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FX Outlook 2024

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Waiting for the tide to come in

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FX Outlook 2024: Executive summary

Just as the gravitational force of the moon draws out the tide, so has the enduring strength of the US economy drawn portfolio capital from the rest of the world. 2024 should be the year US exceptionalism wanes and currencies outside of the US are allowed to refloat

Waiting for the tide to come in

This time last year we were forecasting fewer trends in global FX markets and more volatility. In fact, 2023 has proved a year of two halves: the first half more trendless and the second half characterised by a very orderly and powerful dollar bull trend.

This dollar rally has been built on the exceptionalism of the US economy – registering an incredible growth rate of 4.9% quarter-on-quarter annualised in the third quarter. And despite headline inflation dipping, there is really not enough evidence, yet, for the Fed to drop its hawkish guard. Holding dollars has therefore become the 'no-brainer' trade as investors price slowing aggregate demand globally – a theme that has weighed on the more open economies and currencies of Europe and Asia.

> *"It feels like a wrestling match and the dollar will not roll over that easily."*

Will this theme continue into 2024? It feels like a wrestling match and the dollar will not roll over that easily. Yet our simple thesis is that tighter interest rates finally catch up with the US economy next year, growth registers a paltry 0.5% and the Fed, in line with its dual mandate to focus on inflation and maximum employment, cuts rates back into less restrictive territory. We forecast 150bp of Fed easing next year starting in the second quarter.

The end of US exceptionalism will allow greater diversification amongst the investor community and a lower bar to seek returns outside of the dollar. Portfolio capital can refloat some of those stranded non-dollar currencies.

In advance of the first Fed cut, we would expect the US yield curve to start a bullish steepening trend. This is a particular segment in the business cycle that favours a weaker dollar and is bullish for commodity currencies. It just so happens that some of the commodity currencies are incredibly undervalued based on our medium-term fair value model. This is the area of the FX market in which we see the most value. Or at least the commodity currencies are offered some protection by their extreme undervaluation, whereas the euro and sterling have no such support.

A lower US rate environment should also allow the recovery of what we term 'growth' currencies – similar to growth stocks such as tech and real estate. We consider the Swedish krona one such currency.

Our baseline view for 2024 therefore sees the dollar bear trend picking up pace through the year. Compared to year-end 2024 forwards, currencies could be as little as 2% (China's renminbi) to as much as 13% (Scandinavian FX) firmer against the dollar.

Watch: The dollar's long goodbye

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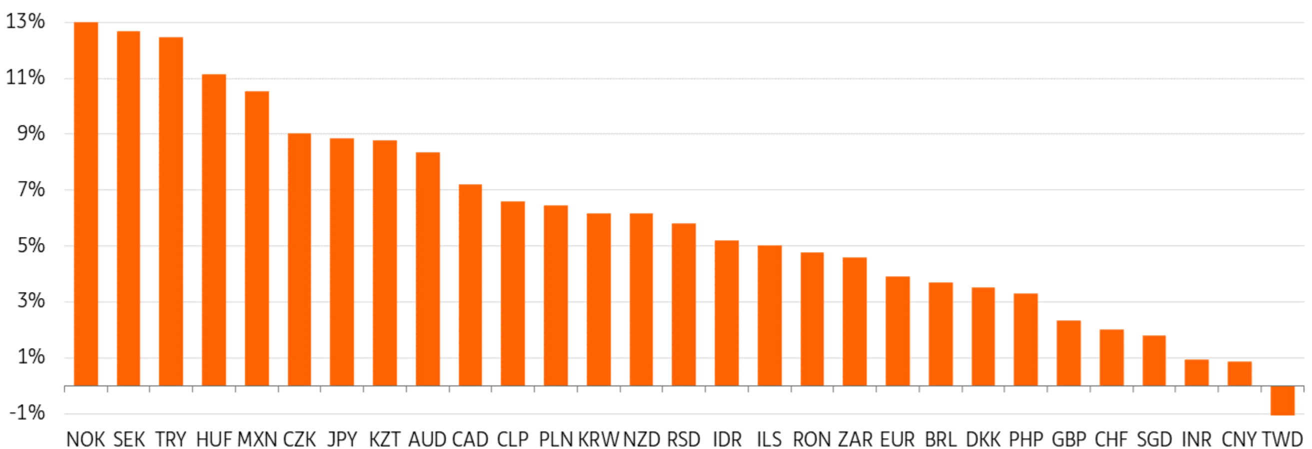
ING forecasted performance versus year-end 2024 USD forwards



Source: ING, Refinitiv

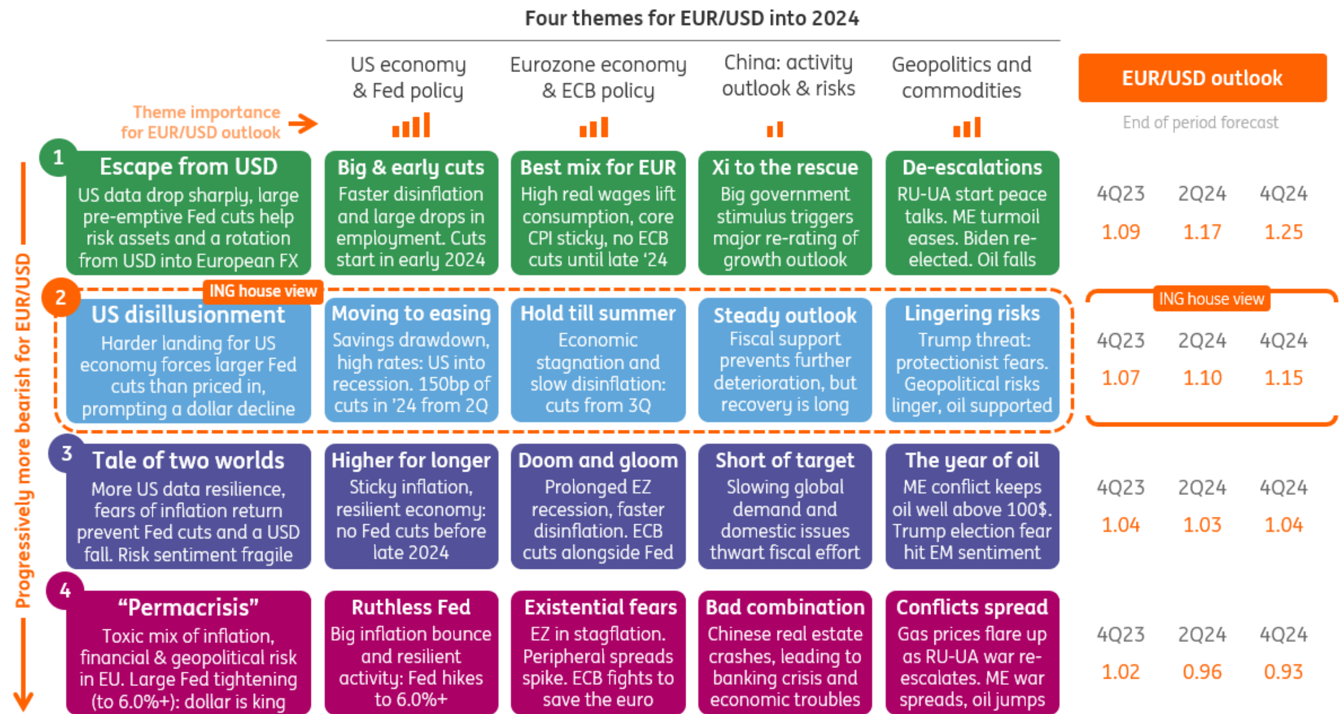
The above forecasts of course are built on many core assumptions. Using the most liquid FX pair, EUR/USD as the benchmark for the FX market in general, we see a range of outcomes in the 0.88 to 1.21 region.

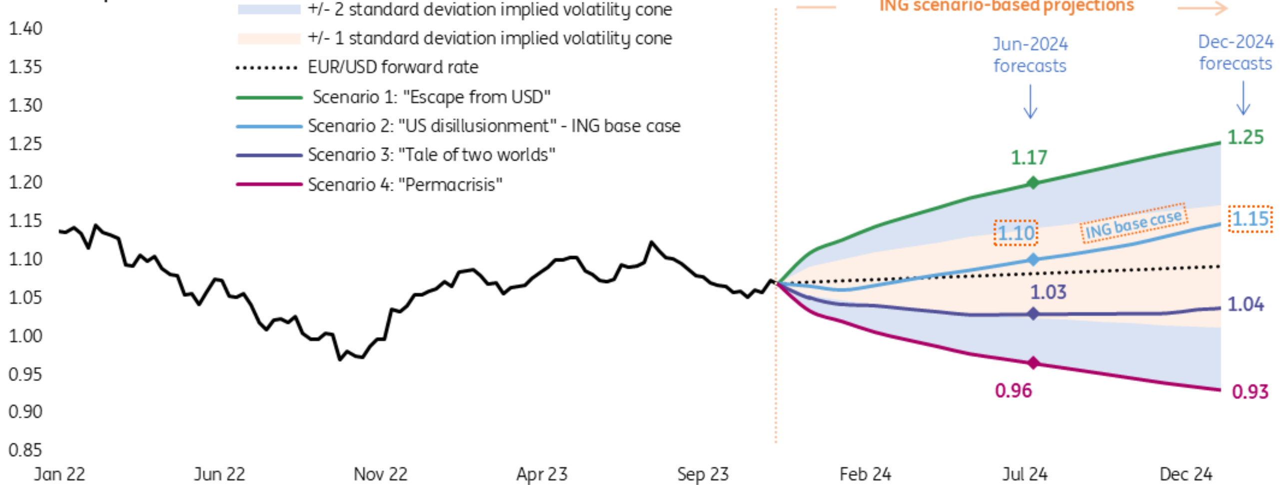
If you think US inflation will not allow the Fed to cut, if you think a local recession and return of the Maastricht criteria sparks a eurozone crisis, if you think President Trump is elected on an even louder anti-China ticket and if you think tensions in the Middle East escalate into a major energy supply shock – then EUR/USD can plumb the depths.

If, however, like us you think that the Fed is allowed to deliver an orderly easing cycle and that soft landings are seen in Europe and China, then EUR/USD could be somewhere near our 1.15 baseline forecast by end-2024.

We now invite you to take a look through our G10, EMEA, ASIA and LATAM sections for insights into key local factors, such as elections, the fiscal-monetary mixes and also the FX preferences of the local authorities – all of which will shape FX trends next year.

EUR/USD: Four potential paths for the next quarter





Source: ING, Refinitiv

G10: The dollar's long goodbye

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A year ago writing for the 2023 G10 FX outlook, we were calling for less trend and more volatility. That worked for the first half of the year before a dollar bull trend took over. Based on our call for Fed easing next year, we now argue that G10 FX markets will be characterised by more trend – a dollar bear trend, that is – and less volatility

We expect the dollar bear trend to pick up a little pace into the second quarter of 2024 as the short-end of the US curve starts to come substantially lower.

To challenge the dollar, currencies will need a lot of protection

A typical financial market response to the start of a Federal Reserve easing cycle would be a bullish steepening of the US yield curve on the prospect of reflationary policy coming through. To speak of 'reflationary' policy right now seems criminal – but the Fed has a dual mandate, and if inflation is coming under control through 2024 it can cut rates to ameliorate the impact on the labour force.

Bullish steepening of the US yield curve normally favours the commodity currencies, and that's our conviction call in the G10 space. As outlined in our Behavioural Equilibrium Exchange Rate (BEER) model below, the commodity currencies are the most undervalued in the G10 space. Their extreme undervaluation provides some much-needed protection against any continuing dollar strength. Notably, the euro and sterling do not have such protection.

Looking across the currency blocs then – after relatively range-bound trading into year-end – we expect the dollar bear trend to pick up a little pace into the second quarter of 2024 as the short-end of the US curve starts to come substantially lower.

European FX should be lifted, but stagnant eurozone growth and the risk that the European Central Bank cuts too early suggest that EUR/USD does not lead this rally. Neither does GBP/USD, given our mildly bullish view on EUR/GBP and 100bp of Bank of England easing. Having outperformed this year, we expect the Swiss franc to be flat against the euro in 2024 as the Swiss National Bank seeks more stability than strength in the nominal trade-weighted franc.

