



December 2023

## Highlights

By Stéfane Marion/Kyle Dahms

- The USD has been battered over the past month, with the trade-weighted value of the greenback falling by the most in seven years. The move has been exacerbated by speculative activity, with non-commercial traders reducing their bullish views on the U.S. currency on the back of better-than-expected inflation data. The anticipation of a Goldilocks scenario has driven bond yields lower, boosted risk assets and undermined the value of the US dollar. After all, if the worst of the collateral damage to the economy is behind us, there is no need for safe-haven assets, is there? We don't buy this scenario. While we too expect rate cuts in 2024, they will be driven by real economic distress, not by immaculate disinflation. As a result, we would expect the USD to rebound.
- The Canadian dollar's recent appreciation has come against a backdrop of falling oil prices and a widening negative 2-year interest rate spread versus the US, two developments that should have weakened the currency, not strengthened it. Looking ahead, we don't see much support for the CAD given our forecast for a slowing global economy and the potential for more aggressive interest rate cuts in Canada relative to the US due to weaker domestic demand. Given our recession scenario for the Canadian economy in H1 2024, we now expect USD/CAD to move towards 1.45 in the coming quarters.
- EUR/USD has staged a comeback in the month of November, rising from the lows of 1.05 to reach nearly 1.10, a level which has not been seen since this summer. Although some participants would point to certain improvements on the data front and comments from the central bank as underpinnings for the recovery, the common currency has been buoyed by a sell-off in USD. The perspectives for the Eurozone remain tepid to say the least and we continue to believe the ECB will front run the Federal Reserve for rate cuts. As such, the currency is expected to experience a bout of weakness until we get a more forceful change in stance from the Fed.

## NBF Currency Outlook

Currency		Current	Forward Estimates				PPP <sup>(1)</sup>
		December 5, 2023	Q4 2023	Q1 2024	Q2 2024	Q3 2024	
<b>Canadian Dollar</b>	<i>(USD / CAD)</i>	<b>1.36</b>	<b>1.38</b>	<b>1.42</b>	<b>1.45</b>	<b>1.40</b>	<b>1.25</b>
<i>United States Dollar</i>	<i>(CAD / USD)</i>	<i>0.74</i>	<i>0.72</i>	<i>0.70</i>	<i>0.69</i>	<i>0.71</i>	-
Euro	<i>(EUR / USD)</i>	1.08	1.06	1.02	1.03	1.06	1.45
Japanese Yen	<i>(USD / JPY)</i>	147	145	140	138	136	99
Australian Dollar	<i>(AUD / USD)</i>	0.66	0.64	0.62	0.63	0.65	0.67
Pound Sterling	<i>(GBP / USD)</i>	1.26	1.23	1.18	1.20	1.23	1.48
Chinese Yuan	<i>(USD / CNY)</i>	7.14	7.20	7.25	7.20	7.10	4.2
Mexican Peso	<i>(USD / MXN)</i>	17.5	18.3	19.5	20.5	19.0	9.7
<b>Broad United States Dollar <sup>(3)</sup></b>		<b>120.7</b>	<b>123.0</b>	<b>126.6</b>	<b>127.4</b>	<b>123.2</b>	-

1) PPP data from OECD, based in Local Currency per USD

2) Current Account Balance data from IMF, as a % of GDP (2020 &amp; 2021 IMF estimates)

3) Federal Reserve Broad Index (26 currencies)

## Canadian Dollar Cross Currencies

Currency		Current	Forward Estimates			
		December 5, 2023	Q4 2023	Q1 2024	Q2 2024	Q3 2024
Euro	<i>(EUR / CAD)</i>	1.47	1.46	1.45	1.49	1.48
Japanese Yen	<i>(CAD / JPY)</i>	108	105	99	95	97
Australian Dollar	<i>(AUD / CAD)</i>	0.89	0.88	0.88	0.91	0.91
Pound Sterling	<i>(GBP / CAD)</i>	1.71	1.70	1.68	1.74	1.72
Chinese Yuan	<i>(CAD / CNY)</i>	5.27	5.22	5.11	4.97	5.07
Mexican Peso	<i>(CAD / MXN)</i>	12.9	13.3	13.7	14.1	13.6

## USD: The fall is overdone

The USD has been battered over the past month, with the trade-weighted US Dollar Index down more than 3% against a basket of 26 currencies, it's worst performance in seven years - chart.

