Insights
Currency & Cash

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Currency Market Commentary

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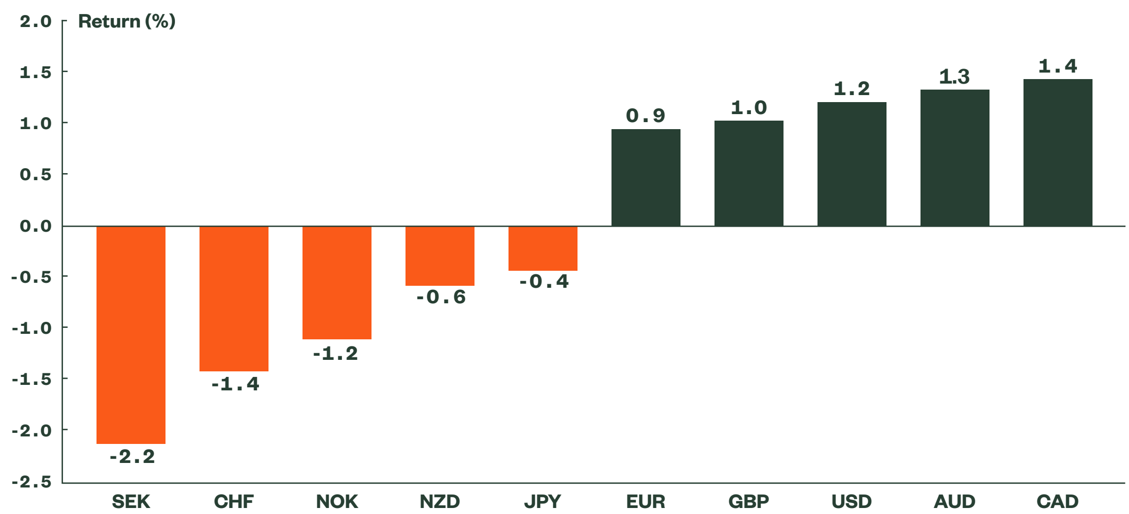
Summary of Views

The broad soft- or no-landing macro theme, which carried through March, sent equities and commodity prices higher, while yields fell back slightly within recent ranges. Having priced in this broad theme in January–February period, currency markets were largely driven by idiosyncratic news — mostly related to modest changes in relative central bank outlooks.

The Swiss National Bank (SNB) became the first G10 bank to ease policy with a surprise rate cut, and Sweden's Riksbank strongly signaled towards a cut as soon as May — likely to be the second bank in the group to ease. Consequently, the Swiss franc and the Swedish krona were the worst-performing G10 currencies during the month; the New Zealand dollar also slumped. New Zealand is unlikely to cut policy rates until Q3 or even Q4, but a weaker growth outlook reduced policy rate expectations. The Australian, Canadian, and US dollars were the top three performing currencies of the month. The US dollar was driven by higher-than-expected inflation and a rise in the Federal Reserve's (Fed) projected policy rates. The Canadian dollar took its cues from the strong US dollar, an upside surprise in local employment data, and a cautious Bank of Canada that is unlikely to ease policy until they see greater progress on inflation and wage growth.

The Australian dollar was a bit of an outlier; most fundamentals favored a weaker currency — a dovish central bank shift, weaker Chinese yuan, and steep fall in terms of trade. Instead, the currency outperformed thanks to rallies following a weak US employment report and strong Australian employment report.

Figure 1
March 2024 Currency Return vs. G10 Average



Source: Bloomberg and State Street Global Advisors, as of 31 March 2024. **Past performance is not a reliable indicator of future performance.**

Figure 2
March 2024
Directional Outlook

	Tactical Outlook	Strategic Outlook
USD	↑	↓
CAD	—	—
EUR	—	—
GBP	↓	—
JPY	↑	↑
CHF	—	↓
NOK	↓	↑
SEK	—	↑
AUD	↓	—
NZD	↓	—

Note: All individual currency views in the table above are relative to the G-10 average.
Source: State Street Global Advisors, as of 31 March 2024.