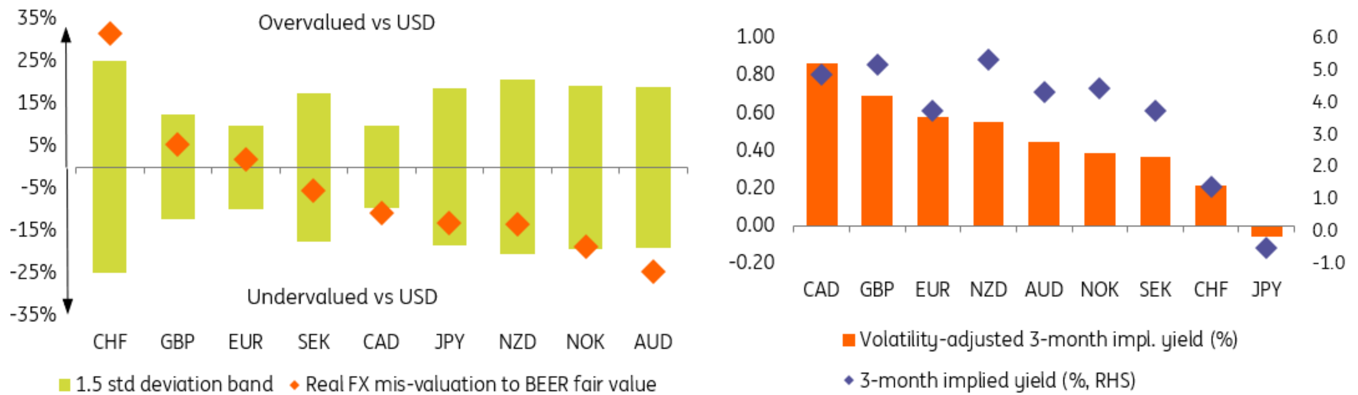
Better positioned in Europe we think (and conditioned on a lower interest rate environment) are the Scandi currencies. Both the Norwegian krone and the Swedish krona are undervalued – the krone more so. Both central banks would prefer stronger currencies and the krone probably has a better chance of a recovery in 2024 given a stronger economy and its more severe undervaluation after the rally in energy prices.

> *“Our favourite currency in 2024 is the Australian dollar”*

Our favourite currency in 2024, however, is the Australian dollar. High US rates and weak Chinese growth have repressed it and made it the most undervalued currency in the G10 space. The release valve of lower US rates should allow the Aussie dollar to lead the currency recovery against the US dollar. A hawkish Reserve Bank of Australia should not hurt either. We are also bullish on the NZD/USD and are interested in whether the new government changes the Reserve Bank of New Zealand’s remit – a potentially bullish factor for NZD. USD/CAD should come lower too, and while Canada’s high yield helps, its proximity to the US may be more of a burden in 2024.

On the subject of carry, lower volatility favours the carry trade and also the yen as a funding currency. However, we have some quite aggressive forecasts for a lower USD/JPY on the back of a weaker dollar and finally a proper Bank of Japan exit from ultra-loose policy. Big policy changes in Japan can have a big impact on USD/JPY as in 2013. Let’s see how the start of 2024 progresses and whether the BoJ is prepared to make its move after all.

G10 FX valuation and carry



Source: ING, Refinitiv

EUR/USD: Lifted higher by the tide of lower US rates

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/USD	1.08	Bullish	1.07	1.08	1.10	1.12	1.15

US slowdown is central. Our forecast for a higher EUR/USD next year hangs wholly on the view that the US will slow down, inflation will ease and the Fed will be able to make monetary policy less restrictive. Currently we forecast 150bp of Fed easing starting next May/June. This is premised on tighter financial conditions finally weighing enough on aggregate demand to see US growth converge on the stagnant trajectories, especially in Europe. Our team forecast US growth at just 0.5% next year versus the consensus of 1.0%. Equally, our end year 2024 EUR/USD forecast of 1.15 is slightly above the current consensus of around 1.11. In terms of timing the trajectory, our current bias is that EUR/USD strength will become more apparent from the second quarter onwards. The dollar traditionally performs well at the start of the year and with the eurozone in recession, the first quarter may be too early to see a decisive turn higher in EUR/USD.

ECB could crumble. The headwinds to a EUR/USD rally largely stem from weak eurozone growth and the risk that the ECB chooses to cut rates alongside the Fed. This would limit the expected narrowing in yield differentials at the short-end of the curve. Our team

forecast three quarters of negative eurozone growth (3Q23 to 1Q24 inclusive) and full-year 2024 eurozone growth at just 0.2%. We expect 75bp of European Central Bank (ECB) easing in 2024 starting in the third quarter, but clearly the risk is that the ECB eases earlier and the Fed later such that the starting pistol for the EUR/USD rally is never fired. Equally, a failure of European governments to agree on fiscal reform by year-end 2023 could see the re-introduction of the Stability and Growth Pact in early 2024 – an unwelcome arrival in a recession.

EUR/USD looks fairly valued. Our medium-term fair value model suggests EUR/USD is fairly valued down at these lowly levels. In other words, there is not the kind of extreme undervaluation that has supported EUR/USD at these levels in the past. This really does build the case that if there is to be a EUR/USD rally, it will have to be driven by the dollar leg. Away from the Fed easing story there is also the risk of US fiscal deterioration and de-dollarisation – perhaps both slow-burn stories. There is also the small matter of the US election. Most commentators warn of a Trump 2.0 administration being 'louder'. Depending on how the opinion polls progress, we presume any swing in favour of a second term for Donald Trump to be dollar positive – given the experience of the loose fiscal and protectionist policy agenda during his last stay at the White House.

USD/JPY: Tokyo prays for a turn in the dollar

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/JPY	151.00	Bearish	148.00	140.00	135.00	130.00	130.00

A US slowdown would make life so much easier. So far this year Japanese authorities have chosen not to intervene in FX markets even though USD/JPY has traded over 150. Under similar circumstances last year, the Japanese sold $70bn. While the rhetoric from Tokyo remains acute – meaning intervention could be imminent – we suspect local policymakers are instead waiting for a market-led turn lower in US rates in the dollar. Such a move would of course avoid the need for intervention but also allow the Bank of Japan (BoJ) to exit its super-loose monetary policy next year without Japanese Government Bond (JGB) yields surging. Here our call is that the BoJ will remove its negative 10bp charge on Policy-Rate Balances in the second quarter. This policy adjustment could well be forewarned in January, with the next release of the BoJ's Outlook for Economic Activity and Prices. A CPI ex food forecast above 2% for FY25 would be a strong signal here that a policy change were forthcoming.

Portfolio flows have been key. Policymakers around the world have acknowledged that higher US yields have dominated the FX environment this year. 10-year US Treasuries have recently been offering over a 400bp pick-up to 10-year JGB yields and Japanese portfolio flow data confirm that Japanese residents have increased their purchases of foreign assets sharply this year. Combined with foreigners cutting back on Japanese investments, data shows that Japan has seen around a net $175bn portfolio outflow over the last six months. The shape of the US yield curves means that a lot of the Japanese flows into US debt will have been unhedged. This means that short-dated US rates – i.e. hedging costs – will have a big say on USD/JPY in 2024. Our call here is that US short-dated rates start to front run the first Fed rate cut in May and that USD/JPY will turn decisively lower.

Geopolitical risks. What we learned in 2022 was that an energy supply shock could do a lot of damage to the yen. As a fossil fuel importer, Japan remains a price taker in energy markets and over recent month's Japan's current account figures have only just managed to crawl back into positive territory after the 2022 shock. Clearly any escalation of the conflict in the Middle East and higher crude prices would again hit

Japan's terms of trade and weaken the yen. The only difference now is that Japanese consumers are becomingly increasingly dissatisfied with cost-of-living challenges and dissatisfied with the government. This suggests that government may take an even greater interest than usual in the value of the yen. Equally, the government is now looking at some extra fiscal and at the margin could support higher wage rounds in 2024 – a requirement for the BoJ undoing loose monetary policy.

GBP/USD: A lacklustre recovery

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
GBP/USD	1.25	Mildly Bullish	1.23	1.23	1.24	1.24	1.28

Bank of England is done. The strong dollar is again keeping GBP/USD pinned down, but compared to this time last year, the UK's finances are seen in safer hands. This means that we are trading in the low 1.20s rather than the low 1.10s. As above, we have outlined the case for a cyclical fall in the dollar as the decline in short-dated US yields accelerates through 2024. Even though the BoE has re-introduced forward guidance on its restrictive 5.25% bank rate for an extended period, we think a lower policy rate is also likely next summer. We forecast that all of the BoE's key inflation metrics will be heading in the right direction through 2024, allowing the BoE to deliver 100bp of easing next year starting in August. This probably means that GBP/USD will struggle to sustain any gains over 1.30.

The fiscal monetary mix. A UK general election needs to be held before January 2025, with speculation that the ruling Conservatives may choose May or October. The question is whether Chancellor Jeremy Hunt opts for some fiscal give-ways pre-election – while promising some fiscal consolidation post-election. Fiscal stimulus is not priced, but at the margin could be a mild sterling positive if it were introduced in a credible manner. For instance, our team forecasts modest, positive UK growth every quarter of next year unlike the mild recessions we forecast for the US and the eurozone. Looser fiscal policy at a time of restrictive monetary policy in 1the first half of 2024 would help the pound.

In the orbit of EUR/USD. EUR/GBP realised volatility is not too far off the lows seen over the last two decades. This means that the broad EUR/USD trend will largely define that of GBP/USD – unless we get some enormous independent move in sterling as was seen around the time of the brief Liz Truss government in September 2022. That probably means GBP/USD trading in the 1.20-1.25 range for the next three to six months (with perhaps some downside risks), before better eurozone growth in the second half of 2024 and lower US rates allow EUR/USD and GBP/USD to make their moves higher.

EUR/JPY: The turn will take time

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/JPY	163.00	Bearish	158.00	151.00	149.00	146.00	150.00

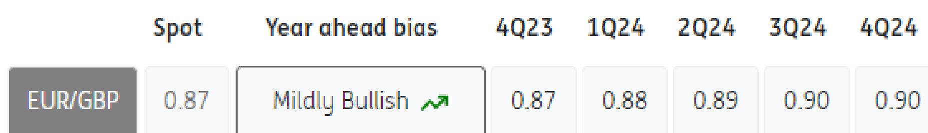
The widow maker. Trying to fight the rally in EUR/JPY has been a fool's game since 2020, as this cross has rallied close to 40% since then. We had thought that the 160 level might have been some kind of line in the sand for Japanese authorities – but maybe that level is 170. Driving the yen underperformance has clearly been the low rates on offer in Japan and the BoJ's policy of continuing to print money even during a global inflation scare. The fact that the perennially dovish ECB switched sides last year and have taken deposit rates to 4.00% has clearly justified this EUR/JPY rally too. That divergence should switch in 2024, first as the BoJ prepares to release itself from its

dovish straitjacket. And weak eurozone growth next year will now switch market attention to the start of the ECB easing cycle – in the third quarter of 2024 or perhaps sooner.

Eurozone business model requires a weak euro. Of the many challenges to eurozone growth, perhaps the largest is faced by the German industrial sector. Germany can no longer rely on cheap energy and globalisation to run its export machine. While domestic demand stagnates – unaided by any fiscal stimulus – and inflation slows, the eurozone may once again be tempted to rely on exports to buy it some time for economic transition. A weaker euro would help – especially if competing in third markets with the likes of Japan and China. In fact, even though EUR/USD is on its lows, the ECB's broad, nominal trade-weighted euro is barely 2% off its all-time highs. In real terms the euro is still well off its peak in the mid-2000s, but that was a period when world trade was booming.

Where we're wrong. EUR/JPY has a modest positive correlation with global equity markets. If a more a traditional business cycle emerges where equities turn lower headed into a US recession (equities normally turn six months before a recession) and bonds rally, then EUR/JPY should come lower in line with our forecasts. If, however, lower US rates lead to both bonds and equities rallying then we are probably underestimating the performance of EUR/JPY. On the bond side as well, we will be interested to watch developments in the eurozone yield. The current inverted yield curves in Europe make it too expensive for Japanese investors to FX hedge European bond portfolios. Bullish steepening of European curves would see FX hedge ratios increase and EUR/JPY finally.

EUR/GBP: What about election risk?



