

October 2023

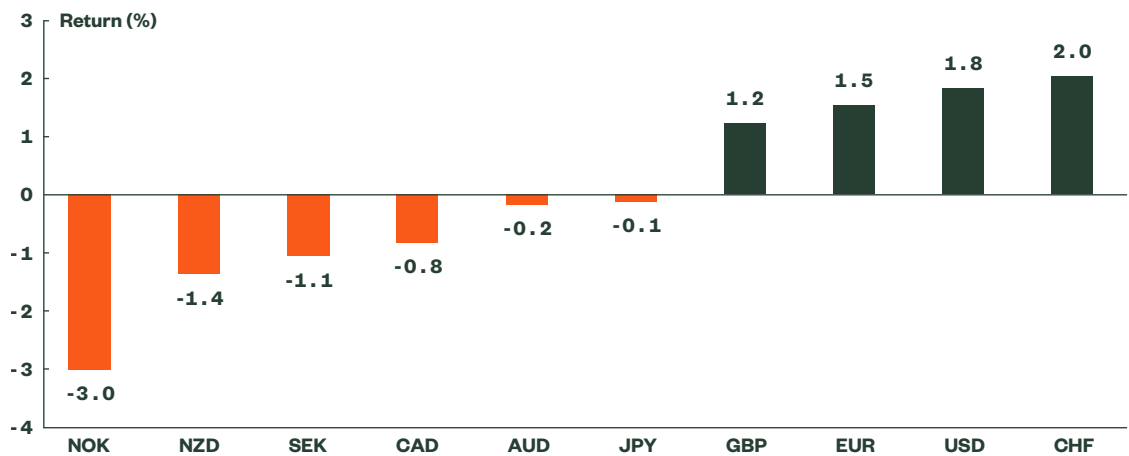
# Currency Market Commentary

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## Summary of Views

Risk-off sentiment was the most influential factor driving currency markets in October as rising yields and, to a lesser extent, the outbreak of fighting between Israel and Palestine drove equity and credit markets lower. Even Brent crude oil, which rallied sharply in response to the fighting in the Middle East, finished the month down more than 8%.





















Figure 1  
**October 2023  
Currency Return vs.  
G10 Average**



Source: Bloomberg and State Street Global Advisors, as of 31 October 2023. **Past performance is not a reliable indicator of future performance.**

As expected, the safer currencies — the US dollar, the Swiss franc, the euro, and the Japanese yen — rallied in this environment, though the yen plummeted on 31 October to end the month slightly negative following a dovish Bank of Japan (BoJ) policy decision. The Norwegian krone, which has the highest beta to equity markets and oil, was unsurprisingly the worst performer followed by the risk-sensitive New Zealand dollar, Swedish krona and Canadian dollar. The performance of the Australian dollar and the British pound was more surprising, as both outperformed expectations despite the deterioration in risk sentiment. The Australian dollar was bolstered by an increasingly hawkish central bank in response to higher-than-expected inflation and better-than-expected growth data. UK economic data continues to point to stagnation/recession and markets see little scope for additional Bank of England (BoE) monetary tightening, but it appears that a combination of oversold conditions following the pound's sharp September sell-off and some stabilization in data helped to support the pound.

Figure 2  
**October 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 31 October 2023.

Following three months of equity market losses and US dollar appreciation, the moves appear to be tiring. This opens the door to a short-lived relief rally in risky assets and a US dollar decline. That said, the US dollar remains both a defensive and high-yielding currency, while the US economy is outperforming — a very attractive trio of factors for the dollar. We see solid ongoing medium-term support for the dollar even if it corrects lower by year-end.

The deeply undervalued yen stands out as a positive risk hedge but is still likely to struggle vs. the US dollar until yields finally peak and begin to move lower. Our models suggest that we are in the very late stages of the yen bear market and see risks skewed clearly to the upside over the 6–12-month horizon. Aside from an increasingly likely relief rally at some point in the next month or two, weaker global growth, volatile risky asset performance and geopolitical uncertainty are likely to keep medium-term pressure on the cyclically sensitive Australian, New Zealand, and Canadian dollars, as well as the Norwegian krone.

