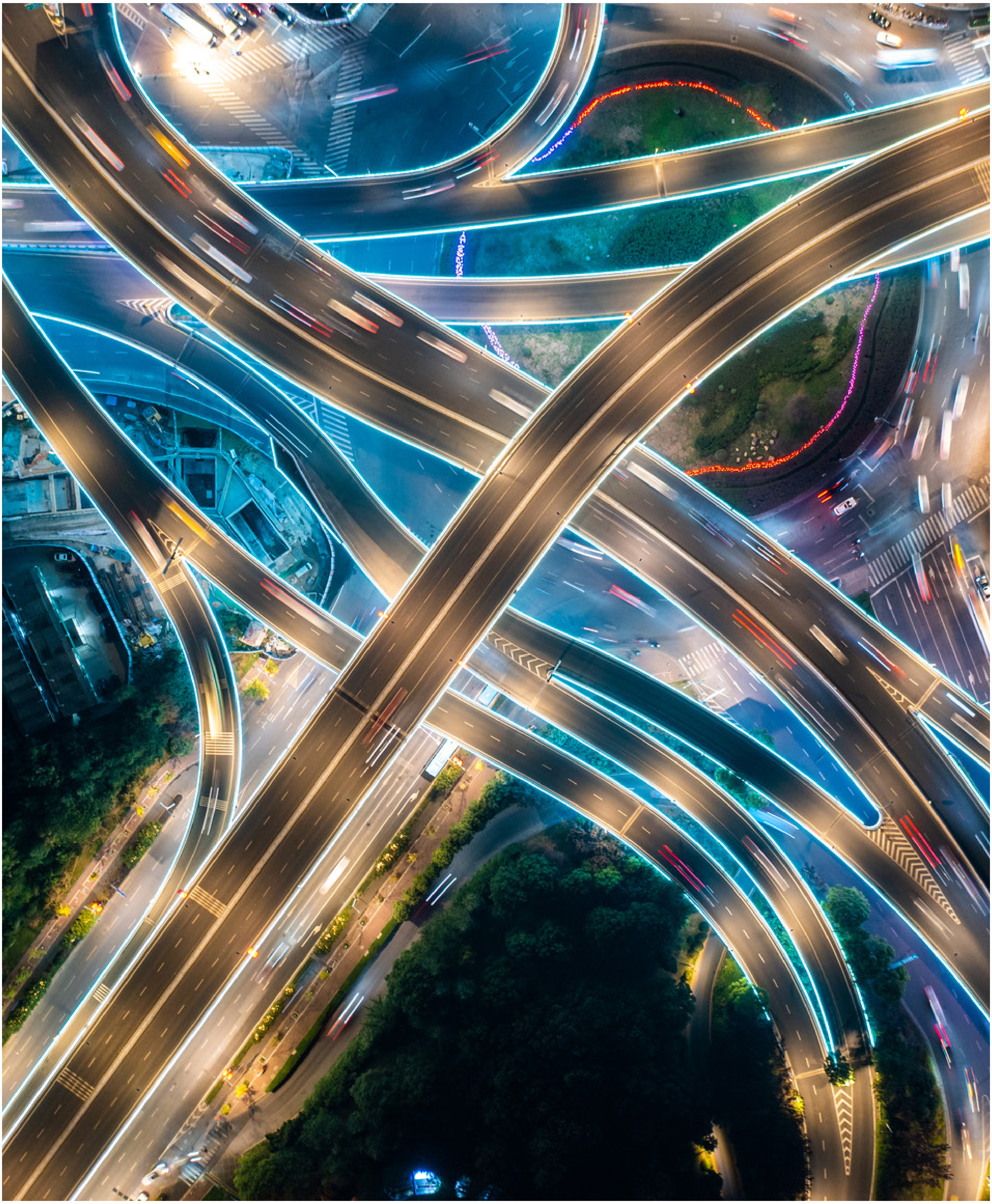
FX Pulse: 2024 Q4

The big ease

October 2024



Summary & conclusions

The Fed has joined the easing party and we expect it to ease more aggressively than other central banks over the next 12 months. Meanwhile, we think BOJ tightening will make JPY the strongest among major currencies.