In the near term, we expect more of the same: currency markets are likely to continue to trade within fairly tight ranges, anchored by a range-bound US dollar, which is currently stuck around its 15–month average level against a broad basket of G10 currencies. We further expect that movements within the range will be largely driven by factors underlying relative monetary policy expectations. In that regard, we see some skew in potential near-term market moves for certain currencies.

Carry rotation: An improved G10 growth outlook, fewer expected rate cuts and low volatility are likely to extend the positive carry trade environment. However, we expect the start of the Swiss rate-cutting cycle and the risk of Japanese intervention to limit yen downside, favoring a rotation from the yen to the Swiss franc as a low-yielding funder for those carry trades.

Greater sensitivity to downside inflation surprises: Rates have backed up alongside a modest pick-up in consumer prices. Currencies have reacted to this through Q1, mainly via a stronger US dollar. Now we expect the market to be primed enough to react more dramatically to downside inflation surprises, including wage and labor market data as key inflation drivers. As a result of that expected skew in market reaction and our belief that disinflation will continue, there is a growing risk of a modest reversal of Q1 US dollar strength over the next month or two.

Stabilization in China: Chinese manufacturing and services Purchasing Managers Index (PMI) have picked back up and signal a recovery, albeit a minor one given the weak property sector, high debt levels that restrain stimulus; and poor consumer and investor sentiment. To date, markets are rightly more focused on downside yuan pressure and those negative macro forces. However, the nascent pick-up in PMI suggests that stabilized growth may limit downside in yuan-sensitive currencies and commodity prices, mostly the Australian and the New Zealand dollars.

Beyond those short-run themes in the market, a more significant breakout will likely require a major change in the macro narrative away from the soft- to no-landing scenario. This could take many forms and we will discuss some of that nuance in the individual currency commentaries below.

Review and Outlook by Currency

US Dollar (USD)

The US dollar appreciated by 1.2% versus the G10 average in March. We entered the month expecting a very short-run correction, which we saw from 1–8 March, as a reaction to weaker ISM prices paid, lower Q4 unit labor costs, a rising unemployment rate, and softer average hourly earnings growth. Mid-month, the dollar began to steadily recover following another upside surprise in core Consumer Price Index (CPI) and Purchasing Power Index (PPI), further reducing expectations of Fed rate cuts. The Fed policy announcement on 20 March reinforced this narrative as they raised growth projections for the next three years and raised policy rate forecasts for 2025–26; 2024 projections still call for three rate cuts. In other words, the Fed clearly foresees a soft- to no-landing scenario, with inflation slowly falling to target down alongside lower policy rates and growth at or above potential. In this scenario, both US policy rates and growth remain among the highest in the G10, providing support for the dollar.

We have long held the view that the US dollar is likely to fall at least 10–15% over the coming years as US yields and growth fall back toward the G10 average, and the US grapples with high fiscal and current account deficits. For investors with a horizon of two years or more, we strongly recommend short US dollar positions; just look through this highly uncertain transition period.

For those with a shorter, tactical horizon, we believe the dollar will remain well-supported in a range-trading environment, at least over the next few months. The G10-leading US growth and interest rates provide strong near-term support, further underpinned by the tendency of the dollar to rise in times of stress, serving as a nice insurance policy should an unforeseen shock derail the current soft or no-landing scenario. There is room for a modest upside over the coming months.

That said, the dollar is now more than 22% above our estimates of long-run fair value and the market has already reduced the number of expected rate cuts from around 6 to around 3 for 2024, aligning with the Fed projections. The US dollar is optimistically priced and vulnerable to a temporary sell-off over the next 4–6 weeks on even minor signs of weaker growth or renewed disinflation.