## Review and Outlook by Currency

### US Dollar (USD)

The US dollar gained 1.8% relative to the G10 average in October. The month began on a weak note as the dollar corrected lower following the strong August–September rally despite the much better-than-expected employment data on 6 October.

The dollar weakness, however, proved short-lived, and it moved sharply higher following the upside surprise in US consumer price index (CPI) inflation — +3.7% YoY vs. +3.6% expected — on 12 October. That surprise in conjunction with the ultra-strong employment report the prior week reinvigorated the higher-yield, lower-equity and stronger-dollar trade that has dominated since mid-July.

Rising concern that the fighting between Israel and Hamas might spill over into a regional conflict also added support. The dollar retraced some of its gains briefly in the final week of the month as equity markets stabilized. However, a stronger-than-expected Employment Cost Index reading and the dramatic yen sell-off on 31 October pushed the dollar to close at its high for the month.

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We have long held the view that the US dollar is likely to fall at least 10%–15% over the coming years but is currently in a noisy transition period from a bull to a bear market — a protracted range-trading environment. Following three months of equity market losses and US dollar appreciation, the moves appear to be tiring. This opens the door to a short-lived relief rally in risky assets and a US dollar decline.

However, the next big US dollar sell-off does not appear imminent. The world is in a fragile place, while the US grows well above trend, offers high yields, and the US dollar tends to provide a good hedge for risky assets if we slide into recession. This is a strong basis of support for the US dollar.

Eventually, by early mid-2024, we suspect US growth to slow substantially, igniting fears of a global recession, and potentially stress the outlook for corporate earnings. In that case, we expect lower yields and lower, more volatile equity markets. Such a deterioration in growth and increased volatility would likely help to support the US dollar in its initial stages. The positive impact of the US dollar's safe-haven appeal in a time of falling equity markets historically dominates the negative dollar impact of lower yields.

Once we get through, or are at least well into, a global slowdown, risky assets price in greater pessimism, and we see the US Federal Reserve (Fed) bias shift toward easier monetary policy, we expect a large, sustained US dollar downtrend.

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## Canadian Dollar (CAD)

The Canadian dollar fell 0.8% against the broader G10 average in October. The pattern was very much in line with the Canadian dollar's typical behavioral profile. The Canadian dollar tends to be sensitive to global risk conditions and crude oil prices.

Equities were broadly lower and West Texas Intermediate (WTI) crude was down 10.75% for the month, both of which are consistent with a weaker Canadian dollar. At the same time, the Canadian dollar is the most highly correlated with the US dollar among the G10 currencies. The US dollar strength likely supported the Canadian dollar, helping it to outperform the more risk-sensitive currencies, such as the Norwegian krone and the New Zealand dollar.

Domestic data was mixed but consistent with a broad slowing of the economy and a weaker currency. An above-expectation labor market report — +63.8k new jobs compared to +20k expected — provided an early month boost. But manufacturing PMI remained in contractionary territory, retail sales fell 0.1% compared to expectations of a 0.1% rise, and August GDP came in at 0% relative to the expected growth of 0.1%.

Weaker-than-expected inflation data plus the sluggish growth data prompted the Bank of Canada (BoC) to remain on hold at its meeting on 25 October. The accompanying policy statement explicitly recognized the slowing of the economy and suggested that further rate increases would be unlikely. The Canadian dollar fell in response to finish the month near its low.

Our models turned negative on the Canadian dollar on falling oil prices, softer economic data and reduced interest rate expectations. While the Canadian dollar is cheap to its long-run fair value, it is likely to have a tough time over the next few months. The rising potential for a downside move in the US dollar after 3.5 months of gains may help the Canadian dollar outperform the US dollar temporarily in November and/or December, but we expect that outperformance to be limited so long as US growth and yields remain strong. Moreover, even if we see a broad, temporary correction in the US dollar, we would expect the Canadian dollar to underperform most other G10 currencies.

