FX Forecast Outlook

Currencies
Global

April 2023

- Falling volatility opened the door for the broad USD to decline
- In case of a hard landing for the US economy, this would likely give only temporary support to the USD, in our view
- We outline our thinking why the CAD is likely to finish the year stronger against the USD in spite of a mixed start

Summary

EUR: Ongoing upside surprises to regional activity data and the European Central Bank's continued hawkish stance are likely to see ongoing EUR strength, in our view.

GBP: We expect the GBP to strengthen further against the USD, as the UK data has been better than expected, together with improving UK's external balances.

JPY: We still believe local factors should provide support for the JPY later in the year.

AUD: AUD-USD will probably increase gradually this year, supported by improving risk sentiment, its yield differentials and Australia's trade balance, in our view.

NZD: While we expect the NZD to strengthen against the USD this year, the near-term upside appears to be moderate.

CAD: We still expect the CAD to finish the year stronger against the USD, supported by rates, commodities and risk appetite; however, the bearish challenges of recession, stagflation and financial stability could turn the CAD outlook on its head.

SGD: As the Monetary Authority of Singapore delivered a dovish end (of tightening), we believe the SGD will cease to be an outperformer among Asian currencies.

INR: We expect USD-INR to fall this year, and the recent support could come from the Reserve Bank of India's FX policy.

MYR: Looking beyond the USD trend, we expect the MYR to benefit from a stable current account surplus and an upside surprise in inflows due to reform optimism.

Key upcoming events

Date	Event
28 April	Bank of Japan's rate announcement
2 May	Reserve Bank of Australia's rate announcement
2-3 May	Federal Reserve's rate announcement
4 May	European Central Bank's rate announcement
11 May	Bank of England's rate announcement

Source: HSBC

HSBC FX forecasts

	Spot	Q2 23	Q3 23	Q4 23
EUR-USD	1.0965	1.10	1.13	1.15
GBP-USD	1.2376	1.23	1.26	1.30
USD-JPY	133.98	130	125	120
USD-CHF	0.8950	0.93	0.92	0.92
AUD-USD	0.6697	0.70	0.73	0.76
NZD-USD	0.6195	0.65	0.67	0.69
USD-CAD	1.3364	1.31	1.28	1.27
USD-SGD	1.3323	1.32	1.30	1.28
USD-INR	81.960	81.0	80.0	78.5
USD-MYR	4.4215	4.40	4.30	4.20

Source: HSBC forecasts, Bloomberg as at 17:00 HKT on 17/04/2023

Central Bank policy rate forecasts (%)

	Current	Q4 2023(f)	Q4 2024(f)
USD	4.75-5.00	5.25-5.50	4.50-4.75
EUR	3.50/3.00	4.00/3.50	4.00/3.50
JPY	-0.10	-0.10	-0.10
GBP	4.25	4.25	4.25

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	1.5	0.5
Japan	1.0	0.9	0.6
Eurozone	3.5	0.6	0.7
UK	4.0	0.4	1.4

Source: HSBC forecasts

HSBC

USD: This is the way

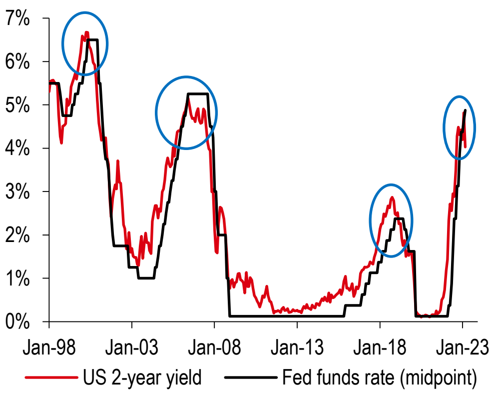
- Falling volatility opened the door for the broad USD to weaken
- While a hard landing for the US economy could test our thinking…
- … such a scenario would likely give only temporary support to the USD, in our view

After enjoying a very brief episode of strength following the onset of the banking stress, the USD has weakened notably given the absence of a liquidity crunch, thanks to the swift policy support to limit the contagion. The Federal Reserve (Fed) increased the frequency of the 7-day USD swaps from weekly to daily to other major central banks from 20 March to at least through the end of April, so as to ensure funding risks are contained.

Without much 'safe haven' demand for the USD, we believe the old theme seen late last year is returning, where lower market volatility and reduced expectations for Fed rate hikes led the broad USD lower. If anything, there could be a continued focus on shorter-term US treasury yields being lower than the Fed's policy rate and how this was a precursor to its easing in the past (Chart 1).