	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/GBP	0.87	Mildly Bullish	0.87	0.88	0.89	0.90	0.90

Labour's election to lose? Moving into a UK election year, the question is whether sterling requires an election risk premium and if so, why? During the last couple of elections, 2017 and 2019, sterling traded with a 5% risk premium – i.e. EUR/GBP traded 5% higher than conventional drivers would expect. A 5% risk premium at those elections was understandable given that in 2017 Theresa May was struggling to take the UK out of the EU and in 2019 the opposition Labour candidate, Jeremy Corbyn, was proposing 'quantitative easing for the people'. Labour voters will be hoping that a 2024 election is more akin to Tony Blair's landslide win in 1997. Back then sterling did not trade with much of a risk premium at all. Indeed, it now seems that the current shadow chancellor, Rachel Reeves, is perceived well by the financial community. Continued strength of Labour in the opinion polls does not need to damage sterling.

Faster BoE easing presents upside bias. Our core view here is that in an environment of lower aggregate demand and inflation moving back towards target, the BoE will ease more aggressively than the eurozone and that EUR/GBP will rise. The BoE has been criticised for the fact that the UK has had a worse inflation problem than elsewhere in the world, but in 2024 we think it will be in a position to unwind its restrictive 5.25% Bank Rate more quickly than the ECB. The risk here is that more disfunction in the eurozone in early 2024 prompts earlier ECB easing than we currently forecast (September 2024), but we doubt that this should lead to too much downside in EUR/GBP.

Low volatility. We have a mildly bullish outlook for EUR/GBP into 2024, but our call for 0.90 in the second half of 2024 is not particularly far above the outright forward. Historical volatility is very low here and that is reflected in one year implied EUR/GBP volatility – now just 5.7%. This had traded as low as 4% in 2006/07 and we do not have

any high conviction in saying that volatility cannot fall further. In other words, we are not looking for major swings in EUR/GBP. For reference, however, one year volatility did trade 11% in September 2022 during Liz Truss's ill-fated government and corporate treasurers, looking for some optionality in FX hedging, could take advantage of the current low level of implieds.

EUR/CHF: SNB will want to keep things stable

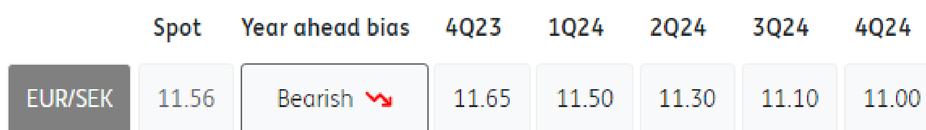
	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/CHF	0.97	Neutral	0.96	0.96	0.96	0.96	0.96

The strongest G10 currency. The Swiss franc (CHF) has proven to be the strongest G10 currency in the world this year – even surpassing the dollar. Despite the natural demand for the CHF from Switzerland's perennially large current account surplus (now around 10% of GDP), the Swiss National Bank (SNB) has also been buying CHF. SNB sales of FX reserves amounted to CHF75bn in the first half of this year and continued the U-turn on FX intervention that the SNB undertook in the summer of 2022. Having traditionally been a large buyer of FX, the SNB switched to FX sales as part of its monetary policy toolkit. As we understand it, its decision has been to target a stable real CHF – requiring nominal CHF appreciation to offset higher inflation amongst overseas trading partners. In fact, the SNB has even allowed the real exchange rate to appreciate this year too – which we speculate could be part of a desired tighter monetary conditions package.

Crunching the numbers. Given that we are not forecasting SNB rate cuts next year, we make the assumption that the SNB will not be looking for monetary stimulus from a weaker real CHF. We assume at a minimum the SNB will want a stable real exchange rate. Plugging in our forecasts for Switzerland's inflation differential with trading partners, what was a 5.5% differential in late 2022 could be narrowing close to zero by the end of 2024. Thus in order to keep the real exchange rate stable, the zero inflation differential means the nominal CHF exchange rate should be roughly stable too. If we plug in our FX assumptions and weights for the Swiss franc's main trade partners, such as the eurozone (49%), the US (20%), China (12%) and the UK (9%), we can calculate what level of EUR/CHF would deliver a stable trade-weighted CHF by the end of 2024. Those assumptions of e.g. EUR/USD at 1.15, USD/CNY at 7.00 and GBP/USD at 1.28 produce a EUR/CHF number near 0.95/96.

Eurozone recession favours a soft EUR/CHF too. Our team forecasts the eurozone entering a technical recession in the first quarter of 2024. Periods of weak growth in the eurozone typically pressure test the system including the fiscal policy of southern Europe. The potential return of the Stability and Growth Pact may clash with loose Italian fiscal policy and hit Italian government debt. These periods typically see EUR/CHF under pressure. As above, we think the SNB may tolerate EUR/CHF down near 0.95 during 2024 while it is still concerned with 2%+ inflation. Into 2025, however, Swiss CPI should be dropping below 2% and the SNB will be more open to listening to Swiss exporters that the Swiss franc is too strong. 2025 is our preliminary estimate for when EUR/CHF turns higher.

EUR/SEK: Obstacles remain for a long-awaited decline



	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/SEK	11.56	Bearish	11.65	11.50	11.30	11.10	11.00

FX hedging sales aren't key. The pace at which the Riksbank has conducted FX hedging operations has put them on track to complete the programme (USD8bn, EUR2bn) in the shortest possible window: four months. That means the bank has a rather restricted room to materially increase SEK purchases, if indeed one of their goals is to prevent SEK sell-offs, and unless SEK is driven higher by other factors in the next couple of months. There is some scope to speed up EUR (but not USD) sales, although some of those sales are done via the EU payments channel that may not be as impactful as FX swaps in moving the exchange rate. In practice, if the Riksbank wants to drive SEK sustainably and substantially higher via FX sales, it needs to increase the size of the programme. For now, FX hedging is a relatively marginal factor for EUR/SEK, and can only help limit short-term upside into 2024.

Overvaluation versus economic slack. EUR/SEK is approximately 8% overvalued in real terms, according to our medium-term BEER model. The path for a reconnection of the krona with its better fundamentals is obstructed not only by the uncertain outlook for pro-cyclical currencies in a high-rates environment, but also by idiosyncratic weakness in the Swedish economic outlook. The fears of a real estate collapse have subsided of late, but we probably haven't seen the bottom in the house price correction. Growth will remain very soft at least until mid-2024 and the risk of recession is high. Inflation is receding at a slow pace, meaning high rates for longer, to which Swedish households are significantly exposed to.

Riksbank to pick inflation battle over growth. We expect one more hike by the Riksbank before year-end. This should be the last one of the cycle, but we see policymakers continue to prioritise the inflation battle over growth concerns. This will be done primarily by keeping a hawkish bias and pushing back against rate cut speculation (which should intensify with sluggish growth figures), even though easing should start with the ECB in the third quarter of 2024. Orthodox and unorthodox attempts to keep supporting the krona will remain part of the script, and we cannot exclude an expansion of the FX hedging programme in 2024. Fed cuts should favour a rotation to activity currencies including SEK, and allow it to cash in on respectable carry and undervaluation. We see EUR/SEK around 11.00 in the second half of 2024.

EUR/NOK: Finally the year of love for the krone?

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/NOK	11.87	Bearish	11.80	11.70	11.30	10.90	10.60

Big misvaluation. NOK is considerably undervalued in the medium term. Our BEER model shows EUR/NOK is trading around 20% above its real fair value, with the mis-valuation having been exacerbated in recent quarters by a growing terms of trade advantage for NOK. The convergence to the krone's higher fair value will continue to be slowed by the poor liquidity characters of the currency, which will make it attractive only in an environment where global rates take a decisive turn lower. It is our base case that this will happen from the second quarter onwards in 2024, but we cannot ignore the risk that an extra resilience in the US economy leaves procyclical currencies in a choppier for longer trading environment.

FX purchases to stay high. Norges Bank foreign currency purchases on behalf of the government will remain elevated for most of 2024 in our view. Our commodities team's view that oil will average $90/bbl next year, and the government's petroleum tax income forecasts have tended to stay on the optimistic side. Unless policymakers decide to ease tension on the currency with lower FX purchases, we currently estimate the monthly amount to average 1.6bn NOK in 2024. That could hinder the pace of re-appreciation of the krone and exacerbate sell-offs during risk-off phases.

Norges Bank can "out-hawk" the Fed. The krone's (under-) performance has taken a more central role in monetary policy decisions throughout 2023. Norges Bank normally operates under a rather strict model-based regime, where NOK is one factor along with rates and oil prices. Our economics team has an out-of-consensus dovish call on the Fed in 2024, which implies a sharp decline in global rates and argues for Norges Bank rate cuts. However, NOK may face more headwinds before US data turns (also given high FX purchases), and Norges Bank could see benefits in holding a hawkish stance longer than the Fed to favour a stable NOK recovery after hiking in December of this year. After all, high commodity prices mean Norway's growth should be among the highest in Europe next year (we forecast 1.2% annualised) and inflation recently rebounded, which grants policymakers room to keep rates tighter for longer. Our base case remains a decline in EUR/NOK below 11.00 before year-end 2024.

EUR/DKK: Intervention to sell DKK unlikely next year

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/DKK	7.46	Neutral	7.46	7.46	7.46	7.46	7.46

Low-intervention environment to linger. Danmarks Nationalbank has stepped out of the FX market in 2023, intervening for only DKK13bn (all in January) to weaken DKK this year after selling almost DKK55bn in 2022 and DKK120bn in 2021. A switch at the helm of the DN led to a smaller hike than the ECB in February, which helped relieve pressure from the Bank to keep intervening. EUR/DKK appreciated gradually until reaching central parity at 7.46 in October. The new levels suggest that the chances of DN returning to a high-intervention regime to sell DKK aren't very high in 2024, especially given our view that EUR/USD will appreciate next year.

How to deal with rate cuts? If anything, interest for DKK as a funding currency could lead to some weakness and DN buying, rather than selling, the krona. Should DKK strength prove persistent – or should DKK appreciate against our predictions – DN will have the chance of adjusting the rate gap with the ECB as rate cycles in Europe start: from the third quarter in our forecasts, but the ECB might move earlier. For now, our call is that DN will mirror ECB moves 1:1 in 2024. While EUR/DKK may trade slightly above the upper-bound of the Bank's tolerance band, we expect DN will be able to tame FX volatility using only FX intervention.

USD/CAD: Good carry, tricky correlations

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/CAD	1.37	Bearish	1.37	1.35	1.33	1.29	1.27

Strong correlation with US data. Our core view for 2024 in FX is a US dollar decline across the board, with lower Treasury yields offering a breeding ground for pro-cyclical currencies to rebound. However, the loonie is in a peculiar spot though. Fed easing would come as a consequence of deteriorating US activity data, to which – somewhat

unintuitively – USD/CAD has negative correlation. Even when looking at the sensitivity of G10 currencies to US yields in the past six months, the impact on CAD is neutral. At times, CAD has traded as a proxy of US economic sentiment, and in our view that can put it in a disadvantageous spot against other pro-cyclical currencies in the period antecedent to Fed cuts, when US data deteriorates. At the same time, a soft-landing scenario in the US would likely shield CAD more than other high-beta currencies in a higher for longer environment.

Best carry in G10, for now. We see more than one scenario where carry trades become an attractive strategy in 2024. As things stand now, the Canadian dollar has the best risk-adjusted 3-month carry in the G10 space excluding USD. We expect, however, the Bank of Canada to follow the Fed with big rate cuts in 2024: 150bp over the course of the year, around 100bp more than what markets are pricing in. We expect the loonie's carry advantage to be slightly eroded over the course of the year, even though the structurally lower volatility compared to other high yielders should keep it a good option should markets interest for carry be revamped.

Canada has already landed hard. Our call for large Bank of Canada (BoC) cuts aren't solely a function of Fed easing. The Canadian economy contracted in the second quarter and growth was zero in July and August, meaning a tangible risk of a technical recession in the third quarter. That said, we expect the growth differential with the US (where we are calling for a recession) to swing in favour of Canada in the first half of 2024. The high exposure of the Canadian economy to the US one will make stagnation the most likely scenario north of the border, but high commodity prices will offer some shield. The BoC could, however, start cutting before the Fed. In two previous instances where the short-term swap rate USD-CAD gap was at the current levels in 2023, USD/CAD was trading below 1.35, so the starting point should be lower. A return to levels below 1.30 by the second half of 2024 remains our base case.

