Insights
Currency & Cash

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Currency Market Commentary

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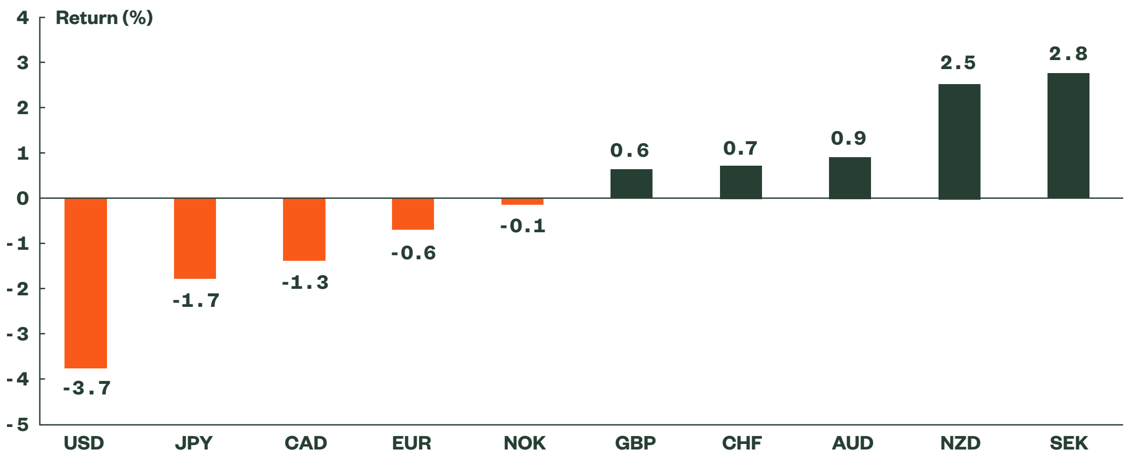
Summary of Views

Signs of slightly softer economic data, continued disinflation, and a likely end to the global central bank tightening cycle triggered a flip from a higher-for-longer rates regime back to a goldilocks (disinflation + positive growth) regime.

This brought a sharp reversal of the mid-July-through-October sell-off in equities, rates, and rally in the US dollar. In just a month, the dollar and rates retraced over 60% of the moves in the prior 3.5 months, while equity markets regained over 90% of their losses. The exception was the commodity market, which appeared to be weighed down by a weak demand outlook and oil supply surplus in contrast to the rosier projections implied by equity markets.

Figure 1
November 2023 Currency Return vs. G10 Average



Source: Bloomberg and State Street Global Advisors, as of 30 November 2023. **Past performance is not a reliable indicator of future performance.**

As one would expect, currencies that are sensitive to global risk sentiment, such as the Australian dollar, New Zealand dollar, British pound, and Swedish krona, outperformed. However, the most cyclically sensitive currency in recent years — the Norwegian krone — was hindered by soft oil prices and a more dovish than expected central bank meeting. The Canadian dollar also faced commodity market headwinds, along with the usual spillover from a weak US dollar. The safe-haven US dollar and the Japanese yen underperformed as expected. The Swiss franc, another typical safe-haven currency, managed a small gain, thanks to a rapid late-month drop in the euro vs. the franc following weak European Union (EU) inflation data.

Figure 2
November 2023 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 30 November 2023.

December and early January tend to bring a risk-positive mood and could see the recent momentum continue to push equities higher and the US dollar lower, though surely with some intermittent corrections and at a much slower pace than in November.

In the longer term, we also see US dollar downside, with the US losing much of its interest rate and growth advantage over the next 1–3 years, leading to a sustained dollar bear market. The unsustainably high combined US fiscal and current account deficits should add to the dollar downside pressure.