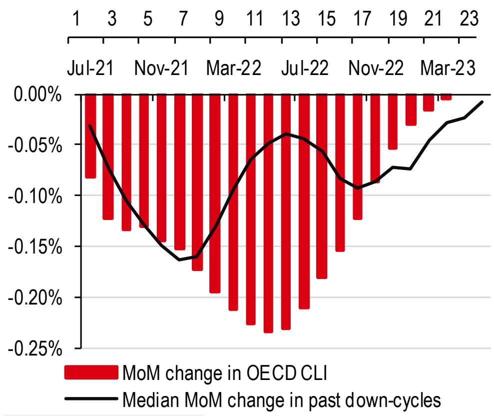
Meanwhile**, the global growth-inflation mix seems to be moving in a less challenging direction compared to last year**. For instance, this has been evident when tracking the momentum of the Organisation for Economic Co-operation and Development's (OECD) Composite Leading Indicators (CLI) – a bellwether of global economic activity (Chart 2). This indicator has been declining since August 2021 but the pace of its fall has been slowing to the point that it appears to have troughed.

1. When the US 2-year yield traded below the Fed's policy rate, it foreshadowed cuts



Source: Bloomberg, HSBC

2. In aggregate global activity data have basically bottomed



Source: OECD, Bloomberg, HSBC

Altogether, this reinforces our bearish view for the broad USD. True, global growth may not be on a synchronous upswing and as a result some of the more cyclically sensitive currencies have been sluggish. However, the forces that are seen undermining the broad USD should dominate more extensively.

The risks to our view remain centred on a hard-landing outcome in the US. But if such a scenario materialises, the USD's ability to rally could prove fleeting. We are also cognisant why some pro-cyclical currencies are not benefiting as much in a weak USD environment.

CAD: Goldilocks to tame the bears

- We continue to expect the CAD to finish the year stronger against the USD
- Rates, commodities and risk appetite point to further CAD gains ahead but this relies on a favourable growth/inflation mix
- Otherwise, the bearish challenges of recession, stagflation and financial instability could turn the CAD outlook on its head

It has been a mixed start to 2023 for USD-CAD, with our year-end forecast of 1.27 looking a distant prospect when it reached a year-to-date high above 1.38 in mid-March. But the last couple of weeks have seen a revival in the CAD's fortunes against the USD, a pattern we expect to extend, notably during 2H23.

A fairy-tale outlook

Rates are at or near their peak in most G10 economies. In addition, leading indicators of global activity suggest the worst is very much behind us (Chart 2 on the previous page). This in turn should prove helpful to commodity markets. We believe oil prices will become higher as the year progresses. The surprise production cut announced by the Organisation of the Petroleum Exporting Countries and its allies (OPEC+) in early April suggests producers are reluctant to allow oil prices to slip a great deal. While the true economic relevance of the energy market for the CAD has faded over the years, it can still be pertinent.

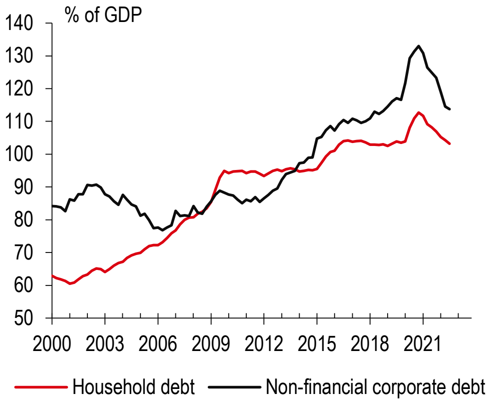
Overall, we believe there is a constructive environment for the CAD. There are sufficient signs of slowing economic growth and inflation to dissuade the Bank of Canada (BoC) from the kind of over-tightening that might create greater downside further out on the forecast horizon. There is also sufficient resilience in the domestic economy and health in the labour market to suggest policy has not been over-tightened. The same observations could be made for the US economy. Together they add up to a "risk on" landscape that should push USD-CAD lower.

The three bears

The factors which argued for CAD strength in the coming quarters could also be its undoing if the global or local economies take a marked turn for the worse. This is a risk, but we do not see grounds as yet for making it a central case. Recession risks could crystallise if the resilience of labour markets drops away more rapidly than expected, for example. A second bearish CAD case, that of stagflation, could become reality if inflation fails to slow as expected and economic activity wilts but does not collapse. The third bearish case could come via heightened financial stability risks. For Canada, this would seem most likely to come through the housing market channel and we would view this as the most probable of the three bears to attack the CAD.

