

Highlights

By Stéfane Marion/Kyle Dahms

- Despite the continued resilience of the economy, the U.S. Federal Reserve continues to keep the greenback in check by with hints of monetary easing. However, the combination of easier financial conditions and a falling unemployment rate from already low levels are not the usual conditions for the start of monetary easing. We remain skeptical about the FOMC's guidance and expect monetary easing in the US to be less aggressive than in the rest of the world. As a result, we continue to expect the dollar to strengthen in the coming months.
- The Canadian dollar's lackluster performance against the US dollar has been a notable curiosity in 2024, particularly given the recent spike in oil prices. Canada's economic woes relative to its southern neighbor and a potential divergence in monetary policy are likely behind this development. As we continue to believe that rate cuts will be more aggressive on this side of the border, we still see USD/CAD moving above 1.40 in H2 2024. That said, the upcoming federal budget on April 16 is a potential wildcard for the currency.
- It has been an odd quarter for the Japanese Yen. After ending 2023 at its strongest level in several months, the island currency has depreciated to its weakest point in over 30 years in the ensuing three months. This, despite a first hike by the Bank of Japan in 17 years and indications that inflation and growth are showing resilience. The coming quarters likely hold some volatility for the third most traded currency in the world. While higher rates should translate into an appreciation for the Yen, we remain cautious in our outlook and are tabulating on a slight improvement over the next few quarters.

NBF Currency Outlook

Currency		Current	Forward Estimates			
		April 5, 2024	Q2 2024	Q3 2024	Q4 2024	Q1 2025
Canadian Dollar	<i>(USD / CAD)</i>	1.36	1.38	1.40	1.42	1.40
<i>United States Dollar</i>	<i>(CAD / USD)</i>	<i>0.74</i>	<i>0.72</i>	<i>0.71</i>	<i>0.70</i>	<i>0.71</i>
Euro	<i>(EUR / USD)</i>	1.08	1.06	1.04	1.03	1.04
Japanese Yen	<i>(USD / JPY)</i>	152	148	145	142	138
Australian Dollar	<i>(AUD / USD)</i>	0.66	0.65	0.63	0.63	0.64
Pound Sterling	<i>(GBP / USD)</i>	1.26	1.24	1.22	1.20	1.22
Chinese Yuan	<i>(USD / CNY)</i>	7.24	7.25	7.25	7.30	7.30
Mexican Peso	<i>(USD / MXN)</i>	16.5	17.0	18.0	18.5	19.0
Broad United States Dollar ⁽¹⁾		120.6	122.1	124.3	125.6	125.1

1) Federal Reserve Broad Index (26 currencies)

Canadian Dollar Cross Currencies

Currency		Current	Forward Estimates			
		April 5, 2024	Q2 2024	Q3 2024	Q4 2024	Q1 2025
Euro	<i>(EUR / CAD)</i>	1.46	1.46	1.46	1.46	1.46
Japanese Yen	<i>(CAD / JPY)</i>	112	107	104	100	99
Australian Dollar	<i>(AUD / CAD)</i>	0.90	0.90	0.88	0.89	0.90
Pound Sterling	<i>(GBP / CAD)</i>	1.71	1.71	1.71	1.70	1.71
Chinese Yuan	<i>(CAD / CNY)</i>	5.33	5.25	5.18	5.14	5.21
Mexican Peso	<i>(CAD / MXN)</i>	12.2	12.3	12.9	13.0	13.6

USD: The Fed is in a bind

It's been another month with little direction for the USD, which has been stuck in a tight range against a basket of 26 currencies since February – chart.

USD: Little direction for the greenback

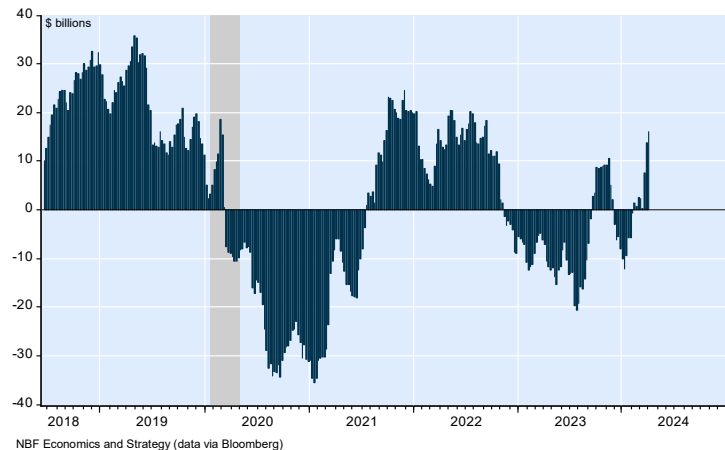
Trade-weighted USD* vs. a basket of 26 currencies



