Markets Research

FX Strategy Forecast Update

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Delayed Fed easing means delayed USD depreciation

- Since a key assumption driving our FX forecasts has been a US Fed easing cycle driving broad-based USD weakness, then in pushing out into Q3 (from Q2) our expectations for when this is likely to commence, it necessitates a revision to our forecasts, reflecting a USD 'stronger for longer' view.
- Amongst other considerations, greater clarity on the likely US Presidential election outcome and policy prescriptions will likely necessitate revisiting our projections once more.
- AUD has now been trapped inside a range of little more than two cents for three months. There are a number of near-term risks favouring at least a temporary downside range break. While a move above 0.70 this year now looks much less likely, an improved global growth outlook would still mean a stronger AUD come H2 2024. Ditto for NZD where even though the domestic economy looks deep in the mire, global forces should prevail.
- China has more work to do to convince markets 5% growth is achievable this year, and which needs to occur if USD/CNY is to fall back to our revised forecasts for 7.15 by year end in conjunction with a softer USD.
- Overt ECB rate cut guidance amid Fed uncertainty has hit both EUR/USD and the previously resilient trade-weighted EUR. In time clarity will prevail and the EUR can recover including against the USD, providing the Fed eases.
- GBP has been hit on relative rate cut pricing. Near-term UK CPI releases will likely amplify this. However, we think there is sufficient uncertainty on UK services inflation and resistance from the hawks for GBP to stabilise and then hold its own against the USD and EUR.

Table 1: FX Forecasts (see p.9 for full forecast table)

Majors		Current	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
AUD/USD	**New**	**0.644**	**0.65**	**0.67**	**0.69**	**0.71**	**0.72**	**0.74**	**0.75**	**0.74**	**0.73**
	Old		0.69	0.71	0.72	0.73	0.75	0.77	0.78	0.78	0.76
NZD/USD	**New**	**0.591**	**0.60**	**0.61**	**0.62**	**0.64**	**0.65**	**0.66**	**0.67**	**0.66**	**0.65**
	Old		0.64	0.64	0.65	0.67	0.69	0.71	0.71	0.69	0.68
AUD/NZD	**New**	**1.091**	**1.08**	**1.10**	**1.11**	**1.11**	**1.11**	**1.12**	**1.12**	**1.12**	**1.12**
	Old		1.08	1.10	1.11	1.10	1.09	1.08	1.10	1.12	1.12
EUR/USD	**New**	**1.063**	**1.07**	**1.09**	**1.11**	**1.13**	**1.14**	**1.16**	**1.17**	**1.18**	**1.18**
	Old		1.13	1.16	1.17	1.18	1.19	1.21	1.22	1.23	1.23
GBP/USD	**New**	**1.245**	**1.25**	**1.28**	**1.30**	**1.31**	**1.32**	**1.34**	**1.35**	**1.36**	**1.36**
	Old		1.33	1.36	1.37	1.38	1.39	1.41	1.42	1.43	1.43
USD/JPY	**New**	**154**	**150**	**146**	**143**	**140**	**137**	**134**	**131**	**129**	**129**
	Old		142	138	135	130	125	120	118	116	115
USD/CNY	**New**	**7.24**	**7.24**	**7.20**	**7.15**	**7.10**	**7.00**	**6.90**	**6.85**	**6.90**	**6.70**
			7.15	7.10	7.00	6.80	6.70	6.65	6.60	6.60	6.70

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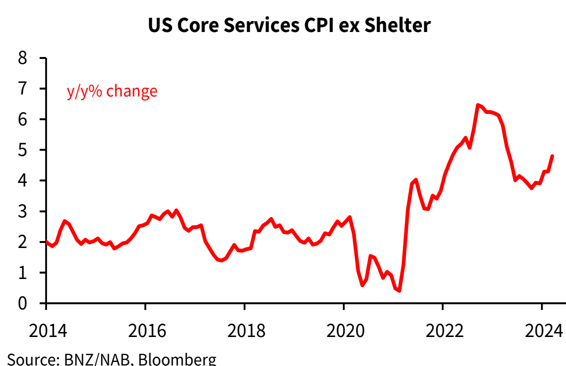
USD – US exceptionalism reigns for longer

For some time, the underlying assumption driving our FX forecasts has been that the beginning of a US Fed easing cycle would drive broad-based USD weakness, allowing a sustained recovery for the key majors. The Fed kick starting a tightening cycle from March 2022 and expectations of tighter policy in the months leading up to that period, drove a significant upturn in the USD and a policy reversal was seen to be critical for any sustained USD downturn to prevail.

Hopes for a dovish Fed pivot escalated after respected Fed Governor Waller late November outlined a path for future easing, suggesting that if inflation continues to cool "for several more months, three months, four months, five months" the Fed could start lowering the policy rate.

Unfortunately, since that time, inflation data have been largely uncooperative, with three positive inflation surprises in a row from January through to March. If anything, core services inflation – a key focus for the Fed at present – has picked up over recent months, reversing some of the decline measured through last year. At the same time, activity data have conveyed a sense of US economic growth resilience, with GDP growth still running above trend and only a mild evident easing of capacity pressures in the labour market. Conditions to give the Fed confidence that inflation can fall to 2% on a sustainable basis have been conspicuously absent.