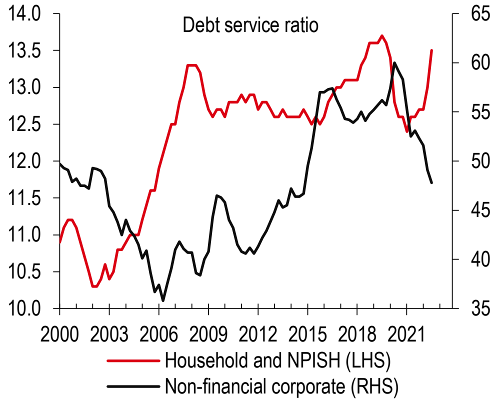
However, current debt levels do not strike us as particularly concerning. Corporate and household debt have fallen since 2020 (Chart 3 overleaf), and while there has been a pick-up in the debt service ratio (DSR) for households, it remains below 2018-2019 levels, and corporate DSR has plummeted as well (Chart 4). Banking sector risks are also less of a concern in Canada, with Canadian banks much less fragmented than their US counterparts. Additionally, systemic banking crisis fears seem to have receded in recent weeks following policymakers' policy response which came with speed and scale – lessons learnt during the global financial crisis and the COVID-19 pandemic.

3. Both household and corporate debt have been declining in Canada…



Source: Bloomberg, HSBC

4. …and household debt service ratio remains below 2018-2019 levels



Note: NPISH refers to non-profit institutions serving households
Source: Bloomberg, HSBC

Conclusion

So in the end, we return to Goldilocks rather than to the three bears in crafting our USD-CAD outlook. We believe policy rates are at, or close to, their peaks in both the US and Canada. We also expect economic growth to slow in both economies, with inflation also expected to move lower, yet we do not anticipate the more onerous outcomes of recession or stagflation. Instead, it is a more "risk on" backdrop that should see the recent drop in USD-CAD extend, sometimes in a choppy fashion, into year-end 2023.

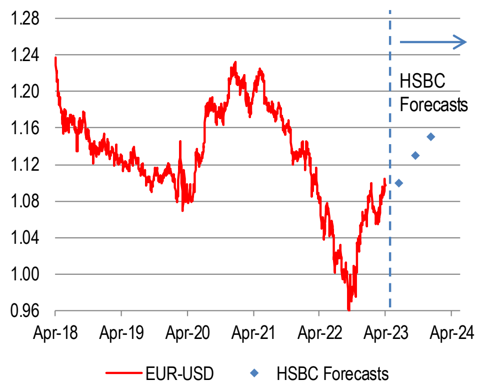
			Past performance			Forecasts		
FX	**L-T view***	**Spot**	**1mth**	**3mth**	**6mth**	**Q2 23**	**Q3 23**	**Q4 23**
USD-CAD	↘	1.3364	-2.67%	-0.19%	-2.57%	1.31	1.28	1.27

Source: HSBC forecasts, Bloomberg as at 17:00 HKT on 17/04/2023
*L-T = long-term

EUR: Back at the top

- The EUR remains resilient after the disruption to financial markets through March, with ongoing upside surprises to regional activity data and the European Central Bank's (ECB) continued hawkish stance likely to see **ongoing EUR strength**, in our view.
- **The broad trends on Eurozone data continue to improve at a faster rate than many in the markets have been expecting**. Recent examples include the flash PMIs for March – especially on the services side – as well as February retail sales and April's investor confidence data. At the same time, a faster decline in headline inflation bodes well for consumers in the months ahead, as the real income squeeze abates.
- The ECB remains more focused on core inflation which is yet to clearly peak. This should keep expectations for further rate hikes in place for the next few months, while the market potentially prices the peak in US rates much sooner. These factors should support **ongoing asset allocation into Europe, which is EUR-positive from a flow perspective**.