AUD/USD: The cheapest pro-cyclical bet

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
AUD/USD	0.65	Bullish	0.64	0.65	0.67	0.69	0.71

Risks skewed to a hawkish Reserve Bank of Australia. In November, the RBA hiked by 25bp after a rebound in inflation, bucking the pausing trend among most developed central banks. Markets, however, interpreted the statement as an implicit admission that rates have peaked: we don't agree, and think there is an underestimated risk the RBA tightens further – even if not our base case. Assuming rates have indeed peaked at 4.35%, the pressure of easing rates from Fed rate cuts should intensify from the second quarter of 2024 onwards. However, we estimate a much smaller package of monetary easing in Australia (50bp) compared to the Fed (150bp), with multiple outside risks of hawkish surprises by the RBA along the path that can help the Aussie dollar recover from the currently deeply undervalued levels. Our BEER model shows medium-term real AUD/USD trading well over 20% below its fair value.

Decent economic outlook. To achieve the RBA's 2-3% inflation target range, CPI needs to average an increase of almost exactly 0.2% each month, and here is where we see potential dislocations getting in the way of an RBA transition to easing. At the same time, the economic outlook should not deteriorate in Australia as fast as we estimate it will in the US. Less squeeze from rates on the economy compared to other countries, a stabilising real estate story (house prices back on the rise) and elevated commodity export prices should contribute to a respectable 1.6% annual growth rate in 2024. On the commodity side, our strategy team forecasts iron ore (62% Fe) prices to average

USD104/t next year, below current levels but in line with the 2022-2023 average and above the 2021 average.

External factors will remain key. While we think the Aussie dollar should have an edge over other pro-cyclical currencies based on domestic factors and sharp undervaluation, external drivers – namely US yields, global risk sentiment and China's economic outlook – will effectively dictate the big bulk of AUD/USD moves in 2024. Our baseline scenario that sees USD yields falling on the back of US economic underperformance and Fed easing would put currencies that have had so far been penalised by the high rate environment and embed many external negatives like AUD in a very advantageous position. When it comes to China, our estimate for 5.0% growth in 2024 mean that there should be enough gradual rebuilding in optimism to direct market attention towards proxy trades for a recovery in Chinese economic sentiment. AUD is one of our favourite currencies for next year.

NZD/USD: New government, higher rates?

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
NZD/USD	0.60	Bullish	0.59	0.60	0.61	0.62	0.64

Kiwi $ should rally in our base-line scenario. The benign outlook we currently forecast for pro-cyclical currencies as the USD declines on Fed easing should see the Kiwi dollar shine from 2Q24 onwards. NZD is not as undervalued as AUD due to New Zealand's current account deficit (which has widened significantly in the past few quarters), but is still some 12% cheaper than its medium-term fair value in real terms. It is also the highest-yielding currency in G10 after the USD, although it is materially more volatile than other high-yielders like CAD and GBP, meaning that a substantial abatement in FX volatility is likely necessary to boost carry-motivated long positioning on NZD. The kiwi dollar should benefit like AUD from a gradual optimistic rerating of growth expectations in China.

Reserve Bank of New Zealand heading to a remit change? The slowdown in inflation, hiring and wage growth in the third quarter suggest the RBNZ's next move will be a cut, in our view in the summer of 2024. Uncertainty about the impact of booming migration, big spending from the outgoing government and increasing incidence of extreme weather events are all risks that inflation will prove stickier than expected into the new year. The recent change in government can have big implications for the RBNZ policy. The new coalition will almost surely be led by the National Party, which promised less spending than the previous Labour-led government, but also tax cuts (which are inflationary). More importantly, it had advocated for a change of the RBNZ remit, so that the dual mandate is dropped to focus on a stricter inflation targeting. The remit review normally happens in June, and should it be changed, it could mean higher for longer rates in New Zealand – an NZD positive.

Clouded economic outlook. On the economic side, we are less optimistic on the outlook for New Zealand than for Australia. Higher rates and risks of more persistent inflation mean a tighter grip on households. On the real estate side, the worst of the correction looks past us, but house prices are still 13% below the 2022 peak. We are broadly optimistic on energy commodities in 2024, but New Zealand is a net energy importer and its exports are mostly concentrated in dairy products. Fonterra estimates a moderate downside risks in milk prices next year (mid-point at NZD6.50 – 8/Kg milksolids). Recession is a non-negligible risk in 2024, but whether this will mean a more dovish RBNZ will effectively depend on a remit review: should the new government leave it unchanged, then bigger rates cuts would likely get in the way of a smooth NZD recovery.

CEEMEA: Same region yet so different

Next year offers an optimistic outlook for the region, but the risks from this year are being carried over into next, and there are some new ones, too. We are bullish but the region is in a precarious position. Falling rate differentials and less attractive carry will have to be offset by a weaker US dollar and a strong economic recovery for FX to stay on track

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For next year, the markets are full of optimism with the prospect of a better tomorrow but there are still many unresolved issues and risks

Optimistic outlook but many risks remain

The central and eastern European region has been hit by a number of negative shocks in the past year due to geopolitical issues but is now probably out of the woods. For next year, the markets are optimistic but there are still many unresolved issues and risks. So the glass half full could become half empty very quickly and we should be vigilant despite our bullish outlook on FX.

On the macro side, this year we have seen optimistic expectations and subsequent disappointment. Most of the time, economies in the region have teetered on the edge of recession, or GDP growth estimates have been revised significantly downwards. Still, most currencies eventually found their way to stronger levels supported by high interest rates and a current account recovery. For next year, on paper, the economy is expected to recover across the board but the end of this year already shows that the outlook is not as positive as it may seem. The market consensus for economic growth next year is already slowly deteriorating and unless we see a recovery in the major European economies, this trend will continue. So recovery is still our baseline but the risks are more to the downside. Moreover, geographic location means that risks from this year carry over into next, and new ones are opening up given the tensions in the Middle East. Commodity and energy prices will thus continue to play a key role for both central banks and FX.

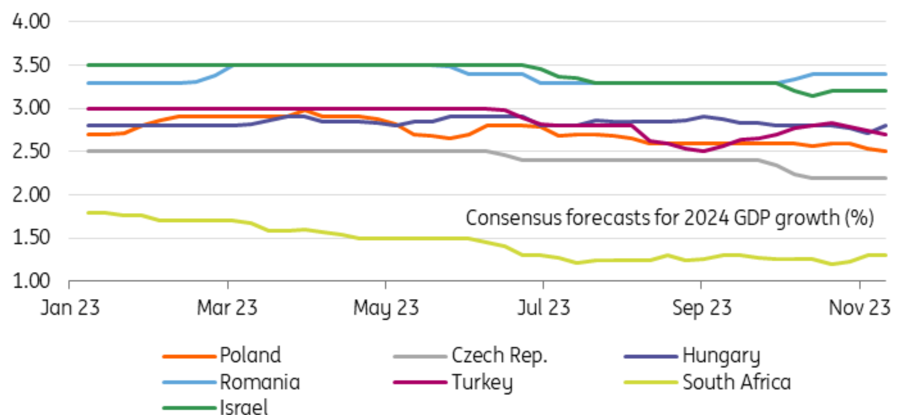
In the CEE4 space, FX will be driven by balancing falling interest rate differentials against a higher EUR/USD. The cutting cycle has started in Hungary and Poland and it is only a matter of time before it starts in the Czech Republic and Romania. Financial markets have largely priced in most of the easing but we still see room to move further in this direction. Meanwhile, global central banks remain at the peak of their cycles, and rate cutting is not yet on the table. Interest rate differentials have already shrunk significantly and the trend here is clearly negative for local currencies. FX carry is thus

becoming less and less of a benefit for CEE FX and can no longer rely on this to the same extent. On the other hand, despite the risks, we expect an economic recovery, a current account surplus across the board and a higher EUR/USD at 1.15 by the end of next year. This should drive CEE FX to stronger levels in our base case scenario, overcoming the negative impact of the interest rate differential. However, based on the risks we mentioned, it is clear that it will be a bumpy road.

Elsewhere, investors are turning a little more optimistic on Turkey as the Erdogan administration embraces more conventional policy. Here, the Central Bank of Turkey (CBT) should take the policy rate up to 40% by year-end and regulatory reforms are now placing more emphasis on the policy rate - hence increasing upside risks to the terminal rate. We expect the CBT to allow a further steady decline in the lira in 2024 - but probably not quite as much as the 30% priced in by the current forwards. South Africa's rand may continue to stay soft ahead of key elections next May. Weak growth may prompt the ANC-led government to increase spending and bring South Africa's fiscal problems back to the fore.

Military activity in both Ukraine and Israel has taken its toll on both the hryvnia and the shekel. On the former, we suspect the National Bank of Ukraine might struggle to hold the hryvnia stronger in the face of a large current account deficit. The Bank of Israel, however, has access to larger FX reserves and the shekel has a strong balance of payments position. Having allocated a large proportion of FX reserves to support the shekel, we suspect USD/ILS can sustain its recent move below 4.00 - especially if the dollar turns lower through 2024.

Optimism about the recovery next year is gradually declining



Source: Macrobond, ING

EUR/PLN: Mixed to positive on the zloty

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/PLN	4.40	Neutral	4.41	4.43	4.45	4.43	4.40

Our short- and medium-term outlook on the zloty is mixed to positive. Our concern is that PLN has already significantly appreciated in real terms since late 2021, as Poland has seen substantially higher inflation than its trade partners. BIS estimates suggest the zloty has gained over 10%. In normal circumstances, this would likely result in a nominal depreciation of the zloty (i.e. higher EUR/PLN). However, there are a few important positives and 'low hanging fruit' that the new government could unlock to revive GDP (FDI, EU funds, private investments). Also, foreign investors are heavily underweight in local government bonds (foreign holding at 14% vs 28% in other CEEs on average) and we expect that to change. Moreover, Poland should likely soon receive payments from

the Recovery Fund, as the coalition that won the October general elections aims to significantly improve relations with the EU and obtain access to the Recovery and Resilience Fund (even if a likely lengthy formation of a new government delays the advances).

Moreover, the rate outlook is PLN-positive. In our view, the National Bank of Poland (NBP) has ended the easing cycle. Investors have trimmed expectations for additional rate cuts, but in our view, they are still excessive. This should provide some support, given wide expectations for core central bank policy easing next year.

However, we expect some policy actions to trim further PLN gains. Polish exports remain profitable above 4.30-40. It was the previous Civic Platform government that started to convert EU funds in the NBP to prevent excessive PLN gains. It is very likely it will continue with this process to shelter the economy, as long as the NBP cooperates. At the same time, we expect Poland's current account to worsen a bit. Domestic demand is rebounding, led by consumption and the adoption of EU funds. This should reinvigorate imports. At the same time, economic activity in the euro area remains soft, with still limited signs of recovery. Hence a rebound in exports is likely to be delayed.

EUR/HUF: We continue to forecast a stronger forint

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/HUF	376.00	Mildly Bearish	375.00	368.00	365.00	370.00	370.00

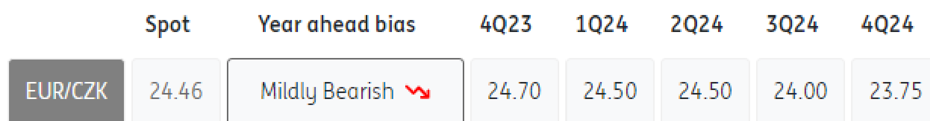
The EU deal is a potential catalyst. History shows that we have been here before. As of the end of 2022, the European Commission (EC) and Hungary achieved a compromise, providing grounds for optimism and improving the fortunes of the forint. However, one year has passed and a positive outcome to the rule-of-law dispute is yet to be seen. The moment of truth is near, yet progress remains painfully slow as the EC has once again posed questions to the Hungarian government about the judicial reforms, halting the net 90-day evaluation period for a second time. With the clock paused, having ticked down to just under 10 days, our viewpoint remains unchanged. There is no "plan B" in place for either side, hence we anticipate a partial agreement between Budapest and Brussels towards the end of November or early December. Such an agreement would release a significant portion of the Cohesion Fund (EUR13bn), providing a substantial and permanent uplift to the forint.

The dawn of an old-new era. We expect the National Bank of Hungary to continue to lower the policy rate and the interest rate corridor as disinflation continues early next year. We wouldn't be surprised to see the Monetary Council maintain the recent pace of easing (75bp), keeping ex-post real interest rates above 350bp, and then slowing the pace in a way that helps maintain a 200bp positive ex-post real interest rate. Given our inflation forecast, which sees inflation hovering around 5% in 2024, we see the policy rate reaching 7% around the summer and then remaining on hold until the end of the year. If our monetary policy and inflation views prove accurate, this setup will lead to the region's highest positive real rate and carry, ultimately aiding the forint's appreciation.

