



FX Forecasts

March 2024

MONEX

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Moving out of step with the Fed

If January was the month where markets sobered up following a Christmas holiday blowout, February saw traders take a pause to assess the damage. This meant that once a set of developed economy central bank meetings and US non-farm payrolls at the beginning of the month were cleared, trading across G10 FX spent much of the month looking distinctly rangebound. It also meant that only one of our two key macro calls heading into the year has played out. The unwind of aggressive Fed easing expectations saw the dollar rally, as we thought it would, but February failed to bring with it the divergence in central banks easing expectations that we continue to anticipate in Q1. With another round of central bank meetings set to land this month, we think policymakers will have to recognise the growing divergence in economic fundamentals and the consequences for policy rates, although this will be limited to just diverging forward guidance as opposed to material changes in policy rates. All told, we now think March will be the month where markets finally begin to factor in diverging easing paths, a dynamic that should inject life back into the FX market.

Volatility across major currency pairs generally trended down throughout February



the tone from Fed officials, which appeared to skew more hawkish as the month wore on. Strength in the two main US data releases was sufficient for markets to continue pricing out Fed easing bets, with the cumulative expected easing for 2024 dropping from 148bps on February 1st to just 84bps by month-end. January effects leave us wary of jumping to these same conclusions, meaning we continue to see the Fed easing from May for now. Even so, risks look increasingly skewed towards the Fed keeping rates higher for longer than we had initially anticipated.

“The continued strength of the US data contrasted with other major economies, where disinflation progress was broadly sustained and growth data remained uninspiring.”

In Europe, despite exceeding expectations, headline and core inflation still fell 0.2pp in February, from 2.8% and 3.3% to 2.6% and 3.1% YoY respectively. Inflation divergence was perhaps most obvious in Canada, however, where last month the headline measure fell to 2.9% YoY. Stripping out the rent and mortgage cost components that are directly impacted by policy rates, inflation fell further to just 1.6%. Furthermore, after rebounding in late-Q4, the BoC’s core measures of inflation are also showing renewed progress on disinflation, meaning all inflation measures are now pointing in the right

The US economy still looks exceptional

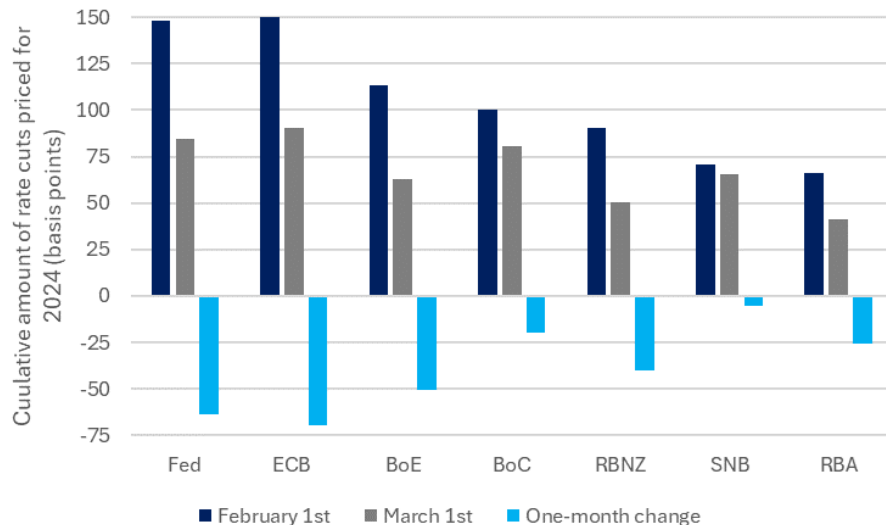
The past month began with an extension of January’s trends, at least as far as the dollar was concerned. Whilst Q4 unit labour costs printed soft at 0.5%, initially putting the greenback on the back foot, nonfarm payrolls the following day reversed this dollar sell-off and then some. Printing at 353k, payrolls massively overshot expectations of a 185k print, and further reinforced the US exceptionalism narrative. Signs of economic outperformance weren’t isolated to just the job market as inflation data out later in the month also overshot expectations, with prices growing 0.4% in January; a rate too hot for the Fed to cut rates in March, but likely also May as well in the eyes of markets. Indeed, this was reflected in

direction for the BoC. Inflation conditions also cooled in Switzerland and Australia, however, this didn't lead markets to materially shift their stance on monetary easing this year. On the growth front, while there was a marginal improvement in current and forward-looking indices outside of the US, such as the eurozone flash PMIs for February, we are yet to be convinced of the investment conditions outside of the US. In the case of the eurozone and China, the improvement in current activity measures come from a low and somewhat unstable base, while the magnitude of the improvement doesn't necessarily incite confidence that global growth conditions are sustainably improving.