Despite the continued resilience of the economy, the U.S. Federal Reserve continues to keep the greenback in check by with hints of monetary easing. Whether Mr. Powell will be able to deliver on this guidance remains to be seen. In the meantime, speculators are getting a little suspicious and are now more bullish on the USD than they have been in almost two years (chart).

USD: Speculators are the most bullish two years

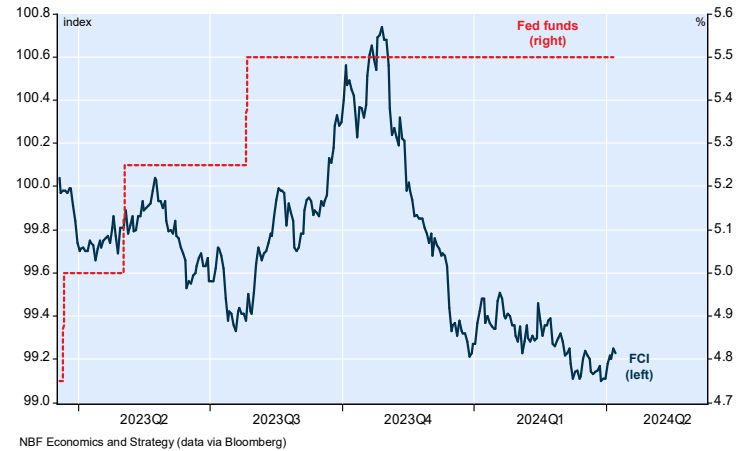
Net speculative positions of non-commercial traders on the USD



We don't disagree. After all, why would the Fed cut rates when overall financial conditions (an index that mixes interest rates, the exchange rate, equity valuations and credit spreads) are actually easier now than they were a year ago, when the fed funds rate was 75 basis points lower than it is today (chart)?

USD: Financial conditions easiest in a year

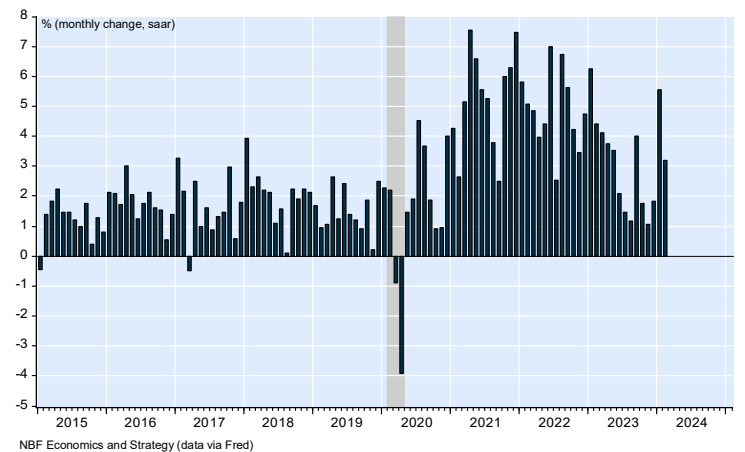
Federal funds rate vs. GS financial conditions index



Yes, it's true that the Fed has been able to point to slower inflation in recent months, but there are signs that progress on that front may be harder to come by now because of a stronger economy. The monthly change in the core PCE deflator has exceeded 3% in each of the last two months (chart).