Chart 1: Core US services inflation heading in the wrong direction



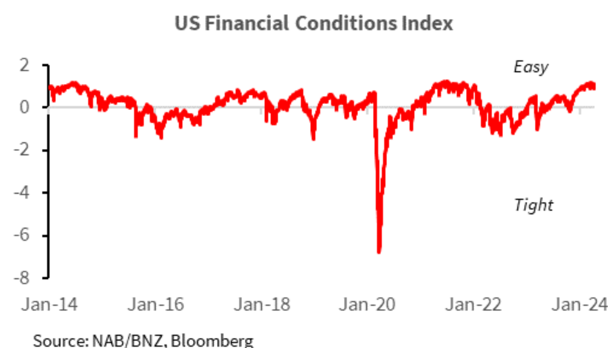
Source: BNZ/NAB, Bloomberg

With the Fed's reaction function communicated clearly, the market has moved to push out the scale and scope for easier policy this year. At the start of the year, some 150bps of easing was priced in for 2024 and that figure now stands at less than 50bps.

With the market heading in this direction, in mid-February we pushed out the timing for a fresh leg in the USD downturn, at the same time noting prevailing upside USD. Two months later we are in the same position, finding ourselves pushing out the timing for lower USD projections, tied to our pushing out and moderation for prospective Fed rate cuts this year. Our central view for the Fed now sees a first cut in September and a follow up move in Q4. At the beginning of the year, we thought the Fed Funds rate could have fallen to 2.75% by the end of next year and that projection now stands a full 100bps higher at 3.75%.

After being wrong, in good company, on the strength of growth and inflation in the US some appropriate questions to ask are should the Fed be easing at all this year? How tight are financial conditions? Is monetary policy as restrictive as commonly believed?

Chart 2: How tight are US financial conditions?



Source: NAB/BNZ, Bloomberg

Communications from the Fed still denote some eagerness to cut rates sometime this year, even if later than previously expected. The risk of keeping policy too tight for too long and generating a harder economic landing than necessary is probably at the heart of this view; kick starting an easing cycle comfortably ahead of the November Presidential election is likely another consideration.

But what now seems patently obvious is that the transmission of tighter policy has been impaired this cycle for the US, but not so much for other nations. One could point to many reasons for this. Ahead of the tightening cycle, US households were sitting on high levels of private savings; households have had limited exposure to rising 30-year fixed mortgage rates with many choosing to remain locked into low rates rather than shifting house; large corporates locking in long term debt at rates near the bottom of the cycle; and ongoing fiscal largesse, evident in the fiscal deficit still running north of 6% of GDP.

Other countries haven't faced such "transmission" obstacles and have therefore got better bang per buck from policy tightening. This is seen in comparatively much weaker economies versus the US for the UK, Euro area, Canada, Australia and NZ. Higher household debt levels and more exposure to floating or short-dated fixed rate mortgages and less fiscal largesse can explain why. These forces are leading the market to now believe that rate cut cycles from the ECB, Bank of England, and Bank of Canada can come ahead of the Fed.

In this context, there has been ongoing support for the USD, defying expectations earlier in the year that 2024 would be a year of much weaker performance. In terms

of how much we should be upgrading our USD forecasts there are a number of considerations to factor in.

- Given the backdrop of a strong USD, there is likely to be some hesitancy in some central banks cutting rates too far and too much ahead of the Fed. The last thing central banks want to see is further depreciation of currencies that would work against their desire to see weaker inflationary forces. Last week, ECB President Lagarde tried to impress the central bank is independent of the Fed and thereby not particularly tied to any protracted delay in Fed easing, but she admitted the ECB could not fully avoid the broad consequences or repercussions of US financial markets.
- Green shoots in the global economic cycle have been evident in PMI data and other indicators, alongside some clear upside in industrial commodity prices. Easier monetary policy from emerging markets and lower inflation are likely reasons behind the more positive growth impulse and therefore the trend ought to be sustainable. A turn in the global economic cycle is typically USD-negative, a counterforce to the pushing out of Fed rate cuts.
- Since our last forecast revision, the BoJ's hawkish pivot proved to be disappointing, given communication of a likely snail-paced policy normalisation – the central bank appearing to be overly cautious, due to a lack of conviction that inflation is on a sustainable path to 2%, and lingering concerns of financial market disruption if it normalises policy too quickly. A weaker yen has followed, putting downward pressure on CNY.
- While the PBoC has been actively trying to contain the spill over to CNY, there are limits to this process. The weaker JPY and CNY dynamic has been a factor constraining performance of the AUD and NZD, and will continue to be, for as long as the yen remains under downside pressure.
- Political polls remain close for the US Presidential election in November. The race looks too close to call with conviction and the policy trajectory under Trump and its impact on currency markets remains highly uncertain. We are loathe to significantly revise our FX projections from this factor, given the inherent uncertainty and possible crosscurrents.
- Iran's launch of over 300 drones and missiles into Israel last weekend – their first ever attack from Iranian soil – was largely symbolic and not designed to inflict death and destruction. It doesn't appear that Iran is seeking an outright war with Israel. Israel's response will determine the next phase of conflict. Overhanging geopolitical risk is ostensibly USD-positive.

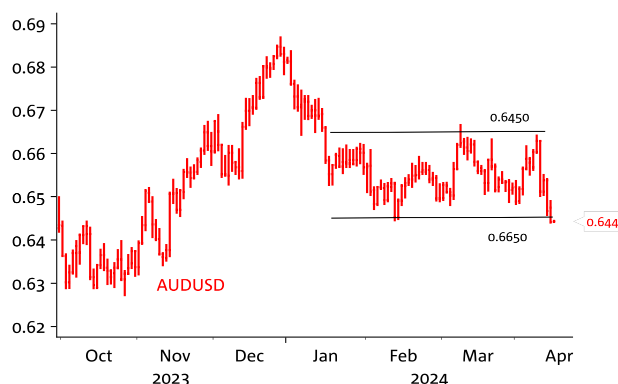
We have made a broadly-based upward revision to our USD projections to reflect the paring of Fed rate cut expectations. It is fair to say that uncertainty about the trajectory of currencies has increased over the past month or so, given new cross currents as mentioned above. Our new projections still show a downturn in the USD developing, but now beginning from Q3.