“Despite the continued divergence in data, short-term interest rate traders remained reluctant to price further divergence in central bank easing paths, even as the number of cuts priced in for the Fed was slashed by a considerable margin.”

Over the course of the month, 63bps of Fed cuts were removed for the year from swaps, while 69bps were taken out for the ECB. Even in Canada where just 19bps of rate cuts were priced out this month, markets still see the BoC delivering just than three rate cuts altogether in 2024, the same as they expect from the Fed this year, despite the broad-based improvement in the inflation data. In our view, this leaves both the euro and the loonie on an unsustainable base and susceptible to a downside correction over a tactical horizon.

Money market pricing of G10 easing paths continued to move in synchrony over the course of February



The franc and the yen continue to be outliers

Two notable exceptions to the theme of rangebound trading this month within G10 FX were CHF and JPY, where 2% moves were recorded as a result of policy speculation. In the Swiss case this was triggered by an inflation reading that significantly undershot expectations. January CPI printed at just 1.3%, significantly undershooting the economist consensus and the SNB's own forecasts. The underlying details of the data were even softer given the headline rate was propped up by a VAT increase, with core inflation falling outright on the month, leaving the 6-month annualised rate tracking below 1% for the sixth consecutive month. The data confirmed our view that the central bank would unlikely tolerate EURCHF trading below 0.94 given the recession and deflation risk, which has since been corroborated by comments by SNB Governor Jordan and Swiss industry leaders. In light of the January inflation data, we [revised up our EURCHF forecasts](#) and now look for the central bank to cut rates at this month's meeting, although we note that the recent depreciation in the franc reduces the certainty of an early rate cut.

“The yen weakened over the course of February too, but not because rate cuts were in focus.”

Instead, a combination of market jitters around the odds of policy normalisation and the continued drop in Fed easing expectations both worked to weigh heavily on the yen in the first half of the month. From mid-February onwards, however, it was rangebound trading for USDJPY too. Having reached the key psychological level of 150, traders were unwilling to take the currency pair higher. The risk of another round of stealth intervention definitely played a part in this reluctance, but so did hawkish commentary from BoJ policymakers, which kept speculation over an April hike alive. In addition to the soft peg in USDCNY over the past month, the rangebound nature of USDJPY in a period of higher US yields transported markets back to late 2023.

With the majors largely range bound in February, attention switched to EM FX

With G10 FX stuck in limbo and lower realised volatility weighing on implied volatility too, it was EM FX that kept traders occupied in February. Most significantly, a PBoC decision to trim the 5-year Loan Prime Rate (LPR) sent shockwaves through Asian FX. Despite being broadly interpreted as an attempt to stimulate the property sector, markets viewed this as a signal that Chinese real estate sector is in a worse condition than many had originally assumed. This weighed on China's trading partners and industrial commodities. Already under pressure from falling Fed rate cut expectations and an associated rise in Treasury yields, the potential terms of trade shock saw many commodity currencies in the region such as MYR sink to multi-year lows against the dollar

last month. Weakness in EM FX wasn't just a story for Asia, however. Dovish monetary policy decisions in CE3 also saw both the Hungarian forint and Czech koruna come under pressure as carry protection for both currencies was eroded faster than expected.

MXN, INR, and to a lesser extent BRL were the exception to this rule as low levels of volatility meant the focus remained firmly on carry expressions in February. In this respect, data out of Mexico and Brazil proved supportive as it highlighted that the recent re-emergence in inflation pressures wasn't a Q4 phenomenon, but actually a dynamic that should keep both central banks on a hawkish footing. Meanwhile, high levels of carry and expectations that the RBI won't pivot on either rates or its FX regime until after the election meant INR also traded sideways, with long positions generating some of the highest total returns within the expanded majors.

More of the same in March?