### USD: USD: Greenback takes a beating

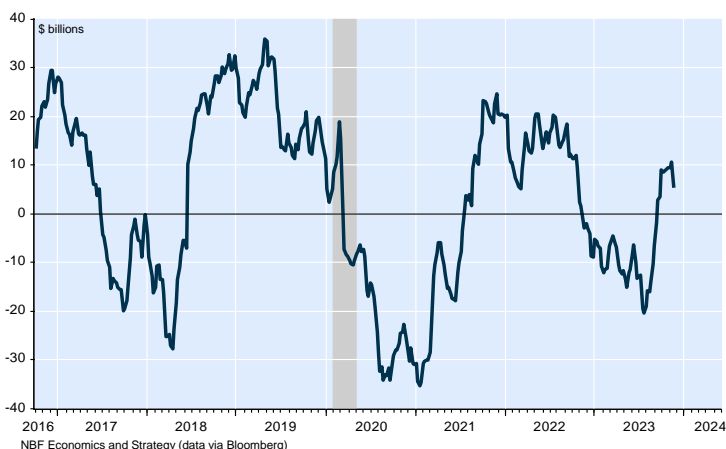
Trade-weighted USD\* vs. a basket of 26 currencies



This move has been exacerbated by speculative activity which has seen non-commercial traders trim their bullish views on the greenback after a very sharp rise earlier in the summer months and early autumn - chart.

### USD: Speculators trim bullish views

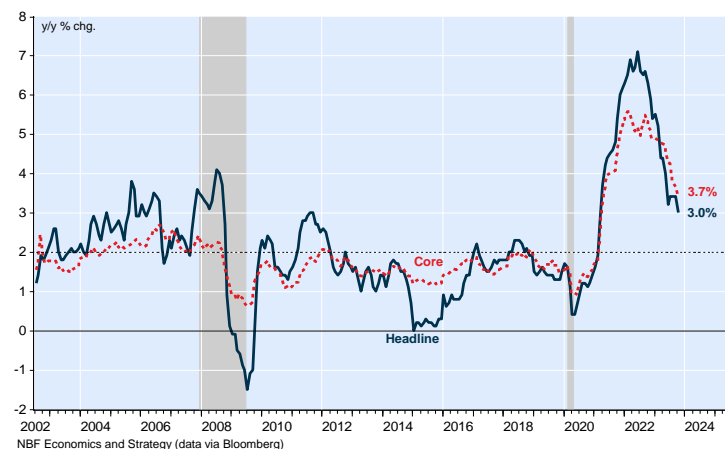
Net speculative positions of non-commercial traders on the USD



This shift in sentiment comes on the back of better-than-expected inflation data, with headline inflation falling to 3% and the core PCE deflator decelerating to a 30-month low of 3.7% (chart).

### United States: Core inflation at 30-month low

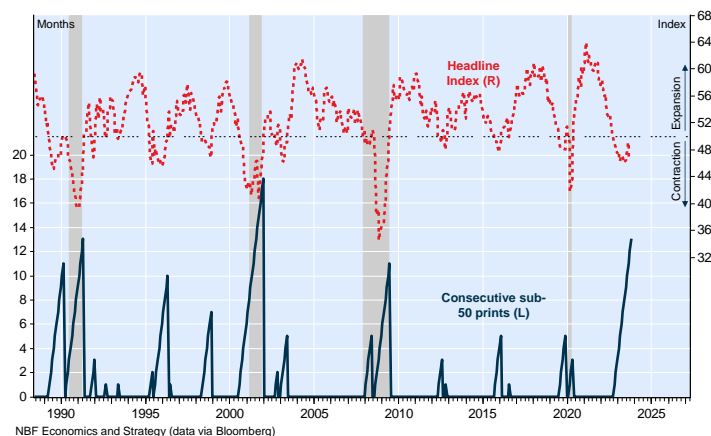
Personal Consumption Expenditures (PCE) deflator



While inflation remains well above the Federal Reserve's 2% target, the fact that PCE inflation has been able to decelerate despite a blockbuster 5.2% increase in real GDP in Q3 suggests that further monetary tightening is no longer in the cards. In fact, the market is now betting on a Fed pivot that could see rates cut by 100 basis points in 2024, while achieving an economic soft landing. This Goldilocks scenario has driven bond yields lower, boosted risk assets, with global equities up 9% over the past month - their best performance in over three years - and undermined the value of the US dollar. After all, if the worst of the collateral damage to the economy is behind us, there is no need for safe-haven assets, is there? We don't buy that scenario. While we too expect rate cuts in 2024, they will be driven by real economic distress, not immaculate disinflation. The latest data on US manufacturing continues to point to a contraction in the economy. Indeed, the ISM diffusion index has now shrunk for thirteen consecutive months, the worst streak since 2001 - chart.