U.S.: Core inflation is sticky

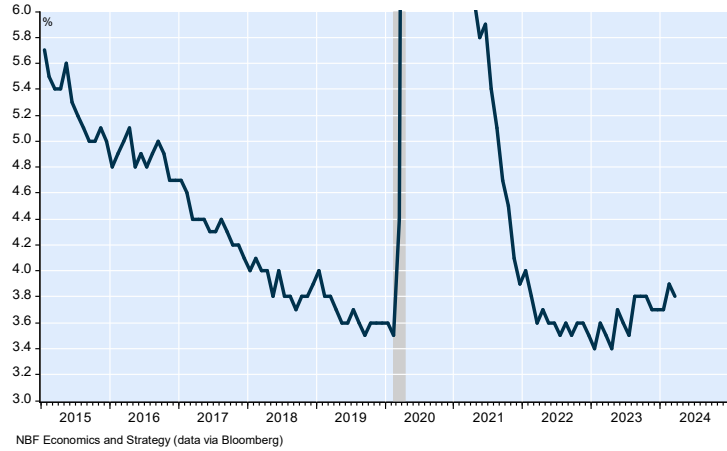
Core PCE deflator



And labour markets have yet to suggest below-trend growth, a necessary condition for bringing inflation down on a sustainable basis. Nonfarm payrolls rose by 303K in March, the best showing in about a year. Adding to the good news, prior months' data were revised upward by a cumulative 22K. For its part, the unemployment rate surprised to the downside, coming in at 3.8% in March (chart).

U.S.: Unemployment rate eases in March

Unemployment rate



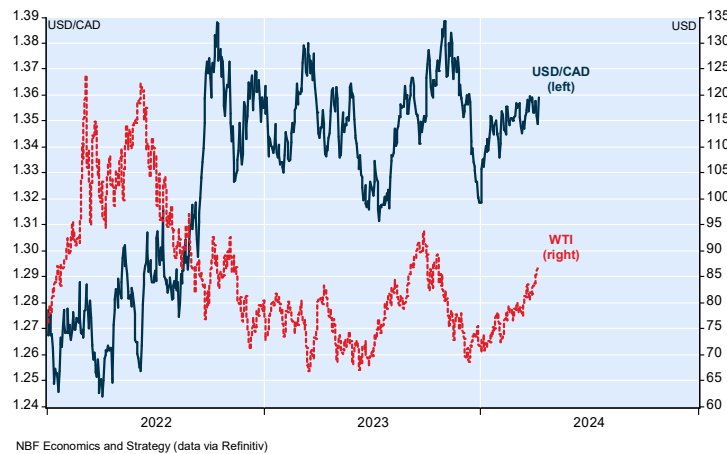
The combination of easier financial conditions and a falling unemployment rate from already low levels are not the usual conditions for the start of monetary easing. We remain skeptical about the FOMC's guidance and expect monetary easing in the US to be less aggressive than in the rest of the world. As a result, we continue to expect the dollar to strengthen in the coming months.

CAD: Oil vs. interest rates

The Canadian dollar's lackluster performance against the US dollar has been a notable curiosity in 2024, particularly given the recent spike in oil prices. Despite the robust start to the year for oil, with prices escalating from \$70 US to \$90 US per barrel, the Canadian dollar has paradoxically weakened, slipping from 1.32 to 1.36 against the U.S. dollar over the same period (chart).

USD/CAD: 1.36 despite \$90 oil

Canada-US exchange rate and WTI

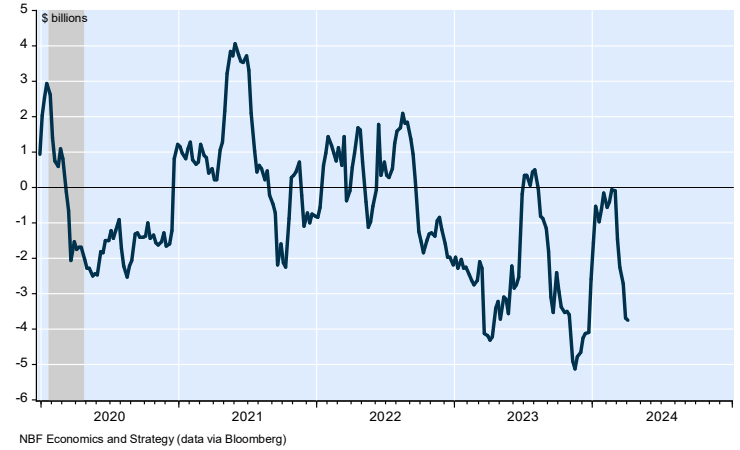


This unusual dynamic can be attributed to various factors, such as investor sentiment, divergent monetary policies between the Bank of Canada and the Federal Reserve and broader economic concerns. On the investor front, we note

that non-commercial traders have moved from neutral to very bearish on the Loonie in recent weeks (chart).