Blessing in disguise. The collapse in domestic demand led to a slowdown in economic activity in the first half of this year, which rapidly reduced the need for imports. In addition, as energy prices were significantly lower than a year earlier, the pressure on the external balance from the import side continued to ease. These factors have led to persistent trade surpluses, while the current account (CA) was also in surplus already in the second quarter. With assistance from the export sector, we foresee a modest CA surplus this year. The 2024 CA balance appears even more promising (approximately 1%

of GDP), with energy contracts being renewed at reduced rates and new capacities aiding exports, along with a sluggish rebound in domestic demand. Consequently, the natural flow of hard currency helps maintain the stability of the forint.

EUR/CZK: Weak economy but responsible policy



	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/CZK	24.46	Mildly Bearish	24.70	24.50	24.50	24.00	23.75

Czech National Bank (CNB) plays it safe but rate cuts are inevitable. Despite expectations, the central bank did not cut rates in November, delaying the start of the cutting cycle. The current discussion is whether the board just wants confirmation of the previous dovish numbers and the December meeting will be the right moment or whether the board wants to see more and we will have to wait until the beginning of next year. At the moment, we lean towards the second option. But the conclusion is that the start of a cutting cycle is inevitable. Even though the vast majority of policy easing has already been priced in, the CNB move itself will still cause some pain to the CZK. Thus, in the short term, we see the CNB's move as a reason for a weaker CZK, but it should not be a game changer given that the market needs just a little time to finish the job the CNB intends to start.

The economy is weak and the recovery is delayed. The Czech economy has been teetering on the brink of recession for the past six quarters and the outlook does not appear to be positive either. Household consumption has been falling for almost two years in a row and industrial production has been declining across sectors, with the exception of the automotive sector. Overall, the Czech Republic is the only economy in the EU that has not reached pre-Covid levels, and is the true weak man of Europe. The outlook is also not very optimistic. The consensus for next year is currently 2.2% for GDP growth, while the CNB revised the outlook down to 1.2% in a new forecast. We are leaning more towards the CNB numbers and expect the coming months to be disappointing for the market as well, which will also hinder the CZK recovery.

Responsible policy should be rewarded by markets later. On the positive side, the Czech Republic runs policy responsibly. Monetary policy is still restrictive and fiscal policy could see significant consolidation next year, while elsewhere in the region we can see the opposite approach. On the one hand, this is one of the reasons for the weak economy; on the other, the Czech Republic will be one of the first countries, perhaps globally, to hit the central bank's inflation target early next year. We thus believe that the market will not punish the Czech Republic for the lack of economic growth and will reward it with higher demand for CZK assets later next year when the results of the work become apparent.

EUR/RON: Limited flexibility to persist in an electoral year

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/RON	4.97	Neutral	4.98	5.02	5.03	5.03	5.05

Super electoral year ahead. Romania is experiencing a somewhat unusually long period of eventless politics, with the grand socialist-liberal coalition apparently working smoothly. Nevertheless, the super electoral cycle of 2024 might stir the waters a bit, as both coalition parties seem more likely to go into elections separately. Despite that, we might have more noise than facts, as the electoral campaign has clear potential to generate negative headlines throughout the year. Traditionally, the National Bank of

Romania (NBR) has been a touch reluctant to intervene in the market around political turmoil, but given the still fragile disinflationary trend and the leu's proximity to all-time lows, it might feel more emboldened to limit excessive fluctuations.

EU fund inflows boosting FX reserves. Due mainly to solid EU funds inflows and also to another year of robust external issuance, the NBR's FX reserves have increased from EUR46.6bn (excluding gold) at the end of 2022 to EUR58.1bn as of October 2023. Given that for 2024 and beyond, the pace of EU funds inflows is likely to be well north of EUR10bn per year, the NBR is likely to see its nominal FX reserves continuing to pile up while staying broadly constant in relative terms (e.g. by IMF's ARA metrics). This should consolidate the market's confidence in the NBR's ability to emphasise the "managed" part of its "managed floating" regime.

Official easing to begin in the second quarter of 2024. The background for 2024 should, in principle, mean that the central bank will remain cautious – leading to the likely scenario of the NBR being the last central bank in the CEE4 to begin its rate-cutting cycle. A pre-requisite for a first cut might be for inflation to go below the key rate, which is likely to happen by the end of the first quarter of 2024. However, historically high excess liquidity in the interbank market is already generating the outcome of conventional policy easing through its visible impact on market rates. From overnight to the one-year tenor, rates are closer now to the 6.00% deposit facility rather than the 7.00% key rate, with the benchmark index for loans granted to consumers printing even well below the deposit facility at times. Therefore, we tend to think that the impact of a rate-cutting cycle might be transferred more to the long end of the curve (above the five-year tenor), which might tend to price in a full cutting cycle once it starts and lead to a flatter yield curve.

EUR/RSD: As tightly managed as ever

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/RSD	117.20	Neutral	117.22	117.21	117.20	117.22	117.23

Geopolitics gets complicated and hinders EU accession. Far from saying "we told you so", the reality for Serbia is that its strategic geopolitical ambivalence comes at a cost, which in this case is an almost de-facto freeze of its European Union accession negotiations, underway for a decade already. Whether it is about Kosovo, the free trade agreement signed with China or the refusal to rally behind EU sanctions on Russia, there are plenty of reasons to be cautious on Serbia's prospective advance towards the EU. To date, the country opened 22 out of 35 negotiation chapters, with only two in principle closed. The early elections called for 17 December 2023 are likely to result in another SNS-led government, though the opposition's chances look much better this time compared to previous elections.

National Bank of Serbia (NBS) will remain FX-centered. Faced with consistent inflows, mainly FDI-related, the NBS continued to intervene in the FX market by buying almost EUR3.4bn over the first nine months of 2023, thus boosting its FX reserves to a record EUR24.2bn. The stability of the EUR/RSD rate seems to remain the NBS's main focus and 2024 will look no different. If anything, the relative stickiness of headline inflation could tilt the balance towards a mild appreciation stance for the dinar, though the magnitude is likely to be extremely limited by any metric. On the other hand, the relatively high FX pass-through of the exchange rate into inflation will likely cap the upside potential of the pair to near its present levels of around 117.20.

IMF to continue acting as a stability anchor. The EUR2.4bn Stand-By Arrangement (SBA) signed with the IMF in late 2022 is likely to be turned into a precautionary

agreement as the authorities consider they have sufficient buffers in case of new shocks. The SBA has been working smoothly, with the country drawing around half of the total amount by October 2023. The new arrangement is facilitated by an overachievement on the current account and fiscal side which are expected to narrow this year towards -2.5% of GDP and below 3.0% of GDP, respectively, and remain below 3.0% of GDP in 2024.

USD/UAH: Hryvnia strength probably will not last

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/UAH	36.35	Bullish	37.00	37.00	39.00	39.00	39.00

NBU shifts the FX regime. Since the National Bank of Ukraine (NBU) decided to shift the hryvnia regime, the currency has appreciated against fundamentals. This also came against wide market expectations. To keep the currency appreciating, the NBU has had to increase FX intervention to an all-time high (over USD$3bn in October, more than at the peak of the Russian aggression), and has possibly been even more aggressive in November. This drove USD/UAH from 37 to 36.

Hryvnia strength unlikely to last. Unfortunately, this is unlikely to last. Ukraine has a significant current account deficit, and it is unlikely to phase out for years. The NBU may continue to try to counter that via FX intervention, but despite foreign aid, FX reserves have been falling for four months straight.

Long-term prospects of the hryvnia are fundamentally negative. The Russian aggression is unlikely to end anytime soon (some analysts pinpoint the US presidential elections as pivotal). The damage to the Ukrainian economy, sadly will likely only intensify. That is why we expect the NBU to allow some hryvnia weakening in the long run, but possibly no sooner than the conflict ends.[Text]

USD/KZT: Supported near-term, more distant prospects less certain

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/KZT	464.00	Neutral	465.00	460.00	460.00	465.00	470.00

Pick-up of imports lowers the role of oil. USD/KZT is trading around 460, the middle of the range of 440-480 in the first 10 months of 2023. This 4% fluctuation is much narrower than Brent's 18% volatility around $85/bbl seen during this period. This can be explained by the normalisation of the current account following the abnormal surplus of 2022. As of August 2023, 12-month rolling import growth reached 27% year-on-year led by Chinese manufacturing products (amid large capex), while exports stagnated in volume terms. As a result, the current account could see a $4bn deficit this year and is likely to remain negative in 2024-25, unless oil exports shoot up.

Transparent private capital inflow is narrow. The weakness in the current account should be offset by the capital inflow. Indeed, as of mid-2023, the current account deficit of US$2.4bn (4Q rolling sum) is overwhelmingly offset by the net private (banks, companies and households) capital inflow of US$13bn. However, the quality and sustainability of the inflow are under question, as two-thirds of this inflow falls under 'errors and omissions', which became large and positive in the third quarter of 2022 following the Russia-related geopolitical turmoil. The transparent and sustainable capital inflows are much more modest, providing much smaller support to the local FX market.

State FX sales may increase shortly but will decline later. FX sales out of the oil fund to finance budget expenditures is the final and crucial variable for the tenge. The KZT's

weakness in 2022 and early 2023 corresponded to a decline in the state oil fund's (NFRK) FX sales from $10bn in 2021 (90% of transfers) to $5bn in 2022 (43%). In the first 10 months of 2023, FX sales picked up to $7.6bn, and the conversion rate (85%) still suggests some room for further recovery in the near term. At the same time, the planned reduction of NFRK transfers by KZT200bn (c.US$0.6bn per year) in 2024-26 due to stricter fiscal rules suggests lower support to the tenge in the longer run, unless higher local borrowing amid elevated real rates attracts more foreign portfolio investors.

USD/TRY: Managed TRY depreciation

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/TRY	28.62	Bullish	30.00	33.30	35.50	37.00	38.00

The Central Bank of Turkey (CBT) remains hawkish implying upside risks to the rate outlook. With five consecutive hikes since the elections, the CBT increased the policy rate to 35%, while repeating its signal for further tightening steps to achieve disinflation. The underlying inflation trend started to improve in October, in line with the CBT's expectation. As the bank also pledged that the policy rate will be determined in a way that will create monetary and financial conditions necessary to ensure a decline in the underlying trend of inflation, we should not rule out the possibility of a deceleration in the pace of hikes at the upcoming Monetary Policy Committee meeting. Accordingly, we expect the terminal policy rate to be 40%, with two more 250bp hikes in November and December, with risks to the upside.

Steps to unwind banking sector regulation to make the policy rate the main monetary tool again. Following the signal of additional macro-prudential measures at the October MPC and thanks to the progress on the monetary tightening process, with high enough rates to control lending and support de-dollarisation, the CBT has taken significant steps to reinforce rate hikes in recent days. These moves and their impact on deposit and lending rates will be important in tightening financial conditions and controlling domestic demand. Given that the macro-prudential framework has been in a process of gradual simplification based on an impact analysis, we will likely see further simplification of the existing micro- and macro-prudential framework with ongoing efforts to return to orthodoxy.

High budget deficit target despite disinflation efforts. In the government's new Medium Term Plan, the budget deficit forecast for 2023 was revised to 6.4% of GDP on the back of earthquake-related reconstruction works and heavy pre-election spending, though the latest budget data indicates a deficit of less than 3% currently. This suggests that a very large deficit may be recorded in the remainder of this year. Additionally, the fiscal stance is likely to remain accommodative in 2024 with another wide deficit at 6.4% of GDP, though excluding earthquake-related spending, the target is below the 3% threshold. Given this backdrop, the fiscal outlook for next year is not fully helping the CBT in the disinflation process. We expect further lira weakness in 2024, but not as much as priced in by the forwards.