### U.S.: Longest streak of contractions in the manufacturing sector since 2001

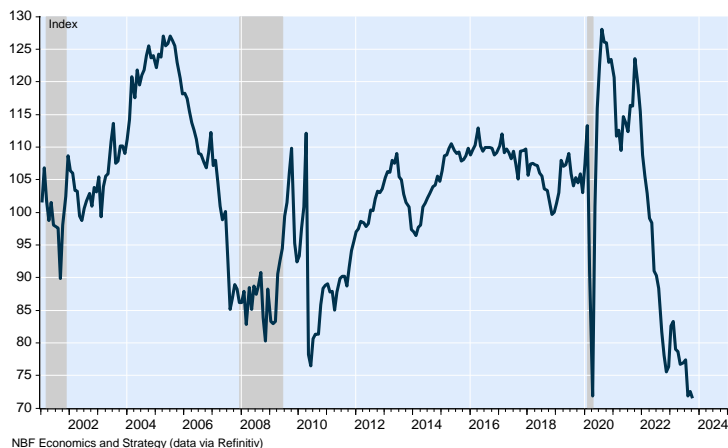
ISM Manufacturing PMI



It's not just the outlook for manufacturing that is challenging. In housing, higher mortgage rates have led to the worst reading on record for the Pending Home Sales index – chart.

#### US: Pending transactions at lowest level ever in October

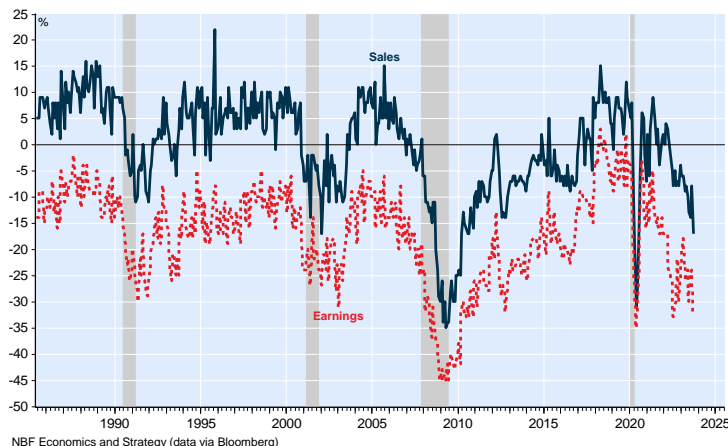
Pending Home Sales Index



Weakness is also spreading to small businesses, which typically account for the bulk of job creation. Indeed, the NFIB's latest measures of SME optimism for sales and profits have both recently fallen to new cyclical lows – chart.

#### U.S.: Small business sentiment sliding further

Net percentage of polled businesses reporting an increase in sales/earnings over the past three months, NFIB Small Business Optimism Index



This can't bode well for the US labour market, U.S. economic growth and risk assets. We still think that a hard rather than a soft landing is the most probable scenario for 2024. As a result, we would expect the USD to rebound in the coming months as the outlook worsens. Let's also not forget the geopolitical uncertainty in the Middle East and the eroding support in the US Congress for large military contributions to Ukraine, which could disrupt the global economy through an escalation of armed conflict.

## CAD: Stronger despite weak GDP

After hitting 1.39 against the USD on 1 November, the Canadian dollar has appreciated by 4 cents to stand at 1.35, its best level in over two months (chart).