Improving global growth conditions, soft currency pegs in China and Japan, and no imminent threat of policy action by G10 central banks have kept volatility in FX markets relatively subdued in February. With most central banks delaying any decision to move on rates until Q2 at the earliest, and FX markets usually requiring risk of an imminent shift before responding, there are grounds to believe that the divergence in rates and FX volatility will remain in March, with the latter trading with a considerable discount. While that may be the case, leading to another rangebound month in spot markets, we believe that guidance from central banks that have sought to delay speculation of imminent easing will be eroded by upcoming data. With growth conditions remaining weak for a considerable period of time and beginning to manifest within inflation and labour market data, the risks associated with holding policy too restrictive for too long, thus prompting a faster eventual easing cycle, should lead markets to resume speculating on earlier easing sequencing despite the official forward guidance. Both the ECB and the Bank of Canada are prime candidates for this scenario, with underlying cyclical conditions scanning as weak but policymakers stressing the need for all data series to evidence the need for easing before embarking upon it. Contrasting with lingering concerns around inflation persistent given robust levels of growth in the US, which could force markets to turn even more hawkish on the Fed this year, we expect eventual policy divergence to arise. The main risk, in our view, is not if, but when this takes place. Given how noisy the macro data out of the eurozone and Canada has been of late, there is a risk that markets don't resume speculating on earlier rate cuts in both economies unless confirmed by a second round of weak data. In effect, this would push the scenario of higher implied volatility and the second leg of dollar strength into the beginning of Q2, leaving markets to trade in tight ranges for yet another month.

FX VIEWS

USD

Starting the hard yards

With pricing of the Fed's easing path having now fallen back from close to 7 cuts at the beginning of the year to almost align with January's dot plot projection of 3 cuts, we think the easy part of the dollar's rally from rising rates is now in the rearview mirror, although continued strength within the data could justify a further hawkish repricing.

As we laid out in our 2024 outlook, the next leg of dollar strength is unlikely to come from the level of US rates, but how they trade on a relative basis. For the second month now, there continued to be a level of synchrony in terms of short-term interest rate expectations, and this has once again blunted the dollar's ability to rally on the US exceptionalism narrative. Unlike January, this can be partly explained by data suggesting a more constructive global growth backdrop, but similar to our scepticism around the start of the year data out of the US, we caution against overinterpreting the improvement in growth data such as February's PMIs. In Europe, the uptick in flash PMIs has come from a low base, and despite the improvement, they still point towards an economy that is struggling to generate growth. This should remain the case if the ECB fulfils its guidance and holds rates until June at the earliest, even as slack re-emerges within the labour market. Similarly, continued support from Chinese policymakers in the form of a cut to the 5-year Loan Prime Rate signalled to us greater concern over the housing market and economic growth instead of an outright growth supportive measure. Accordingly, we think markets have jumped the gun on the improved global growth trade, which we don't expect to transpire until the easing cycle is well underway in most DM economies in 24H2.

“Over a tactical horizon, we expect these cyclical divergences to remain apparent in the growth data and to broaden into inflation and labour market indicators.”

This should induce central banks in cyclically weak economies to begin easing before the Federal Reserve, where we continue to see no action on policy until May, with the risk of a later start to easing should incoming data corroborate the strength seen in January's prints. This should unlock another wave of broad USD appreciation, although it remains to be seen if this happens this month or in early Q2 as central banks like the ECB seek to delay policy easing in the absence of further data. Even if this is the case, and global growth conditions

continue to improve in March, we don't think another wave of broad USD depreciation similar to 23Q4 is likely seeing as the improvement in cyclical conditions is set against a backdrop of a higher terminal rate in the US. In this environment, we think bullish procyclical positioning should be selective and favour currencies with improving fundamentals, limited exposure to US rates, and cheap valuations within the G10. SEK and GBP stand out in this respect.

Although we think the current market backdrop remains conducive for further USD appreciation in the short-run, especially as long dollar positioning scans as fairly neutral, our medium-term view remains that eventual DM policy easing will be net-negative for the dollar. This is largely due to the positive impact easing monetary policy will have on investor sentiment and global growth expectations. That said, we think risks are tilted towards a persistently stronger dollar over the medium-term, primarily from a shallower Fed easing cycle and higher political risk premium, both of which should limit the extent of DM yield compression. While we think it remains too soon in the US election cycle to take a stance, repeated threats of trade sanctions risk further stagflationary impulses and support defensive dollar positioning into the event.