CAD: Speculators don't like the loonie

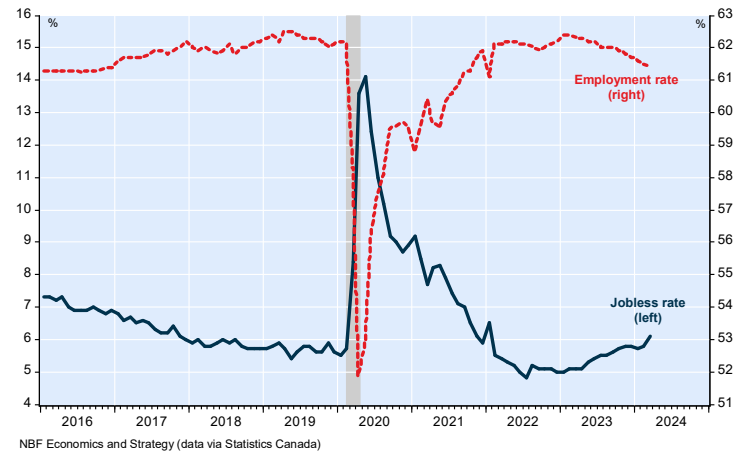
Net speculative positions of non-commercial traders on the CAD



Canada's economic woes relative to its southern neighbor and a potential divergence in monetary policy are likely behind this behaviour. Employment trends remain of particular concern. In contrast to the U.S., where labour markets have been resilient, Canada's unemployment rate rose above 6% in March, while the employment-population ratio fell to a 2-year low (chart).

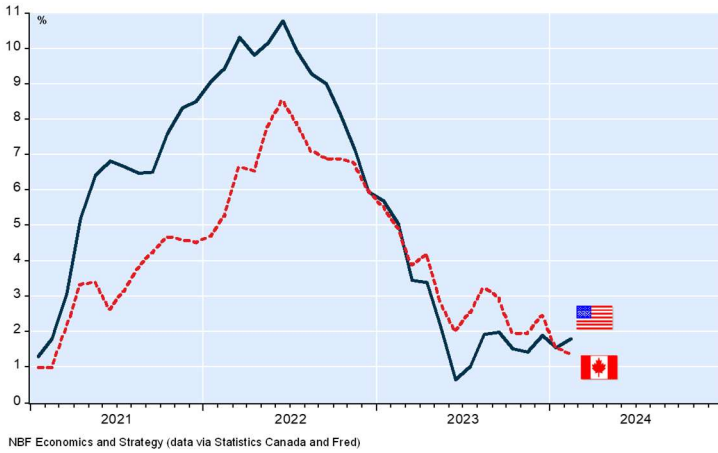
Canada: Labour markets are weakening

Employment rate and unemployment rate



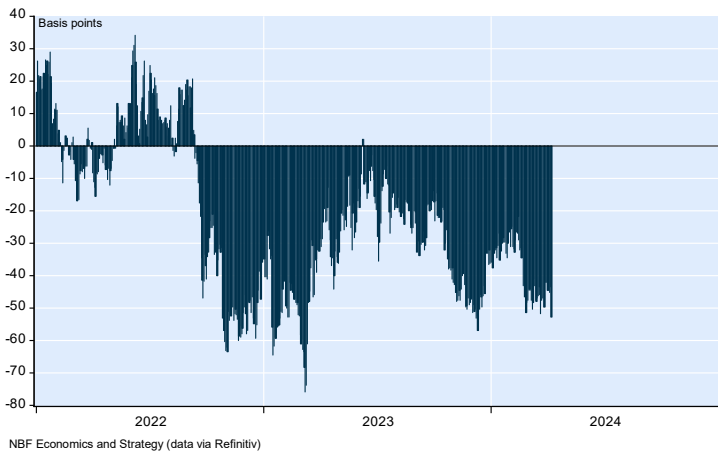
Continued weakness in domestic demand has translated into slower inflation. The CPI surprised on the downside in February with an annual increase of 2.8%. Excluding mortgage interest costs, inflation was a much tamer 1.9%, and excluding shelter, it was only 1.3%, down from more than 3% last summer (chart).

