



MONEX

Week Ahead

15th - 19th April 2024

A break in the ranges

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INTRODUCTION

This week saw three of our key calls begin to play out in FX markets. First, that strong US data would eventually translate into more hawkish Fed expectations, and as a result, dollar strength. This week it was a US CPI that provided the catalyst. Coming in modestly ahead of expectations at 0.3% MoM, the details of the inflation report were enough to convince traders that the Fed now looks unlikely to have “sufficient confidence” to cut rates in June. The resulting jump in Treasury yields triggered a renewed pickup in the greenback, with the DXY index climbing 1.7% on the week to record its largest five-day gain since September 2022.

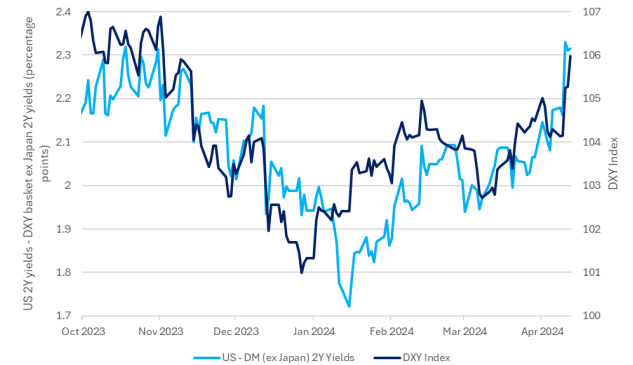
Our second call was that other central banks would begin signalling faster easing paths than markets had priced in light of weak domestic conditions, leading their expected rate paths to finally begin diverging from those of the Fed, having moved in lock step so far this year. As we noted in advance, we were expecting both the BoC and ECB to do just that in their meetings this week. Both central banks met those expectations, with commentary leaning dovish and opening the door to rate cuts commencing in June. For the BoC, this largely came in the form of the updated economic projections, which foresaw much weaker inflation conditions ahead. In the ECB’s case this was driven by a combination of policymaker interviews and “sources” stories following the meeting that also pointed towards a faster pace of easing through Q2, triggering an explosive sell-off in the euro, which triggered a broader USD rally against G10 FX on Friday. Third, volatility began to resurface in markets, as year-to-date ranges across a multitude of dollar pairs were broken and options markets awakened to the prospect of a more turbulent Q2 for markets.

JP Morgan’s global FX volatility index shot up from multi-year lows as options markets awakened to the risk of a more turbulent Q2



Next week, the economic calendar is a little more sparse, but what events we do have will once again be focused on the diverging paths for monetary policy. In Canada, March’s inflation data will be watched like a hawk. Granted, the headline measure is set to rise, but it is the core measures that will be doing all of the talking. Since the turn of the year, core inflation has cooled considerably, and if the current pace is maintained, the BoC’s 3-month annualised rates will drop to a 1-handle. Moreover, in the UK, markets will receive a slew of data, peaking with March’s inflation report. On the whole, the data should point towards a more optimistic UK economic outlook, but one that won’t have the BoE jumping for the scissors just yet. Inflation data is also due from Japan, which could lead BoJ policymakers to sound more hawkish; an outcome that would only assist in their defence against further JPY depreciation. Moreover, markets will hear from some heavy hitters in the monetary policy space. BoC Governor Macklem, ECB Executive Board members Lane and Schnabel, Fed Governors Jefferson and Goolsbee, NY Fed President Williams, and BoE Governor Bailey (twice) are all set to hit the wires. This should see volatility remain elevated next week.