EUR

It boils down to April

The single currency fell just half a percent against the dollar in February to close out the month a full point above our 1.07 forecast. This was largely driven by improving sentiment over global growth, which limited the extent to which the dollar rallied on the back of firmed US data and higher yields. Commentary from ECB hawks about a more delayed start to the easing cycle also helped the euro, especially as these concerns over inflation persistence were validated by the slower pace of core disinflation in February. Despite the continued resilience of the euro and the reluctance amongst rates traders to bet against the ECB's guidance that no policy action would take place ahead of May's wage data, we are once again rolling our view that EURUSD is more likely to fall to the 1.05 region than return to 1.10 in the coming months. Our view continues to be predicated on the US exceptionalism narrative and pronounced cyclical weaknesses in the eurozone, both of which should eventually combine to re-widen rate differentials and lead the euro lower.

The main counterargument to this view is the recent improvement in eurozone PMIs and the slowing pace of core disinflation. However, we note that the PMIs are improving from an incredibly low base, and despite the fact that weak growth conditions have had limited impact on materially bringing down wage growth and inflation to date, we believe this is merely a delayed dynamic. As the eurozone economy continues to struggle to build momentum, the ability of firms to hoard workers and individuals to consumption smooth will begin to fade, eventually causing the labour market to unwind and the economy to potentially flirt with another recession. This is the risk that the ECB runs by delaying any policy easing until late-Q2 or beyond.

“As such, while reduced bets on an April rate cut have supported EURUSD in current ranges, we don't believe higher eurozone rates will be supportive of the euro over the medium-term as the longer the ECB delays, the more it will ultimately need to cut.”

It is for this reason that we expect the ECB to commence its easing cycle in April, opting for 25bp cuts and a shallower easing trajectory, a view shared by a minority of the Governing Council. If taken, this approach should see policy remain restrictive, while mitigating any adverse effects on growth. Whether the ECB guides markets to this outcome by the end of Q1 will largely depend on the next round of inflation data and whether that too undershoots the ECB's new staff projections. If our expectations are met and weak growth conditions finally manifest within domestic inflation dynamics, there is substantial scope for markets to reprice the ECB's easing path, especially in relation to the Fed's. That said, we think the risks the ECB delays the start of its easing cycle until June and have rolled our one-month 1.07 forecast accordingly to reflect this. As previously stated, we aren't given up on our medium-term 1.05 forecast, however. We just note that the time in which it is achieved may be delayed into Q2.

CAD

The stars are aligning for a cut

Except for Q4 growth exceeding expectations, the macroeconomic data released out of Canada over the course of February began to show more uniform signs of economic weakness. Even within the growth data, which printed at an annualised rate of 1% relative to the BoC's expectations of no change, the economy continued to grow at a below-potential pace whilst domestic demand conditions remained soft. With slack re-emerging within the labour market and a broad-based improvement visible within the inflation data, the BoC's confidence that inflation will sustainably return to target has likely increased, raising the chances of an April rate cut as per our base case. While we don't expect that to be relayed explicitly to markets at the March 6th meeting, with policymakers instead aiming to retain full optionality heading into Q2, we do expect the subsequent inflation and jobs data to support such an outcome.

“With the probability of a rate cut in April priced at just 30% and only three full rate cuts embedded in the CAD swap curve, there is considerable scope for the data to drive a reassessment in the market implied path for BoC easing towards our base case for six cuts this year starting from April.”

As the data continues to support such a view, we expect CAD to weaken on monetary policy divergence, targeting 1.37 this month. That said, with the currency positively correlated with US equities, which alongside US yields continue to be underpinned by stronger US growth conditions, there is a risk that the USDCAD rally underperforms the widening in rate differentials. As a result, earlier sequencing in BoC easing may be best expressed against other high beta currencies that also benefit in an environment of stronger equities, with long GBPCAD specifically standing out due to our expectation that the BoE will hold rates until the second half of the year. Over the medium-term, we expect further USDCAD upside in Q2 on the basis that the BoC does deliver rate cuts prior to the Fed, with the pair climbing as high as 1.38-1.40 before staging a recovery on spread compression and improving growth conditions.

GBP

March should play host to some notable non-events

Two key risks events are set to play out this month, though on balance we expect both to contribute only marginal upside for sterling. This should keep GBP evolving broadly in line with our previous short-run forecasts, tracking sideways against the dollar and grinding higher against the euro. That said, risks are tilted to the downside in March.

The budget should be non-event for FX markets...