The problem with that bearish dollar thesis is that in the medium term — Q1–Q2 next year — we see potential for rebounds or at least limited downside in the US dollar. For the recent dollar sell-off to become a sustained bear market, we will need a perfectly soft landing: a moderate US slowdown, modest recovery outside the US, and large enough disinflation to prompt a global normalization of interest rates. It is far more likely that investors will continue to oscillate between expectations of a hard landing, soft landing, or overly hot no-landing, keeping the US dollar supported in a range.

As the US consumer becomes more constrained and the impact of tight monetary policy continues to build, we expect growth surprises to tilt to the downside, making the no-landing scenario less likely over time. Thus, of the three landing scenarios, we are more likely to see investor sentiment switching between soft and harder landing scenarios, which point to lower yields and choppy equity markets. That environment keeps the dollar supported but is even more favorable for the Japanese yen as it is a key beneficiary of both lower rates and greater risky asset volatility.

Other non-US dollar G10 currencies will likely move together against the US dollar as they have in 2023, with some differentiation based on local economic conditions and monetary policy outlook.

Review and Outlook by Currency

US Dollar (USD)

The US dollar lost 3.7% in November. The dollar's downtrend began on 1 November following a downside surprise in the ADP payroll report and the US Federal Reserve (Fed) decision to hold policy rates steady at 5.25%–5.5%.

Fed Chair Powell cautioned that the committee would raise rates again if needed, but also noted that the Fed was proceeding carefully. The market interpreted his comments as an end to the tightening cycle. A few days later, that more dovish policy outlook was validated by a softer than expected payrolls report — +150k new jobs vs. +180k expected and 0.2% growth in average hourly earnings vs. consensus forecast of 0.3%.

The dollar continued its decline. After a period of consolidation, the US dollar began to fall again in response to lower than expected inflation on 14 November. Both headline and core consumer price index (CPI) printed 0.1% below forecasts at 0% and 0.2%, respectively. Markets completely priced out the chance of another rate increase in December or January and by month-end had priced in a rather aggressive rate-cutting cycle through 2024, beginning in March and the dollar weakness persisted through month-end.

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 investment horizons beyond two years, we strongly recommend short US dollar positions. For those with a shorter horizon, we believe the dollar will remain in a range-trading environment into 2024.

The near perfect soft-landing scenario, with much lower yields and a resilient growth and corporate earnings outlook, would see the recent US dollar downtrend continue. We cannot rule that out. However, any deviation from the perfect soft landing would result in additional intermittent US dollar rallies.

We forecast US growth to slow substantially enough to introduce fears of a global recession and potential stress in the outlook for corporate earnings, even if recession is avoided in the end. In that case we expect lower yields; lower, more volatile equity markets; and another US dollar rally.

Conversely, any temporary uptick in US growth or inflation would likely reignite a backup in yields and once again support the US dollar. After we get through, or are at least well into, a global slowdown, risky assets price in greater pessimism, and we see the Fed bias shift toward easier monetary policy, we expect a large, sustained US dollar downtrend.

Canadian Dollar (CAD)

The Canadian dollar fell 1.3% against the G10 average. The weakness can partly be explained by the US dollar weakness as the Canadian dollar tends to follow the broad US dollar moves given the close linkages between their economies.

Beyond that US dollar effect, weaker domestic Canadian data and falling commodity prices also dragged the currency lower. The unemployment rate continued to rise to 5.7% from its low of 5% in April. Both services and composite PMI data point to a stronger contraction, which was validated by a significant downside surprise in quarterly GDP data released on 30 November (–1.1% QoQ annualized relative to market expectations of +0.1%). Inflation remains well above target but is falling steadily and may open the door for easier monetary policy sooner than many G10 economies.

The Canadian dollar is now the lowest-ranked currency by our short- and medium-term models. Rapid deceleration in growth, alongside rising levels of unemployment and weak commodity prices, suggests further Canadian dollar weakness.

Market expectations for Bank of Canada policy easing as soon as March 2024 have risen as they have for US Fed policy. However, the more pronounced economic slowdown and the equally rapid disinflation raise the risk of recession and an even earlier or more rapid monetary easing cycle in Canada. This risk appears to be underappreciated in current market pricing and suggests scope for Canadian dollar weakness.