For this to occur, we'll need to see more concrete evidence of a weaker US labour market and the recent lift in underlying US inflation to prove temporary, to provide the confidence the Fed needs to cut rates in Q3. We assume geopolitical risk in the Middle East doesn't escalate enough to perturb currency markets. If we get more clarity on the likely US Presidential election outcome and policy prescriptions then we are willing to revisit our projections.

AUD – The low and high side range risks

Beyond the direct USD implications of a 'higher for longer' Fed policy trajectory and with that lower for longer AUD/USD, risks surrounding AUD have become more two sided. Our revised forecasts reflect an underlying assumption that the pro-AUD influences will ultimately win out, but as far as the remainder of Q2 (and into Q3) go, we need to allow for at least temporary breaks to the downside from what has been, in effect, a 0.6450-0.6650 range since mid-January with only small extensions either side.

Chart 3: the narrow range is now 3-months old



Source: National Australia Bank, Macrobond

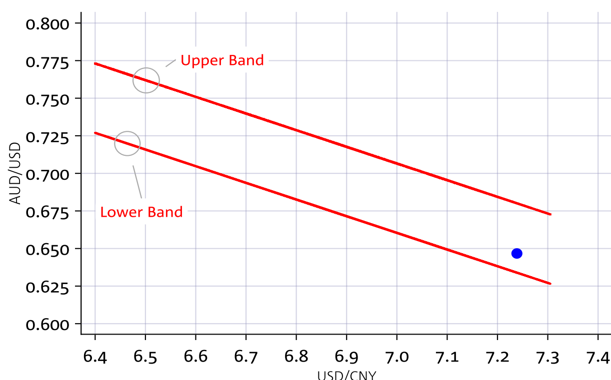
Price action at the end of last week, when markets braced for action against Israel by Iran in retaliation for the latter's early April attacks in Damascus, serve as graphic reminder that AUD remains highly susceptible to periodic bouts of risk aversion – from whatever source. With the exception of the much less actively traded SEK, and sometimes NZD, AUD typically suffer more than other G10 currencies in such circumstances. In the absence of a further significant re-pricing of 2024 Fed policy prospects that provide a fresh leg up for the USD, this is one source for a possible now near term downside AUD range break.

Another would be any deterioration in global growth prospects were, for example, western nations to take pre-

emptive action against the risk of Chinese dumping of (energy transition-centred) manufactured goods into European and North American markets. We assume this is avoided, and at this stage also make no assumption about a stepped-up trade tariff war against China were Donald Trump to win November's US election, other than to flag it as a material 2025 risk.

A third risk and now perhaps closest to home, is that the upward pressure on USD/JPY persists to the point where the PBoC lifts its current defence of the USD/CNY topside in order to contain upward pressure on CNY/JPY. If the historical relationship of recent years between AUD/USD and USD/CNY prevails, AUD would inevitably fall.

Chart 4: the JPY-CNY-AUD nexus risk to AUD/USD

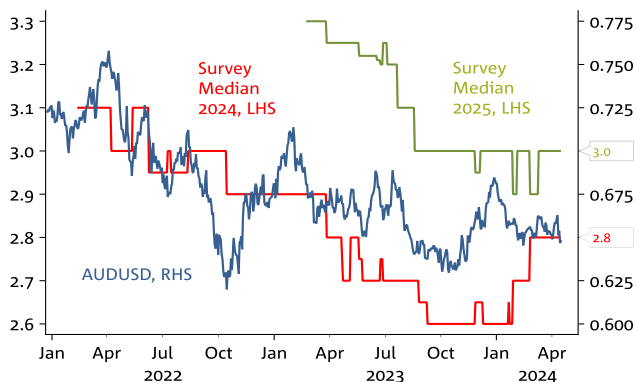


Source: National Australia Bank, Macrobond

Our more constructive H2 2024 (and 2025) AUD forecasts, albeit lowered by on average 3 cents versus our February forecast iteration, is predicated not just on a Fed easing cycle bringing the USD lower - now presumed to begin in September but with risks of both an earlier or later starts - but on the veracity of current indications of improving global growth prospects, including PMIs and many commodity prices - beyond the influence of various supply side factors.

While growth relativities matter for broader USD direction as per the 'USD Smile' framework, when it comes to AUD and other procyclical currencies, the absolute level of global growth is what ultimately matters. We need to see improvements in the current private sector GDP consensus in coming months (2.8% for 2024, 3% in 2025) and not just because the US economy is proving more resilient than early-year estimates.

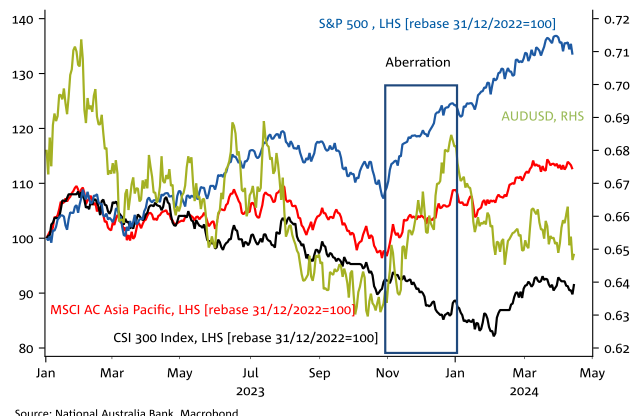
Chart 5: Global growth consensus needs a lift



Source: National Australia Bank, Macrobond, Bloomberg

As well as playing catch up to commodity prices – and where the correlation with AUD has been poor since the pandemic in large part because commodity price strength has not been associated with strong global growth – the AUD also needs to better connect with risk sentiment. Here, the divergence between Developed Markets (DM) and Emerging Market (EM) proxies since early 2023 and which saw AUD more closely track the latter, means that the current omens for improvements in many emerging market economies (including China) need to show up in a shift in the performance of EM versus DM markets, within the context of overall positive risk sentiment.