Monetary divergence finally picks up steam in DM economies, resulting in rate differentials to widen in favour of the dollar



All told, the week finished with the entirety of the expanded majors closing in the red against the dollar. Markets remain on BoJ intervention watch with USDJPY trading north of 153, while sterling, euro and the loonie were left to plumb depths not seen since last November. That said, EM FX found itself more insulated from these moves. In Asia, the PBoC’s soft USDCNY peg combined with BoJ intervention concerns to stymie the worst of any selloff, whilst in Latin America, inflation developments meant that both Banxico and the BCB are likely to remain relatively cautious in easing policy this year, protecting their currencies from any significant depreciation. Given these developments, and the queries they have raised across our front office, we have dedicated this week’s look ahead to answering some of the burning issues that have been raised, and what we think they mean for FX markets going forward.

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ECONOMIC CALENDAR

All times in BST

Monday 15/04

Time	Country	Event	Period	Estimate	Prior
02:20	China	1-year Medium-term Lending Facility rate	April	2.50%	2.50%
07:30	Switzerland	Producer and import prices MoM (YoY)	Mar		0.1% (-2.0%)
08:00	Turkey	Unemployment rate	Feb		9.1%
08:30	Eurozone	ECB's Simkus speaks			
09:00	Switzerland	Domestic sight deposits	April 12		452.1b
12:15	UK	Bank of England's Breeden speaks			
13:00	Eurozone	ECB's Lane speaks			
13:30	US	Retail sales control group	Mar	0.3%	0.0%
15:00	US	NAHB housing market index	April	51	51

Tuesday 16/04

Time	Country	Event	Period	Estimate	Prior
01:00	US	Fed's Daily speaks			
03:00	China	GDP QoQ (YoY)	Q1	1.6% (4.8%)	1.0% (5.2%)
		New home prices MoM	March		-0.36%
		Retail sales YTD YoY	March	5.4%	5.5%
		Residential property sales YTD YoY	March		-32.7%
07:00	UK	ILO unemployment rate 3-months	Feb	4.0%	3.9%
		Employment change 3m/3m	Feb		-21k
		Payrolled employment change	March		20k
09:00	Eurozone	ECB's Rehn speaks			
10:00	Germany	ZEW survey expectations	April	34.0	31.7
	Eurozone	ZEW survey expectations	April		33.5
	Eurozone	Trade balance	Feb		28.1b
	UK	Bank of England Deputy Lombardelli tesitifes			
13:00	Poland	Core CPI MoM (YoY)	March	0.5% (4.6%)	0.5% (5.4%)
13:30	Canada	CPI MoM (YoY)	March	0.7% (3.0%)	0.3% (2.8%)
		Core CPI - Median YoY	March	3.0%	3.1%
		Core CPI - Trimmed mean YoY	March	3.2%	3.2%
14:00	US	Fed's Jefferson speaks at Monetary Policy Forum			
17:30	Eurozone	ECB's Villeroy speaks			
18:00	UK	Bank of England's Governor Bailey speaks			
18:15	Canada	Fireside chat with BoC Governor Macklem			
23:45	New Zealand	CPI QoQ (YoY)	Q1	0.6% (4.0%)	0.5% (4.7%)

Wednesday 17/04

Time	Country	Event	Period	Estimate	Prior
01:30	Singapore	Electronic exports YoY	March		5.2%
		Non-oil domestic exports MoM (YoY)	March	4.4% (-6.7%)	-4.8% (-0.1%)
07:00	UK	CPI MoM (YoY)	March	0.4% (2.9%)	0.6% (3.4%)
		CPI services YoY	March		6.1%
09:00	South Africa	CPI MoM (YoY)	March	0.9% (5.4%)	1.0% (5.6%)
		Core CPI MoM (YoY)	March	0.7% (4.9%)	1.2% (5.0%)
10:00	Eurozone	CPI MoM (YoY)	March F	0.8% (2.4%)	0.8% (2.4%)
12:00	South Africa	Retail sales MoM (YoY)	Feb		-2.1% (-3.2%)
	US	MBA mortgage applications	April 12		0.1%
13:00	Brazil	Economic activity MoM (YoY)	Feb	0.70% (3.2%)	0.60% (3.45%)
13:05	UK	Bank of England's Greene speaks on panel			
14:00	Eurozone	ECB's Cipollone speaks			
15:00	Sweden	Riksbank's Floden speaks			
16:45	Eurozone	ECB's Schnabel speaks			
17:00	UK	Bank of England Governor Bailey speaks in Washington			
19:00	US	Fed Beige book			
	UK	Bank of England's Haskel speaks			