In the long term, looking through the weaker cyclical picture, the Canadian dollar looks more attractive as it is cheap in our estimates of fair value relative to the euro, the Swiss franc, and the US dollar, and 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 recovered nicely during the first half of November before turning lower to finish down 0.6% against the G10 average. Outperformance during the first couple of weeks of the month was caused by signs that the US Fed was done tightening policy, the more dovish than expected Reserve Bank of Australia (RBA) comments, and weaker than expected US employment data. In other words, the strength in the euro was not driven by local economic conditions.

EU data continued to point to stagnation with negative September industrial production and retail sales. During the latter half of the month, a second straight quarter of negative gross domestic product (GDP) growth (–0.1% for Q3 following –0.1% for Q2) and a very weak 30 November CPI print (outright deflation of –0.5% MoM) pushed the euro lower. The ultra-positive macro sentiment and the massive equity rally also likely weighed on the euro as it favored more risk-sensitive currencies.

We maintain a neutral view on the euro against the G10 average and a negative view on the US dollar and the yen. Heightened global uncertainty and equity volatility over the next few months may help support the euro vs. higher-beta currencies as will the ongoing weakness in commodity markets. Against the US dollar and other less cyclically sensitive currencies, we expect the euro to struggle as they benefit more from global uncertainty than the euro and the combination of high EU recession risk and softening European Central Bank (ECB) policy outlook is likely going to weigh on the euro.

British Pound (GBP)

The British pound rose 0.6% against the G10 average during the month in choppy trade. The Bank of England's (BoE) 2 November decision to hold policy rates steady and downgrade expected 2024 growth from +0.25% to 0% had little impact on the currency likely due to the even more dovish Fed message the prior day and the strong rally in risky assets.

Stronger-than-expected purchasing managers' index (PMI) data on 3 November triggered a sharp move higher in the pound. However, that reversed after only a couple of days in response to comments from the BoE Chief Economist Huw Pill that UK inflation is likely to fall rapidly next year. On 14 November, the pound surged again on a combination of weaker US inflation data and higher-than-expected gains in UK average weekly earnings — +7.9% 3M YoY vs. 7.3% expected.

Again, the pound's strength proved short-lived and completely reversed following a soft October CPI report on 15 November — 0.0% MoM vs. +0.1% expected. From there, the pound languished for over a week until the November preliminary UK PMI report showed a return to expansion at 50.1, which prompted the pound to move higher again. This time, it managed to hold the gains into the month-end.

Our factor models remain neutral on the pound vs. the G10 average but are quite negative against the yen and the US dollar. We see risks to the pound skewed lower as the economy teeters on the brink of recession, inflation and wages remain uncomfortably high, the central bank turns away from further rate increases, and the UK economy faces the constraints of high fiscal and current account deficits.

However, we see similar average risks across G10 economies/currencies, leaving the relative tactical pound outlook close to neutral. Our long-run 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 relative to the US dollar has fallen from 1.55 to 1.42 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, although, from current levels in the mid-1.20s, the pound is still materially cheap even if fair value trends down as expected.

Japanese Yen (JPY)

The yen finished November 1.7% lower against the G10 average. Aside from a small gain on 1 November, the yen moved down, mostly driven by the strong equity rally and the rapidly falling global yields.

Over the first two weeks of the month, the S&P 500 index rose over 7%, while US 2-year yields fell about 0.18%. The yield move is usually yen-supportive but the equity move was much more dramatic and pushed the yen down to a mid-month low of –2.2% by 15 November.

From there the pace of the equity rally slowed dramatically, while the fall in global yields accelerated. The interest rate effect became the primary driver, helping the yen recover some ground into month-end.