First up is the Spring Budget on March 6th, which is almost certain to be the last before a general election is held later this year. Both our figures and consensus expectations suggest that the Chancellor Jeremy Hunt will have little room for fiscal manoeuvring. Some modest giveaways should add fractional upside for both growth and the pound. But the key determining factor in what the Chancellor can deliver are set to be latest set of forecasts from the OBR. The set that accompanied November's fiscal event showed just £13bn of headroom. We think the OBR could upgrade its forecast for potential economic growth on the back of higher immigration, and downgrade the profile for Bank Rate. But with these potentially offset by a projected rise in long run borrowing costs and a downgrade to productivity growth, resulting in only a small increase in headroom, the Chancellor's room to manoeuvre could well be tightly constrained.

As such, market attention is likely to focus on what the budget implies for general election timings. In our view this is most likely to be held in Q4, but a budget that supported this rationale would help crystallise this risk for markets, removing a source of potential uncertainty that could have weighed on the pound. That said, if the Chancellor cannot offer any meaningful giveaways at all, the lack of additional spending would be a negative surprise for markets that could see a modest selloff in the pound. What we don't think is likely, however, is a repeat of the Truss-Kwarteng budget of 2022. The Chancellor appears to have learnt from his predecessor's mistake and is highly unlikely to try ditching his fiscal rules again, though memories of the event could temporarily weigh on sterling.

...as should the March BoE meeting

The second event of note is the Bank of England's March 21st meeting. We are maintaining our call for no rate cuts until the second half of the year, and as such expect no change in stance from the BoE this month. On this point, when it comes to Bank Rate expectations, the past month has been notable for the extent to which markets have aligned with our base call for the BoE to begin easing policy in August. We suspect that the BoE is happy with this profile for rates, and with no MPR at this meeting, policymakers are unlikely to do much to rock the boat. That suggests to us a that largely unchanged policy statement is likely, with risks set to be centred on the April rise in the National Living Wage, similar to the commentary presented in February. All told, this should see market pricing little changed following the event, providing sterling with a modest boost.

“That said, a dovish pivot from the BoE remains a risk. This would see markets accelerating rate cut bets and could see a sharp sterling sell-off as a result, especially as it would likely coincide with a more hawkish tone from the Federal Reserve the day prior.”

On the data front, a set of prints that disrupts the narrative for sterling looks unlikely. Official growth figures should pick up as predicted by PMIs and retail sales data, disinflation should continue to play out slowly, and the labour market looks set to loosen further, albeit not fast enough for the BoE to cut rates in the immediate future. Given this outlook, we are broadly maintaining our sterling forecasts this month, with risks to our projections for both GBPUSD and GBPEUR likely to be concentrated on developments in the US and eurozone respectively rather than the UK, despite the two notable risk events taking place this month.

CHF

Cuts are coming

The past month has seen some notable changes for both the Swiss franc and the SNB, triggered by January's inflation report, where headline inflation printed at just 1.3% YoY, significantly undershooting the economist consensus and the SNB's own forecasts. This led us to upgrade our EURCHF forecasts for the year under the expectation that policymakers' concern over the drop in price pressures would translate into a preference for the franc to weaken and a growing likelihood of a rate cut this month. As such, we now expect 0.95 to be a floor for EURCHF in the short term, below which the SNB will likely intervene to weaken the currency. Reflecting this risk of intervention and the likelihood that the SNB commences the DM easing cycle this month, we expect the currency to trade in the range of 0.955-0.98 in the coming three months, before improving global growth conditions and lower global inflation rates leads the cross to return to parity by year-end.

Underpinning our view of a March rate cut is continued weakness in near-term price pressures, specifically private services inflation and core inflation. While data for February suggest that the underlying run rate of inflation may not be as benign as previously assumed, the pace of inflation across all metrics still support the SNB significantly downgrading its inflation forecasts this month. For reference, headline inflation has averaged 1.25% this quarter so far, undershooting the Bank's December forecast of 1.8%, and poses little threat of returning to the upper bound of its tolerance band in the middle months of the year as previously assumed. Consequently, March's meeting should see the SNB deliver another dovish policy shift, which we expect in the form of a 25bp cut.