Figure 1: Our favoured currencies and favoured hedging activity over the next 3 and 12 months

	Favoured currency	Hedge from	Hedge to
3M view	JPY, AUD	USD, HKD, EUR	AUD, JPY, CAD
12M view	JPY, AUD	USD, HKD, CNY	JPY, AUD, GBP

Note: See appendix for currency and central bank abbreviations.
Source: Invesco Global Market Strategy Office

Recent developments

The Fed was late to the easing party, with more than 40 other central banks having already cut interest rates during 2024 before the Fed's 19 September cut (according to CentralBankRates). Indeed, 42 central banks eased during 2024 Q4, with eight of them linked to our selection of the 10 most traded currencies (the BOJ and Australia's RBA were the exceptions).

But the Fed started the easing cycle with a bang, making a first rate cut of 50 basis points (bps). This was surprising in both its magnitude and timing (the Fed traditionally avoids making policy changes so close to an election). The accompanying FOMC member forecasts suggest there is a lot more to come. Markets agree, judging by Federal Funds futures, which suggest the upper end of the Fed's policy range will be around 3.00% by the end of 2025 (versus the current 5.00%).

To our surprise, the larger than expected Fed easing didn't depress the dollar (see Figure 2). Fed Chair Powell seemed to convince markets that the bigger than expected cut was designed to keep the economy on track and not a sign of concern about growth. We are not so sure.

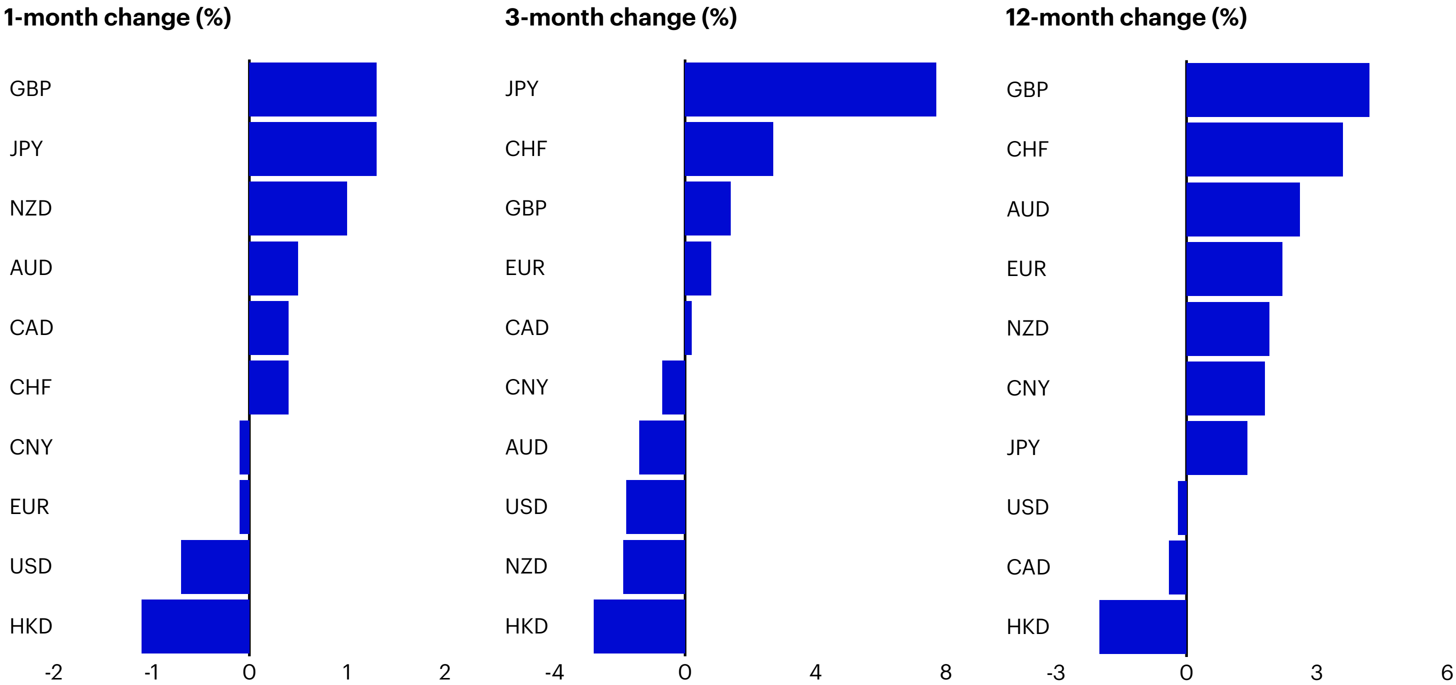
The post-Fed easing resilience of the dollar may also be explained by the fact that other central banks eased sooner than the Fed. For example, the Swiss National Bank (SNB) recently cut for the third time in six months, bringing its policy rate down to 1.00% (though CHF has been supported by positive fundamentals), while the ECB has already eased twice (each time by 25 bps).