Thursday 18/04

Time	Country	Event	Period	Estimate	Prior
02:00	China	Swift global payments CNY	March		4.0%
02:30	Australia	NAB business confidence	Q1		-6
		Employment change	March	10.0k	116.5k
		Participation rate	March	66.7%	66.7%
		Unemployment rate	March	3.9%	3.7%
	Japan	BoJ Board Noguchi speaks			
07:00	Switzerland	Imports / Exports MoM	March		3.8% / 0.2%
07:30	Sweden	Riksbank's Bunge speaks			
09:00	Eurozone	Current account	Feb		39.4b
	Poland	Consumer confidence	April	-12.0	-12.3
09:30	Hong Kong	Unemployment rate	March		2.9%
13:00	Eurozone	ECB's Nagel speaks in Washington			
14:15	US	Fed's Williams speaks			
15:00	Sweden	Riksbank's Jansson speaks			
16:00	US	Fed's Bostic speaks in fireside chat			
17:00	Switzerland	SNB's Martin speaks			
22:45	US	Fed's Bostic speaks in fireside chat			

Friday 19/04

Time	Country	Event	Period	Estimate	Prior
00:30	Japan	National CPI YoY	March	2.8%	2.8%
		National core-CPI YoY	March	2.7%	2.8%
07:00	UK	Retail sales MoM (YoY)	March	0.3%	0.0% (-0.4%)
		Core retail sales MoM (YoY)	March		0.2% (-0.5%)
13:00	Mexico	Retail sales MoM (YoY)	Feb		-0.6% (-0.8%)
15:15	UK	Bank of England's Ramsden speaks			
15:30	US	Fed's Goolsbee speaks			
20:00	Eurozone	ECB's Nagel speaks			

QUESTIONS FROM THE FLOOR

What does March's CPI data mean for the Fed and US rates?

In the short term, it appears to have killed off almost all prospects of the Fed cutting rates in the first half of this year. Swap market implied expectations of a rate cut in June have fallen from 55% at the start of the week, to just 25% now. Granted, the Fed does not target CPI inflation, but it instead watches the PCE measure. But having seen both CPI and PPI, a relatively good estimate for the March PCE can be calculated. Most sell side analysts expect this to come in around 0.3% MoM for March. This is rate of price growth that, if confirmed, would almost certainly be too hot for Fed voters to attain "sufficient confidence" that inflation will return sustainably to target. Particularly worrying on this score is the rebound of supercore inflation, seen by the Fed as a measure of domestically generate inflation pressures. This has risen for three successive months on a 3-month annualised basis and now lies at 8.2%, up from 4.0% in December and just 2.1% last July. Moreover, with only two more inflation prints due before the June meeting, the bar for price growth to cool enough to begin cutting rate in the first half of the year now looks unattainably high.

"As a result, we have pushed back our forecast for the first Fed rate cut to the September meeting, and now expect only two rate cuts in total across 2024, broadly in line with current market consensus."

However, the continued strength of inflation also raises longer term questions around neutral rates of interest in the US. If the economy can continue to generate robust growth and inflationary pressures, even with rates at 5.25-5.50%, it suggests that the rate needed to balance supply and demand in the

