14 July 2023

FX Forecast Outlook

Currencies
Global

July 2023

- The USD has been range bound and choppy for some time but we now expect this to change
- The end of the Fed's rate hike cycle is near, while risk appetite is holding up
- Signs of further improvement in the global growth-inflation mix and a US soft landing point to a weaker USD

Summary

EUR: We expect the EUR to grind higher against the USD this year, as downside data surprises are unlikely to persist and there is improvement in the broader macroeconomic backdrop.

GBP: GBP-USD may find it hard to go much beyond the 1.30 level, amid downside risks to current economic resilience.

JPY: Improvement in Japan's current account balance and higher inflation expectations should be positive for the JPY, while we are waiting for yield differentials to move in the JPY's favour.

AUD: With a hawkish RBA, we think that how much the AUD can benefit from a broad USD decline hinges on whether a more meaningful recovery in China takes place over the next six months.

CAD: The CAD will probably be supported by both yield differentials and risk appetite this year.

RMB (CNY): We are cautiously optimistic that the worse may soon be over for the RMB, assuming more policy support for growth over the coming months.

SGD: The slightly less dovish MAS is likely to keep the SGD supported this year.

INR: Against the backdrop of improving underlying picture, we expect USD-INR to grind lower by the end of the year, but the RBI's FX policy poses upside risks to our forecast.

MYR: Local issues and falling commodity prices could be weighing on the MYR over the near term.

Key upcoming events

Date	Event
25-26 July	The Federal Reserve's rate announcement
27 July	The European Central Bank's rate announcement
28 July	The Bank of Japan's rate announcement
1 August	The Reserve Bank of Australia's rate announcement
3 August	The Bank of England's rate announcement

Source: HSBC

HSBC FX forecasts

	Spot	Q3 23	Q4 23	Q1 24	Q2 24
EUR-USD	1.1241	1.13	1.15	1.15	1.15
GBP-USD	1.3138	1.30	1.30	1.30	1.30
USD-JPY	138.24	132	127	124	120
USD-CHF	0.8572	0.89	0.92	0.92	0.92
AUD-USD	0.6878	0.70	0.72	0.72	0.72
NZD-USD	0.6379	0.63	0.66	0.66	0.66
USD-CAD	1.3112	1.28	1.27	1.27	1.27
USD-CNY	7.1362	6.90	6.80	6.75	6.70
USD-SGD	1.3195	1.33	1.31	1.30	1.29
USD-INR	82.114	81.5	80.5	80.0	79.5
USD-MYR	4.5303	4.50	4.40	4.30	4.25

Source: HSBC forecasts, Bloomberg as at 17:17 HKT on 14/07/2023

Central Bank policy rate forecasts (%)

	Current	Q4 2023(f)	Q4 2024(f)
USD	5.00-5.25	5.25-5.50	4.50-4.75
EUR	4.00/3.50	4.50/4.00	4.50/4.00
JPY	-0.10	-0.10	-0.10
GBP	5.00	5.75	5.75

Source: HSBC forecasts for Fed funds, Refi rate/Deposit rate, Overnight Call rate and Base rate

Real GDP forecasts (%)

	2022e	2023(f)	2024(f)
US	2.1	1.6	0.7
China	3.0	5.3	4.9
Japan	1.0	1.1	0.7
Eurozone	3.5	0.4	0.7
UK	4.0	0.2	0.7

Source: HSBC forecasts

HSBC

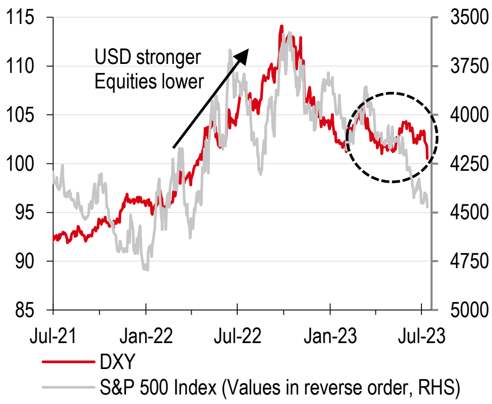
USD: Chasing the tail

- The USD has been range bound and choppy for some time but we now expect this to change and a further downward move to occur
- Markets have gone round in circles over the Fed outlook, but the end of the rate hike cycle is near, while risk appetite is holding up
- Signs of further improvement in the global growth-inflation mix and a US soft landing sow the seeds for USD weakness ahead

We have been emphasising the shifting drivers of the broad USD. Through most of last year, the US Dollar Index (DXY) exhibited a close inverse connection with risk appetite (which we use S&P 500 Index as a proxy), but this has been changing (Chart 1), as there has been a tighter association between the USD and yield differentials as of late.