The Chinese authorities have also been active, with PBOC rate cuts in July followed by a string of actions by the central bank and other governing entities in late September. This has revitalised the Chinese equity market but has not impacted CNY (see Figure 2). We expect these actions to support the Chinese housing market and economy, though how much is to be seen.

Elsewhere, GBP has shown the most consistent momentum, aided by the BOE's reticence to ease (the only cut so far was on 1 August 2024) and perhaps by the change in government. Likewise the reluctance of the RBA to ease has probably aided AUD, while BOJ tightening is no doubt behind the improved momentum in JPY.

On the other hand, we believe that Fed easing and rich valuations explain the weakness of USD and HKD.

Figure 2: Currency momentum (based on nominal broad trade weighted indices)



Notes: **Past performance is no guarantee of future results.** As of 30 September 2024. Based on JP Morgan Nominal Broad Trade Weighted Indices.
Source: JP Morgan, LSEG Datastream and Invesco Global Market Strategy Office

Fundamentals

We believe interest rate spreads have been supporting USD, with Figure 3 showing that other interest rates are lower than normal versus US counterparts. Indeed, with internal (budget balance) and external (current account) indicators suggesting the US economy is imbalanced, we think that generous rate spreads (and reserve currency status) were an important factor in USD strength over recent years. This could become critical if Donald Trump again becomes president (based on his 8 August 2024 press conference statement that when it comes to interest rate decisions "...the president should have at least (a) say in there. Yeah, I feel that strongly", as reported by CNBC).

Similar imbalances are seen in New Zealand and the UK, both of which also have large negative net international investment positions (the cumulation of historical current account positions), though not as big as the US.

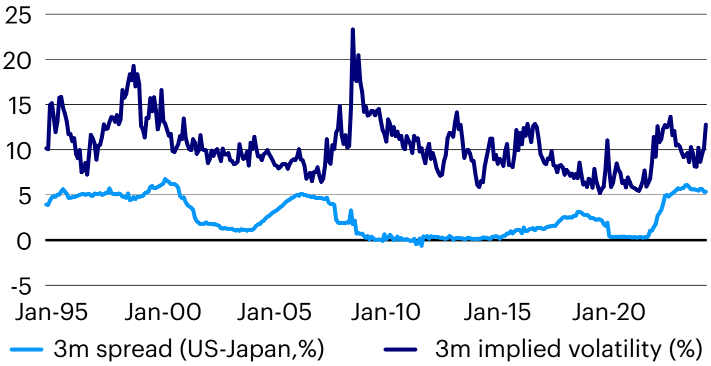
China, Japan and Hong Kong also have budget issues but their external positions are stronger, with current account surpluses and NIIP positions that are very healthy (they are net creditors to the rest of the world, while the US is a large net debtor). CHF is perhaps the currency with the best underlying fundamentals (budget surplus, large current account surplus and large positive NIIP), which may explain why it remains resilient despite 1.00% policy rates.