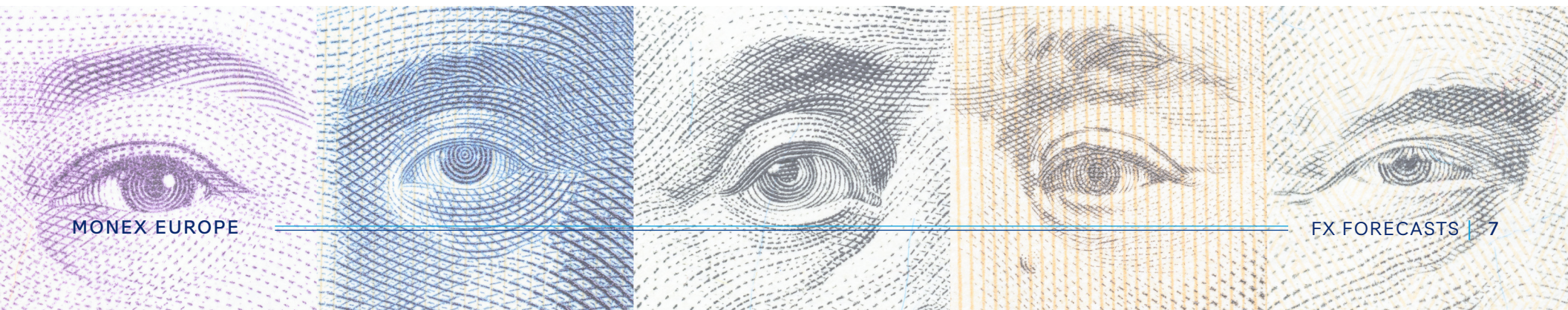
While the recent depreciation in the franc means the risk of a rate cut have since moderated, with markets already pricing a 60% change of a cut this month, any delay to the easing cycle runs the risk of renewed CHF appreciation and an increase in deflationary pressures. This is especially pertinent given the ECB is likely to cut at least once by the time the SNB announces its next policy decision in June. Given the central bank has also come under a lot of scrutiny of late for the associated cost of weakening the currency, we believe policymakers would rather lean against market forces to strengthen the franc as opposed to weakening it, again supporting our view to cut. As a result of SNB easing, we think EURCHF should continue to rally, although we note that the risk of FX intervention, perceived or realised, should ensure this occurs on a gradual basis. Reflecting this, we expect the cross to end the month at 0.97, before rallying up to 0.98 over the next three months.

SGD

Little room to manoeuvre

Despite another month of broad USD strength, especially against popular funding currencies within Asia, upside in USDUSD remained limited. The pair briefly broke through the 1.35 handle following a positive surprise in US inflation data, a level we deem to be a near-term top, before retracing to close the month out just 0.52% higher and slightly above our 3-month 1.34 forecast. The price action in USDUSD corresponded with our view that upside in USDUSD will be restricted by the MAS's current tightening stance and limited room for SGD to appreciate against peers within the S\$NEER basket, barring a material improvement in inflation conditions. While January did see both headline and core inflation cool quicker-than-expected, we think it remains premature to assume that the MAS will shift towards a neutral policy setting given inflation remains above target, especially on a sequential basis, and the recent decline could be due to base effects as the Lunar New Year commenced a month later this year. Resultantly, we think February's setup in USDUSD remains intact.

We expect the MAS to retain its tightening bias, favouring the S\$NEER rate to track near the top of its trading range until inflation conditions show sustained improvement, while upside against major peers remains restricted - upside in USDJPY and USDCNY is credibly capped by policy intervention (both actual and verbal), while the scope for appreciation against MYR is capped by the



threat of intervention after the ringgit recently hit multi-decade lows in a move that was deemed inconsistent with the economy's fundamentals by both monetary and fiscal authorities. While there remain paths higher for USDSGD, we think the probability of a sustained break above 1.35 in USDSGD is low.

One such avenue is for significant euro depreciation. While we do expect the euro to weaken further on earlier ECB easing, this should have only a limited impact on USDSGD given MAS's current monetary policy stance. Under our base case of EURUSD falling to 1.05 in the coming months, we think USDSGD could climb as high as 1.3550, although we note that the impact of euro depreciation on USDSGD will be constrained by the scope for the S\$NEER rate to appreciate before it reaches the upper band of its trading range.

SEK

Rangebound for now

After falling 8.3% from a high in mid-September to December's low, EURSEK has since rallied roughly 2% to stabilise in a range of 11.15-11.4. Whilst long term we expect a trend of broad SEK appreciation as European growth conditions improve and DM monetary policy is eased, we see little reason for the cross to break out of this range in the immediate future. In fact, our forecasts still project a bias towards the upper end of this range over the coming three months, with a sustained break below 11.15 only likely to come in Q3.