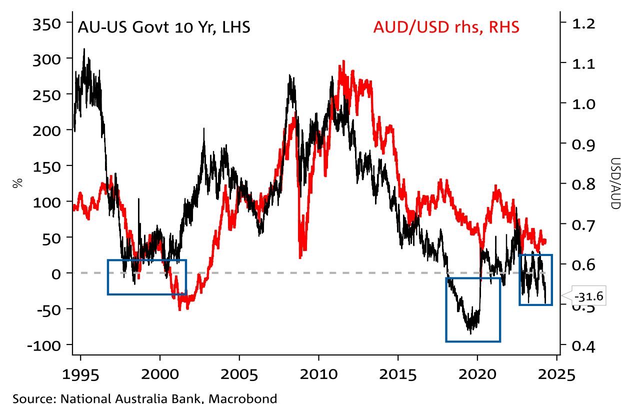
Chart 6: Risk metrics more in sync. (just not with AUD)



Source: National Australia Bank, Macrobond

That said, with EM and DM risk markets more in (positive) sync. in the last two months and all rising, then if maintained AUD has some catch up to play.

Chart 7: AU-US yields real yields need to turn up



Source: National Australia Bank, Macrobond

Also necessary for stronger AUD/USD performance is a widening (i.e. less negative) Australia-US bond yield differential - consistent with our view of an earlier and somewhat more aggressive Fed easing cycle versus the RBA, and where we continue not to expect anything from the latter at least before November.

NZD – Economy in the mire but global forces matter most

Upward revisions to our USD forecasts mean a weaker profile for NZD/USD than previously projected, with only minor revisions for the NZD crosses. Our new end Q2 target of 0.60 implies a 0.58-0.62 trading range, suggesting that we aren't ruling out a possible temporary

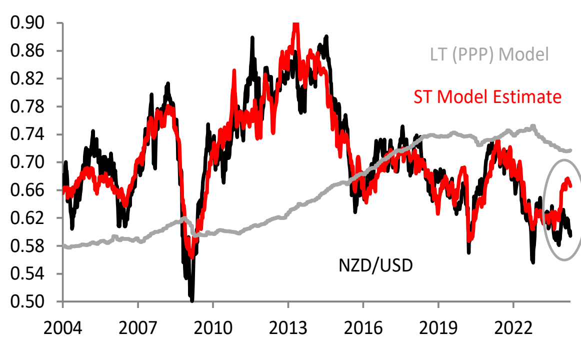
move to last year's low around 0.58. Our projections now show a more pedestrian move higher in the second half of the year and into 2025, when the assumed new downward leg for the USD gets underway. Our year-end target is now 0.62, consistent with the previous and very familiar 0.60-0.64 trading range.

A fair question to ask is why aren't we more bearish on the NZD? After all, NZ's economy is significantly underperforming relative peer groups. The RBNZ has got significant traction from its 525bps of policy tightening and is signalling no imminent desire to cut rates. There is still further tightening in the pipeline, with the average mortgage rate on the stock of outstanding mortgages still well below current market rates. The unemployment rate is on the verge of spiralling higher, based on leading indicators. Government fiscal austerity is about to hit. NZ's relative economic performance is likely to lag peers for some time yet.

That's all well and good, but global forces drive at least 90% of the NZD's performance. Furthermore, the poor performance of the NZ economy is already well-acknowledged.

We are encouraged by the uplift in global manufacturing activity indicators, global commodity prices and upgrades to the outlook for the global economy. Typically, these are positive dynamics for the performance of the NZD.

Chart 8: NZD looking unusually cheap on our short-term model



Source: BNZ/NAB, Bloomberg

At a sub-60 level, the NZD already prices in a significant quantum of "bad news". That is reflected in the spot rate being "extremely" low against our short-term fair value model estimate, which currently sits north of 0.66. Largely, this reflects the NZD being unresponsive to the strong rise in risk appetite over the past six months.

We put this down to the NZD being lumped in with other Asia-Pacific currencies. Widespread pessimism on China and the BoJ's effective debasement of the yen have been significant drags on the NZD, factors not well captured by our simple currency model. Our projections don't incorporate any further sustained downside for the yuan or the yen, so that limits downside risk for the NZD from these forces.

The bottom line is the NZD is trading very cheaply at present on both short-term and long-term (PPP) considerations and we are hesitant to project significant downside at this juncture.

On AUD/NZD our year-end target remains at 1.11, which implies the trading range can extend up to 1.14 and we are open to the idea of an even higher topside break.

JPY - Not just one-way risk

Compared to other G10 pairs, JPY has depreciated the most against the USD year to date, down almost 8%. The combination of a reassessment of the Fed's rates outlook (higher for longer) alongside an underwhelming BoJ exit from its negative interest rate policy has resulted in USD/JPY trading to levels not seen since 1990.

