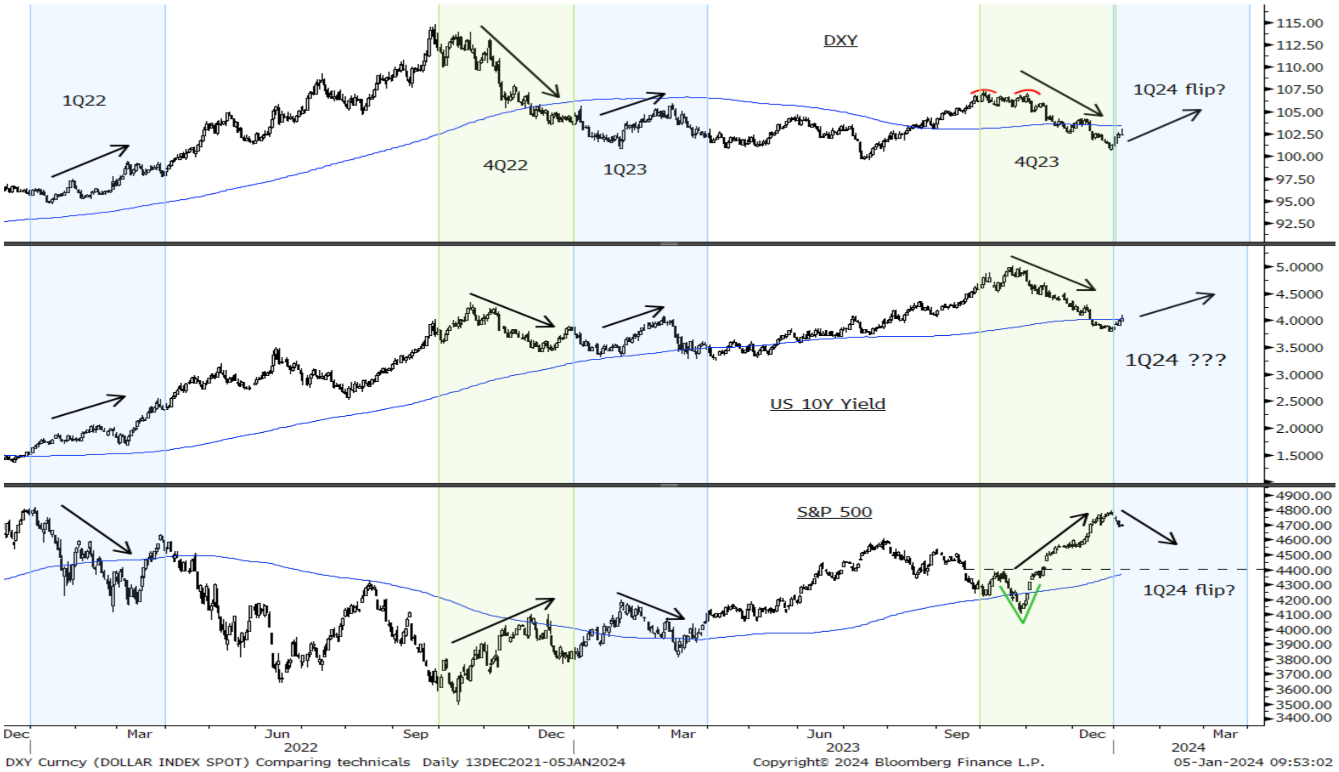
- A goldilocks 4Q23 repeated 4Q22, so will 1Q24 flip like 1Q23 and 1Q22? Beware of the 1Q24 trend flip to higher DXY, higher US 10y yield and lower SPX. (Chart 23)

Chart 23: DXY (top), US 10Y Yield (middle), SPX (Bottom)

Beware of the 1Q24 trend flip to higher DXY, higher US 10y yield and lower SPX. In other words, 1Q24 may repeat 1Q23 and 1Q22 should US data beat survey.



Source: BofA Global Research, Bloomberg

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- DXY average trends since euro began trading in 1999: DXY tends to strengthen in Q1, swing sideways in May through August, rally back into November and then decline into year-end. (Chart 24)

Chart 24: DXY average trend is up in Q1, sideways/lower through Aug, up to Nov and down to YE

DXY tends to strengthen in Q1, swing sideways in May through August, rally back into November and then decline into year-end.

Source: BofA Global Research, Bloomberg

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- For more, see: Technicals Explained: In 2024, get to know technical strategy 05 January 2024,
- FX Technical Advantage: Euro's golden cross favors mid-January bounce back 03 January 2024,
- Technical Advantage: First five trading day signals 10 January 2024

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