Unfortunately, USD is also more expensive than normal (compared to a broad basket of currencies, when adjusted for inflation differentials). CHF is the next most expensive, while JPY is at the other end of the spectrum (much cheaper than usual, even after the recent rally).

We suspect that positive fundamentals will result in upward pressure on CHF and HKD over the coming year. We believe that any such appreciation would be unwelcome: in Switzerland for reasons of export competitiveness and in Hong Kong because of the peg to USD. Hence, the respective central banks may need to take action to dampen their currencies.

Given the above cited valuation gap, we think that USDJPY will remain the focus for currency markets, now that the Fed has initiated an aggressive easing cycle, while the BOJ tightens. Figure 4 shows that the spread between US and Japanese interest rates has started to narrow and we believe this is the start of a multi-year process. At the same time, USDJPY implied volatility has risen, thus making carry trades from JPY to USD riskier, just as the potential reward for such trades (the interest rate spread) is diminishing. No wonder JPY has appreciated sharply from what we thought was an oversold level (USDJPY of 162). Despite the recent consolidation, we expect USDJPY to fall a lot further over the coming year (to 125, as shown in Figure 7).

Figure 4: USDJPY spreads and implied volatility

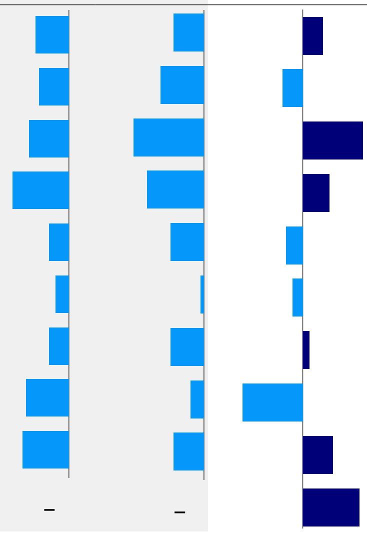


Note: Past performance is no guarantee of future results. Based on monthly data form January 1995 to September 2024 (as of 30 September 2024). 3m implied volatility is based on 3m currency options between the US dollar and Japanese yen. Source: LSEG Datastream and Invesco Global Market Strategy Office.

Given our belief that the US economy is slowing, and that the Fed will ease aggressively, we expect USD to be the weakest among our 10 focus currencies, with JPY and AUD expected to be the strongest (see the forecasts on the following page).

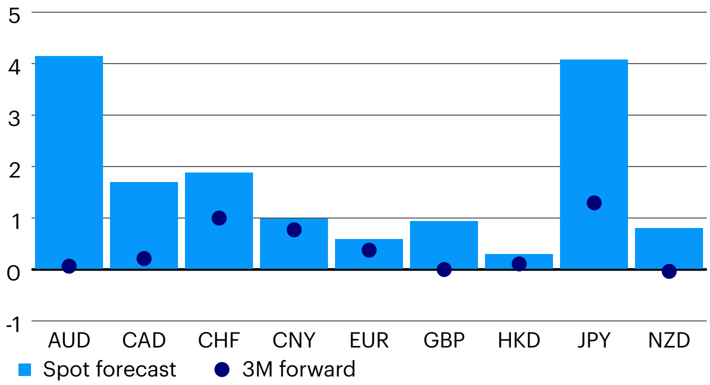
Figure 3: Currency fundamentals (as of 30 September 2024)

	GDP Growth 2024 (%)	CPI Inflation 2024 (%)	Current Account % of GDP	Budget Balance % of GDP	Net Intl Inv Pos % of GDP	Interest Rates 3M %	Interest Rates 10Y %	Spreads vs US 3M bps	Spreads vs US 10Y bps	Spreads vs US Std vs norm 3M	Spreads vs US Std vs norm 10Y	Real Effective Exchange Rate Std vs norm
AUD	1.5	3.4	0.5	-1.3	-32.8	4.5	4.0	-34.0	17.3			
CAD	1.3	2.1	0.3	-1.1	59.2	3.9	3.0	-92.0	-83.4			
CHF	1.3	1.4	8.2	0.5	102.1	0.9	0.4	-390.0	-338.5			
CNY	5.0	1.9	1.3	-7.4	16.5	1.9	2.2	-289.0	-163.0			
EUR	0.9	2.3	2.3	-2.9	4.2	3.3	2.1	-153.1	-165.7			
GBP	0.7	2.2	-2.6	-4.6	-31.4	5.0	4.0	17.0	21.9			
HKD	2.9	1.8	8.8	-4.5	473.4	4.2	2.8	-66.0	-97.0			
JPY	0.7	2.0	3.5	-6.5	78.8	-0.2	0.9	-501.5	-293.5			
NZD	1.0	2.4	-6.0	-3.5	-53.5	4.7	4.3	-16.0	48.9			
USD	2.6	2.4	-2.5	-6.5	-72.6	4.8	3.8	-	-	–	–	