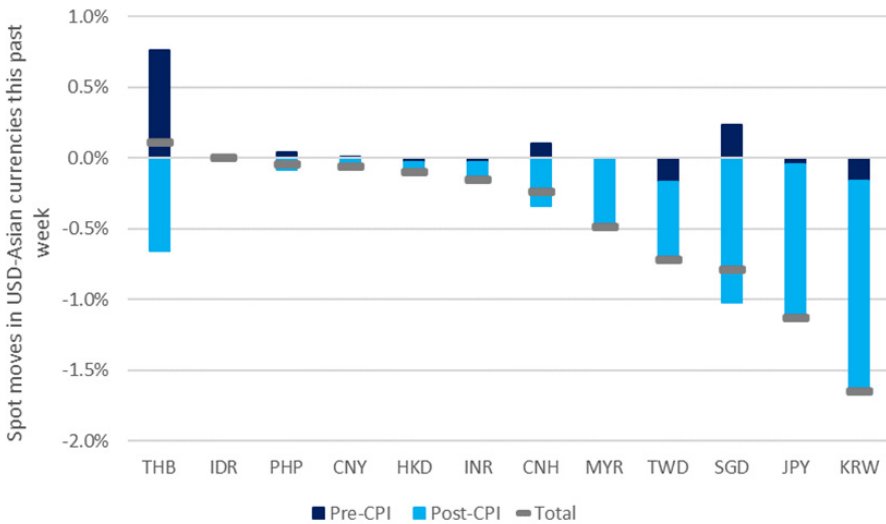
economy (r^*) has risen substantially when compared to the pre-Covid period. This is seemingly being recognised by the Fed as well. While Fed speakers have been reluctant to discuss r^* in public, it is notable that the long run median dot contained in the Fed's Summary of Economic Projections, rose in March. We suspect this is the first of many moves higher. If anything, the Fed remains behind the curve when it comes to pricing a higher neutral rate, with model-based estimates and market pricing broadly pointing to a higher estimate. Admittedly the range of these estimates is broad, but collectively we see them as suggesting that the Fed Funds Rate should ultimately settle in the 3-4% range.

That said, the recent strength of inflation has seen some suggest that r^* may in fact be even higher still. This is implicit in recent calls that the Fed may not need to ease policy rates this year at all. While we are sympathetic to the argument that US r^* has risen, we would also caution against reading too much into the strong growth, labour market and inflation readings since the start of the year. Several leading indicators are pointing to a slowdown in activity in Q2, particularly from recent NFIB surveys which have softened alarmingly, implying a normalisation in labour market and inflation conditions is set to take place. As such, we still expect the next move from the Fed to be a cut in rates, albeit one that will likely have to wait until September under our base case, given the lags with which this slowdown in activity will show up in official statistics. All told we expect this dynamic should put a ceiling on US yields over the coming months, keeping dollar upside contained. Instead, any further dollar appreciation pressure is likely to stem primarily from traders accelerating easing bets for other central banks, rather than from expectations for tighter Fed policy.

How much will higher Treasury yields impact Asian currencies and will we see another round of intervention?

March's hot CPI report saw the Treasury yields break significant psychological barriers; the 2-year soared north of 4.8% to print fresh year-to-date highs while the 10-year broke through 4.5% for the first time since late-November. We had long warned that a move higher in back-end yields above 4.5% would be deterministic for Asian currencies, namely the Japanese yen. That proved to be the case this week as USDJPY broke through the 152 level that had proven a ceiling for almost a month, leading the pair to chart highs last seen in Q2 1990. The combination of higher US yields and a weaker yen also had knock-on effects across the region, especially for trade-reliant currencies and those already under pressure from capital outflows due to wide rate differentials.

Asian currencies most exposed to trade and capital flows led losses against the dollar this week



However, despite the deterioration in cross-asset conditions, the move higher in USD-Asia pairs was somewhat limited. We think the reason for this was two-fold. First, the pace of the rally in yields was somewhat limited relative to the duration sell-off in 3Q23, while the scope for yields to rally is also limited from here – after all, the Fed will have to cut rates at some point. Second, while USDJPY broke fresh highs following this week's US inflation report, USDCNY continued to flatline at the top of its daily trading range as the PBoC maintained its daily fixings below 7.10. This has important implications for currencies within the region, as without CNY depreciation, other central banks are unlikely to allow further sustained depreciation of their currencies against the dollar as it would pose significant risks of exacerbating capital outflows and importing more

inflation. With currencies in the region already trading at significantly cheap valuations, this meant the pace of depreciation was relatively moderate. This was exemplified by price action in USDJPY. While the pair spiked alongside back-end Treasury yields on Wednesday, concerns over central bank intervention saw upwards momentum in the pair stall.