EUR-USD



Source: HSBC, Bloomberg

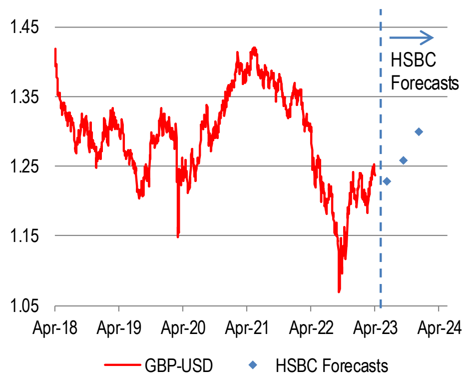
			Past performance			Forecasts		
FX	**L-T view***	**Spot**	**1mth**	**3mth**	**6mth**	**Q2 23**	**Q3 23**	**Q4 23**
EUR-USD	↗	1.0965	2.76%	1.64%	11.42%	1.10	1.13	1.15

Source: HSBC forecasts, Bloomberg as at 17:00 HKT on 17/04/2023
*L-T = long-term

GBP: Unbowed and bullish

- **We retain a bullish stance on the GBP**, as the UK economy displays continued resilience compared to very negative expectations, and the UK's external balances show ongoing signs of improvement.
- Similar to the Eurozone, **the UK economy has performed much better than many feared in recent months**. Upside surprises to Q4 GDP, February retail sales, March PMIs and some signs of a bottoming out in the housing sector all paint a rosier picture than much of the narrative that had been building about the UK facing a deep and prolonged recession. Although headline inflation has yet to come down as meaningfully, the biggest base effects should fade from here, allowing consumers to see less of a squeeze in the months ahead.
- **The UK's twin deficit challenge also appears to be abating**. The seasonally adjusted current account deficit for Q4 2022 was the smallest in a year (the non-seasonally adjusted data actually showed a modest surplus), due to strength in both income inflows and net services exports. This is a stark turnaround from mid-2022 and continues to support the case for GBP appreciation.

GBP-USD



Source: HSBC, Bloomberg

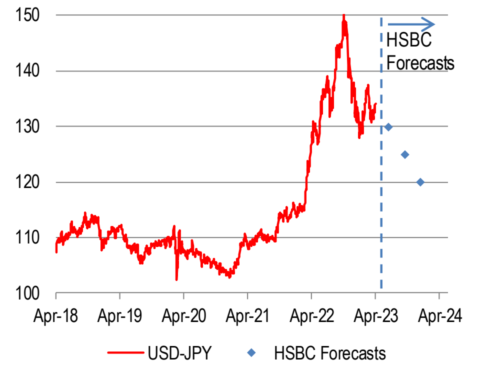
			Past performance			Forecasts		
FX	**L-T view***	**Spot**	**1mth**	**3mth**	**6mth**	**Q2 23**	**Q3 23**	**Q4 23**
GBP-USD	↗	1.2376	1.67%	0.73%	8.96%	1.23	1.26	1.30

Source: HSBC forecasts, Bloomberg as at 17:00 HKT on 17/04/2023
*L-T = long-term

JPY: Cautious BoJ

- Against the backdrop of falling market volatility, **USD-JPY once again focuses on its rate differentials.** The market now sees a c82% chance of one more 25bp rate hike on 3 May (but probably the last one) by the Federal Reserve (*Bloomberg*, 14 April 2023), while 10-year Japanese government bond yields are now quite close to the Bank of Japan's (BoJ) upper-bound again.
- While the new BoJ Governor Ueda signalled no change to monetary policy settings in the near-term during his inaugural press conference (*Bloomberg*, 10 April 2023), he acknowledged positive developments in wage growth and underlying inflation. We still think **a policy tweak in the 16 June meeting is 'live'**, as signalling ahead of the decision could potentially lead to unsustainably large bond purchases by the BoJ in the meantime
- Beyond the BoJ's policy tweak, Japan's improving current account among other factors should support the JPY's appreciation later in the year, in our view.

USD-JPY



Source: HSBC, Bloomberg

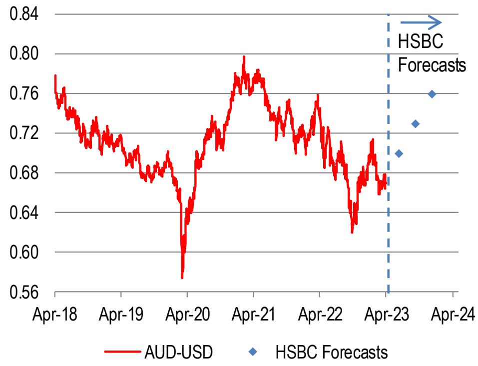
FX	L-T view*	Spot	Past performance 1mth	3mth	6mth	Forecasts Q2 23	Q3 23	Q4 23
USD-JPY	↘	133.98	1.62%	4.57%	-10.10%	130	125	120