#### CAD: A very sharp appreciation

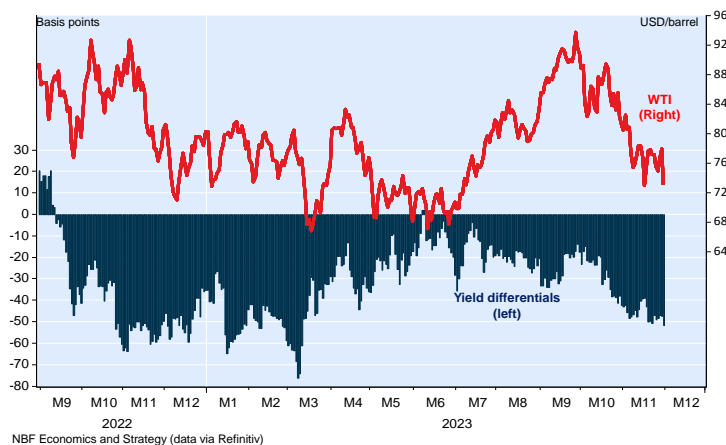
Canada/U.S. exchange rate



The Loonie's appreciation has come against a backdrop of falling oil prices and a widening negative 2-year interest rate spread versus the US, two developments that should have weakened the currency, not strengthened it (chart).

#### CAD: Not a good combination for currency appreciation

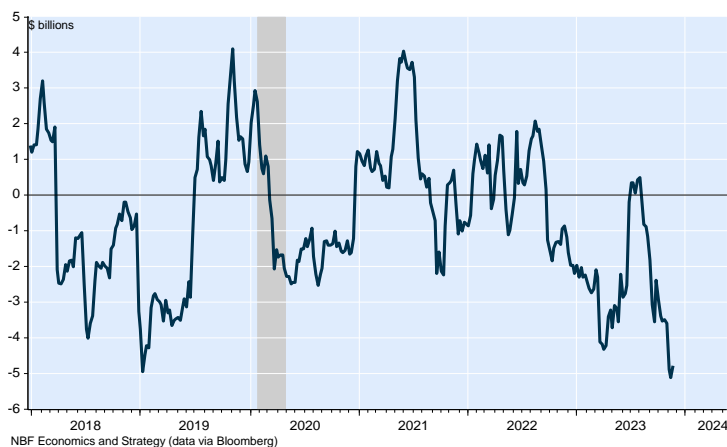
Canada/U.S. 2-year Treasury yield differential and WTI



At this point, we would attribute much of the recent volatility in the Canadian dollar to speculative activity. Non-commercial traders had built up the largest negative positions against the CAD in more than four years. A partial unwinding of this bearish stance certainly explains some of the Canadian dollar's recent appreciation (chart).

**CAD: Speculators add to currency volatility**

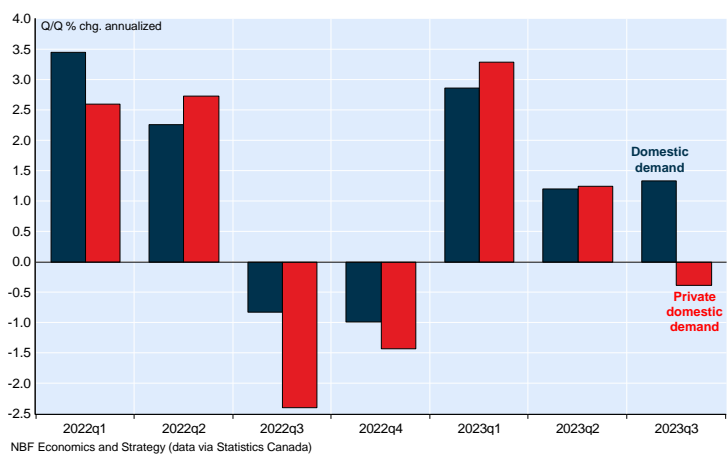
Net speculative positions of non-commercial traders on the CAD



Looking ahead, we don't see much support for the CAD given our forecast for a weakening global economy and the potential for more aggressive rate cuts in Canada compared to that in the U.S. due to weaker domestic demand. According to Statistics Canada's GDP estimate for 2023Q3, the economy contracted at an annualized rate of 1.1% in the quarter (whereas the U.S. was up 5.2%). While the decline in GDP was caused by international trade and lower inventories, the domestic economy was far from robust. Domestic demand held up at first glance, but this was due to a surge in public spending. If we exclude government, activity shrank 0.4% (chart).