Our new US central scenario sees its economy cooling from around the middle of the year, opening the door to a new Fed easing cycle which should also prompt a move lower in US Treasury yields. Our new USD/JPY forecast track retains a downward trend, albeit from a higher starting level with the pair ending the year at ¥143 (previously ¥135) with lower (¥130-area) levels projected towards the end of 2025. A key assumption here is that 10y US Treasury yields need to end this year much closer to 4% rather than near 5%.

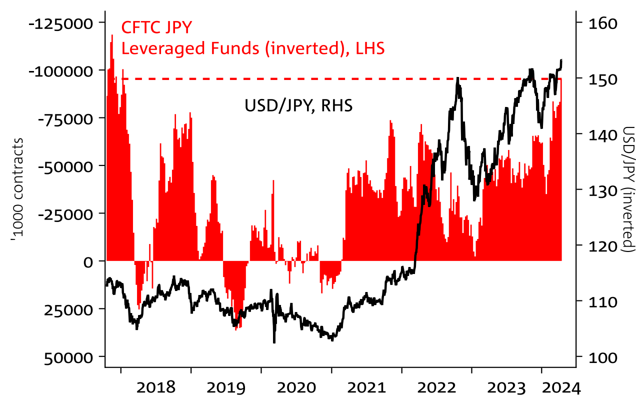
The other key consideration is a repricing of BoJ rate hike expectations. The widening of US-JN rate spreads is a fundamental driver of JPY weakness. We assume a narrowing of this spread before year end, driven by Fed easing but also by a BoJ delivering on its policy normalisation process. The market currently prices a BoJ cash rate of 0.3% by year end, but we think 0.5% is more likely, given Japan's encouraging wages outcomes, positive activity outlook and a weaker JPY.

Our base case for Japan is that the economy will be exiting its deflationary regime on a sustained basis with second round inflation dynamics (the so-called virtuous cycle of price and wages) keeping inflation around 2%. The BoJ thinks Japan's real neutral rate is somewhere between -1% and +0.5% and if inflation is around 2%, then aiming for a nominal policy rate close to 1% by the end of 2025 doesn't seem unreasonable. A Fed easing over 2025 and a BoJ gradually removing its easy policy should result in narrower US-JN spreads and a lower USD/JPY.

Near term the risk is that USD/JPY tests the ¥155 level. The risk of currency intervention should keep a lid on USD/JPY surging much above this level, but much will depend on whether 10y UST yields test higher levels too.

On the other hand, we are also mindful of speculative positioning, USD longs are close to historical highs and JPY shorts are on the other extreme. According to CFTC data, leveraged accounts increased their bets against JPY to the highest since January 2018. If our base case of Fed easing and BoJ hiking over the second half of 2024 proves right, then the unwinding of speculative trades suggest USD/JPY could be at risk of ending the year at lower levels than we currently project. So, upside risk near term, but potentially bigger downside before year end.

Chart 9: Be mindful of USD/JPY spec. positioning



Source: National Australia Bank, Macrobond

CNY – China growth outlook key

CNY has remained under pressure versus the USD not helped by wider US-CNY spreads amid a US economy that continues to perform better than expected with little signs of cooling. The China domestic story has, however, not been CNY helpful.

The bigger than expected fall in China's March CPI reading (0.1%yoy from 0.7% previously) is a reminder that China's deflationary dynamics originate from structural problems that are unlikely to be resolved quickly. China has an overcapacity challenge alongside a consumer that remains in an anaemic state not helped by a depressed property sector that is yet to find a base. It is clear that the economy needs more support.

Our base case is that China will deliver on more fiscal spending to achieve its 5% GDP growth target. Activity readings are encouraging with the March official Composite PMI jumping to 52.7 from 50.9, but the key from here is maintaining this momentum, something Beijing has failed to do since the pandemic.

The PBoC remains committed to supporting the growth target and reflating the economy. But at the same time the Bank has made it clear that a stable CNY is also an imperative. The Bank has a new line of defence for USD/CNY just above 7.23, a steady CNY will allow the Bank to lower the MLF rate and something we expect over 2024 with an end of the year rate of MLF rate 2.25% (currently 2.50%).

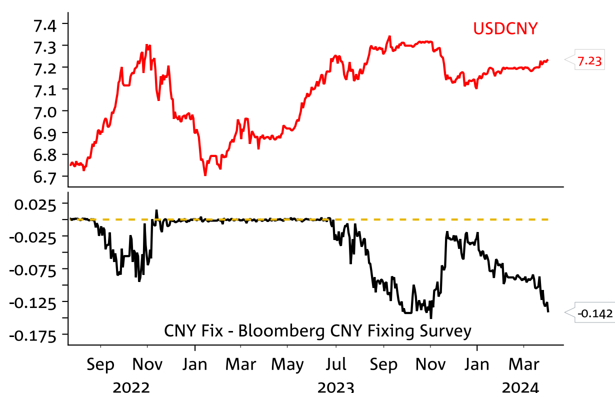
Our new USD/CNY forecast assumes the PBoC will be successful in defending the pair around the 7.23/7.25 area over coming months. One risk here is an extension to the current move up in US Treasury yields. CNY is under pressure vs the USD but has also been appreciating against Asian pairs with the INR and HKD the only exceptions. Further weakness, particularly against JPY could force the PBoC re-asses CNY's line of defence. Notwithstanding disapproval by several trading partners, China is trying to export its way out of its growth trouble and losing competitiveness particularly against Japan is a sensitive issue.

