

## Our 3 calls for FX

After a clean dollar bull trend since the summer of 2021, the story for FX markets in 2023 becomes a little murkier. Our baseline view is that central banks tightening into recessions will keep the dollar supported a little longer than most expect. A broader decline may not emerge until the second half of next year and even then, EUR/USD may struggle to rally



### 1 Less trend, more volatility

The main conclusion we drew in our [2023 FX Outlook](#) was that a repeat of a dominant dollar trend looks unlikely next year. Even though the Federal Reserve may be cutting rates in the second half of next year, we doubt the investment in Europe or Asia will be strong enough to draw funds out of dollar deposits in a sustained manner. At the same time, central banks withdrawing liquidity into a recession look set to exacerbate thinning liquidity conditions. Fewer FX trends and more volatility is our conclusion here.

### 2 Defensive currencies favoured

While it is tempting to argue that some heavily hit European or Asian currencies are due a substantial re-rating next year, we believe such a conclusion is premature. European currencies will struggle with a German economy re-orienting itself to a new world order, while it also seems

too early to expect the Chinese renminbi to lead the Asian FX complex substantially higher. Instead, a weak growth environment and a clear drop in bond yields should see defensive currencies like the Japanese yen start to outperform. Here we could see USD/JPY trading well under 130 by late 2023.

### 3 Local stories to trigger greater differentiation

Given our call for EUR/USD to demonstrate less trending behaviour, there will be more scope for differentiation in local currencies next year. In Europe, for example, we look for out-performance of the Swiss franc (a hawkish Swiss National Bank) and the Hungarian forint (better relations with the EU), while sterling (external deficits) and the Polish zloty (electoral uncertainty) may well underperform. In Asia, we like the Korean won on the back of Korean government bonds' potential inclusion in a key sovereign bond index, and in the Americas, we favour the Mexican peso for its high carry-to-risk ratio.

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