

Liquid Insight

Halftime for G10 FX

Key takeaways

- Going into 2023H2, we look for a moderately lower EUR-USD with an end-year forecast 1.05, as inflation remains elevated.
- Since last month, our forecast horizon still looks for longer-term USD softening, but moderate strength in the near-term.
- We do look for a stronger GBP, and we also have now revised our USD-JPY forecasts higher with a year-end forecast of 145.

By John Shin, Athanasios Vamvakidis and Shusuke Yamada

Chart of the day: We expect near-term USD strength, longer-term weakness

Trade-weighted USD index forecast to rise, then drift lower



Source: Federal Reserve Board, BofA Global Research, Bloomberg

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Halfway into 2023

As we approach the halfway mark of 2023, we have adjusted our FX views to ultimately look for a moderately stronger USD over the remainder of the year (see: [World at a Glance, "Halftime", 21 June 2023](#)). Despite a variety of different crises in the first half of the year, such as banking difficulties on both sides of the Atlantic, or the US debt limit ceiling, central banks are still primarily focused on dealing with inflation that remains elevated despite repeated rate hikes, while also trying to manage the potential recessionary consequences of deliberately engineering a slowdown. We still see the USD as ultimately overvalued, and likely to weaken over the medium term despite likely near-term strength (see the Chart of the Day).

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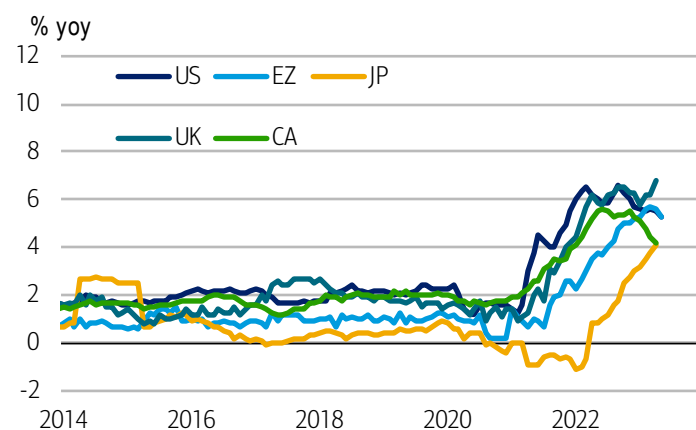
USD: inflation still the key driver

Inflation stickiness, combined with the continued strength in the US labor market, underpins our US Economics team's expectations for two more rate hikes, taking the Fed Funds Rate to 5.50-5.75% by the end of the year, which should also wind up supporting USD overall (see: [US Economic Viewpoint: "Resilient economy, higher policy rates", 14 June 2023](#)).

The crucial difficulty in the fight against inflation lies in core measures (Exhibit 1), which indicates the underlying price pressures in the economy. Despite the most recent May CPI report coming in as expected, core inflation is still running at persistently higher levels at which central banks can feel comfortable. The inertia in core inflation points to the distance still left to inflation targets, despite the somewhat recent narrowness in higher US core inflation.

Exhibit 1: Core inflation remains stuck at high levels

Measures of core inflation for G5 economies remain elevated

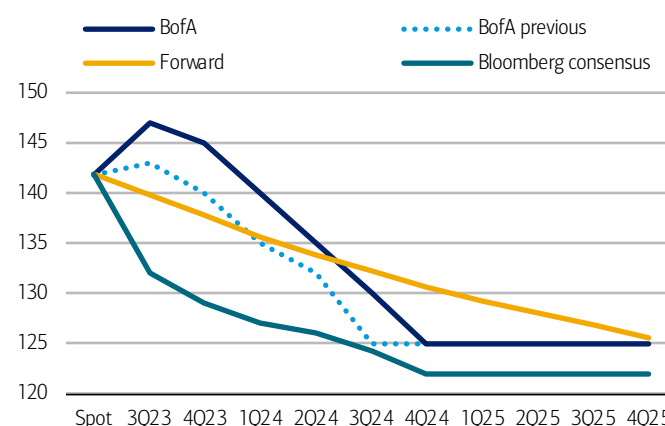


Note: we use ex food and energy for core; for JP we use ex fresh food and energy; for CA, we use trimmed mean. Source: Bloomberg and BofA Global Research

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Exhibit 2: USD/JPY forecasts

BofA remains bearish on JPY



Source: BofA Global Research, Bloomberg

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EURUSD somewhat up for the year

EURUSD is somewhat up for the year, after strengthening from a 20-year low in Q4 last year and fluctuating within a range this year. The EUR has done better vs. most of the rest of G10 beyond the USD; the failure of the EUR to sustain a rally is mostly against the USD. In real effective terms (REER), the EUR is only slightly below its long-term average. In nominal effective terms (NEER), the EUR is actually historically strong.

Eurozone data has recently weakened, but still very high core inflation and tight labor markets leave no room for ECB complacency. EURUSD weakened in May on weak China data, but strengthened so far in June on hopes for China stimulus. However, for as long as global and particularly US inflation remain high, we would expect EURUSD to remain historically weak, with further downside during the inevitable (hard) landing.