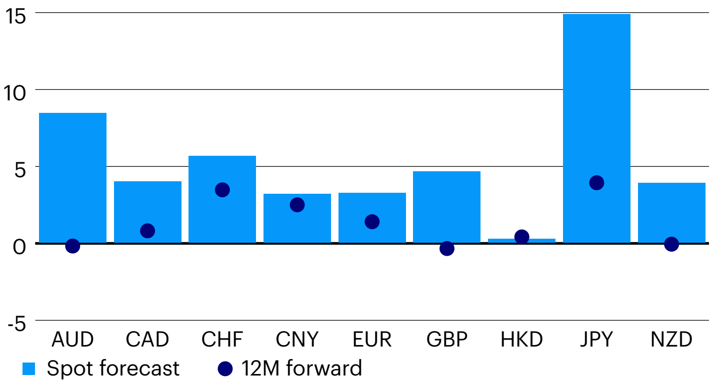
Note: GDP Growth, CPI Inflation, Current Account and Budget Balance are taken from the IMF World Economic Outlook (and are for 2024). Net International Investment Position (for 2023) is sourced from the IMF Balance of Payments Statistics (with GDP taken from the IMF World Economic Outlook). 3M (three-month) and 10Y (10-year) interest rates are sourced form Refinitiv. "Std vs norm" shows the current deviation from the historical average, expressed in standard deviations. Data used for the historical norm is from January 1990 to September 2024, with the following exceptions for start dates: AUD (Jan 1994 for 3M), CHF (Feb 1994 for 10Y), CNY (Jan 2002 for 3M and June 2002 for 10Y) and EUR (June 1990 for 3M and August 1992 for 10Y). Real Effective Exchange rate is provided by JP Morgan, using consumer prices to make the adjustment for inflation differentials, and the "norm" is measured over the period from January 1990 to September 2024. As of 30 September 2024. Source: IMF, JP Morgan, Refinitiv, LSEG Datastream and Invesco Global Market Strategy Office.

Figure 5: Projected 3-month return vs USD (%)



Note: **These projections may not come to pass.** "Spot forecast" shows projected currency changes versus USD based on our forecasts. "3M forward" shows the difference between the 3-month forward rate versus USD and spot rates. As of 30 September 2024.
Source: Refinitiv, LSEG Datastream and Invesco Global Market Strategy Office.

Figure 6: Projected 12-month return vs USD (%)



Note: **These projections may not come to pass.** ""Spot forecast" shows projected currency changes versus USD based on our forecasts. "12M forward" shows the difference between the 12-month forward rate versus USD and spot rates. As of 30 September 2024.
Source: Refinitiv, LSEG Datastream and Invesco Global Market Strategy Office.

Forecasts and hedging strategies

Figures 5 and 6 show our 3-month and 12-month currency forecasts in percentage change terms (versus USD) and compare them to market-based forward currency rates.

The forecasts are based on the information presented in Figures 3 and 7, with the 12-month forecasts placing more emphasis on fundamentals and forecast changes in interest rates and bond yields. The 3-month forecasts are also influenced by recent momentum, volatility and current interest rate spreads.

The following page gives more detail on individual currencies but the most important conclusion is that we expect all of our currencies to appreciate against USD on both a 3-month and a 12-month basis. Put another way, we expect USD to weaken, thus reversing the trends of recent years. This view is based largely on the expectation of rapid Fed easing.