“Arguably the major driver of the cross over the past twelve months have been rate differentials, particularly given the challenge the Riksbank faced in balancing the need to cool inflation but protect the economy from falling into deep recession.”

However, with tightening cycles largely complete across the DM space and SEK having recently appreciated, weighing on imported inflation as a result, the interest rate differential between the eurozone and Sweden is now fairly priced in our view. This has led rates to have a lesser impact on EURSEK in recent weeks. Despite this, we also think that markets are underpricing the overall pace of the respective easing cycles. Under our base case, weak domestic growth conditions should weigh more on underlying inflation in coming months, prompting larger rate cuts from both respective central banks. As such, while a simultaneous acceleration in the easing paths for both central banks should not move the EURSEK rate, our expectation for weaker than expected growth should weigh on the krona more than the euro given its cyclical beta, suggesting a short-term upwards bias for the cross.

We think risks to our base case look skewed towards EURSEK upside in the short term too, largely stemming from the risks of a monetary policy surprise. To this point, our base case still sees the ECB cutting first in April, followed by a first Riksbank cut at some point in the summer. However, risks look skewed

towards a later start by the ECB, especially if policymakers are determined to wait to see wage data published following the April meeting. In the Riksbank's case the opposite is true. Admittedly January inflation data surprised to the upside, but this was largely the result of energy and shelter components directly influenced by policy rates, both of which the Riksbank should be ignoring. Stripping these out, inflation in Sweden continues to cool rapidly towards target, with risks that the Riksbank could feel comfortable cutting earlier than we expect. Doubly so given the unexpectedly dovish suggestion by policymakers at the February rate decision suggesting that a rate cut could come in the first half of the year, and more recent suggestions that the Riksbank could cut in advance of the ECB if policymakers deem it necessary. In either case this would see rate differentials become a primary driver of EURSEK once again, shifting in favour of renewed upside.

Longer term, we still think the overriding dynamic for the pair will come from the krona's reversion towards its fundamental value. This should see sustained longer run appreciation for SEK. The preconditions for this are likely only to be met in the second half of the year, however. Namely, that the broad developed market easing cycle is underway, and growth conditions begin to improve both domestically in Sweden, and externally in Europe, all of which would support eventual krona upside.

ZAR

Selling the family silver

Entering 2024, we knew a general election would have to be held in South Africa this year. But we had assumed that this would not take place until Q3, with the ruling ANC opting for the latest possible date under our base case. However, last month the election was announced for May, three months earlier than we had originally envisaged. This poses two key risks to our ZAR forecasts.

“First, we still expect that political risk will weigh on the rand, but given the election timing, this should now play out earlier than we previously anticipated.”

In particular, the possibility of an ANC-EFF coalition now looks like less of a tail risk and more likely the central outcome scenario, based on current opinion polling. Given the broadly anti-market policies advocated by the EFF, their potential participation in government will worry investors, particularly if polls fail to shift back towards the ANC as election day approaches.

That said, not all election risks are skewed to the downside. Notably, a recent announcement that the government would tap the SARB's reserves in order to pay down debt was well received by investors. Admittedly, we think the long-term wisdom of such a decision is questionable at best as this amounts to selling the family silver in return for a pre-election economic stimulus

designed to woo voters – this is hard to square with the actions of responsible government. Nonetheless we do recognise that this is clearly a positive for the economy in the short run, especially given concerns over the economy’s long-run growth profile and the government’s ability to consolidate its debt. In the run-up to the election, we suspect that more, similar, interventions are likely, especially if the ANC remains below 50% in the polls. However, this shouldn’t translate into sustained ZAR strength as these short-sighted measures will likely be set against a backdrop of higher US yields.

All told, with no clarity on where the balance of risks lies for our ZAR forecasts given the offsetting factors, we are holding our previous forecasts for now, which see a strong rebound through the second half of 2024, fuelled by Chinese growth. Uncertainty around our forecasts has notably risen, however, with higher chances of deviation to both sides of the appreciations path we are forecasting.