We think concerns over China's growth outlook are already priced and reflected in CNY's level. But as we move towards the second half of 2024, we expect this narrative to shift towards a broader China growth recovery, aided by credible fiscal support and a consumer showing signs of a revival. Commodity prices are already signalling a turn in the global growth outlook. If the Fed and other major central banks join their EM counterparts into a new easing cycle, a lower USD alongside better China growth should be a good combination for CNY.

Our new USD/CNY forecasts reflect this expected improvement alongside a new Fed easing cycle. Our new numbers show a gradual decline in the exchange rate that sees USD/CNY ending the year at 7.15 (previously 7.0) with levels sub 7 now only projected by H2-25 rather than Q1-25 as per our previous forecast. A key assumption is Beijing achieving its goal of 5% GDP growth this year with a similar outcome for 2025, with the risk they are not fulfilled.

As noted elsewhere, there is a growing risk new China tariffs on anti-dumping grounds could be forthcoming even before a possible Trump re-election. Our new forecasts do not make any assumptions in this regard. Although we acknowledge the risk of a lower CNY if China was to face new trade tariffs.

Chart 10: PBoC defence of CNY likely to continue



Source: National Australia Bank, Macrobond

EUR – ECB rate cut nod dents EUR resiliance

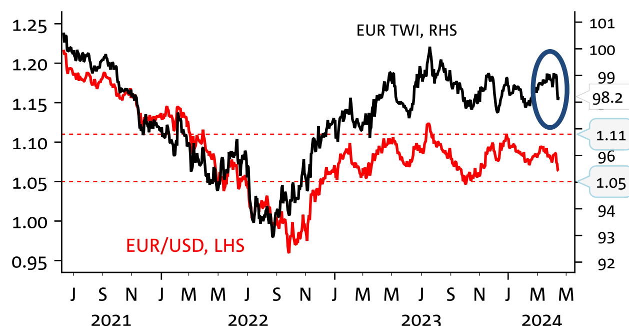
We've long maintained our higher EUR view is linked to our expectation of US rate cuts. Though the ECB and other major central banks will also be easing policy ahead, we had believed US monetary easing will dominate, especially in an environment where the USD is heavily over-valued on a PPP or Real Effective Exchange Rate basis. As argued above, while US economic resilience has been the driving force in markets broadly pushing back the timing and extent of monetary easing, rate cut pricing at other central banks for 2024 has also eased from the peak back in late December last year. That process has helped shield other currencies such as the EUR from the USD - until now.

As investors start to more seriously query the sequencing of rate cuts across major economies and where the prospect and timing of a Fed ease becomes more opaque, other currencies are starting to crack. With the ECB verbally acknowledging it will be in the vanguard of an initial rate cut, the to-now very stable EUR has taken a dive.

It is the case that financial markets have been observing an improvement in the outlooks for other economies, including the Eurozone alongside the UK and China, that collectively can play against the USD via a RoW economic and risk

recovery, commensurate with the centre-bottom of the USD 'Smile' framework. For all the USD supportive factors in the mix of relative rate and current economic situations, a shift has been under way in the broader market narrative that accepts the improved outlook elsewhere, which also - until now – has seen major currencies remain in tight ranges against the USD.

Chart 11: EUR TWI takes a hit on rate cut 'divergence'



Source: National Australia Bank, Macrobond

As we highlighted in the most recent Global FX Strategist EUR/USD has traded a rough 1.05 - 1.11 range for the last 15-months and in this period has rarely sustained moves from its 1.08 average. We recently pointed out the EUR has performed well on a trade-weighted basis, even rising while EUR/USD had been trading sideways. Part of the reason for the EUR's TWI relative 'loftiness' (see chart 11 above) has been weakness in some the TWI's constituent parts, such as the CNY, which accounts for around 20% and the JPY's 7%.

As chart 11 depicts, even the TWI EUR has taken a knock very recently. This as markets start to dial in on ECB rate cuts from June in a world where a Fed easing is uncertain and where our Fed base case is September, but where we recognise there are risks for both July and November. While we acknowledge this argument and can see it playing out for a while yet, we feel it may in time prove unrealistic. Rather than rate divergence between the Fed and ECB, we think this is merely a case of the ECB potentially moving two meetings and four months before the Fed – a case of sequencing rather than actual divergence, as it was in 2014/15.

To assume this process will continue seems idealistic to us at this stage. Having signalled things are moving into line for a June rate cut, the ECB – which formulates a quarterly view and then broadly sticks to it, remaining almost on autopilot and at times sounds as if it is isolated from external events. At last week's post ECB rate meeting press conference, the statement changed the wording so that a rate cut on 6 June is all-but guaranteed. Only an unexpected shock would derail it. But the ECB was also clear that past this there is no pre-committed easing path. True, with inflation in Europe set to decline to just below 2% over the coming months and with the weak economic backdrop, why wouldn't the ECB just carry on cutting as in a normal easing cycle?

One factor is that the ECB remains purely price stability-focused and even if headline HICP drops to just below2% over the summer, private sector forecasts have it moving back up to 2.5% in 2025 as some of the base effects go temporarily into reverse and as the economy gathers more momentum via a combination of higher real incomes, low energy prices and rate cuts themselves. The ECB's own inflation forecasts don't see inflation dropping below 2% until next year, with wages as well as companies passing on higher profits, remaining concerns.

Lastly and while Lagarde was at pains to stress the ECB is 'data-dependent, not Fed-dependent,' she acknowledges the sheer size of the US market and economy will have an impact on Europe. While we acknowledge there's a gap here derived by relative rate cut timing expectations and where the EUR remains vulnerable, this is also a gap that is one-sided currently. It won't remain the case that the ECB is all-but committed to ease, but where the Fed is opaque. Clarity will prevail. We also believe and to Lagarde's point, that if a Fed easing is pushed so far back or so limited in size of cuts, other central banks will not stand by and cut regardless, only to see their currencies drop. To that point we are reducing our forecast of four ECB rate cuts in 2024 to three.