Source: HSBC forecasts, Bloomberg as at 17:00 HKT on 17/04/2023
*L-T = long-term

AUD: Maintaining optionality

- The Reserve Bank of Australia (RBA) held its cash rate unchanged at 3.60% at its 4 April meeting, in line with market expectations. There was no meaningful dovish surprise, i.e. neither ruling out future hikes nor indicating a potential cut by year-end, but **the overall tone was slightly more dovish**, maintaining optionality and reinforcing a data-dependent stance when determining its future monetary policy path.
- The AUD weakened1.6% against the USD year-to-date (*Bloomberg*, 14 April 2023); however, **we expect the currency to capitalise on some improvement in Australia's terms of trade and services exports** amid by China's re-opening, over 2H23.
- We are also hopeful for a gradual rise in AUD-USD via the risk sentiment and relative yield channels.

AUD-USD



Source: HSBC, Bloomberg

FX	L-T view*	Spot	Past performance 1mth	3mth	6mth	Forecasts Q2 23	Q3 23	Q4 23
AUD-USD	↗	0.6697	0.00%	-4.16%	6.45%	0.70	0.73	0.76

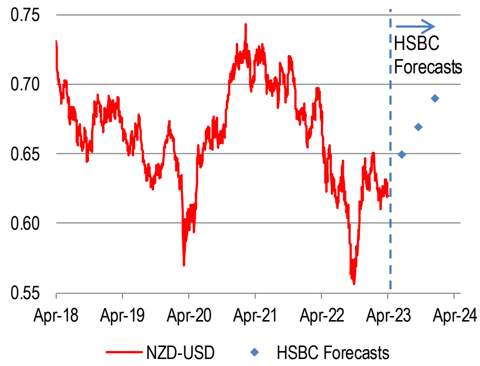
Source: HSBC forecasts, Bloomberg as at 17:00 HKT on 17/04/2023
*L-T = long-term

NZD: The hawk flies into headwinds

- Both the risk sentiment and relative yield channels turned more supportive for the NZD lately. The Reserve Bank of New Zealand's (RBNZ) April meeting reinforced **our bullish NZD bias over the near term**. However, three headwinds may keep the upside moderate for now, in our view:

1. New Zealand's 4Q22 GDP marked the largest negative GDP shock (actual release minus the RBNZ's last forecast prior to release) in the past decade. **Maintaining a hawkish stance into a recession should see limited upside in shorter-term rates**, as markets price in more rate cuts following the peak rate.
2. New Zealand's 4Q22 current account deficit reached the widest level in history, highlighting **the risks of an underfunded deficit**, as non-resident holdings of New Zealand government bonds showed the first decline since August 2022, while S&P mentioned that credit ratings could come under pressure (*Bloomberg*, 15 March 2023). Historically, **negative shifts in credit rating were followed by significant portfolio outflows**.
3. Dairy exports and prices remained weak, while a limited rise in China's outbound international flights dampened services exports.

NZD-USD



Source: HSBC, Bloomberg

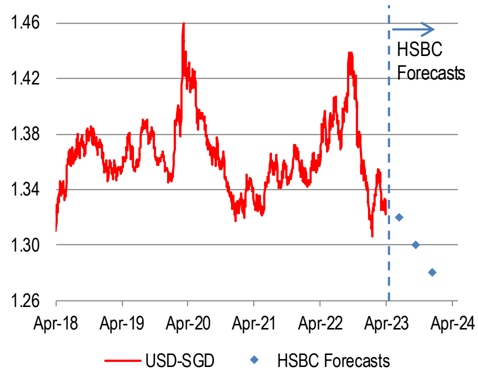
FX	L-T view*	Spot	Past performance 1mth	3mth	6mth	Forecasts Q2 23	Q3 23	Q4 23
NZD-USD	↗	0.6195	-1.18%	-3.58%	9.96%	0.65	0.67	0.69

Source: HSBC forecasts, Bloomberg as at 17:00 HKT on 17/04/2023
*L-T = long-term

SGD: A dovish end of tightening

- On 14 April, **the Monetary Authority of Singapore (MAS) kept all its monetary policy settings unchanged** and sounded more dovish than expected. Leading up to the MAS meeting, the market was split between a "dovish re-centring" and a "hawkish hold", but the MAS delivered a dovish end (of tightening), reflecting its increasing concerns on growth.
- Going forward, the market's discussion on the SGD could even be shifting to **when the MAS will ease its monetary policy.** It may not be that soon and dependent on growth data.
- We believe the SGD will cease to be an outperformer among Asian currencies, but become a "beta" play to the broad USD or even a funding currency for relative value trades in Asia.