Canada: Inflation continues to fall
CPI excluding shelter



In our view, this turn of events sets the stage for a monetary policy divergence between the Fed and the Bank of Canada in 2024 and a possible further widening of interest rate differentials (chart).

Canada: Interest rate differential is widening
Canada-US spread on 2-year Treasuries



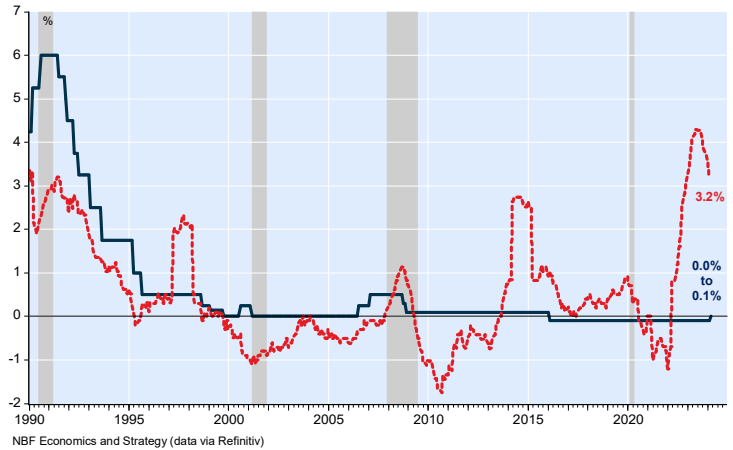
As we continue to believe that rate cuts will be more aggressive on this side of the border, we still see USD/CAD moving above 1.40 in H2 2024. That said, the upcoming federal budget on April 16 is a potential wild card for the currency if Ottawa opts to finance new program spending only through new debt issuance, a development that could lead the BoC to back away from cutting rates because of the fiscal stimulus.

JPY: Too little, too late?

It has been an odd quarter for the Japanese Yen. After ending 2023 at its strongest level in several months, the island currency has depreciated to its weakest point in over 30 years in the ensuing three months. This, despite a first hike by the Bank of Japan in 17 years and indications that inflation and growth are showing resilience. The coming quarters likely hold some volatility for the third most traded currency in the world.

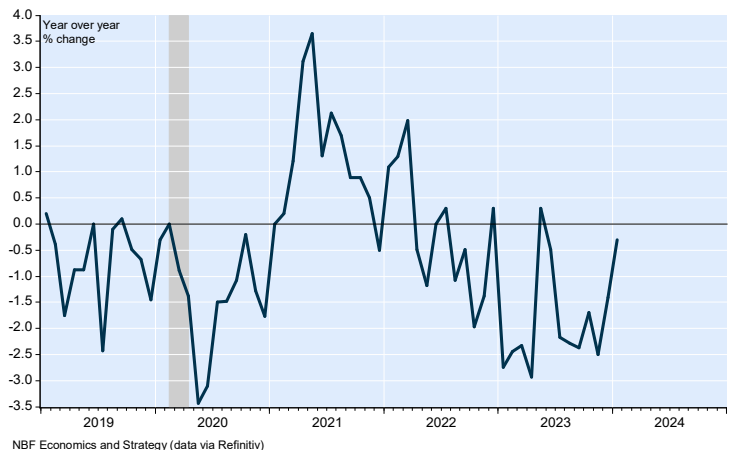
What was widely regarded as the biggest news for Japanese markets in the recent past was the relatively tame and long overdue switch from negative to more-or-less positive interest rates. Indeed, it marks the first time in 8 years that Japan no longer has a negative policy rate. The Bank of Japan had been laying the groundwork over the past few months, hinting at an attempt to normalize policy from its ultra-accommodative stance. The change in position was long overdue, especially as inflation has been running well above target for the last year. Combined with the quasi-abandonment of yield curve control, which had been putting pressure on the currency, it appeared that the pieces were in place for a strengthening of the Yen. But that was not to be.