Canadian Dollar (CAD)

The Canadian dollar appreciated by 1.4% against the G10 average in March. The dollar was very quiet to start the month. The Bank of Canada (BoC) met on 6 March and held rates steady at 5%, not mentioning the potential for rate cuts, noting that while there was some excess capacity in the economy, inflation and wages remained too high. In the following days, the Canadian dollar outperformed the US dollar after the weaker-than-expected US employment report and stronger-than-expected Canadian employment report. However, US dollar weakness spilled over to the Canadian dollar, causing it to underperform versus the G10 average. That US dollar — Canadian dollar linkage persisted through the month, as it usually does, lifting the Canadian dollar steadily higher as US growth, inflation, and the US dollar all surprised to the upside after 9 March. During that time, Canadian data was a touch weaker than US data, notably with Canadian inflation surprising to the downside — 2.8% YoY compared to the expected 3.1%. Thus, while the Canadian dollar trended higher versus the G10, it weakened versus the US dollar. That is until 28 March when the combination of better-than-expected Canadian Gross Domestic Price (GDP) and Survey of Employment, Payrolls and Hours (SEPH) employment data triggered a strong 0.5% rally, pushing the currency to close at its high for the month, beating all G10 currencies.

We are neutral to slightly negative on the Canadian dollar relative to the G10 average, but see it struggling versus the yen and the US dollar. This is a marked improvement in our view since last month-end on higher oil prices, stronger Canadian growth expectations, and improved local equity market performance. The BoC is likely to cut rates by the summer in line with expectations for most central banks, preserving the Canadian dollar's position as one of the higher yielders in the G10. However, lower growth and faster disinflation relative to the US are likely to provide the BoC with greater scope to ease monetary policy relative to the Fed. This is likely to keep the Canadian dollar depressed relative to the US dollar for the next quarter or two.

In the long term, looking through the weaker cyclical picture, the Canadian dollar looks more attractive, as it is cheap to our estimates of fair value relative to the euro, the Swiss franc, and the US dollar. Additionally, its long-term potential growth is poised to improve on an aggressive increase in immigration and substantial plans to invest in sectors such as green energy technology.

Euro (EUR)

The euro gained 0.9% against the G10 average in March. The month began on a positive note following an upside surprise in core CPI — 3.1% YoY versus the expected 2.9%. Weaker-than-expected retail sales on the 6 March and indications from the European Central Bank (ECB) following their meeting on 7 March, that a first rate cut is likely in June weighed on the currency; but after 8 March, the euro enjoyed a steady trend higher for the remainder of the month. The euro uptrend was more likely a function of weakness in the yen, the Swiss franc, and the Scandinavian currencies than it was a reflection of indigenous euro and European Union (EU) economic optimism. Notably, monetary policy in Japan, Switzerland, and Sweden surprised on the dovish side versus unchanged ECB expectations. During this period, EU data was okay but not consistent with a steady rally. The composite PMI increased on strong services, while the ZEW economic survey expectations surged to 33.5, its highest level in a year. Most importantly, the euro did not react significantly around the time of those data releases.

We maintain a neutral view on the euro against the G10 average and a negative view against the US dollar and the yen. On the positive side, we have seen better-than-expected economic data and a larger improvement in year-ahead growth forecasts for the EU, as well as improved short-run relative equity market performance. Meanwhile, sticky headline inflation around 2.6% YoY and rising energy prices are likely to prevent a rate cut before June, as we saw in Switzerland and expect in Sweden.

We believe the world is in a fragile place; a lot can go wrong economically and geopolitically, which introduces higher-than-average risks to the sanguine soft landing narrative, biasing our models to favor the euro over more risk-sensitive currencies. Offsetting those positives is the fact that growth remain nearly stagnant despite its recent improvement. That stagnation, plus the steady pace of core disinflation, makes it more likely that the ECB will find itself able to ease policy more than the Fed, leaving us with a negative view versus the US dollar and the yen.