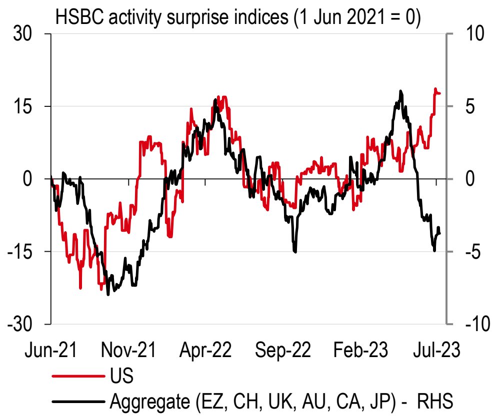
Much of this has been rationalised by the very positive growth surprises in the US compared to elsewhere, which became more noticeable over the past month (Chart 2). Subsequently, the belief that the US Federal Reserve (Fed) will have to maintain a 'higher for longer' stance is another feature that has mattered more for the USD (Chart 3, overleaf).

1. The relationship between equities and the USD has diverged recently



Source: Bloomberg, HSBC

2. US activity surprises have diverged meaningfully from other countries



Source: Bloomberg, HSBC

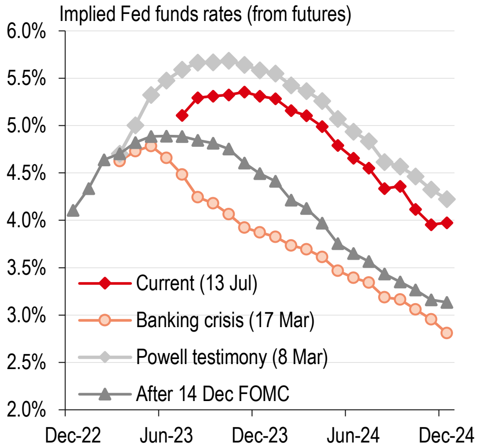
In some ways, it seems like we have been going around in circles. There has been a regular pattern of the market thinking the Fed would soon stop raising rates and then embark upon an easing period. This constant back and forth about what the Fed would do has kept the USD generally range bound year-to-date.

The question is whether this will be sustained. We are doubtful, which means the 'range bound' behaviour of the broad USD should end, if it has not already. This is our central case through the rest of this year and into 2024.

The end of the Fed's hiking cycle will help to soften the USD, and further signs of inflation ebbing will also matter – as we have already witnessed. But to really see the USD's range bound behaviour finish and renewed weakness emerge, stronger evidence that a softer landing for global growth, including the US economy, must also materialise.

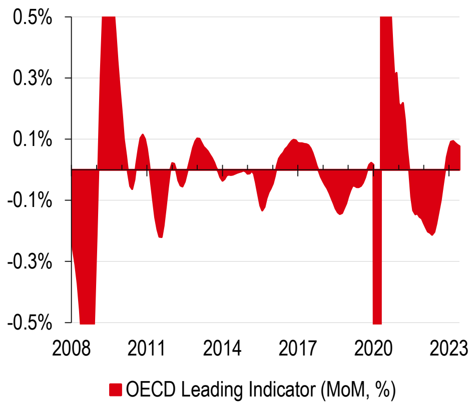
We are modestly optimistic that such conditions are materialising when taking into account a few developments. For example, the OECD leading indicator bottomed out at the start of the year and has been rising modestly since (Chart 4). Looking at global PMI readings, this tentative recovery was led by the services sector. Meanwhile, the manufacturing industry remained in the doldrums in 1H23 but the contraction has not turned worse, compared to 4Q22 and there are nascent signs that the technology cycle could be bottoming (*Bloomberg*, 13 July 2023). Interestingly, global surprises on industrial production have started to turn higher, even while the survey data remain weak.

3. Fed rate cut expectations subsided meaningfully versus a few months ago



Source: Bloomberg, HSBC

4. The global growth indicator has recovered modestly since the start of the year



Source: OECD, Bloomberg, HSBC

Conclusion

In short, we believe the range bound USD is set to end, if it has not already, and its downtrend should resume.