Japan: Core inflation at odds with monetary policy
Bank of Japan Policy Rate & Consumer price index excluding food and energy (core-core)



The change in stance is perhaps a situation of too little, too late. On a comparative basis, the BoJ policy rate is well below the levels seen in other developed nations. Moreover, the central bank remains very accommodating on a real rate basis. Wages have also provided very little pressure over the last year, running for the most part below inflation.

Japan: Real wages remain negative
Real wage index

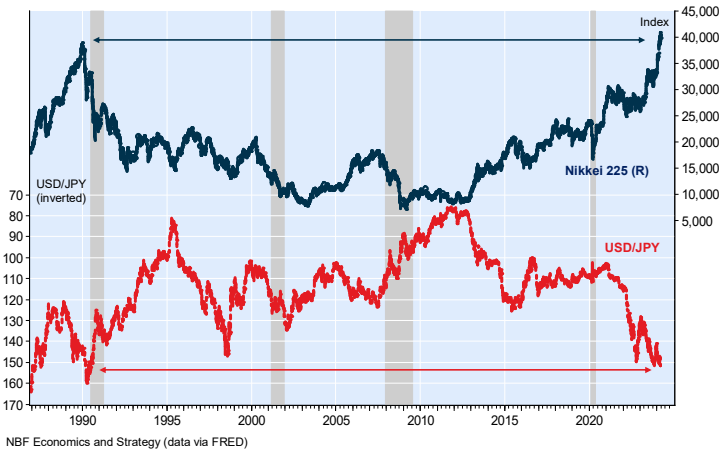


True, but that is about to change. The most prominent wage increases in over 30 years were bargained by the country's largest union group. Japan's biggest corporations agreed to raise wages by 5.3%, a level estimated to comfortably surpass inflation projections. With real wages expected to rise, Governor Ueda was recently more explicit in his wording towards higher rates, signaling that pay increases would spur further tightening. There is also a sensitivity to the currently weak Yen, and policy would take that into account.

The combination of rising labour costs and a less accommodating rate environment could dampen a feverish Japanese stock market. The Nikkei 225 recently surpassed its previous all-time high, propelled in part by a weak currency which has benefited exporters.

Japan: All-time high for equities while the currency wanes

Nikkei 225 Index and USD/JPY

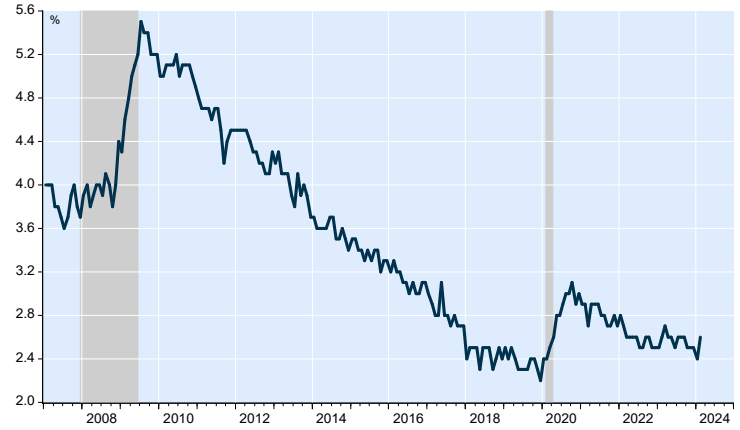


NBF Economics and Strategy (data via FRED)

The island nation's largest corporation, Toyota, upgraded guidance for the coming year on the back of already strong results. But the latter, among other businesses, has cited labour shortages and rising wages as concerns going forward. For small and medium size businesses, which account for the bulk of the Japanese economy, a weak Yen is counterproductive as import prices (inputs) remain elevated and are difficult to pass on to consumers. No matter the size of organization, the unemployment rate in Japan, remains near cyclical lows and will likely continue to be a challenge in a country with negative population growth.