For the ECB the typical exchange rate pass-through is a 10% fall (rise) in the currency is worth 0.4% to 0.5% on (off) headline HICP over the medium-term. The ECB simply does not have 0.5% higher inflation to spare to hit its 2% target on a sustainable basis. We've already said we expect the EUR to find support in this environment around 1.05-1.06. That remains the case, but with spot at 1.0635, it is reasonably close. Way back after Europe's Russia-induced energy hit in 2022 and the recovery into 2023, we used to talk of key support at 1.03/1.0350 – below which would only be seen if something truly significant – such as a big terms of trade hit – were to happen that changes the view of Europe for the worse. Once again, we're sticking with our view of the EUR eventually drawing more strength from a Fed ease and ongoing EZ economic recovery. The nearer the US election comes, this may also feature, but not yet.

Chart 12: EUR/USD support 1.05/1.06 and then 1.03

Source: National Australia Bank, Macrobond

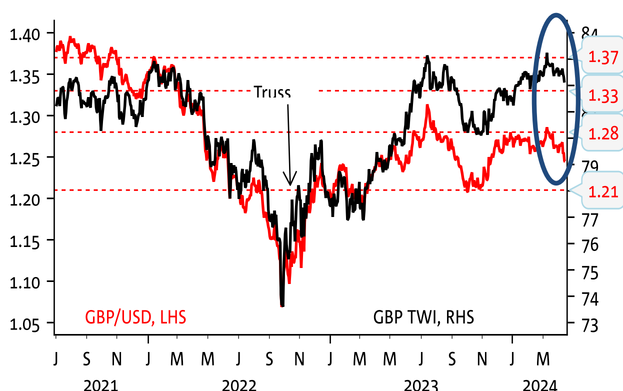
GBP - Rate cut uncertainty can still support

GBP has not been immune to the FX market reassessment of when rate cuts at major central banks will occur. For most of this year markets have accepted the BoE will cut rates behind the Fed and the ECB and – until recently – that the BoE would also likely ease by less than its peers, with around three cuts to 4.5% by the end of 2024. That broadly consensus view has stood GBP in good stead. Until late

March GBP was the best-performing major currency against 31 of its peers, only losing out to the MXN.

Helping GBP out has been decent all-important service sector PMI readings that have been sitting above 53 – better than the UK's peers – for some months. Until last week lagging GDP data was at odds with this view, suggesting the economy was flatlining at best and for H2, 2023 in a technical recession. Data out last week showed monthly GDP for February was positive by one tenth, despite extremely wet weather that took an almost 2% chunk out of construction. Most other sectors held up well, adding to the emerging consensus that the worst is behind the UK and that 2024 and 2025 – as in the EZ - will see UK growth benefit from lower inflation and thereby higher real incomes, low energy prices, some recently awarded tax cuts (National Insurance Contributions) and a 9.8% rise in the minimum wage.

Chart 13: GBP knocked vs USD and on its TWI



Source: National Australia Bank, Macrobond

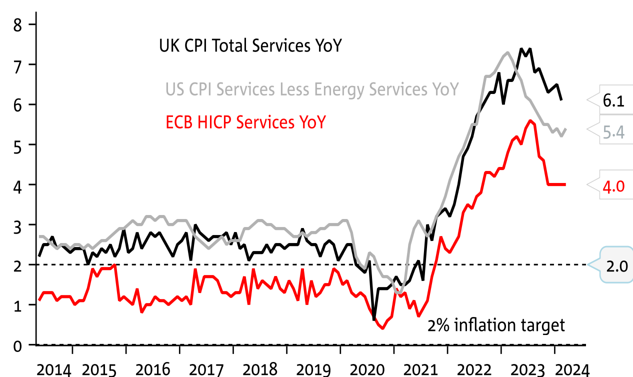
That shift in the narrative to a less bleak/more positive one had helped GBP stay resilient to the USD. The very recent reappraisal of US rate cut expectations and where the Fed is now priced to reduce rates by no more than twice in 2024, has helped erode GBP's top-performing status. As seen in chart 13, this shows – like the EUR – GBP's trade-weighted value has taken a knock as well as GBP/USD, as markets start to think about a world where the BoE cuts before an uncertain Fed.

We have had a forecast of three BoE cuts in 2024 from August since October 2023 and we continue to see that as our base case. UK inflation at 3.4% is we think set to fall below 2%, probably in the next two months and may well slip closer to 1% over the summer. That on its own will get markets more enthusiastic the BoE can follow the ECB, even if a couple of months later. What we don't yet know is once that situation is upon us, where will the debate be on the Fed? Again, this is a one-sided argument right now where the UK and Europe have had less robust economies thanks to things like weaker fiscal stimulus during the pandemic and also suffered a greater hit from the Russia energy shock.

The way energy is priced in the UK is one key factor why the UK is seeing some more powerful downward base effects coming through and pushing inflation lower over the next few months. Like the EZ however, these impacts will also be time-limited and by late 2024, UK headline CPI will likely be back up around 2%, rising to 2.5% and potentially above in 2025. The tailwinds supporting the UK economy through this year and next will all be central to the BoE and rate cut timing and size.