EUR: Surprise, surprise

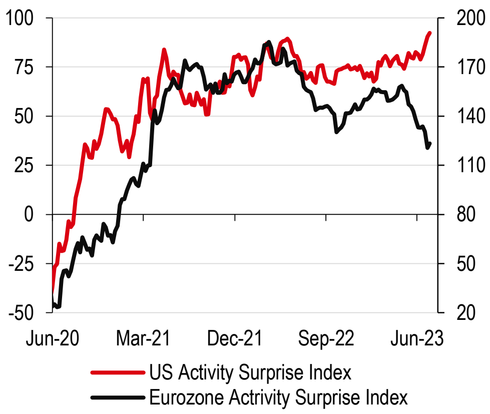
- Eurozone data surprises have taken a sharp turn for the worse…
- …but the EUR has been somewhat immune as external dynamics have offset local cyclical concerns
- It is rare for data to keep surprising to the downside to this degree, and the broader macro backdrop remains supportive for the EUR

The Eurozone economic data surprises have deteriorated sharply. These data disappointments have occurred as **US activity data have surprised to the upside** (Chart 1). This is the first notable divergence in the two surprise indices since the start of the post-pandemic recovery. While the EUR has faced some cyclical challenges in the last few months, we believe that there is little reason to shift away from the bullish view we have held since November last year.

History suggests that downside data surprises are unlikely to persist to the same extent as they have over the last few months. **The broader macro backdrop in Europe is also still improving.** For example, the positive impact of disinflationary pressures continues and will remain a tailwind for consumers through the summer. There has also been a rapid turnaround in the Eurozone's current account position, which dipped into deficit territory in 2022 but is now improving sharply (Chart 2). All this should provide some upside to the EUR, especially if FX markets continue to take more of a lead from risk appetite rather than interest rates, in the months ahead.

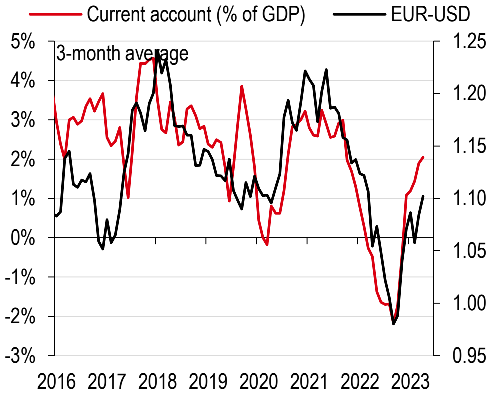
We maintain our forecasts that EUR-USD will grind higher to 1.15 this year.

1. Eurozone activity data surprises diverging to the downside versus the US



Source: Bloomberg, HSBC

2. Improving terms of trade continue to help the current account rebalancing



Source: Bloomberg, HSBC

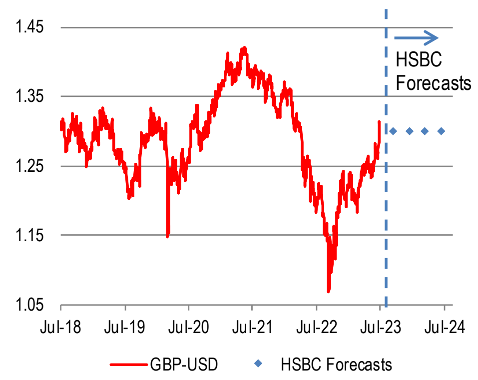
			Past performance			Forecasts			
FX	**L-T view***	**Spot**	**1mth**	**3mth**	**6mth**	**Q3 23**	**Q4 23**	**Q1 24**	**Q2 24**
EUR-USD	↗	1.1241	3.80%	2.27%	3.87%	1.13	1.15	1.15	1.15

Source: HSBC forecasts, Bloomberg as at 17:17 HKT on 14/07/2023
*L-T = long-term

GBP: Leader of the pack

- **The GBP has persistently outperformed in G10 currencies**, rising nearly 8.7% year-to-date versus the USD (*Bloomberg*, 13 July 2023). This has been largely in line with our expectations that a resilient UK economy, rebounding consumer confidence amid easing supply side inflationary pressures, and an improved external backdrop would help the GBP to flourish.
- Admittedly, some aspects of the economy – for example, the labour market and sticky services inflation – have surpassed the strength we anticipated. This has led the Bank of England (BoE) to stay increasingly hawkish compared to many of its G10 peers, allowing **the GBP to benefit from both higher rates and firm risk appetite**.
- But we caution that, after the summer and beyond our forecasts of a 1.30 peak in GBP-USD, it may become harder for the GBP to keep making such gains. **Prior monetary tightening will only bite harder through time**, and with fewer supportive disinflationary forces in Q4, there are **downside risks to current economic resilience.** While we remain bullish, we are closely watching to see if such signs become more apparent as this could curb GBP gains.