Local Japanese data was on the weak side, with disappointing GDP (–0.5% QoQ relative to –0.1% expected) and softer-than-expected inflation (core CPI at 4% YoY vs. 4.1% expected). The weak GDP print on 14 November appears to have pressured the yen lower for a day but the market showed little reaction to the inflation data. The BoJ is on a patient path and neither of these data points suggested a change in that path; therefore they had little to no impact.

Our models have shifted to a positive view on the yen relative to the G10 but retain a negative view vs. the US dollar given high US interest rates and strong relative growth.

Into 2024, we see risks skewed toward a broad yen recovery as yields peak and turn lower, while below-trend global growth creates an increasingly fragile environment for risky assets. The uncertain timing of the turn in global yields and growth is an issue that requires patience and tolerance for additional near-term losses in long-yen positions. Intervention by the BoJ may also help to limit further yen downside, though it is not as likely in the near term now that global yields have fallen and USD/JPY is off its highs. But if the yen rises above 155 vs. the US dollar, the risk of intervention is high.

Swiss Franc (CHF)

The franc gained 0.6% in November vs. the G10 average due entirely to a sharp spike on 30 November. The positive risk environment in November and a sharp drop in interest rates across the higher-yielding G10 currencies generally favor a weaker franc. However, the franc moved sideways in a tight range up until 28 November.

Swiss National Bank (SNB) reserves have been quickly falling since May 2022 largely as the result of franc-supportive market intervention. It is likely that SNB intervention continued through November and helped to stabilize the currency through the month.

On 30 November, the notable downside surprise in EU inflation (−0.5% vs. −0.2% expected) triggered a violent move lower in the euro vs. the franc. That buying interest (euro-selling interest) resulted in a broad 0.85% rally in the franc vs. the G10 average, allowing the franc to finish the month with a gain.

We are negative on the franc over both the tactical and strategic horizons. It is the most expensive G10 currency per our estimates of long-run fair value; growth data continues to soften; inflation is rolling over; and, aside from the yen, the franc has the lowest yields in the G10. The monetary policy outlook is also likely to shift in Q1.

The downtrend in inflation and soft growth data suggest a pivot by the SNB toward an easing bias, or at least the end of currency intervention to support the franc. The December meeting may be a bit early to completely abandon its more vigilant inflation-fighting message, but we do expect more balanced language that will ultimately turn more dovish next year. Such a shift is likely to provide a catalyst for the highly overvalued franc to begin a reversion toward our estimate of its longer-term fair value.

Norwegian Krone (NOK)

The krone lost 0.1% relative to the G10 average. That seemingly neutral outcome is actually quite disappointing relative to the krone's historical behavior. The krone has been the G10 currency most highly correlated to large equity market moves for a number of years, yet it failed to appreciate despite the huge equity rally.

Weaker oil, which is almost as important to the krone as equity markets, was likely a drag through the month. The Norges Bank decision to keep rates on hold at its 2 November meeting, as well as a drop in manufacturing PMI into contractionary territory to 47.9, started the krone off on the wrong foot. Its fortunes improved after a strong upside inflation surprise on 10 November, which in combination with the equity rally, saw the krone move up almost 2.5% over the subsequent two weeks. Volatility in oil prices on 22 November following a postponement of the planned OPEC+ meeting ended that rally and triggered the krone to reverse lower.

A much weaker than expected Q3 GDP report on 23 November (−0.5% QoQ growth vs. +0.2% expected) added to the downside pressure into the final week of November, wiping away the krone's entire month-to-date gain.

Our short- and medium-term models are negative on the krone due to falling oil prices, weaker equity markets, and disappointing growth data. On a positive note, inflation appears far too high for the Norges Bank to cut rates as early as the Fed and ECB, which could be supportive for the currency. And, at least in December, equity markets tend to hold up well. Unless there is another round of substantially negative economic data in Norway, we could see the krone partly catch up to the bullish equity environment during the month.