While BoE Governor Andrew Bailey has talked of rate cuts being 'in play' colleagues on the MPC such as Megan Greene think they are 'way off'. There is certainty in hawks Greene, Mann and Haskel believing that much more work needs to be done in reducing wage settlements and in seeing a reduction in the still very high 6.1% services inflation to think the risks are the BoE either delays rate cuts, which will then better chime with the US, or will take a slow, methodical approach. That can help put something of a floor under GBP once greater clarity is found on the Fed, but perhaps like the EUR not just yet. With spot at 1.2450 our 1.25 support in GBP/USD has already been broken. The 1.23 level meshes with EUR/USD at 1.05, while 1.21 (see chart 14) aligns with a EUR/USD at 1.03.

Chart 14: UK services CPI; elevated and above peers



Source: National Australia Bank, Macrobond

Spot FX Forecasts

Majors		Current	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
AUD/USD	New	0.644	0.65	0.67	0.69	0.71	0.72	0.74	0.75	0.74	0.73
	Old		0.69	0.71	0.72	0.73	0.75	0.77	0.78	0.78	0.76
NZD/USD	New	0.591	0.60	0.61	0.62	0.64	0.65	0.66	0.67	0.66	0.65
	Old		0.64	0.64	0.65	0.67	0.69	0.71	0.71	0.69	0.68
USD/JPY	New	154.2	150	146	143	140	137	134	131	129	129
	Old		142	138	135	130	125	120	118	116	115
EUR/USD	New	1.063	1.07	1.09	1.11	1.13	1.14	1.16	1.17	1.18	1.18
	Old		1.13	1.16	1.17	1.18	1.19	1.21	1.22	1.23	1.23
GBP/USD	New	1.245	1.25	1.28	1.30	1.31	1.32	1.34	1.35	1.36	1.36
	Old		1.33	1.36	1.37	1.38	1.39	1.41	1.42	1.43	1.43
USD/CHF	New	0.912	0.91	0.89	0.87	0.86	0.85	0.84	0.83	0.82	0.81
	Old		0.83	0.81	0.81	0.81	0.80	0.79	0.78	0.78	0.78
USD/CAD	New	1.38	1.37	1.36	1.35	1.34	1.33	1.32	1.29	1.29	1.32
	Old		1.33	1.31	1.33	1.32	1.31	1.29	1.26	1.26	1.29
USD/CNY	New	7.238	7.24	7.20	7.15	7.10	7.00	6.90	6.85	6.90	6.70
			7.15	7.10	7.00	6.80	6.70	6.65	6.60	6.60	6.70
USD (DXY)	New	106.21	105.2	103.2	101.4	99.8	98.8	97.1	96.0	95.2	95.4
	Old		101.6	99.1	98.3	97.1	95.9	94.1	93.1	92.3	92.4
AUD Cross Rates											
AUD/NZD	New	1.091	1.08	1.10	1.11	1.11	1.11	1.12	1.12	1.12	1.12
	Old		1.08	1.10	1.11	1.10	1.09	1.08	1.10	1.12	1.12
AUD/JPY	New	99.4	98	98	99	99	99	99	98	95	94
	Old		98	98	97	95	94	92	92	90	87
AUD/EUR	New	0.606	0.61	0.61	0.62	0.62	0.63	0.64	0.64	0.63	0.62
	Old		0.61	0.61	0.62	0.62	0.63	0.64	0.64	0.63	0.62
AUD/GBP	New	0.518	0.52	0.52	0.53	0.54	0.55	0.55	0.56	0.54	0.54
	Old		0.52	0.52	0.53	0.53	0.54	0.55	0.55	0.55	0.53
AUD/CHF	New	0.587	0.59	0.60	0.60	0.61	0.61	0.62	0.62	0.61	0.59
	Old		0.57	0.58	0.58	0.59	0.60	0.61	0.61	0.61	0.59
AUD/CAD	New	0.888	0.92	0.93	0.96	0.96	0.98	0.99	0.98	0.98	0.98
	Old		0.92	0.93	0.96	0.96	0.98	0.99	0.98	0.98	0.98
AUD/CNY	New	4.66	4.71	4.82	4.93	5.01	5.04	5.11	5.14	5.11	5.07
			4.93	5.04	5.04	4.96	5.03	5.12	5.15	5.15	5.02
NZD Cross Rates											
NZD/AUD	New	0.916	0.92	0.91	0.90	0.90	0.90	0.89	0.89	0.89	0.89
	Old		0.92	0.91	0.90	0.91	0.92	0.92	0.91	0.89	0.89
NZD/JPY	New	91.1	90	89	89	89	89	88	88	85	84
	Old		91	89	88	86	86	85	84	81	78
NZD/EUR	New	0.556	0.56	0.56	0.56	0.56	0.57	0.57	0.57	0.56	0.55
	Old		0.56	0.55	0.56	0.56	0.58	0.59	0.58	0.56	0.55
NZD/GBP	New	0.474	0.48	0.48	0.48	0.48	0.49	0.49	0.50	0.49	0.48
	Old		0.48	0.47	0.47	0.48	0.50	0.50	0.50	0.49	0.48
NZD/CHF	New	0.538	0.54	0.54	0.54	0.55	0.55	0.55	0.56	0.54	0.53
	Old		0.53	0.52	0.53	0.54	0.55	0.56	0.56	0.54	0.53
NZD/CAD	New	0.814	0.82	0.83	0.84	0.85	0.86	0.87	0.86	0.85	0.86
	Old		0.85	0.84	0.87	0.87	0.90	0.91	0.89	0.87	0.88
NZD/CNY	New	4.27	4.34	4.39	4.43	4.51	4.55	4.55	4.59	4.55	4.52
	Old		4.56	4.57	4.55	4.52	4.62	4.72	4.69	4.58	4.49

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