**Canada: Private domestic demand contracted in Q3**

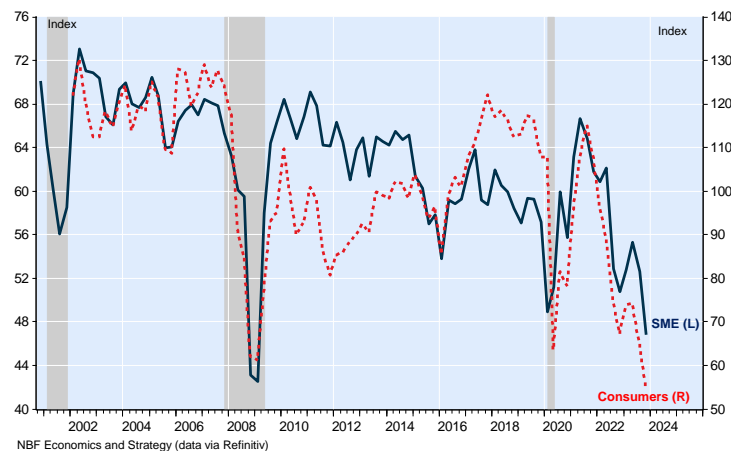
Final domestic demand and private final domestic demand



Although the monthly momentum with GDP growth in September and October (preliminary) suggests that Canada could avoid a second consecutive contraction in Q4, what comes after may be less enviable. According to the Conference Board of Canada, consumer confidence in Q4 was even lower than at the start of the pandemic and during the 2008-2009 recession. This comes at a time when businesses are facing difficult decisions that could translate into a weak appetite for hiring and, in some cases, even job losses. Indeed, the latest SME confidence survey also fell to a new multi-year low in October, with a lack of domestic demand now the main concern for business owners (as opposed to a lack of skilled labour) - chart.

**Canada: Soft data do not suggest revival in months ahead**

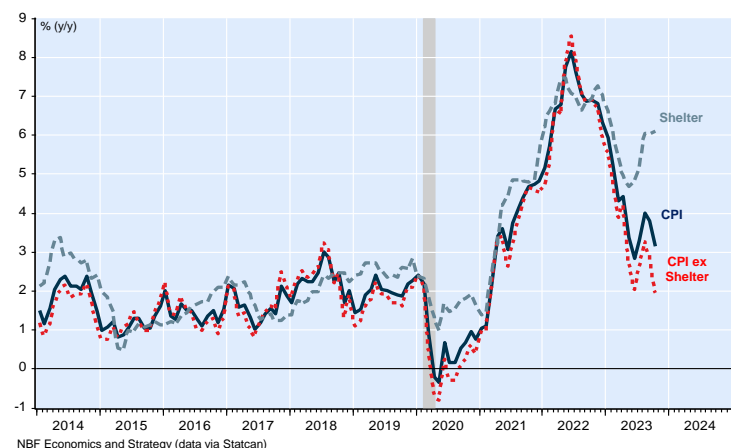
Consumer and Small Businesses Confidence Index (quarterly data, after two -months of data in Q4 2023)



Against this backdrop, the Bank of Canada (BoC) left its overnight target unchanged at 5.0% for the third consecutive meeting on 6th December. Although the BoC maintained a de facto hawkish bias by promising further hikes if needed, it also acknowledged that the economy is "no longer in excess demand", which clearly softens the nature of that threat. It's clear to us that the Bank doesn't need to hike any further, but it's also clear that it's not comfortable putting bets on earlier and more aggressive easing when inflationary pressures are not fully under control. According to our rates strategists, "there's a full seven weeks until the next decision, so the Governing Council will be able to gather more data to further assess how its restrictive policy stance is affecting the economy and inflation". If these data are in line with our expectations, i.e. on the weak side, we could see a more substantial change in tone from the BoC, possibly replacing its "we are ready to hike further" line with something more neutral. In our view, the time for easing isn't too far away and it will be more aggressive than in the US in 2024. We note that CPI inflation excluding shelter has fallen below 2% for the first time since the COVID recession - chart.

**Canada: CPI inflation already below 2% outside shelter**

CPI inflation: Total, shelter and total excluding shelter



Given our recession scenario for the Canadian economy in H1 2024, we now expect USD/CAD to move towards 1.45 in the coming months and don't see much room for CAD appreciation until the second half of 2024.