The scope for a further rally in 10-year yields is limited as the Fed should eventually begin to cut. This limited the extent to which Asian FX came under pressure this week



Although we don't see much room for US yields to climb higher and don't expect the PBoC's staunch defence of the yuan to change anytime soon, we think we could see continued depreciation in Asian currencies against the dollar. The absence of intervention from Japanese officials following Wednesday's inflation report suggests that USDJPY could climb to 155 over a tactical horizon, provided it converges to this level in a slow and steady manner.

“Moreover, we think higher US rates and the impact that will have on global growth sentiment could weigh further on KRW and MYR, both of which are subject to frail investor sentiment at present.”

Finally, with components of its S\$NEER basket set to depreciate, we now see further upside in USDSGD. However, as we noted in our MAS piece this week, we doubt USDSGD can return to last year's highs of 1.37 without significant moves in USDJPY above 155 and EURUSD below 1.05. While more substantive ECB easing could produce the latter, we doubt USDJPY can traverse 155 without another round of BoJ intervention as policymakers have previously stressed the speed of depreciation as one of the determining factors underpinning their actions.

The ECB were non-committal on rate cuts, so why did EURUSD break through 1.07?

The single currency fell close to 2% last week, its largest weekly decline since September 2022 and its eleventh worst week since the onset of the pandemic. Driving the weakness in the euro was the eventual divergence in easing bets for the ECB and the Fed after the US data supported more hawkish pricing in US rates and markets came to the realisation that the ECB would struggle to match them. While President Lagarde managed to avoid exacerbating this divergence by setting eurozone rates in the opposite direction at Thursday's meeting, markets came to their own conclusions shortly after, assisted by dovish commentary from ECB member Stournaras and this ECB sources article in the FT, both of which argued in favour of the ECB breaking away from the Fed. This saw eurozone bonds outperform Treasuries once again on Friday, leading yield spreads to widen further to the detriment of the euro. For markets, this was the fundamental reason that the bears needed to take the euro below 1.07, after weeks in which such attempts were stymied by sentiment over eventual Fed easing and improving global growth conditions.

EURUSD plummets below 1.07 as front-end rate differentials widen in favour of the greenback



The natural question is now how low can it go? We suspect things will get worse for the euro before it gets better, as implied by our Q2 forecast of 1.05. Ultimately, the ECB will be facing significantly different cyclical conditions to the Fed, which should warrant a string of successive rate cuts from June before the US central bank begins to loosen its grip on the economy. Moreover, with markets buying into the higher for longer scenario for the Fed, and the risks of them not cutting this year at all materially increasing, financial conditions globally should remain tight, diluting any support the euro may have received from improving global growth conditions. That said, we don't think the euro can slide back to parity as some doomsday analysts have suggested, at least not without another significant stagflationary shock from global commodity markets or an unexpected recession. Fundamentally, as much as the ECB attests that it isn't the Fed, there is a limit to how far it can de-anchor from the US central bank in the short-run without stoking another round of inflation via the import channel. Whether ECB policymakers like it or not, they are only autonomous up until a point.

Can GBPEUR finally break 1.18?

This week's round of central bank meetings has finally put divergent easing paths front and centre for markets. As a result, both sterling and the euro hit year-to-date lows against the dollar. Yet, despite this, GBPEUR has remained largely unmoved. The cross continues to trade within the same 1% range that it has been stuck in for the past three months. In our view, however, this leaves GBPEUR primed for a breakout, with current levels not yet reflecting a number of factors that weigh in favour of sterling appreciation in the coming months.