Japan: The unemployment rate has increased but remains low

Unemployment rate

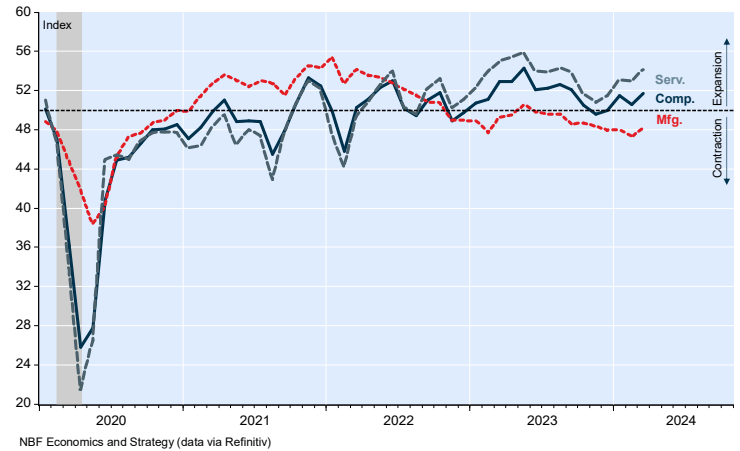


NBF Economics and Strategy (data via Refinitiv)

Nonetheless, growth perspectives for the country remain decent this year, although the manufacturing sector continues to lag services according to the latest PMI indicators. Assuming global demand remains adequate, economic growth should be positive in 2024.

Japan: Services sector surging, manufacturing still contracting

JiBun Flash PMI. Last observation: March 2024



NBF Economics and Strategy (data via Refinitiv)

Overall, while there are signs that the Japanese economy should hold this year, it is uncharted territory to quantifying the impacts of tightening monetary policy in a country with negative population growth. While higher rates should translate into an appreciation for the Yen, we remain cautious in our outlook and are tabulating on a slight improvement over the next few quarters.

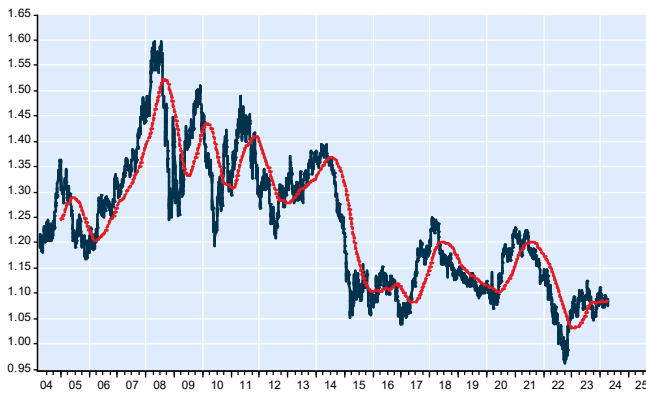


Regional Overview

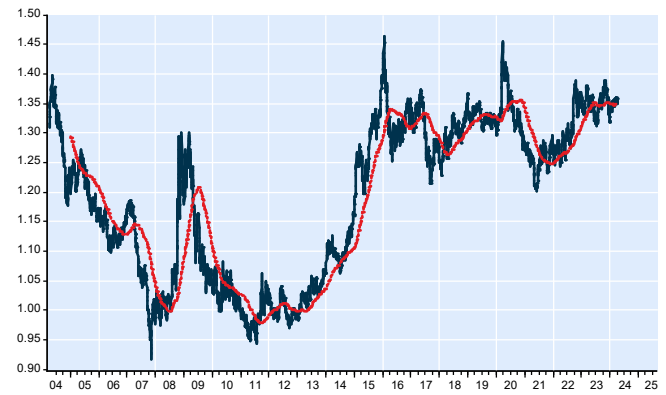
Currency	\$		Current	1M Prior	% Change	Current	Relative to UST	Current	Upcoming	
			USD FX	USD FX	1-Month Performance	2Y Yield	2Y Spread	Policy Rate	Next MP Meeting	
Canada	Canadian Dollar	CAD	<i>(USD/CAD)</i>	1.36	1.35	0.79%	4.22	-53.8	5.00	2024-04-10
<i>United States</i>	<i>United States Dollar</i>	<i>USD</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>4.75</i>	<i>-</i>	<i>5.50</i>	<i>2024-05-01</i>	
Eurozone	Euro	EUR	<i>(EUR/USD)</i>	1.08	1.09	-0.93%	2.88	-187.8	4.50	2024-04-11
Japan	Japanese Yen	JPY	<i>(USD/JPY)</i>	152	147	3.10%	0.21	-454.7	-0.10	2024-04-25
Australia	Australian Dollar	AUD	<i>(AUD/USD)</i>	0.66	0.66	-0.68%	3.75	-100.7	4.35	2024-05-07
United Kingdom	Pound Sterling	GBP	<i>(GBP/USD)</i>	1.26	1.29	-1.71%	4.22	-52.9	5.25	2024-05-09
China	Chinese Yuan	CNY	<i>(USD/CNY)</i>	7.23	7.19	0.64%	1.89	-286.5	2.00	2024-06-13
Mexico	Mexican Peso	MXN	<i>(USD/MXN)</i>	16.5	16.8	-2.14%	10.38	563.1	11.00	2024-05-09