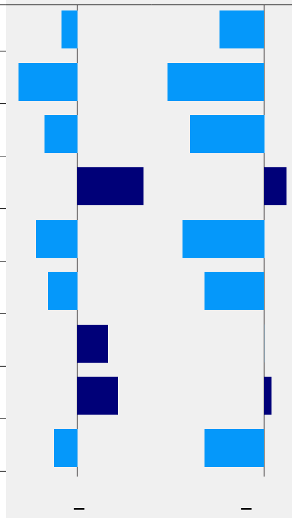
Though we expect other central banks to ease over the next 12 months (with the obvious exception of the BOJ), we expect the Fed to be more aggressive. We expect a narrowing of the spread advantage recently enjoyed by USD. As that spread advantage wanes, we expect the poor fundamentals of USD to become a factor.

Figure 7 shows the spot exchange rate forecasts and the most striking is that we expect USDJPY to fall to 125 over 12 months (from the current 144). Figure 6 shows the extent to which we expect JPY to outperform other currencies, largely on the belief that the BOJ will continue raising rates, while other central banks cut.

Figure 7 also shows conclusions about whether we think it worth hedging from other currencies into USD (based on a comparison of forecast currency movements and hedging costs, with a cushion for implementation costs). The answer is universally no. Figure 8 shows the conclusions for all currency crosses.

Figure 7: Currency forecasts and hedging strategies versus USD

	Momentum (% change)			FX rates			3M Projections			12M Projections			Implied Volatility Std vs norm	
	1M	3M	12M	Spot vs USD	3M fwd vs USD	12M fwd vs USD	3M rate bpsΔ	Spot FX vs USD	Hedge Into USD?	3M rate bpsΔ	Spot FX vs USD	Hedge Into USD?	3M	12M
AUD	0.5	-1.4	2.6	0.6914	0.6918	0.6902	0	0.7200	NO	-100	0.7500	NO		
CAD	0.4	0.2	-0.4	1.3525	1.3496	1.3416	-25	1.3300	NO	-100	1.3000	NO		
CHF	0.4	2.7	3.6	0.8456	0.8372	0.8172	-25	0.8300	NO	-50	0.8000	NO		
CNY	-0.1	-0.7	1.8	7.0185	6.9648	6.8469	-10	6.9500	NO	-30	6.8000	NO		
EUR	-0.1	0.8	2.2	1.1135	1.1176	1.1291	-50	1.1200	NO	-130	1.1500	NO		
GBP	1.3	1.4	4.2	1.3375	1.3374	1.3330	-50	1.3500	NO	-150	1.4000	NO		
HKD	-1.1	-2.8	-2.0	7.7728	7.7644	7.7402	-75	7.7500	NO	-180	7.7500	NO		
JPY	1.3	7.7	1.4	143.63	141.79	138.18	10	138.00	NO	50	125.00	NO		
NZD	1.0	-1.9	1.9	0.6349	0.6347	0.6346	-50	0.6400	NO	-150	0.6600	NO		
USD	-0.7	-1.8	-0.2	-	-	-	-75	-	-	-180	-	-	_	_



Note: **Past performance is no guarantee of future results. These projections may not come to pass.** Momentum is based on recent changes in JP Morgan Nominal Broad Effective Exchange rates. Spot and forward exchange rates are provided by Refinitiv and are expressed according to market norms. Projections are provided by Invesco Global Market Strategy Office and conclusions about whether to hedge into USD are based on a comparison between current forward rates and projected spot rates (with an annualised 1% hurdle rate of return designed to allow for implementation costs). Implied Volatility is based on 3m and 12m currency options between the US dollar and the respective currencies, as provided by Refinitiv. "Std vs norm" measures the distance from historical averages in standard deviations, based on monthly data starting in March 2003. As of 30 September 2024.
Source: JP Morgan, Refinitiv, LSEG Datastream and Invesco Global Market Strategy Office.