The Fed must turn for a sustained EURUSD rally, while for now carry is also weighing on the EUR. Non-USD EUR crosses can remain strong, but we think further upside may be limited. Longer term, EUR strength depends on ECB's increasingly difficult commitment to inflation target vs. the rest of G10 (for details, see [Why is the EUR failing to rally? 07 June 2023](#)).

Forecasts: USD to remain strong in H2, revising USD-JPY higher

We recently revised our general G10 FX forecasts and look for more broad USD upside in the near-term (see: [FX Viewpoint: "G10 FX midyear forecasts update: USD strong\(er\) until landing", 15 June 2023](#)). In the World at a Glance report, we also extend out our forecast horizon to the end of 2025 (see: [World at a Glance, "Halftime", 21 June 2023](#)).

We had been forecasting EURUSD at 1.05 for H1 and 1.10 by year-end, but we extended our 1.05 forecast for the rest of the year, as we still have to see a landing of the economy that will bring inflation to a sustained path towards the target. However, we kept our longer-term end-2024 forecast the same at 1.15, as we also see the USD overvalued compared with equilibrium estimates. Our end-2025 forecast for EUR-USD is 1.20, approaching fair value.

Elsewhere we incrementally revised down our Dollar Bloc forecasts, although we continue to keep an upward sloping profile over the longer-term against the USD, reflecting our general view of USD overvaluation. We did raise our GBP outlook, while leaving our direct forecasts against CHF, NOK and SEK unchanged.

We are revising up our bullish USD-JPY forecasts further (Exhibit 2, previous page), reflecting our updated forecasts on Fed policy action. We expect USD/JPY and G10/JPY to be supported by FX carry. We expect USD/JPY to rise to 147 (143 previous, 132 consensus) by September and end the year at 145 (140 previous, 129 consensus).

Risks: All about the landing...

Our baseline assumes the landing of the global economy will allow a drop of inflation, allowing the EUR to move towards its long-term equilibrium. In addition to uncertainty about timing, a stagflation scenario remains a risk, in which case interest rates have to remain high for longer, risk sentiment suffers, and the EUR weakens further.

... otherwise, concerns on stagflation, central bank credibility, delayed landing

Our key risk scenario has been one of stagflation, with the USD getting even stronger for longer than in our forecasts, pushing EUR-USD towards parity-type levels. A related risk is the Federal Reserve's response to initial distinct signs of weakness in the US labor market.

At the other extreme, the landing of the economy could be delayed further, with FX remaining in tight ranges in the meantime. And of course, broader global risks are prevalent as well, including downturn in China and the war in Ukraine.

Exhibit 3: G10 FX Forecasts

We look for near-term EUR-USD softness, but then a longer-term rise to fair value in the 1.20s

	Spot	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
G3											
EUR-USD	1.09	1.05	1.05	1.07	1.10	1.15	1.15	1.16	1.17	1.18	1.20
USD-JPY	142	147	145	140	135	130	125	125	125	125	125
EUR-JPY	154	154	152	150	149	150	144	145	146	148	150
Dollar Bloc											
USD-CAD	1.32	1.32	1.30	1.30	1.29	1.28	1.26	1.26	1.26	1.26	1.26
AUD-USD	0.68	0.67	0.69	0.72	0.73	0.74	0.75	0.75	0.75	0.75	0.75
NZD-USD	0.62	0.61	0.62	0.64	0.65	0.66	0.67	0.67	0.67	0.67	0.67
Europe											
EUR-GBP	0.86	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
GBP-USD	1.27	1.24	1.24	1.26	1.29	1.35	1.35	1.36	1.38	1.39	1.41
EUR-CHF	0.98	0.98	0.98	0.99	0.99	1.00	1.00	1.02	1.02	1.05	1.05
USD-CHF	0.90	0.93	0.93	0.93	0.90	0.87	0.87	0.88	0.87	0.89	0.88
EUR-SEK	11.79	11.50	11.00	10.70	10.60	10.50	10.30	10.20	10.10	10.10	10.00
USD-SEK	10.81	10.95	10.48	10.00	9.64	9.13	8.96	8.79	8.63	8.56	8.33
EUR-NOK	11.74	10.90	10.60	10.40	10.40	10.20	10.00	9.90	9.80	9.80	9.70
USD-NOK	10.76	10.38	10.10	9.72	9.45	8.87	8.70	8.53	8.38	8.31	8.08

Forecast as of Jun-20-2023. Spot exchange rate as of Jun-20-2023. The left of the currency pair is the denominator of the exchange rate. **Source:** BofA Global Research

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Notable Rates and FX Research

- **Global Rates, FX & EM Year Ahead 2023** – [Year Ahead 2023: Pivot ≠ Peak](#), 20 Nov 2022
- [The second half of the year](#), **Global FX Weekly**, 16 June 2023
- [No decisive drop](#), **Global Rates Weekly**, 16 June 2023
- [On a wait & see mode...](#), **Liquid Cross Border Flows**, 12 June 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: The second half of the year 16 June 2023](#)

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