GBP-USD



Source: HSBC, Bloomberg

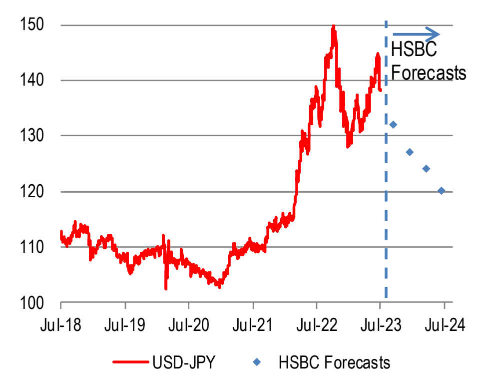
			Past performance			Forecasts			
FX	**L-T view***	**Spot**	**1mth**	**3mth**	**6mth**	**Q3 23**	**Q4 23**	**Q1 24**	**Q2 24**
GBP-USD	→	1.3138	3.74%	5.84%	7.74%	1.30	1.30	1.30	1.30

Source: HSBC forecasts, Bloomberg as at 17:17 HKT on 14/07/2023
*L-T = long-term

JPY: All quiet on the Eastern front

- USD-JPY has fallen but there is still a small risk it may rebound later – we consider some conditions that may trigger the Japan's Ministry of Finance (MoF) to intervene. If we consider month-on-month and week-on-week increases, **USD-JPY rising to around 148 could be regarded as rapid.** Our study based on a few factors, such as yield differentials and volatility index, suggest that **levels exceeding 145 could be deemed as excessive.**
- MoF's intervention could buy time until the underlying fundamentals for USD-JPY change. Our economists expect **the Bank of Japan to make adjustments to the yield curve control policy in 3Q** (probably more likely on 22 September than on 28 July).
- Extreme JPY undervaluation is already raising inflation expectations and improving Japan's current account balance. **We still expect the JPY to strengthen this year and into 2024.**

USD-JPY



Source: HSBC, Bloomberg

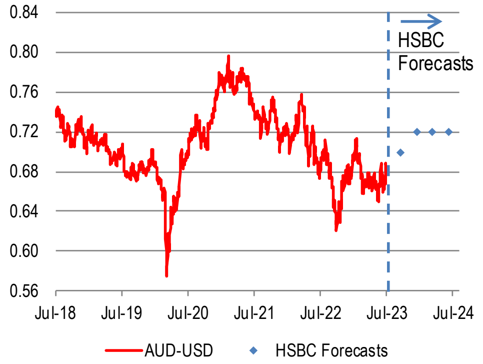
			Past performance			Forecasts			
FX	**L-T view***	**Spot**	**1mth**	**3mth**	**6mth**	**Q3 23**	**Q4 23**	**Q1 24**	**Q2 24**
USD-JPY	↘	138.24	-1.32%	3.33%	7.51%	132	127	124	120

Source: HSBC forecasts, Bloomberg as at 17:17 HKT on 14/07/2023
*L-T = long-term

AUD: Recipe of strength

- Our recipe of a higher AUD-USD over 2H23 requires three key ingredients:
  1. China's recovery needs to accelerate, particularly in the property sector, which may improve the demand outlook for Australia's key exports and help to stabilise Australia's terms of trade.
  2. The Reserve Bank of Australia (RBA) needs to remain hawkish, which should see yield differentials moving in the AUD's favour.
  3. A gradual recovery in global growth with continued disinflation, which may bolster risk appetite, reduce market volatility, and weaken the broad USD.
- Under our base case, **the third ingredient is expected be in place in 2H23**, while we think that **the RBA will likely remain hawkish** amid its inflation expectations.
- So, how much the AUD can benefit from a broad USD decline hinges on China's recovery prospects. **We maintain a year-end AUD-USD forecast of 0.72, but acknowledge that risks are likely skewed towards the downside.**