USD/ZAR: Fiscal risks ahead of May elections

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/ZAR	18.36	Mildly Bearish	18.75	18.75	18.50	18.00	18.00

First half challenges. It looks as though it could be a difficult couple of quarters for the rand. Slowing global growth as the US converges lower on the Rest of the World will not

be good news for industrial commodity prices – some of South Africa's key exports. This will come at a time when domestic growth remains weak. The South African Reserve Bank (SARB) is forecasting very tepid growth of around 1% in 2024 and 2025, which will do little to alleviate South Africa's 33% unemployment rate. That weak growth may spark some ANC fiscal giveaways before the general election scheduled in May. The ANC faces one of the stiffest races here in 30 years and higher public sector wages may bring fiscal concerns back to the fore. Like Brazil, fiscal accounts have often been one of South Africa's weaknesses.

SARB set for now. The SARB was a little late to hike and also may be a little later to cut if the rand comes under pressure over coming quarters. Inflation has been slightly better behaved in South Africa than in the rest of the world, but the SARB was very close to one further hike in September and may not be in a position to cut until much deeper into 2024. That will keep the policy rate around 8.25% and real rates quite attractive around the 3% area – providing some welcome support to the rand. On the external side, the current account deficit is expected to widen a little further to the 2.0/2.5% of GDP area. This is not quite as bad as the 5%+ deficit seen a decade ago, but a long way from the 4% surplus seen in early 2021.

Our thesis. We expect the rand to be stronger by the end of 2024 as global growth starts to pick up and the dollar turns lower. Before then, however, the elections and weak growth will probably prevent a major bullish re-assessment of the rand's outlook. Indeed, before then there could be further challenges to portfolio flows into South Africa. We note that from June next year, India will be included in the JPM GBI-EM local currency government bond index. South Africa currently has quite a large 8.7% weight in that index. India's inclusion stands to squeeze out investment in South Africa and prove another headwind to the rand.

USD/ILS: Counting the cost of war

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/ILS	3.81	Bearish	3.90	3.80	3.70	3.60	3.50

The impact on GDP. Large uncertainty remains over the path of Israel's economy and financial markets after the horrendous events of 7 October. For reference, Israel's economy contracted 10% at the start of the pandemic and some are suggesting that a six-month conflict could trigger the same kind of contraction. Clearly, Israeli authorities will be doing all they can to stabilise growth, including aggressive fiscal spending. Some banks have forecast early Bank of Israel (BoI) rate cuts and money markets have shifted to pricing in 125bp over the next 12 months. For the time being, however, it looks as though the Bank of Israel is prioritising shekel stability and will thus prefer to avoid large rate cuts at this time.

The shekel support plan. In the immediate aftermath of the attack, the BoI announced a financial support package, including $30bn in FX intervention, $15bn in USD/ILS swaps and a repo programme. In October, the BoI sold $8.2bn in FX intervention and has managed to drive USD/ILS back below 4.00. Currently, the BoI's FX reserves are around 37% of GDP and would have to fall by around another $35bn to get back to the 30% of GDP level that persisted between 2010 and 2020. We do not see FX reserve adequacy being an issue for Israel, which could probably count on a Fed dollar swap line if a much larger intervention meant that FX reserves were falling quickly.

The shekel outlook. In prior years we have been very bullish on the shekel, which tends to lead currencies during periods of a dollar bear trend. Typically, Israel also produced large current account surpluses to support the shekel. How quickly the Israeli economy

adjusts to this new war footing remains to be seen, but it seems unlikely USD/ILS will be pressing the lows near 3.10/3.20 again in 2024. As we had mentioned previously in FX Talking publications, the BoI had also estimated that the shekel contained a 10% risk premium pre-war due to the tension over constitutional reforms. What happens to Israeli politics from here of course remains uncertain too, but until a clearer outcome emerges in the region, that risk premium likely remains in the shekel.

Asia: Event risk could dominate

A turn in the dollar should, in theory, offer some respite to the beleaguered Asian currency bloc. Yet soft growth in China and a whole host of elections - kicking off with Taiwan in January - warn that it will again be a bumpy year for local currencies

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With the exception of India, China is the single largest trading partner of every country in the region

The fate of Asian FX in 2023 was largely a function of US dollar strength, overlaid with a myriad of local economic factors, which saw some currencies perform better than others at different times, though the broad theme was Asian FX losses against the USD. The Malaysian Ringgit came bottom of the pack, losing more than 5.5%, while Indonesia's rupiah, India's rupee and the Phillippine peso all made smaller losses, weakening by around 0.5%. All currencies have nevertheless lost ground to the US dollar in 2023 year-to-date, and we would anticipate all of them making up some, though probably not all of this lost ground in 2024.

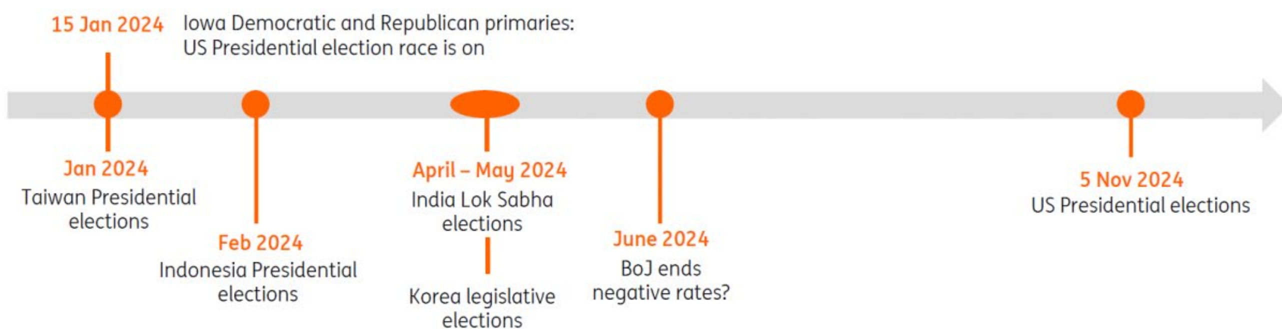
Within the FX pack, some currencies were essentially propped up by the local central bank, which stepped in to manage volatility. That sums up the Chinese yuan and Indian rupee and likely means that they will underperform their peers when broad trends call for some appreciation against the USD. Indonesia and the Philippines have taken a slightly different tack, using monetary policy tightening to support their currencies, and in turn, they too may see their 2024 upside capped, especially if they choose to remove some of this tightening.

China's macro story is also likely to be a strong factor limiting the upside when (and indeed if) it eventually materialises. With the exception of India, China is the single largest trading partner of every country in the region. That could help to cap any upside in the North Asian currencies in 2024, as none are likely to totally shake off the drag from a more sluggish CNY in 2024 and our China outlook remains for only modest growth in 2024.

One factor that we shouldn't discount in 2024 is the possibility that in removing Japan's negative policy rates in mid-2024, a seismic shift in the JPY could occur that pulls other Asian FX along for the ride. We'd put this out as a risk case rather than a base case, though we do seem to be making glacial progress in this direction. As an isolated event risk, this is one we will be keeping firmly on our radar, even if it is not a central view.

The other factors that are likely to feature heavily are geopolitics and external demand. On the geopolitical front, we start the year with Taiwan's presidential elections. Historical precedent leads us to expect that Mainland China will respond with military confrontations across the Straits of Taiwan, which are likely to manifest through weaker Taiwanese stocks and a weaker Taiwan dollar. The extent to which this happens will be heavily dependent on which candidate is leading the polls.

Timeline of event risk for Asia 2024



Source: ING

Presidential elections in Indonesia next year are also worth watching, though continuity seems to be the approach of most candidates – so this may be less of an event risk. And we also have elections in India next year. Also, don't rule out the impact of the US presidential election race, especially if Donald Trump is a candidate. Anti-China rhetoric is not a vote loser for either party in the run-up to the next US election and could add further volatility.

On the external front, with the region's fortunes highly attuned to global trade flows, the continued stagnation in Europe, likely recession in the US, and Mainland China's ongoing struggles aren't likely to lead to a substantially better export outlook, though the bulk of the decline looks as if it is already through the pipeline. 2024 could see some modest improvement in volumes.

The apparent upturn in the semiconductor cycle could also be important for a number of economies in the region, not just the North Asian ones, though we would make a distinction between legacy semiconductors that are the mainstay of most of South East Asia, and the high-end chips that are driving the upturn, which is mainly limited to Taiwan and South Korea and could see the high-beta Korean won outperform. And in the background, the steady ratcheting up of US sanctions on Chinese trade in hi-tech components could dampen this cycle's upswing.

Summing up the outlook then, it is a cautiously positive one, though the backdrop is far from trouble-free, with some substantial event risks along the way.

USD/CNY: Deleveraging has only just begun

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/CNY	7.26	Mildly Bearish	7.30	7.30	7.25	7.15	7.00

Capital flows. Balance of payments data for 3Q23 showed negative liabilities for Foreign Direct Investment – indicating actual outflows. This is a significant deterioration from the previous situation, where inflows had simply been slowing. It also suggests that the deterioration has further to run. In net terms, the flip to negative investment flows has been even more pronounced, which suggests that firms have used profit repatriation and intercompany transfers to take money out of China. There is a slightly more positive story for portfolio flows, which have reverted to something close to zero in 2023 after

outflows in 2022. With global investor sentiment on China still challenging, this may be as good as it gets for a while.

Macro backdrop. The macro backdrop is extremely mixed. On a GDP basis, recent data has suggested that activity is firming slightly. Though the real GDP figures are flattered by an extremely negative deflator, the problems of the property sector are still weighing on the whole of the construction and manufacturing sectors while more timely PMI indices have recently worsened again, as has export data. The government seems to be becoming slowly more open to using a limited expansion of central government fiscal deficits to help cash-strapped local governments, which could include some targeted assistance for construction and infrastructure in early 2024. However, China's property and fiscal issues are substantial and unlikely to be resolved in a year. So, although the 2023 GDP target of 5% looks like it will be achieved, we aren't looking for anything more from GDP growth in 2024.

Central Bank and rates. The depreciation pressure that the CNY has experienced this year stopped the People's Bank of China from undertaking any further policy rate cuts after the two mid-year cuts took the 7-day repo rate down to 1.80%, with the last cut coming in August. It is possible that if we see a broad-based turn in the USD, this frees up the PBoC to implement further rate cuts in 2024, but this is not our central view, and we expect rates to remain at 1.80% throughout 2024. Until such time as the USD does shift to a depreciation trend, we expect the central bank to support CNY at about a 7.30/USD rate. Like the INR, which has also been held at a stronger rate than regional peers, this will also likely limit the CNY appreciation once the USD turns.

USD/INR: Limited upside despite economic strength

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/INR	83.33	Neutral	83.00	82.00	81.00	83.00	84.00

Capital flows. In 2022, a strong pipeline of IPOs and overseas listings boosted capital inflows to India, which was helped in the second half of the year by a stronger equity backdrop. While this has not been such a strong story in 2023, the equity environment has again been supportive, and as we move into 2024, this is likely to remain the case and potentially even improve with the global and local rates environment becoming more supportive of risk assets. India's financial account continues to be supported by strong portfolio inflows, direct investment and global and American depositary receipts stemming from overseas equity listings. 2024 brings a new feature as Indian government bonds are included in the JP Morgan Global bond index, EM (GBI-EM) for the first time. Fitch suggests that up to $24bn of passive inflows will occur between June 2024 and March 2025. At the margin, this should support the INR.

Macro backdrop. India has bucked global trends for a weakening economy and is on track to grow by about 7% in 2023 and should achieve a similar growth rate in 2024. Limited exposure to direct China trade and also to the downbeat semiconductor market have been helpful in 2023, though they also limit the upside to a recovery in 2024. The switch to cheaper Russian oil and gas supplies has shielded India from some of the worst of the fluctuations in inflation seen elsewhere in the region. Elections in 2024 could elicit some stronger government spending, though so far, India's fiscal policy has remained firmly on track, and we don't believe they will throw away their recently discovered credibility easily. Next year's Union budget will likely continue the theme of modest deficit reduction and strong government spending on infrastructure and capital enhancements.

Central Bank and rates. At 6.5%, the Reserve Bank of India's repo rate is not only one of the highest policy rates in the region, but it also has one of the widest spreads over the US Fed funds rate of any Asian central bank. This puts the RBI in a good position to begin to withdraw some of the tightening put in place once the global environment permits, and on the assumption that inflation continues to move in a benign range. The long-awaited turn in the USD should support the INR in 2024 but given how tightly the RBI has controlled the rupee since October 2022, the currency is already arguably stronger than justified relative to most of its peer currencies in the region, and we would anticipate a more modest appreciation during 2024 than its peers as a result. We suspect the RBI's FX control is asymmetric, and that it won't prevent the INR from appreciating slightly in the first half of 2024.