USD-SGD



Source: HSBC, Bloomberg

FX	L-T view*	Spot	Past performance 1mth	3mth	6mth	Forecasts Q2 23	Q3 23	Q4 23
USD-SGD	↘	1.3323	-0.74%	0.92%	-6.27%	1..32	1.30	1.28

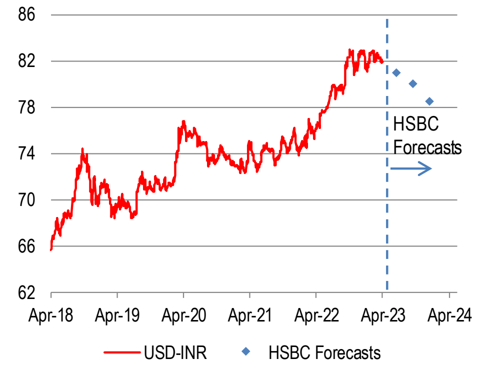
Source: HSBC forecasts, Bloomberg as at 17:00 HKT on 17/04/2023
*L-T = long-term

INR: Too much stability

- The Reserve Bank of India (RBI) kept policy rates on hold at its April meeting, against market expectations of a 25bp rate hike. But this may not be too detrimental for the INR, since the Fed seems close to the end of its hiking cycle. Rather, we think **the RBI's FX policy is more important.** There seems to be **a bias for supporting USD-INR recently**. We can see this in two ways:

1. The monthly average of USD purchases (spot and forward) in November 2022-January 2023 (USD10bn per month on average) exceeded USD sales in February by our estimates, and FX reserves rose again in March 2023.
2. According to RBI's bi-annual monetary policy report released on 6 April, its assumption for USD-INR for this fiscal year (April 2023 – March 2024) is 82, not much different from spot. In comparison, in the previous report released on 30 September 2022, its assumption for USD-INR for the next six months (October 2022 – March 2023) was 80, which was below the spot rate (also near 82) at that time.

USD-INR



Source: HSBC, Bloomberg

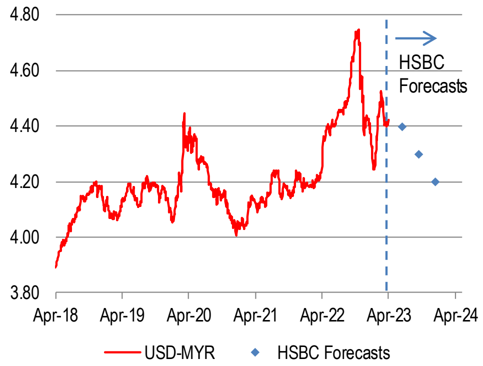
FX	L-T view*	Spot	Past performance 1mth	3mth	6mth	Forecasts Q2 23	Q3 23	Q4 23
USD-INR	↘	81.960	-0.71%	0.24%	-0.48%	81.00	80.00	78.50

Source: HSBC forecasts, Bloomberg as at 17:00 HKT on 17/04/2023
*L-T = long-term

MYR: On the road to recovery

- **The MYR is largely flat against the USD year-to-date** (*Bloomberg*, 14 April 2023). This lacklustre performance of Asian currencies (including the MYR) reflects four things in our view: (1) no clear trend in the US Dollar Index (DXY), (2) a decline in portfolio inflows amid unstable risk appetite, (3) modest cross-border spill-over thus far from mainland China's re-opening and growth recovery, due to international flight constrains and (4) benefits of lower energy prices offset by very weak exports.
- **The MYR is still exhibiting a high sensitivity to DXY**. We think locals' FX hoarding and the unusually positive US-Malaysia interest rate gap has made their behaviour more leveraged to external developments.
- **Looking beyond the USD trend, we see more positive local factors than negative ones for the MYR:** Malaysia's current account surplus is likely to be stable and here could be an upside surprise in inflows due to reform optimism.

USD-MYR



Source: HSBC, Bloomberg

FX	L-T view*	Spot	Past performance 1mth	3mth	6mth	Forecasts Q2 23	Q3 23	Q4 23
USD-MYR	↘	4.4215	-1.44%	2.21%	-6.26%	4.40	4.30	4.20

Source: HSBC forecasts, Bloomberg as at 17:00 HKT on 17/04/2023
*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.
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)
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 14 April 2023, unless a different date and/or a specific time of day is indicated in the report.

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