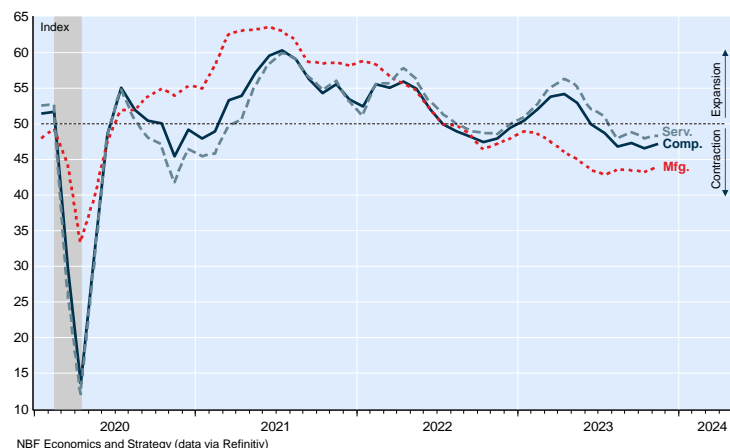
## EUR: Tough times ahead

The euro has staged a comeback in the month of November, with EUR/USD rising from the lows of 1.05 to reach nearly 1.10, a level which has not been seen since this summer. Although some participants would point to certain improvements on the data front and comments from the central bank as underpinnings for the recovery, the common currency has been buoyed by a sell-off in USD. The perspectives for the Eurozone remain tepid to say the least and we continue to hold the view that the currency could weaken before long.

There was some optimism on the latest Flash Composite PMI numbers for the Eurozone. The latter suggested that operating conditions were deteriorating at a lesser pace in the month of November. In other words, the composite index remained in contraction for a sixth consecutive month. Not exactly an optimistic result. A weak international backdrop continues to weigh on orders and declining backlogs of work translated into reduced headcount. Both services and manufacturing remain in contraction with the latter being specifically worse.

### Eurozone: Private sector contracted for sixth month in a row

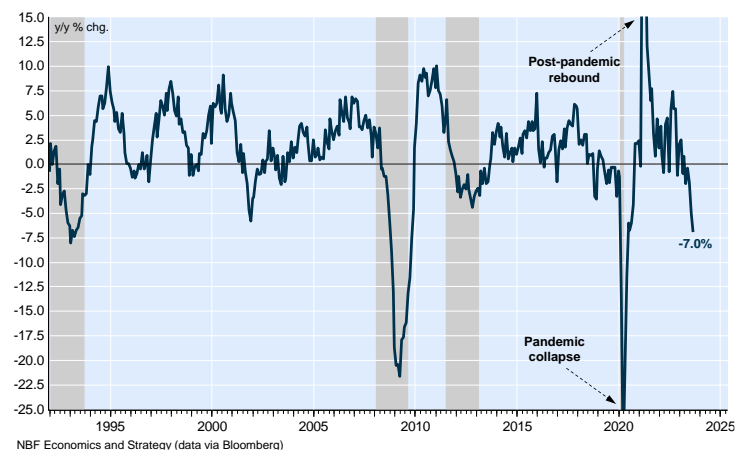
HCOB Flash PMI. Last observation: November 2023



While not as timely as the previous indicator, the recession in manufacturing is confirmed by manufacturing production data for September which sank to -7% on a year-over-year basis. That contraction is the largest outside of a recession in the common-currency union and deeper than the 2012 European debt crisis.

### Eurozone: Factories in trouble

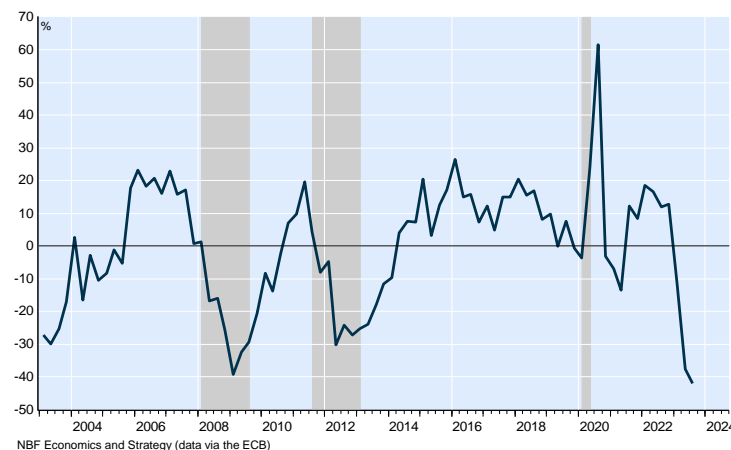
Manufacturing production



The potential for a rebound following this lethargy is at risk. As the European Central Bank has tightened monetary policy, borrowing costs have risen to dizzying levels. Without much surprise, demand for credit has fallen off a cliff according to the ECB bank lending survey. The net percentage of banks reporting increased demand for business loans over the previous 3 months has reached its lowest level on record, surpassing the 2008-09 global financial crisis.