USD/KRW: Exports will be the main driver of the KRW

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/KRW	1329.00	Bearish	1350.00	1350.00	1300.00	1250.00	1200.00

Capital flows. The KOSPI gained 8.9% year-to-date in 2023 despite several price corrections throughout the year. Foreigners came back to the market in the first half of the year but became net sellers in the third quarter. We are concerned that the recently announced ban on short selling may lower the investment appetite of foreign investors. However, Korean firms' earnings expectations for 2024 are some of the highest among EM markets, so foreign inflows will likely be maintained. Korea has been added to the watch list for World Global Bond Index (WGBI) inclusion since last year and it may join the WGBI next year (at the earliest). Major initiatives, including extending trading hours and the gradual opening of onshore FX markets to improve accessibility to the KRW market will be executed from early next year. As we already argued in our recent research "KRW: the benefits of deliverability", this is a positive factor providing support for the Korean won.

Macro backdrop. Korea's economy will likely be caught in the crosscurrents of improving exports and softening domestic demand. The trade balance returned to surplus only recently, but the surplus will continue throughout next year mostly due to a solid bounce in semiconductor exports and a gradual recovery of China's exports. We expect a turnaround in the semiconductor cycle. Korean chip makers, holding the largest market shares in the high-end chip market, will benefit the most from the continued US investment in the IT sector. Meanwhile, household consumption and construction investment will soften on the back of higher borrowing costs and likely weigh on growth.

BoK and rates. The Bank of Korea has paused its rate hike action since February 2023 and is expected to stay at the current level for policy rates of 3.5% for another couple of quarters. But the BoK is likely to enter an easing cycle from the second quarter of next year at the earliest, as inflation will drop back down into a 2% range again while consumption and investment will likely weaken due to prolonged tight credit conditions. However, considering the yield gap between the US and Korea, rate cuts will be quite limited and gradual.

USD/IDR: BI reluctant to hike but may need to

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/IDR	15695.00	Bearish	15500.00	15300.00	15160.00	15000.00	14850.00

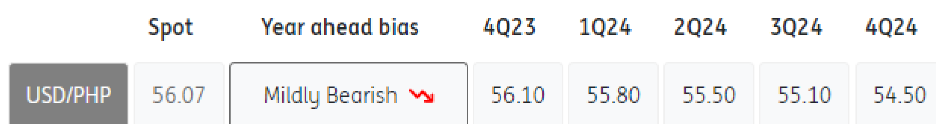
2024 elections could boost growth but keep investors sidelined. Economic growth has been relatively robust, although momentum could be slowing as hinted by the 4.9% YoY 3Q GDP report. Lackluster global demand and falling commodity prices resulted in the

export sector contracting in six out of the first nine months of the year. Meanwhile, government spending, which had been a key driver for growth since the pandemic, faded. Economic growth could rebound in the next few months with presidential elections scheduled for February 2024. However, foreign investors may opt to stay sidelined until Indonesia chooses a new president, which could translate into slower foreign investment flows.

Trade balance support faded as expected. With a key support for the rupiah less potent in 2023, the currency came under pressure, especially in the second half of the year. With the currency under pressure, Bank Indonesia (BI) implemented new foreign exchange rules geared towards supporting the currency, mandating exporters to deposit a portion of earnings domestically for a period of three months. Exports are likely to face another challenging year in 2024 with most major trading partners facing economic headwinds of their own. This could translate to sustained pressure on IDR well into 2024.

BI likely views rate hikes as a last resort. BI has been less aggressive in deploying rate hikes in 2023, opting to support the currency through other tools. The central bank rolled out regulations for exporters as well as various versions of bond purchases and issuance programmes (operation twist and SRBI) to steady the IDR with mixed results. Recent comments from BI Governor Perry Warjiyo suggest that BI prefers to refrain from further rate hikes, perhaps given concerns about growth momentum. With BI still maintaining a relatively tight interest rate differential over the Fed (75bp) the IDR could remain under pressure until the differential widens due to additional BI rate hikes or potential rate cuts from the Fed sometime in 2024.

USD/PHP: Sentiment stays fragile



	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/PHP	56.07	Mildly Bearish	56.10	55.80	55.50	55.10	54.50

Pent-up demand fading. Philippine economic growth remains robust although momentum appears to be slowing somewhat. Pent-up demand related to so-called "revenge spending" appears to have run its course with households focusing on rebuilding savings post-pandemic. Inflation remains a concern with headline inflation likely breaching the BSP's inflation target of 2-4% for a third straight year in 2023. Stubbornly high inflation and elevated borrowing costs could translate to slower growth, which complicates the national government's fiscal consolidation efforts with GDP growth expected to miss the 6-7% YoY growth target. Slow growth means the debt-to-GDP ratio will stay above 60%, which could limit foreign investment inflows.

Current account deficit narrows but remains a challenge. Recurring trade deficits have resulted in the Philippines running current account deficits for some time, indicating a fundamental depreciation trend for the PHP. A combination of weak exports and dependence on energy imports contribute towards making trade deficits chronic for the Philippines. Exports remain heavily dependent on electronics shipments and with global trade expected to remain subdued next year, we can expect the current account to remain in deep deficit. BSP expects the current account deficit to remain substantial for both 2023 ($11.1bn or 2.5% of GDP) and 2024 ($10.3bn or 2.1% of GDP). Thus, current account dynamics for the Philippines suggest that the PHP will be on the back foot unless foreign investment flows return to prop up the currency.

BSP hikes aggressively, signals more to come. The Bangko Sentral ng Pilipinas (BSP) has been aggressively hiking rates to deal with stubborn inflation. BSP has hiked a cumulative 450bp since mid-2022 and Governor Eli Remolona, who took over in July,

signalled his openness to hiking rates further next year. Remolona has suggested that there might need to be additional tightening, hiking at an off-cycle meeting in a bid to safeguard the 2024 inflation target. BSP expects inflation to breach their 2-4% target and average 4.5% and thus we expect Remolona to hike further in the coming months given his hawkish tone.

USD/SGD: MAS to extend pause, meet more often

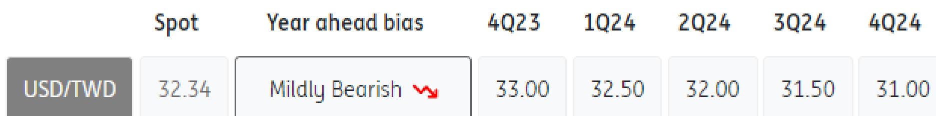
	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/SGD	1.35	Mildly Bearish	1.34	1.34	1.32	1.31	1.30

Macro outlook. Growth momentum has been challenging in 2023. Soft global demand hit the export sector with non-oil domestic exports (NODX) in contraction throughout the year. Stalling NODX, in turn, impacted industrial output which has likewise been falling for all of 2023. One of the few bright spots for growth has been retail sales, bolstered in part by the pickup in visitor arrivals with global travel normalising. Some improvement in global demand coupled with the sustained recovery in visitor arrivals could help support growth next year. Singapore's Tourism Board indicated that visitors from China recovered but are only 30% of pre-Covid levels, suggesting that there is room for further recovery for the tourism sector.

Inflation slows but remains elevated. Headline inflation has slowed from the peak of 7.5% in mid-2022 to settle at 4.1% YoY as of September. Despite the slowdown, headline inflation remains elevated and is likely weighing on domestic demand conditions. Core inflation, which is MAS's preferred measure of inflation, tracked headline inflation's decline, slipping to 3.0% YoY. Inflation could head closer to the MAS's target of about 2%, however, the recent spike in volatility and uptick in global energy prices could mean that the decline back to target may stretch out into mid-2024.

MAS to meet more frequently beginning 2024. The MAS carried out two off-cycle meetings in 2022 on top of the two scheduled meetings to adjust its policy stance amidst accelerating inflation. The central bank recently announced it would be meeting more often beginning in 2024 to give them more flexibility with regard to policy decisions. MAS recently left settings untouched at the October 2023 meeting and we expect them to maintain their stance until core inflation is closer to their target of roughly 2%.

USD/TWD: Expect a volatile start to 2024



	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/TWD	32.34	Mildly Bearish	33.00	32.50	32.00	31.50	31.00

Capital flows. The second half of 2023 has been characterised by a run of negative net foreign investor position changes in Taiwanese equities. The TAIEX index remains up by 18.2% YTD in TWD but less than 13% in USD terms, and most of that gain came in the first half of 2023 with equities sliding slowly in the second half of 2023. The outlook for 2024 is brighter. There is clear evidence of a turn in the semiconductor cycle which underpins much of Taiwan's economy and stock market. But near-term, there is also the presidential election in January, and this could be a period of strong volatility, perhaps exacerbated by Mainland Chinese threats, depending on which candidate appears to be leading the running. Heightened geopolitical tensions will likely weigh on risk assets at the beginning of the year and drive further capital outflows, but this could give way to a more favourable trend once this is out of the way.

Macro backdrop. Taiwan's GDP started 2023 underwater as activity in the fourth quarter of 2022 contracted ahead of a further contraction in 1Q23. The rest of the year has been about clawing the economy back above zero, which it managed in 2Q23, though by 3Q23, GDP was only 2.3% higher than the same quarter a year ago and it has been slow-going. At least things no longer appear to be getting incrementally worse. On the export side, total USD exports now look to have stopped falling and year-on-year rates broke above zero in September, only to drop marginally below again in October. Exports of integrated circuits to mainland China have picked up strongly in recent months and the outlook for 2024 is looking slightly better, though with Europe skirting recession, the bulk of the US slowdown still to come, and Mainland China still struggling, any improvement in the macro story is likely to be modest, even with renewed appetite for high-end chips picking up.

Central Bank and rates. One positive note is that Taiwan's inflation didn't suffer anything like as big a spike as has been seen elsewhere in the region and is hovering at only around 3% YoY currently. As a result, Taiwan's central bank has not needed to raise rates very far. From the pandemic trough of the discount rate at 1.125%, CBC-Taiwan has raised policy rates to just 1.875%, with the last hike coming back in March this year. This isn't much higher than the prevailing rate pre-pandemic, though this also means that the prospects for easier monetary policy in 2024 are also therefore quite small. We look for rates to drop only to 1.7% by the end of 2024.

Latam: Holding firm in the face of rate cuts

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Disinflation trends have been in force across the region and both Chile and Brazil have embarked on what appear to be aggressive easing cycles. Mexico hints that it wants to follow suit. We have the greatest confidence in the Mexican peso outperforming its forward curve

Claudia Sheinbaum, official candidate for the presidency of Mexico in 2024, receives the baton of command from Andres Manuel Lopez Obrador, president of Mexico, at the facilities of the Porrua bookstore in Mexico City

Lower rates but attractive yields

Policymakers in Latin America will be pleased that disinflation trends look to be firmly in place and inflation expectations for 2024/25 look well anchored. These inflation expectations have been key in allowing both Chile and Brazil to embark on easing cycles this summer. Both would probably like to get their policy rates (Brazil at 12.25% and Chile at 9.00%) down towards the 7-8% area. This would leave them with a real policy rate somewhere near 4% and seen somewhere near neutral. And a real policy rate near 4% is still very attractive for international investors.

The problem has been the international environment, where high US yields and local currency weakness – especially in Chile – have made it difficult to cut rates as quickly as had been hoped. And it seems that Chile is re-prioritising currency stability in cancelling its FX reserve rebuild programme. We have forecasts for USD/CLP largely trading in an 800-900 range next year, with the potential for reserve accumulation to restart should USD/CLP be pressing 800 again.

That said, Chile's large current account deficit puts its peso in a different class to those in Brazil and Mexico. The latter two have been big winners of the carry trade in 2023 and should again be recipients of those flows in 2024. Certainly, Latam implied yields should remain globally attractive in 2024 and supportive for currencies – unless domestic stories come to the fore.