Australian dollar (↑↑)

We expect AUD to be supported by a central bank that is reticent to ease, due to a relatively high inflation rate, and by any growth boost in China. We expect AUD to be among the stronger currencies and would hedge into AUD from all but JPY (see Figure 8).

Canadian dollar (-)

Because the BOC is ahead of the Fed easing curve, we expect CAD to strengthen versus USD (as the Fed catches up). As with AUD, a rebound in the Chinese economy could help (via commodity prices). Hedging conclusions are mixed.

Swiss franc (↑)

CHF has strengthened despite SNB already cutting rates three times to 1.00%. Fundamentals are strong and other central banks will cut more rapidly, but the currency appears expensive and we expect SNB to resist CHF strength. Hedging signals are mixed.

Chinese yuan (-)

The PBOC has eased again but other central banks are easing more rapidly and CNY has broadly held its own. Though we expect appreciation against USD, we expect losses against some currencies. Low interest rates favour hedging into most other currencies.

Euro (-)

EUR is close to valuation norms and we expect the ECB to be in the middle of the central bank easing pack. We expect EUR to strengthen against USD but weaken against some other currencies. Hedging signals are mixed.

Sterling (-)

GBP has been strong (BOE reluctance to ease and a new government may have helped). Valuations are fair but fundamentals are weak (we think). BOE is likely to be slow to ease, which could help GBP. We think high rates make GBP a better hedging target, than funding source.

Hong Kong dollar (↓↓)

The peg to USD means the fate of HKD depends on the Fed. Fundamentals are strong, so HKMA may struggle to prevent appreciation against USD, especially if Chinese economy strengthens. We think it is worth hedging out of HKD into most currencies.

Japanese yen (↑↑↑)

JPY appears to have turned a corner (upward). It remains cheap and we expect interest rate differentials to narrow as the BOJ tightens. We expect JPY to be the strongest among our group of currencies and would hedge into yen from all counterparts.

New Zealand dollar (-)

NZD is a little expensive (we think), the current account deficit is large and RBNZ is easing more rapidly than its Australian counterpart. However, NZD may be helped for a while by relatively high rates that make it more appealing as a target for hedging than as a source.

US dollar (↓↓)

In our view USD remains expensive, has poor fundamentals and the Fed is about to ease more aggressively than other central banks. Hence, we expect recent poor momentum to continue and would hedge out of USD into most of this group of currencies.

Figure 8: 12-Month currency hedging decision matrix

From \ To	AUD	CAD	CHF	CNY	EUR	GBP	HKD	JPY	NZD	USD
AUD		X	X	X	X	X	X	✓	X	X
CAD	✓		X	X	X	✓	X	✓	—	X
CHF	✓	✓		X	X	✓	X	✓	✓	X
CNY	✓	✓	✓		✓	✓	X	✓	✓	X
EUR	✓	✓	—	X		✓	X	✓	✓	X
GBP	✓	X	X	X	X		X	✓	X	X
HKD	✓	✓	✓	—	✓	✓		✓	✓	—
JPY	X	X	X	X	X	X	X		X	X
NZD	✓	X	X	X	X	—	X	✓		X
USD	✓	✓	✓	—	✓	✓	X	✓	✓	

Note: The above matrix shows our analysis of whether it is economic to hedge currency exposure, based on a comparison of our 12-month currency forecast and the cost of hedging (using 12-month forward contracts). All currency pairings are tested (from the currencies down the vertical axis to those along the top). A tick signifies that the profit from hedging (currency movement less hedging cost) would be 1% or more (which we deem offers sufficient cushion to cover implementation costs). A dash signifies that the profit would be greater than zero but less than 1%, so may notv offer enough of a cushion. A cross signifies that the profit would be negative. This is a theoretical exercise and is for illustrative purposes only. It does not represent an actual portfolio and is not a recommendation of any investment or trading strategy. As of 30 September 2024.
Source: Invesco Global Market Strategy Office.