Beyond that, we expect a general slowing of global growth led by the US, which will likely increase recession fears and result in periods of greater equity market volatility and subdued oil prices. Both are consistent with a weaker krone.

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

Swedish Krona (SEK)

The krona led the G10 in November with a 2.8% gain vs. the G10 average. The move appears to be the result of generally positive risk sentiment and rising equity markets, along with the Riksbank's steady krona purchases as it hedges a large portion of its currency reserves.

Domestic Swedish data and policy mostly pointed to a weaker currency. Inflation surprised lower. Q3 GDP came in at –0.3%, a second consecutive quarterly decline. The markets had priced a 30% chance of a rate hike going into the Riksbank meeting on 23 November but the central bank opted to keep rates on hold. There was a slight move up in manufacturing PMI but that was hardly krona-supportive as it remains in recessionary territory at 45.7.

Because the recent strength in the krona was not justified by economic data, our short-term value model has shifted the krona outlook from neutral to negative. The ongoing Riksbank reserves hedging program and the potential for further near-term resilience in equity market sentiment probably limit downside over the near term, but it is difficult to make a short-term bullish case for the krona.

Eventually, though maybe not in the next several months, Swedish and global inflation will be under control and the economy will begin a more durable recovery. Once that happens, the historically cheap krona has substantial room to enjoy a broad-based appreciation back toward its long-run fair value on a sustained basis.

Australian Dollar (AUD)

The Australian dollar rose 0.9% relative to the G10 average during November. The month started with strong gains after the more dovish than expected US Fed meeting and weaker US jobs data triggered a rally in risk assets and a drop in global yields.

The RBA met on 6 November holding rates steady at 4.35% as expected but shifted from a tightening bias to a more neutral data-dependent bias. The Australian dollar fell almost 1.4% over the following days until better than expected wage growth data on 13 November, weaker than expected US inflation data on 14 November, and a strong Australian labor market report on 15 November reignited the dollar's uptrend. That positive trend persisted through month-end aside from a modest one-day drop on 28 November in response to weaker than expected Australian inflation.

Our models continue to see medium-term risks tilted to the downside on weak commodity prices, sluggish economic growth, underperformance of Australian equity markets, and the overall fragility of the global growth outlook heading into 2024. That said, we respect the potential for the global risk sentiment and risky assets to stay well supported through year-end, which would lend further support for a stronger Australian dollar.

We also expect a small improvement in Chinese growth following recent fiscal and monetary stimulus. In the longer term, the Australian dollar outlook is mixed. It is cheap vs. 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 the Australian commodity export demand.

New Zealand Dollar (NZD)

The New Zealand dollar was the second best-performing currency in the G10 for the month, up 2.5% vs. the G10 average. It surged at the start of the month alongside the strong Australian dollar rally and the surge in equity markets.

That surge stalled on 6 November and the currency reversed lower through mid-month with a particularly large 0.5% loss after weak manufacturing PMI on 9 November. The softer US inflation data on 14 November provided temporary relief but that proved short-lived. It was not until 20 November that the New Zealand dollar began to trend steadily higher with a very strong 0.8% jump following the Reserve Bank of New Zealand (RBNZ) meeting on 29 November.

The RBNZ kept rates on hold at 5.5%, but its forward-looking projections upgraded the chance of another rate hike to 80%. This stood in stark contrast to the more dovish shifts from most other central banks and provided strong support for the currency into month-end.

We remain pessimistic on the New Zealand dollar over the near term. Sluggish near-term growth and the weak external balance — the current account is –7.5% of the GDP — more than offset any benefit of high yields, even with the RBNZ raising the probability of another rate hike.

Any further relief from the pessimistic China growth theme is likely to prove temporary. We expect China growth to enjoy a modest bounce over the next several months but the outlook is for a gradual decline in growth rate over the next several years. In the longer term, our New Zealand dollar outlook is mixed. Our estimates of long-run fair value suggest that it is cheap vs. 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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