British Pound (GBP)

The British pound rose by 1.0% against the G10 average in March, marking its third consecutive monthly gain. Contrary to that gain, the data through the month was consistent with a weaker pound. Markets priced in an additional 10 basis points of rate cuts over the month following weaker-than-expected inflation, a soft labor report, and a dovish tilt to the March Bank of England (BoE) policy decision. The market-implied probability of a June rate cut rose to 70% from 48% at the end of February. The only notable positive growth surprise was better-than-expected February retail sales — 0.0% MoM versus an expected 0.4% dip — but the pound had already reached its intra-month high by the time that was released on 22 March.

Given the moderately negative news flow, it appears that the pound enjoyed a carryover of its positive Q1 momentum backed by the broader UK positive narrative. Specifically, UK growth will be better than feared last year, though only expected to be in the neighborhood of 0.3%, while stubbornly high services and wage inflation keep the BoE on a more shallow policy easing trajectory than other major central banks.

Our factor models are slightly negative on the pound versus the G10. We expect the pound to remain in a range with a slight negative bias. The positive UK growth surprises relative to weak expectations and the presumed BoE caution to cut rates may have been enough to lift the pound from deeply discounted territory in Q1, but as we described above, the more recent economic data is no longer surprising in a positive direction. We see risks to the pound from the near-stagnant economy, disinflation (transition to monetary easing), and the growth constraints from high fiscal and current account deficits.

Our long-term valuation model has a more positive pound outlook. It is particularly cheap against the US dollar and the Swiss franc. But it is important to temper upside expectations as low productivity growth and high inflation are pushing fair value lower. Fair value to the US dollar has fallen from 1.55 to 1.41 since May 2022. Breakeven inflation expectations and recent trend productivity differentials suggest that fair value will trend down to at least the mid-1.30s over the next few years. Despite this trend, the pound, currently trading in the mid-1.20s, remain materially cheap, even if fair value trends down as expected.

Japanese Yen (JPY)

The yen fell by 0.4% in March relative to the G10 average despite the first Bank of Japan (BoJ) rate hike since 2007. Early reports of strong wage gains fueled speculation that the 15 March announcement from the major union group Rengo would show a similarly strong gain for its seven million members. That news sent the yen higher through mid-March on hopes that it would induce the BoJ to exit negative interest rate policy (NIRP) and perhaps end yield curve control (YCC).

Indeed, the Rengo group negotiated a 5.28% pay increase, marking the highest in 33 years. Meanwhile, during their meeting on 18 March the BoJ made a significant move by exiting both NIRP and YCC. However, the cliché refrain "buy rumor, sell the fact" held in this case, and the yen sold off following the actual announcement. Although NIRP ended with the upper rate band raised to +0.1%, it was only good enough to reduce negative yen carry from –5.6% to –5.5%, hardly enough to support any significant yen strength. Instead, with the threat of a sudden NIRP exit and a possible yen short squeeze out of the way, the short yen speculators appeared emboldened to add to positions, at least for a few days.

The SNB surprise rate cut increased the attractiveness of short franc as an alternative to the yen, while notable threats of currency intervention from Japanese officials helped the yen to recover into month-end, though not quite enough to end March with a gain.

Our models maintain a positive view on the yen relative to the G10 average, but a modestly negative view versus the US dollar, given high US interest rates, strong relative US growth, and the dollar's superior recent performance as a safe haven. The recent trend to push out expected global monetary policy easing is likely to keep global yields higher and the yen on the defensive for longer, but we see risks skewed toward a broad yen recovery later in 2024.

We expect global yields to peak and turn lower, while below-trend global growth (maybe only returning to trend in the US) should increase the chance for periods of volatility in risky assets. However, that may take a while as inflation and growth remain more resilient than expected. Until we see a more definitive turn lower in global yields, the yen is likely to remain weak. Still, we see further weakness as limited due to the increasing threat of currency intervention.