Appendix

Abbreviations for currencies

AUD	Australian dollar
CAD	Canadian dollar
CHF	Swiss franc
CNY	Chinese yuan (onshore)
EUR	Euro
GBP	British pound (sterling)
HKD	Hong Kong Dollar
JPY	Japanese yen
NZD	New Zealand dollar
USD	US dollar

Abbreviations for central banks

RBA	Reserve Bank of Australia
BOC	Bank of Canada
SNB	Swiss National Bank
PBOC	People's Bank of China
ECB	European Central Bank
BOE	Bank of England
HKMA	Hong Kong Monetary Authority
BOJ	Bank of Japan
RBNZ	Reserve Bank of New Zealand
FED	US Federal Reserve

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Important information

This document is intended only for Professional Investors in Hong Kong, for Institutional Investors and/or Accredited Investors in Singapore, for certain specific sovereign wealth funds and/or Qualified Domestic Institutional Investors approved by local regulators only in the People's Republic of China, for certain specific Qualified Institutions and/or Sophisticated Investors only in Taiwan, for Qualified Professional Investors in Korea, for certain specific institutional investors in Brunei, for Qualified Institutional Investors and/or certain specific institutional investors in Thailand, for certain specific institutional investors in Malaysia upon request, for certain specific institutional investors in Indonesia and for qualified buyers in Philippines for informational purposes only. This document is not an offering of a financial product and should not be distributed to retail clients who are resident in jurisdiction where its distribution is not authorized or is unlawful. Circulation, disclosure, or dissemination of all or any part of this document to any unauthorized person is prohibited.

This document may contain statements that are not purely historical in nature but are "forward-looking statements," which are based on certain assumptions of future events. Forward-looking statements are based on information available on the date hereof, and Invesco does not assume any duty to update any forward-looking statement. Actual events may differ from those assumed. There can be no assurance that forward-looking statements, including any projected returns, will materialize or that actual market conditions and/or performance results will not be materially different or worse than those presented.

All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. Investment involves risk. Please review all financial material carefully before investing. The opinions expressed are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

The distribution and offering of this document in certain jurisdictions may be restricted by law. Persons into whose possession this marketing material may come are required to inform themselves about and to comply with any relevant restrictions. This does not constitute an offer or solicitation by anyone in any jurisdiction in which such an offer is not authorised or to any person to whom it is unlawful to make such an offer or solicitation.

This document is issued in the following countries:

- in Hong Kong by Invesco Hong Kong Limited景順投資管理有限公司, 45/F, Jardine House, 1 Connaught Place, Central, Hong Kong.
- in Singapore by Invesco Asset Management Singapore Ltd, 9 Raffles Place, #18-01 Republic Plaza, Singapore 048619.
- in Taiwan by Invesco Taiwan Limited, 22F, No.1, Songzhi Road, Taipei 11047, Taiwan (0800-045-066). **Invesco Taiwan Limited is operated and managed independently.**

Authors

Paul Jackson
Global Head of Asset Allocation Research
Telephone +44(0)20 3370 1172
paul.jackson@invesco.com
London, EMEA

Global Market Strategy Office

Kristina Hooper
Chief Global Market Strategist
kristina.hooper@invesco.com
New York, Americas

Brian Levitt
Global Market Strategist, Americas
brian.levitt@invesco.com
New York, Americas

David Chao
Global Market Strategist, Asia Pacific
david.chao@invesco.com
Hong Kong, Asia Pacific

Tomo Kinoshita
Global Market Strategist, Japan
tomo.kinoshita@invesco.com
Tokyo, Asia Pacific

Paul Jackson
Global Head of Asset Allocation Research
paul.jackson@invesco.com
London, EMEA

Ashley Oerth
Associate Global Market Strategist
ashley.oerth@invesco.com
London, EMEA

James Anania
Investment Strategy Analyst, Americas
james.anania@invesco.com
New York, Americas

Thomas Wu
Market Strategy Analyst, Asia Pacific
thomas.wu@invesco.com
Hong Kong, Asia Pacific

Arnab Das
Global Market Strategist
arnab.das@invesco.com
London, EMEA

András Vig
Multi-Asset Strategist
andras.vig@invesco.com
London, EMEA

Telephone calls may be recorded

20241009-3921704-AP