### Eurozone: Businesses' demand for credit collapsing

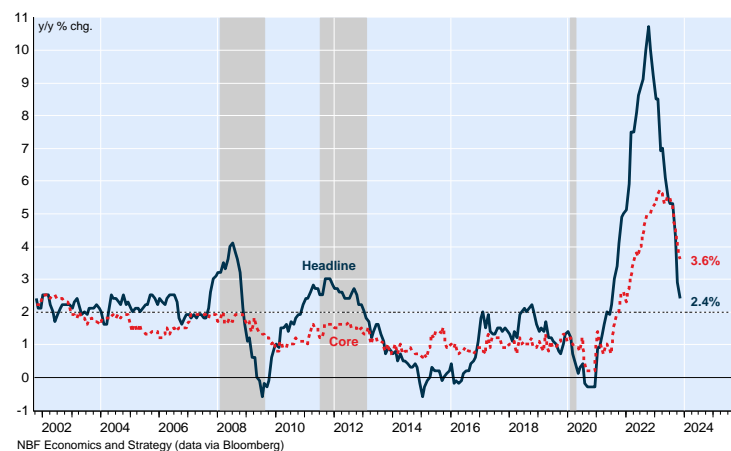
Net percentage of banks reporting increased demand for business loans over the previous 3 months, ECB Bank Lending Survey



Commentary from the ECB has been trending towards dovish territory albeit some holdouts remain. It has ranged from Governing Council member Kazimir calling a first quarter rate cut "science fiction" to Schnabel admitting that monetary policy was working and inflation developments were encouraging. We tend to side with the latter, as evidently inflation is moderating quickly. The latest figures show that prices were up 2.4% year-over-year in November, below consensus estimates and a decent clip below the prior months print of 2.9%. True, core inflation remains above the central bank's comfort zone but that was mostly due to services inflation which remains stickier.

### Eurozone: Headline inflation drops closer to the ECB's target

Harmonized Index of Consumer Prices



Combining the latest developments, we continue to believe the ECB will front run the Federal Reserve for rate cuts. As such, the currency is expected to experience a bout of weakness until we get a more forceful change in stance from the Fed.



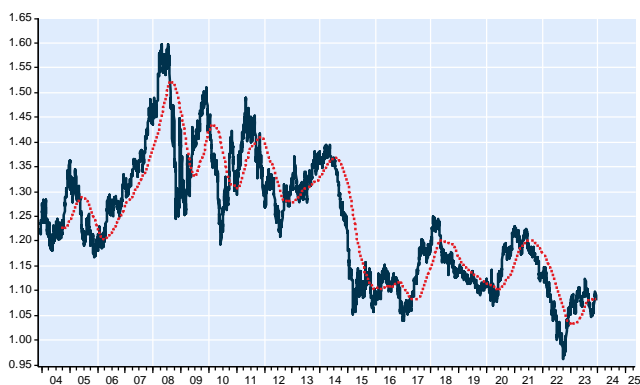


## Regional Overview

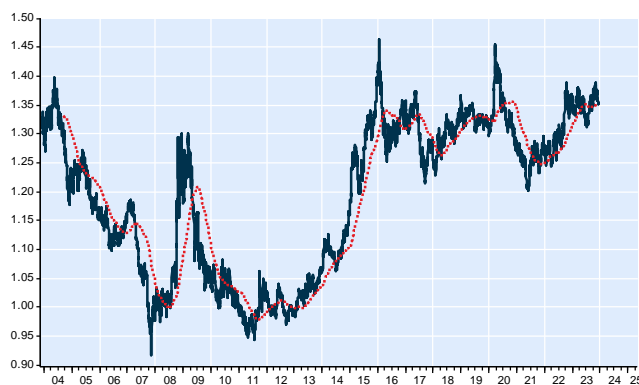
Region	\$		Current	1M Prior	Current	Relative to UST	Current	Upcoming
			USD FX	USD FX	2Y Yield	2Y Spread	Policy Rate	Next MP Meeting
Canada	CAD	(USD/CAD)	1.36	1.37	4.07	-51.1	5.00	2023-12-06
United States	USD	-	-	-	4.58	-	5.50	2023-12-13
Eurozone	EUR	(EUR/USD)	1.08	1.07	2.61	-196.9	4.50	2023-12-14
Japan	JPY	(USD/JPY)	147	150	0.04	-453.9	-0.10	2023-12-19
Australia	AUD	(AUD/USD)	0.66	0.65	4.09	-49.1	4.35	2024-02-05
United Kingdom	GBP	(GBP/USD)	1.26	1.23	4.51	-6.5	5.25	2023-12-14
China	CNY	(USD/CNY)	7.15	7.27	2.43	-214.5	1.88	2023-12-14
Mexico	MXN	(USD/MXN)	17.4	17.5	10.24	566.0	11.25	2023-12-14