AUD-USD



Source: HSBC, Bloomberg

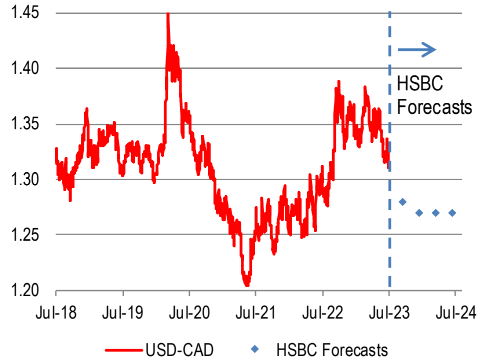
FX	L-T view*	Spot	Past performance 1mth	3mth	6mth	Forecasts Q3 23	Q4 23	Q1 24	Q2 24
AUD-USD	↗	0.6878	1.21%	2.55%	-1.11%	0.70	0.72	0.72	0.72

Source: HSBC forecasts, Bloomberg as at 17:17 HKT on 14/07/2023
*L-T = long-term

CAD: Rating the CAD

- Our forecasts for USD-CAD remain unchanged, as we continue to anticipate a move below 1.30 in the coming months to finish the year at 1.27. **The outlook for USD-CAD remains a blend of interest rate differentials and risk appetite**, with oil prices mostly taking a back seat in terms of relevance for now.
- On the rate differential side, both the Fed and the Bank of Canada (BoC) are signalling a willingness to tighten further, should the data warrant it. While the Fed has signalled that two more rate hikes are likely, the BoC has merely said decisions will be taken on a meeting-by-meeting basis. Arguably this leaves **a little more scope for a hawkish surprise from the BoC**, especially given elevated inflation and a resilient labour market. **The main negative risk to the CAD stems mostly from the highly leveraged household sector's vulnerability to the monetary tightening.**
- On the risk appetite front, the CAD continues to track moves in the S&P 500 Index. Given our view of US rates being close to their peak, a likely avoidance of deep recession in the global economy, and a disinflation trend during H2 2023, **we expect risk appetite (and the CAD) to remain supported**.

USD-CAD



Source: HSBC, Bloomberg

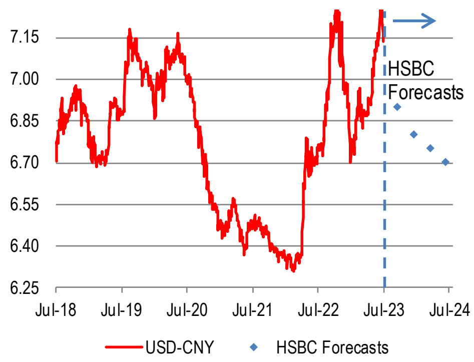
FX	L-T view*	Spot	Past performance 1mth	3mth	6mth	Forecasts Q3 23	Q4 23	Q1 24	Q2 24
USD-CAD	↘	1.3112	-1.59%	-1.96%	-2.21%	1.28	1.27	1.27	1.27

Source: HSBC forecasts, Bloomberg as at 17:17 HKT on 14/07/2023
*L-T = long-term

China (CNY): A turnaround?

- **USD-RMB seems to be losing upward momentum.** Both USD-CNH and USD-CNY fell below the 7.20 level. Lower US yields, a decline in the broad USD, and the unwinding of carry trades all helped the move lower in USD-RMB recently.
- On the domestic side, we think China Foreign Exchange Trade System (CFETS)'s fixing rates continued to deviate from Bloomberg estimates as of late, reinforcing the trend of a lower USD-RMB. **Sentiment around China has also turned slightly more positive**, supported by further extension of property developers' outstanding loans and heathier growth in new loans and corporate bond issuance. Together with the hope for more non-monetary stimulus to be announced by the end of the month, it may help put a floor on shorter-term RMB yields and cap the upside of USD-RMB over the near term, in our view.
- **For this decline in USD-RMB to sustain over the medium term**, we think some of the conditions need to further mature, including **lower US yields, a softening DXY, and the realisation of the market's expectations for more property sector support and fiscal spending**. **Positive risk sentiment and equity inflows** are also needed to overcome the negative impact via the rates channel.