Chief amongst these are the actions of the ECB and Bank of England. Markets have now close to fully priced a rate cut in June from the former following this week's policy decision. But the implied odds of a subsequent cut in July are less than 50%. We disagree, and expect the ECB will cut at both meetings, prompted by wage and inflation data that looks set to undershoot ECB forecasts based on recent outturns. We have good reason to think this view is shared by several Governing Council members as well based on the latest commentary. In contrast to the ECB, markets assign just a 50% chance that the BoE cuts in June, with their next policy decision only due in August. In this

case, however, uncertainty around disinflation due to the impact of April wage rises leads us to think that the MPC will ultimately try to avoid cutting rates until H2. If our base case is met then, this would leave the ECB to cut rates twice before the BoE begins easing policy, an outcome that should support GBPEUR upside in the coming months as markets come to a similar realisation.

“Despite our expectations for UK rates to remain elevated for the time being, it is also notable that real wages in Britain have now been positive for almost a year, something we think is unlikely to change.”

Our base case has been that this would support a recovery in economic activity in the UK, a dynamic that is beginning to play out based on the improved GDP readings since the start of the year. Not to mention, it should also underpin house prices that have also started to show signs of recovery in recent months. This is in sharp contrast to the eurozone, where forward looking indicators continue to look disappointing, implying the growth on the continent is set to remain subdued until at least the second half of the year. When set against US growth that we expect to begin slowing, this leaves the UK looking relatively more attractive as a destination for capital, doubly so given that UK assets are still trading with a post-Brexit discount.

Towards the back end of the year, external conditions should also favour sterling against the euro on net. The pound's relatively higher beta to global growth conditions should support GPPEUR through the second half of the year as coordinated easing by G10 central banks sees a broad improvement in global risk conditions. Moreover, we do not expect a general election in Q4 to weigh unduly on the pound. A large poll leads for Labour, the prospects of closer UK-EU relations, and little risk of major tax rises based on policy announcements to date, should mean that pre-election jitters are kept to a minimum for sterling traders. All told, we think this adds up to GBPEUR rising to the top of its post-Brexit range, targeting 1.18 by the end of Q2, with expectations that the pair can move higher yet in Q3.

Disinflation resumed in Mexico and Brazil, do these central banks have a clearer path of tightening?

This week seemed to be all about inflation as well in Latin America. The releases of CPI and IPCA data from Mexico and Brazil, respectively, caught the attention of traders and analysts especially after both central banks came across hawkish at their recent meetings despite cutting rates. In the case of Mexico, Banxico's Board of Governors decided to cut its benchmark interest rate by 25 basis points to 11.00% for the first time this cycle, having previously kept rates on pause for 12 months. However, the accompanying guidance suggested that this wouldn't be the start of a successive easing cycle, but

instead the beginning of a bumpy path. The BCB's Copom also sounded hawkish on net, despite unanimously deciding to cut the Selic rate by 50 basis points for the sixth consecutive time to 10.75%. This is because the tone throughout the statement tightened consistently. Most striking, in our view, was the shift from anticipating cuts of the same magnitude, in the plural, to anticipating “a reduction of the same magnitude at the next meeting”, singular, explicitly guiding markets towards a slower pace of easing from the May meeting onwards. While the latest inflation data from both economies undershot market expectations and showed renewed disinflationary progress on a headline basis, we doubt it will change the view amongst policymakers at each Bank. After all, both sets of policymakers took a more hawkish stance due to unwelcoming underlying inflation dynamics, which still remain prominent in March's data.