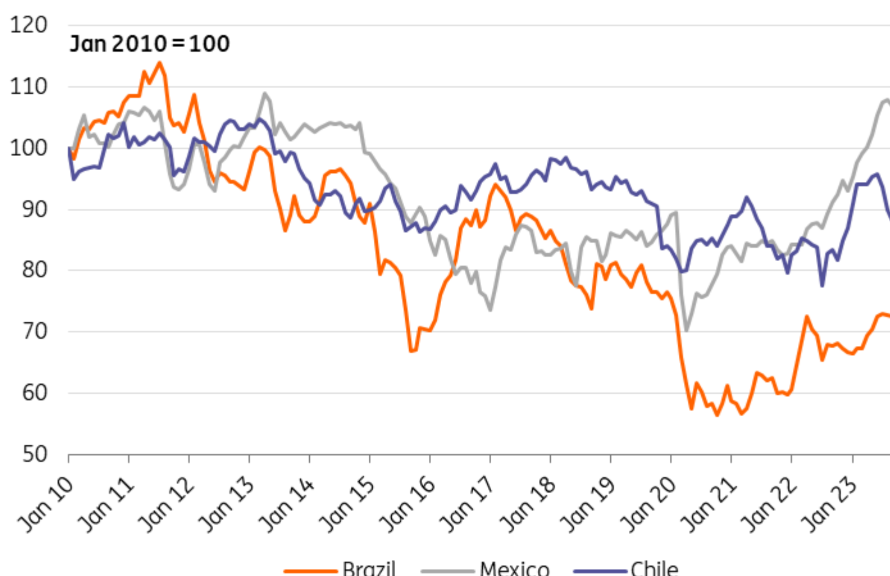
When it comes to the domestic story, let's first look at Brazil. Part of the real's strength this year has been built on fiscal credibility once its new Fiscal Rule was passed in the summer. However, the challenge in 2024 will be that slower growth could see President Lula tempted to bypass the commitment to a zero deficit primary budget balance. That

is why we see greater downside risks to the Brazilian real than the Mexican peso. At present, we see USD/BRL trading around 5.00 at end-2024.

When it comes to Mexico, the peso has quickly become the darling of the EMFX universe – offering high yields, stability and the tailwind from its proximity to the US. We still very much like the peso and do not see a threat from elections next June. Indeed, the Mexican government does have the fiscal headroom to boost growth next year. We are starting to wonder, however, if Mexican authorities consider the peso to be too strong.

We were not so worried when Banxico in September announced plans to unwind the short dollar position in its forward book. However, its recent decision to soften its forward guidance on restrictive rates suggests it is prepared to cut before the Federal Reserve. Perhaps then, Banxico is a little concerned by peso strength (we present the real, broad trade-weighted measure of the peso below) in an environment of slowing US growth. For that reason, we are paring back our downside USD/MXN forecasts a little – even if the peso remains an attractive carry trade investment.

Latam real exchange rates: Is the Mexican peso too strong?



Source: BIS, ING

USD/BRL: The fiscal versus monetary trade-off

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/BRL	4.86	Neutral	4.90	5.00	5.00	4.90	4.90

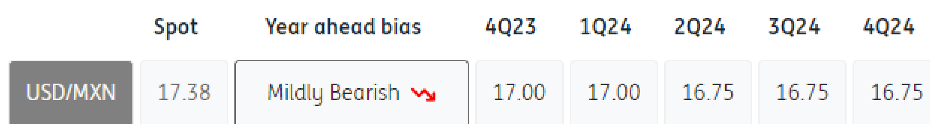
How far will growth slow? Brazilian growth has surprised on the upside this year. This was largely down to some strong commodity prices in Brazil's key export markets of iron ore and soybeans. Unfortunately, our outlook for those commodities is softer next year, where both could be 10-15% weaker as the energy transition hits the steel market and China's imports of soybeans stay soft. With domestic demand still hit by prior monetary tightening, most now expect growth to come in closer to 1.5% next year from near 3% this year. Even though Brazil's current account deficit looks manageable and is covered by Foreign Direct Investment, lower terms of trade may hold the currency back and weak growth may see pressure build on the fiscal side – always Brazil's Achilles heel.

Will the fiscal rule be compromised? In order to get investors onside earlier this year, the local administration passed a fiscal rule. This was a path to engineer a primary fiscal balance from -1% of GDP to +1% by 2026. The plan for 2024 was a zero deficit. However,

President Lula has already started to soften up this target with words to the effect of 'why should we curtail investment just to satisfy the market'. Weak growth and President Lula's commitment to welfare spending warn that the fiscal rule could come under further pressure in 2024 – pulling the rug from under the real. It is not all bad news, however. Any progress on a major reform of Brazil's convoluted consumption tax framework would be seen as a big positive.

Central bank likely to push ahead with easing. Most expect inflation in Brazil to stay subdued in the 4% area next year. While that may be above the central bank's 3% target, it should not prevent further orderly easing from the Banco Central do Brasil (BCB). It has made clear it hopes to continue easing with 50bp adjustments, which would leave the selic policy rate at 11.75% this year and 9.75% next summer were that pace maintained. However, the market struggles to price the selic below 10% throughout the entirety of 2024. This could change if external conditions were benign (dollar weaker) and the BCB re-iterated a view that a neutral real rate for Brazil was 4.5% – probably equating to 8.5% nominal. In short, it looks like the real will be backed by a decent real rate for most of 2024. We have a conservative set of forecasts for the local currency given the fiscal risks but do acknowledge a second half 2024 scenario where USD/BRL could be trading closer to 4.50.

USD/MXN: Elections both sides of the border



	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/MXN	17.38	Mildly Bearish	17.00	17.00	16.75	16.75	16.75

US politics poses the greater risk. The Mexican peso has had a strong year and has only been bettered in the emerging markets space by Colombia. All conclude that Mexico's risk-adjusted carry has been the dominant driver – plus the prospect of being a key beneficiary of nearshoring. While those medium-term factors will remain bullish for the peso, the biggest challenge in 2024 is likely to be the political cycle. Risks probably will not come from Mexico's elections in June. Here, Claudia Sheinbaum, as President Obrador's heir apparent, looks set to comfortably win the presidency – according to opinion polls. She represents the continuity candidate. The bigger risk to the peso comes from US elections in November. Presumably, the Republican front-runners will continue their threats against Mexico's drug cartels and one could not rule out Donald Trump trying to pull the rug from under nearshoring strategies for Mexico. The good news is, however, NAFTA has already been re-negotiated under his prior administration.

External position is manageable. Despite strong domestic demand which has helped Mexico to grow around 3% this year, the current account position is manageable. This is expected to remain in deficit at around 1.5% of GDP over coming years and should easily be financed by FDI. Here, the focus is on whether Tesla's decision to build a $15bn gigafactory in the State of Nuevo Leon sparks more of the same. Analysts say the government needs to do more to encourage public-private partnerships and the rule of law. However, forecasts from most are for FDI to continue growing, as US companies look to shorten supply chains and foreign companies look to build out EV production facilities – e.g. companies such as BMW and Jetour.

Banxico manages the peso well. The FX regime in Mexico is a free float, but Banxico consistently creates an environment of stability in which the peso can prosper. In what could be a difficult period in early 2024 if the US goes into recession, we doubt Banxico will want to cut rates too aggressively. However, at its November meeting, it shifted its forward guidance on restrictive rates being kept on hold from 'an extended period' to 'some time'. It seems Banxico's confidence in the disinflation process may encourage it to ease before the Fed after all. The ultimate landing path for the 11.25% policy rate

may be somewhere in the 7-8% area, though we doubt Banxico would want to see the policy spread to the US narrow from its current 575bp to inside of 400/425bp. This potentially opens up 150bp of easing pre-Fed. That would still leave MXN implied yields above 10% and if we are right with our call for a weaker dollar next year, 16.50 levels for USD/MXN should be in reach.

USD/CLP: Reserve rebuild Take Two

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/CLP	902.00	Bearish	900.00	875.00	850.00	850.00	850.00

Chile will try to rebuild FX reserves again. Last November in our 2023 FX outlook, we said that Chile would probably need to rebuild FX reserves and USD/CLP would struggle to trade under 900. We had the right call on the FX reserve rebuild, but the threshold proved to be 800 not 900. Unfortunately for the central bank, tough global conditions forced it to abandon plans this October to rebuild FX reserves by $10bn. This was when USD/CLP was close to 950. If we are right with our call for slightly more benign global conditions in 2024 – lower US rates, lower dollar – we suspect the central bank will again try to build FX reserves. We also presume that it will roll its $18bn Flexible Credit Line from the IMF. This was always seen as precautionary, but it seems too early to forgo it.

Policy rate heading for 7.75/8.00%. The same forces which derailed the central bank's reserve accumulation plan also derailed the easing cycle. The central bank had targeted rate cuts to the 7.75/8.00% by year-end 2023. However, with just a 50bp rate cut in October, that target looks unlikely with just one more meeting to go. With growth potentially contracting by 0.2% in 2024, according to consensus, expect the central bank to use every opportunity to take rates lower. We imagine the central bank's easing cycle will grow in confidence as 2024 progresses and do not disagree with year-end 2024 pricing of the policy rate at 6.00% versus 9.00% today. That would still leave the real policy rate at around 2.00/2.50% and should help to keep USD/CLP at the lows near 800 in the second half of 2024.

Copper, China, etc. Chile has struggled with copper exports over recent years and copper production is not expected to exceed 2018 levels until 2027. Our commodities team sees copper prices flat to lower next year and in total we suspect Chile's copper exports will be slightly lower in 2024. Obviously, the copper story will also be driven by the outlook for Chinese demand, where any calls for a V-shape recovery are conspicuous by their absence. As to whether Chile's deposits of Lithium can present a very welcome alternative to Chile's export portfolio, our team has its doubts. Lithium prices are down drastically this year and fast-changing designs for EV batteries question whether Lithium demand endures.

Forecasts

	Spot	4Q23	1Q24	2Q24	3Q24	4Q24	Year Ahead Bias
G10							
EUR/USD	1.08	1.07	1.08	1.10	1.12	1.15	Bullish
USD/JPY	151	148	140	135	130	130	Bearish
GBP/USD	1.25	1.23	1.23	1.24	1.24	1.28	Mildly Bullish
EUR/JPY	163	158	151	149	146	150	Bearish
EUR/GBP	0.87	0.87	0.88	0.89	0.90	0.90	Mildly Bullish
EUR/CHF	0.97	0.96	0.96	0.96	0.96	0.96	Neutral
EUR/SEK	11.56	11.65	11.50	11.30	11.10	11.00	Bearish
EUR/NOK	11.87	11.80	11.70	11.30	10.90	10.60	Bearish
EUR/DKK	7.46	7.46	7.46	7.46	7.46	7.46	Neutral
USD/CAD	1.37	1.37	1.35	1.33	1.29	1.27	Bearish
AUD/USD	0.65	0.64	0.65	0.67	0.69	0.71	Bullish
NZD/USD	0.60	0.59	0.60	0.61	0.62	0.64	Bullish
CEEMEA							
EUR/PLN	4.40	4.41	4.43	4.45	4.43	4.40	Neutral
EUR/HUF	376	375	368	365	370	370	Mildly Bearish
EUR/CZK	24.46	24.70	24.50	24.50	24.00	23.75	Mildly Bearish
EUR/RON	4.97	4.98	5.02	5.03	5.03	5.05	Neutral
EUR/RSD	117.20	117.22	117.21	117.20	117.22	117.23	Neutral
USD/UAH	36.35	37.00	37.00	39.00	39.00	39.00	Bullish
USD/KZT	464	465	460	460	465	470	Neutral
USD/TRY	28.62	30.00	33.30	35.50	37.00	38.00	Bullish
USD/ZAR	18.36	18.75	18.75	18.50	18.00	18.00	Mildly Bearish
USD/ILS	3.81	3.90	3.80	3.70	3.60	3.50	Bearish
Asia							
USD/CNY	7.26	7.30	7.30	7.25	7.15	7.00	Mildly Bearish
USD/INR	83.33	83.00	82.00	81.00	83.00	84.00	Neutral
USD/KRW	1329	1350	1350	1300	1250	1200	Bearish
USD/IDR	15695	15500	15300	15160	15000	14850	Bearish
USD/PHP	56.07	56.10	55.80	55.50	55.10	54.50	Mildly Bearish
USD/SGD	1.35	1.34	1.34	1.32	1.31	1.30	Mildly Bearish
USD/TWD	32.34	33.00	32.50	32.00	31.50	31.00	Mildly Bearish
Latam							
USD/BRL	4.86	4.90	5.00	5.00	4.90	4.90	Neutral
USD/MXN	17.38	17.00	17.00	16.75	16.75	16.75	Mildly Bearish
USD/CLP	902	900	875	850	850	850	Bearish

Source: ING

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