USD-CNY



Source: HSBC, Bloomberg

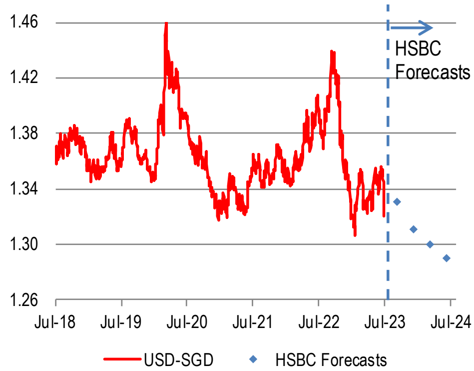
			Past performance			Forecasts			
FX	**L-T view***	**Spot**	**1mth**	**3mth**	**6mth**	**Q3 23**	**Q4 23**	**Q1 24**	**Q2 24**
USD-CNY	↘	7.1362	-0.36%	3.89%	5.91%	6.90	6.80	6.75	6.70

Source: HSBC forecasts, Bloomberg as at 17:17 HKT on 14/07/2023
*L-T = long-term

SGD: Slightly less dovish than in April

- The Monetary Authority of Singapore (MAS) published its annual report on 5 July. **The MAS is confident of a decline in headline inflation** (it lowered its 2023 forecast by 1ppt to 4.5-5.5%), but **it sees upside risk to its core inflation forecast** for the end of the year (2.5%).
- For the first time, the MAS used the word "pause" to address its policy decision made in April and emphasised that **it has not pivoted from "inflation fighting" mode to "growth supporting" mode.**
- We believe **the MAS is trying to sound slightly less dovish** than it did in April, because core inflation was higher than expected in April-May (actual: 4.8%; MAS's forecast: 4.4**%). We still think the MAS is done with policy tightening** but it may keep the nominal effective exchange rate (NEER) of the SGD on the high side until disinflation is back on track.

USD-SGD



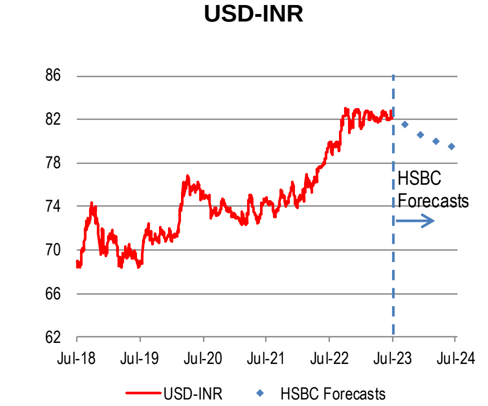
Source: HSBC, Bloomberg

			Past performance			Forecasts			
FX	**L-T view***	**Spot**	**1mth**	**3mth**	**6mth**	**Q3 23**	**Q4 23**	**Q1 24**	**Q2 24**
USD-SGD	↘	1.3195	-1.63%	-0.80%	-0.13%	1.33	1.31	1.30	1.29

Source: HSBC forecasts, Bloomberg as at 17:17 HKT on 14/07/2023
*L-T = long-term

INR: Underlying picture is improving

- USD-INR has been stuck in a narrow range of 81-83 for the past six months. Meanwhile, **the underlying balance of payments picture has improved** – India's combined goods and services trade deficit has narrowed substantially, to the point that it can be quite easily covered by remittances and foreign direct investment (FDI) inflows. Recent portfolio equity inflows are thus icing on the cake.
- As a high-yielding currency, **the INR may not benefit from a 'peak US rates and peak USD' theme as much initially.** Much also depends on the market's conviction about a "soft landing".
- **We still think USD-INR will grind lower by the end of the year**, but **the Reserve Bank of India's (RBI) FX policy is the key upside risk to our forecast.** The RBI has been accumulating FX reserves and it is forecasting USD-INR at 82 for this fiscal year.