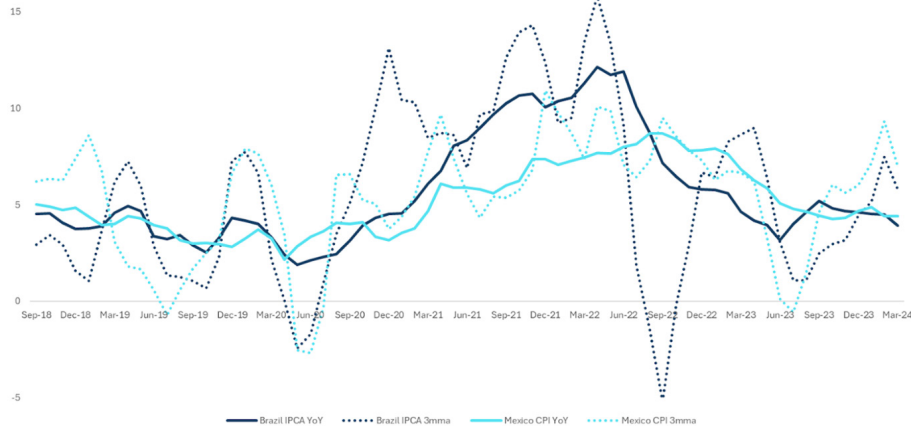
“In Mexico, core inflation continued to moderate, falling 0.09pp in March to just 4.55% YoY, undershooting Banxico's Q1 forecast of 4.6%.”

Moreover, headline inflation rose only moderately to 4.42% YoY in March, undershooting expectations and Banxico's forecast of 4.7%. Nevertheless, the data revealed the same concerns that kept Banxico cautious last month. Despite the decline in the annual rates of inflation, the three-month annualised pace of core inflation rose further in March, climbing to 5.45%, suggesting the disinflation trend in the annual core measure should soon reverse. Moreover, core services inflation remained unfavourable, reflecting high levels of consumer demand and limited slack in the labour market.

“The index reached a new 10-month high last month, and together with the accelerated momentum in underlying inflation, validates Banxico's more cautious stance towards easing.”

A similar story was also visible in Brazil. While headline and core inflation came in significantly below economists' forecasts in March, reversing the previous three-month trend of surprisingly strong inflation prints, the details of the report once again exhibited the risks a tight labour market and looser policy have on future disinflation progress. Notably, policy sensitive core services inflation printed at 0.45% MoM, up slightly from February, to take annual core services inflation up 0.1pp to 4.99%. Labour sensitive services rose at a similarly alarming rate of 0.57%, lifting the annual measure too from 5.45% to 5.53%. This reflects the latent upside risks to the Copom's inflation forecasts, which should keep policymakers in Brazil relatively hawkish despite notable progress on the economy-wide data.

With three-month annualised rates above year-on-year rates, upside risks to inflation remain for Q2 in both Brazil and Mexico



All in all, we believe that although these latest reports have provided valuable updated information, they hardly change the central banks' baseline scenarios. In the case of Mexico, the March data shows upside risks to aggregate inflation measures remain pronounced, justifying the "vigilant" and "cautious" approach that was evident throughout Banxico's rate statement at the March meeting. Given that the latest data suggest that these risks have not abated since the March meeting, we believe that Banxico's chosen strategy will be to wait for clear signs that core inflation is decelerating before cutting rates in a sustained manner, which we do not expect to happen until well into the third quarter.

"Until then, we believe that Banxico is likely to cut rates in non-consecutive meetings in order to avoid excessive policy easing that could trigger a reacceleration of the economy at a time when services inflation remains elevated and the labour market is tight."

In Brazil, the March inflation report, although better than expected, does not contradict the BCB's latest guidance. Our interpretation of the data concludes that, despite the signs of disinflation, risks to core inflation remain skewed to the upside. This is especially true in the context of the government's latest rumoured spending plans, which have suggested a further loosening in spending at a time when the economy remains capacity constrained. We therefore expect the BCB to cut rates by only 25bps in June after another promised 50bp cut in May, although upside risks to core inflation may justify a pause at this juncture if the rumoured spending plans are true.

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