MXN

The odds of March

February has been a decisive month in Mexico. While the first weeks of the year were generally quiet, with broad continuations of the trends seen at the end of the year, the release of the January inflation report, followed shortly after by the first interest rate statement of the year, proved decisive in adjusting agents’ expectations about the future of monetary policy in Mexico. First, headline and core inflation levels continued to prove uncomfortably high and confirmed that the disinflationary process is slowing in early 2024, leading many to dismiss February as the most likely start of the easing cycle. While we never thought this was a feasible option, Banxico’s interest rate statement also made us rethink the prospects for March. At its first meeting of the year, Banxico’s Governing Board made it very clear that the risks to its inflation outlook remained tilted to the upside, focusing on the disappointing dynamics of non-core inflation, which could continue to put disinflationary progress at risk if geopolitical risks and weather conditions worsen going forward. Given this latent risk, Banxico policymakers not only revised up their near-term inflation path, now forecasting 4.7% in 1Q24 from 4.3% previously, but also changed their tone to relay that easing would be gradual once it occurs.

As a result, we now think the commencement of Banxico’s easing cycle is dependent on February’s inflation report, released March 7th. While a cut in March remains an option, Banxico’s emphasis on the inflation risks makes May the modal option in our view, especially as data out from the first two weeks of February once again shows core services inflation tracking at uncomfortably high rates. This suggests that the balance of risks to inflation is indeed still skewed to the upside, especially given that the labour market remains strong, with nominal wage growth rebounding to 9.3% at the beginning of the year, and with the economy operating with positive output gap despite the moderation of growth in 4Q23. The external backdrop also supports our view that Banxico will continue to delay its easing cycle. With expectations of the Fed’s easing cycle now delayed well into Q2, and Banxico’s Board of Governors stating that they are actively monitoring the impact of currency depreciation on the inflation trajectory, a March rate cut could be ruled out solely on the impact earlier easing will have on imported inflation.

“Based on our updated call of no cuts until May, we think MXN will remain well supported around the 17.00 handle, even in a market environment where speculation over a higher Fed terminal rate re-emerges.”

This is not only due to the higher levels of relative carry that MXN will hold as rates on other high yielding currencies are cut further, but due to the conditions in which the Fed would be forced to acknowledge a higher terminal rate – higher structural growth and inflation rates. Due to the interlinked nature of the economies, this would naturally raise the prospect of a higher terminal rate in Mexico, leading MXN to retain its defensive properties in a higher rates environment. That said, risks to our sustained bullish view on MXN are tilted to the downside in the near-term, largely due to the latent risk that core inflation does in fact cool in February, leading Banxico to join its regional peers in slashing rates.



Forecasts

Currency Pair	1-month (31 st March 2024)	3-month (31 st May 2024)	6-month (31 st August 2024)	12-month (28 th February 2025)
G10				
EUR/USD	1.07	1.07	1.10	1.14
USD/JPY	150	140	138	130
GBP/USD	1.26	1.26	1.28	1.32
USD/CHF	0.91	0.92	0.89	0.88
USD/CAD	1.37	1.38	1.36	1.32
AUD/USD	0.66	0.67	0.70	0.74
NZD/USD	0.61	0.62	0.65	0.69
USD/SEK	10.7	10.7	10.0	9.5
USD/NOK	10.65	10.4	9.7	9.3
DXY	105.04	104.17	101.62	97.84
Emerging Markets				
USD/CNY	7.18	7.15	7.0	6.8
USD/INR	83	83	82	80
USD/SGD	1.34	1.34	1.30	1.28
USD/ZAR	19.0	19.0	18.0	17.0
USD/TRY	32	33	33	28
USD/PLN	4.0	4.0	3.8	3.7
USD/HUF	374	374	345	316
USD/CZK	24.1	24.3	22.9	21.6
USD/BRL	4.9	4.9	5.0	5.2
USD/MXN	17.0	17.1	17.1	17.0
Euro Crosses				
EUR/GBP	0.85	0.85	0.86	0.86
GBP/EUR	1.18	1.18	1.16	1.16
EUR/CHF	0.97	0.98	0.98	1.00
EUR/CAD	1.47	1.48	1.50	1.50
EUR/SEK	11.4	11.4	11.0	10.8
EUR/NOK	11.4	11.2	10.7	10.6
EUR/TRY	34.4	35.5	36.3	31.9
EUR/PLN	4.3	4.3	4.2	4.2
EUR/HUF	400	400	380	360
EUR/CZK	25.75	26.0	25.2	24.6
EUR/BRL	5.2	5.2	5.5	5.9
EUR/MXN	18.2	18.3	18.8	19.4

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