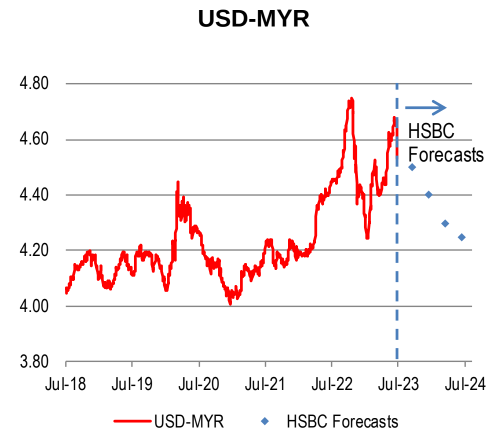
Source: HSBC, Bloomberg

FX	L-T view*	Spot	Past performance 1mth	3mth	6mth	Forecasts Q3 23	Q4 23	Q1 24	Q2 24
USD-INR	↘	82.114	0.01%	0.32%	0.61%	81.50	80.50	80.00	79.50

Source: HSBC forecasts, Bloomberg as at 17:17 HKT on 14/07/2023
*L-T = long-term

MYR: Lacklustre performance

- **The MYR is the worst performing Asian currency year-to-date**, losing 3.9% against USD, with most of the depreciation occurring in 2Q alongside the RMB (*Bloomberg*, 13 July 2023)
- Local issues, such as **a deteriorating current account**, locals' purchase of foreign assets and **a deeply negative rate differential with the US**, undermine the currency. The Bank Negara Malaysia (BNM) thinks that recent MYR weakness is excessive and said it will intervene.
- **Falling commodity prices** could also be weighing on the MYR. But **until the DXY's downtrend resumes and mainland China's recovery broadens, we believe the MYR may remain quite lacklustre over the near term.**



Source: HSBC, Bloomberg

FX	L-T view*	Spot	Past performance 1mth	3mth	6mth	Forecasts Q3 23	Q4 23	Q1 24	Q2 24
USD-MYR	↘	4.5303	-1.98%	2.93%	4.93%	4.50	4.40	4.30	4.25

Source: HSBC forecasts, Bloomberg as at 17:17 HKT on 14/07/2023
*L-T = long-term

Glossary

Dovish	Dovish refers to an economic outlook which generally supports low interest rates as a means of encouraging growth within the economy.
Hawkish	Hawkish is typically used to describe monetary policy which favours higher interest rates, and tighter monetary controls to keep inflation in check.
MoM, YoY	Month on month, year on year.
RMB CFETS Index	This index refers to the currency basket accepted by China Foreign Exchange Trade System (CFETS) comprising 24 currencies vs. RMB.
Curve	Refers to the yield curve for the respective country's sovereign bonds.
2's-30's curve	Refers to the difference in yield between 2-year and 30-year sovereign bonds for the specified country.
NEER	Nominal effective exchange rate.
PMI	Purchasing Managers Index – an indicator of economic health of the manufacturing sector (>50 represents expansion vs. previous month).
FDI	Foreign direct investment is an investment made by a company or entity based in one country, into a company or entity based in another country. It typically involves the investor having a significant degree of influence and control over the company in which the investment is made.

Fed	Federal Reserve System (US's Central Bank)
ECB	European Central Bank (Eurozone's Central Bank)
BoE	Bank of England (UK's Central Bank)
BoJ	Bank of Japan (Japan's Central Bank)
BoC	Bank of Canada (Canada's Central Bank)
PBoC	People's Bank of China (China's Central Bank)
RBA	Reserve Bank of Australia (Australia's Central Bank)
RBNZ	Reserve Bank of New Zealand (New Zealand's Central Bank)
SNB	Swiss National Bank (Switzerland's Central Bank)
MAS	Monetary Authority of Singapore (Singapore's Central Bank)
BNM	Bank Negara Malaysia (Malaysia's Central Bank)

Explanation of terms

Meaning of the arrows:

As per HSBC Global Research, an upward sloping (↗) / downward sloping (↘) arrow indicates that the first currency quoted in the pair is expected to appreciate/depreciate against the second currency quoted by the end of the last forecast period shown in the report. For example, an upward sloping arrow for EUR-USD means that the EUR is expected to appreciate against the USD by the end of the last forecast period.

A sideways arrow (→) indicates that the currency is expected to be at a similar level to the spot price stated in the report by the end of the last forecast period.

Note: The direction of the arrow is dictated by the difference between the spot price and the furthest forecast stated in the forecast table. Within that timeframe, it is quite possible that the currency is expected to move in an opposing direction. This is depicted both by the forecast 'dots' shown on the charts as well as in the forecast table.

Disclosure appendix

Important disclosures

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2 All market data included in this report are dated as at close 13 July 2023, unless a different date and/or a specific time of day is indicated in the report.

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