Swiss Franc (CHF)

The Swiss franc depreciated by 1.4% in March versus the G10 as low inflation, below-potential growth, and a surprise SNB rate cut all weighed on the currency. Despite being the second-lowest yielding currency in the G10, the franc has outperformed during this low-volatility, carry-friendly environment. Over the past 18 months, the yen has been the only consistent low-yield funding currency in developed markets. This has been in part the result of SNB intervention to support the currency, some level of safe-haven demand from geopolitical uncertainty and heightened EU recession risk, and of course the important fact that yen interest rates have been 1.75% lower than franc interest rates. February and March brought a rotation out of the yen and into the franc as a low-yield funding currency for carry traders. We think this will continue and drive the franc gradually lower, albeit with the usual currency volatility that will see occasional rebounds in the franc. The threat of Japanese intervention to limit yen weakness while the SNB has stepped away from supporting the franc, as well as the beginning of the Swiss monetary easing cycle, favored a weaker currency.

We are negative on the franc over the strategic horizon. Tactically our very short-term fair value model sees potential for a quick, temporary rebound. Beyond that the franc remains the most expensive G10 currency per our estimates of long-run fair value, has the second lowest-yields in the G10, and inflation is falling faster than expected.

With the real-trade weighted franc near 30-year highs, any further strength could easily induce the SNB to intervene to weaken the franc which is consistent with its March rate cut. We believe we are in the early stages of a prolonged reversion back down toward our estimate of its longer-term fair value, though we also likely need to see further stabilization and early signs of recovery in the EU economy and further yen upside to accelerate the move.

Norwegian Krone (NOK)

The krone lost 1.2% versus the G10 average on the month. The month began on a strong note after better-than-expected manufacturing PMI and industrial production, as well as broad US dollar weakness following the US employment report. That krone strength quickly evaporated after a downside miss on CPI on 11 March — with core at 0.4% MoM versus the expected 0.6%. The miss introduced fear that the Norges Bank may deliver a more dovish message at its upcoming meeting on 21 March. The krone trended gradually lower through mid-month. However, the Norges Bank stuck with its steady, hawkish tone and is unlikely to ease policy until late Q3 or Q4 and expects to do so only gradually. Despite the hawkish message, the krone continued to fall, diverging from its usual fundamental drivers. The Norges Bank was among the most hawkish of all central banks on the month; growth data has been lackluster but stably positive, oil rallied to its highest level since last October, and equity markets trended higher. Each of these factors suggest a krone rally, but instead it dropped almost 1% in the final three days of the month.

Our short- and medium-term models remain negative on the krone but much less so than last month, as the result of stronger growth expectations, higher oil prices, and improved local equity market performance. The relatively more hawkish Norges Bank policy stance is also an important support, though it does not appear to have impacted the currency to date. That said, we continue to have important near-term concerns which keep the tactical signal negative. Equity markets appear overextended relative to potential global growth and political risks; at very least, they may experience a temporary (some would say healthy) pullback. The krone is usually quite sensitive to equity downdrafts. Additionally, while the growth outlook has improved, it remains weak in absolute terms. If this persists and inflation continues to surprise to the downside, the Norges Bank may find itself in a more dovish position by summer.

In the long term, the outlook is more convincingly positive. The krone is historically cheap relative to our estimates of fair value and is supported by steady long-run potential growth.

Swedish Krona (SEK)

The krona was the worst-performing G10 currency in March, down 2.2% versus the average. The krona traded sideways in a very tight range through mid-month. That changed abruptly with the release of softer-than-expected inflation on 14 March — +0.2% MoM versus the expected 0.4%. That surprise validated increasingly dovish Riksbank rhetoric over the past month and pushed the currency steadily lower. The hawkish tone of the Norges Bank and Fed meetings, along with the surprise rate cut from the SNB, focused investors on relative monetary policy, which culminated in a sharp fall in the krona following the dovish Riksbank policy message at its meeting on 27 March. The Riksbank acknowledged an increased probability that it eases policy as soon as May. The krona understandably finished the month at its low.