Appendix: Spot rates with their 200d MA

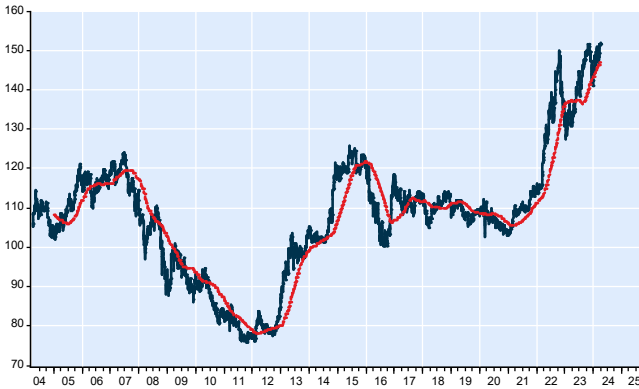
EUR / USD



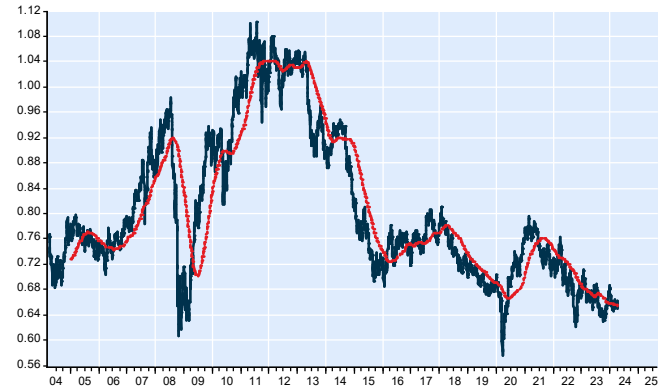
USD / CAD



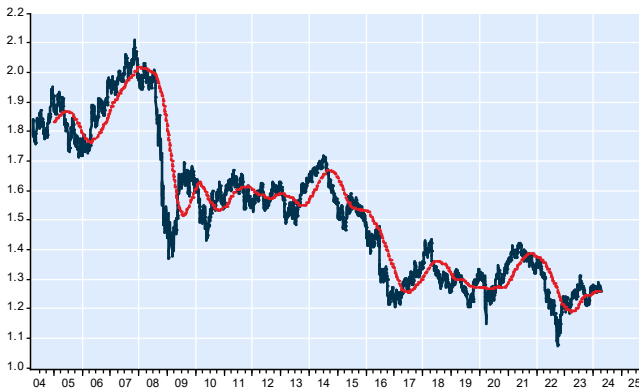
USD / JPY



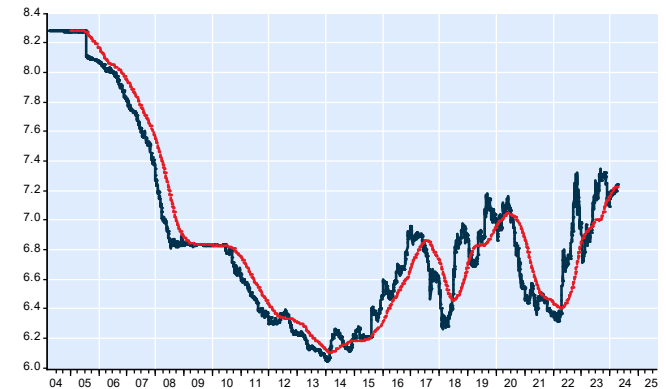
AUD / USD



GBP / USD



USD / CNY



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