## Appendix: Spot rates with their 200d MA

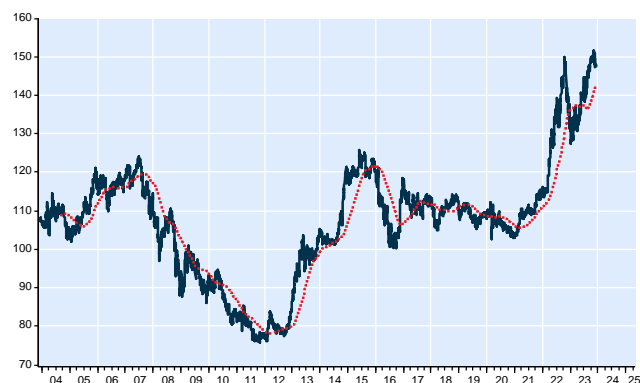
EUR / USD



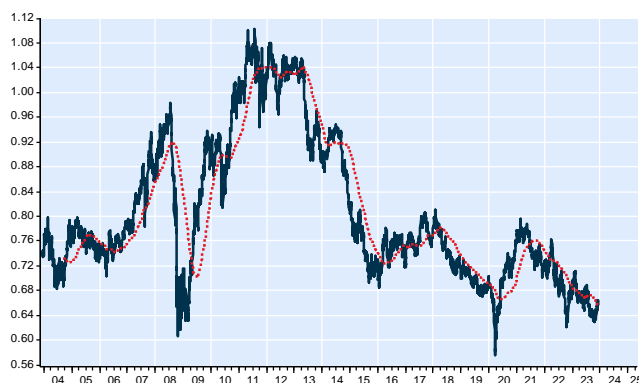
USD / CAD



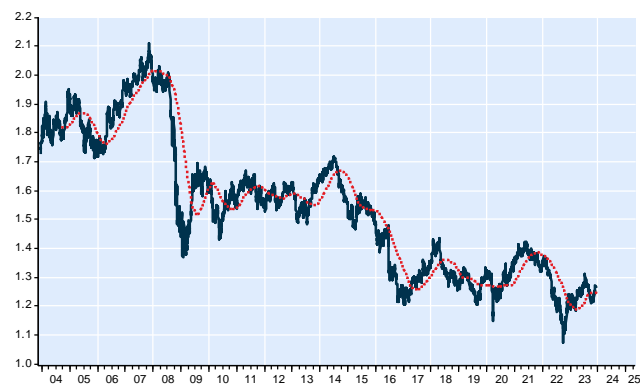
USD / JPY



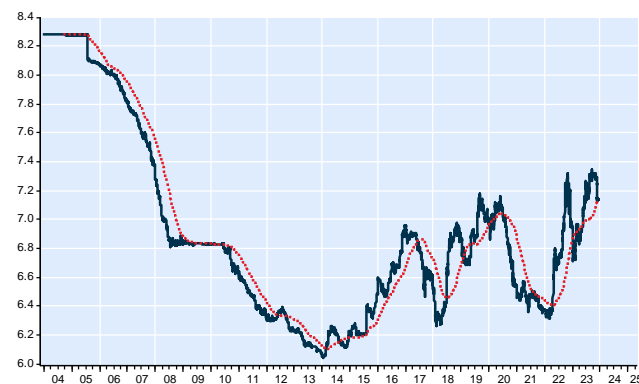
AUD / USD



GBP / USD



USD / CNY





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