Our models are neutral on the krona over the near term. Growth has been chronically weak but is showing some signs of improvement, especially versus depressed expectations, very much like the broader EU. This stabilization in the context of the historically cheap krona valuation suggests recovery.

However, any resulting krona bullishness is offset by near-stagnant to negative growth in absolute terms and an ongoing fall in consumer prices, both of which validate the dovish Riksbank message. We believe that the Riksbank may cut sooner and faster than the ECB, the BoE, and the Fed, something that would be very welcome news to the heavily indebted household and property sectors, but not great for the currency over the short run.

Australian Dollar (AUD)

The Australian dollar was the second-best-performing G10 currency during March — up 1.3% versus the average. The gains were concentrated over two periods. First, from 6–8 March, coinciding with broad US dollar weakness and the softer-than-expected US employment report. Second, from 20–21 March, following a much stronger-than-expected Australian employment report showing jobs gains — 116,500 jobs versus expected 40,000 jobs — and a drop in the unemployment rate from 4% to 3.7%.

Outside of those two brief periods of Australian dollar appreciation, it traded sideways with relatively little volatility. However, it is impressive that the dollar was able to hold its gains given a sharp fall in iron ore prices, softer-than-expected consumer sentiment, weaker-than-expected retail sales, downward pressure on the Chinese yuan, and a slight dovish shift from the Reserve Bank of Australia (RBA). The RBA removed their warning of further rate increases from the statement following the policy meeting on 18 March.

Our models continue to see medium-term risks tilted to the downside for the Australian dollar on weak terms of trade, underperformance of Australian equity markets, and the recent downside inflation surprises. While we have seen some improvement in one-year ahead consensus growth expectations, the more recent growth data has been disappointing.

However, it is important to note that the Australian dollar is cheap relative to history, suggesting many of these negative factors are priced into the currency. We also expect stabilization (but not a material recovery) in Chinese growth over coming quarters, though investors are currently reacting poorly to announcements of Chinese stimulus and likely have to see the positive impacts before it spills over to support the dollar.

In long term, the Australian dollar outlook is mixed. It is cheap versus the US dollar, the British pound, the euro, and the Swiss franc and has room to appreciate, but is expensive against the yen and the Scandinavian currencies. Here, the Chinese story is less positive as we see a structural downtrend in Chinese growth as well as a rotation toward domestic consumption and higher value-added industries, which is likely to gradually reduce the growth rate of Australian commodity export demand.

New Zealand Dollar (NZD)

The New Zealand dollar fell 0.6% versus the G10 average in March. The dollar started off strong due to broad US dollar weakness, which began on 1 March after weaker-than-expected US consumer and ISM manufacturing data and extended through the weaker-than-expected US employment report on 8 March. Even as the US dollar began to recover following 8 March, the New Zealand dollar held on to small gains through mid-month; it even held up after the positive US inflation surprise on 12 March. On 15 March, Finance Minister Nicola Willis warned that upcoming official growth estimates for the next few years would likely be "significantly slower." The New Zealand dollar sank 0.45% that day and continued lower following weaker-than-expected Q4 2023 released on 20 March — –0.1% QoQ versus an expected uptick of 0.1%. A steady fall in milk prices and broader terms of trade added to the downside pressure through month-end.

We are negative on the New Zealand dollar over the near term. Ongoing challenges to growth, choppy commodity prices, and the weak external balance — the current account is –6.9% of GDP — more than offset any benefit of high yields, especially after weak growth forecasts reduced future expected yields.

However, all is not bad. Markets priced in an extra 2024 rate cut from the central bank, but even with that, the New Zealand dollar is likely to remain among the highes-yielding G10 currencies through 2024. China is likely to remain a drag in the short term, but early signs of stabilization in Chinese growth may provide some relief to the New Zealand export outlook.

In the long term, our New Zealand dollar outlook is mixed. Our estimates of long-run fair value suggest that it is cheap versus the US dollar and the Swiss franc and has ample room to appreciate, but is expensive against the yen and the Scandinavian currencies.

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Marketing communication

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