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In the long term, 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.

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## Euro (EUR)

The euro trended higher steadily in October to finish 1.5% up against the G10 average. There was little fundamental news to justify the euro strength. The European Union (EU) economy is stagnant and at serious risk of tipping into a mild recession.

Recent data shows little reason to change that outlook. Retail sales, services purchasing managers' index (PMI), manufacturing PMI, and inflation all surprised to the downside as did Q3 gross domestic product (GDP) growth (-0.1% QoQ relative to 0% expected). Against this backdrop the European Central Bank (ECB) paused its monetary tightening cycle and signaled that it is likely done hiking rates. Euro 10Y yields fell in response, while they increased in most other G10 economies.

The reason for euro strength appears to be a combination of technical factors and a little bit of a safe-haven bid. The euro tends to hold up reasonably well vs. the G10 average when equity markets are weak and the steady euro pessimism in Q3 appears to have created conditions for some profit-taking on short positions in October.

We maintain a neutral to slightly negative view on the euro in response to the steady stream of weaker economic data and the dovish shift in the ECB outlook. Heightened global uncertainty and equity volatility over the next few months may help support the euro vs. higher-beta currencies, but a continued broad euro strength appears unlikely in the near future. Against the US dollar and other less cyclically sensitive currencies, we expect the euro to struggle. That said, the extreme US dollar bullishness of late increases odds of a temporary correction lower in the US dollar and the euro rally over the next 1-2 months.

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## British Pound (GBP)

The British pound rose 1.2% against the G10 average during the month. From a high-level perspective, the pound strength during October appears unjustified. The PMI data points to ongoing contraction in both the services and manufacturing sectors. Industrial production, manufacturing production, retail sales and employment data all surprised to the downside. And, historically, the pound has had a positive correlation to equities, suggesting it should have fallen during the month.

However, the currency bounced higher on 4 October following a better-than-expected (but still contractionary) final UK composite PMI report for September. The growing pessimism regarding the UK outlook and a sharp sell-off in the pound during September likely set the stage for a rebound on even a minor positive data surprise. Strong US inflation data on 12 October prompted a retracement lower until falling US yields and a general US dollar sell-off sent it sharply higher on 23 October. The pound enjoyed a final surge higher on 31 October vs. the G10 average as the Japanese yen plummeted following the Bank of Japan meeting.

Our factor models remain neutral, but with a slightly improved short-term pound outlook, driven by negative but modestly improved economic growth signals and the recent UK equity market outperformance. In contrast to that slight improvement in the average signal, we see risks to the pound skewed lower as the economy teeters on the brink of recession, inflation and wages remain uncomfortably high, and the central bank turns away from further rate increases.

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Our long-run valuation model has a more positive pound outlook. It is particularly cheap vs. 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. The fair value 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 low 1.20s — the pound is still materially cheap even if fair value trends down to the 1.30s.

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## Japanese Yen (JPY)

The yen finished October down 0.1% against the G10 average thanks to a 1.1% decline on 31 October. The month began with an even larger — but positive — shock. In a span of about three minutes, in the morning of 3 October in New York, the yen appreciated 1.75% against the US dollar.

Investors speculated that the BoJ intervened to support the market, though it did not confirm. Also, rumors of one or more very large yen buy orders unrelated to government intervention suddenly hit the market. In the following days, the yen completely reversed its sudden gain as 10-year US yields shot up to 5%. However, the combination of weak equity markets and the worry that the BoJ did intervene on 3 October helped keep the yen at or below 150 vs. the US dollar and stronger vs. the G10 average up until 31 October.

On 31 October, the BoJ further relaxed its yield curve control (YCC) cap on 10-year Japanese Government Bonds (JGBs), making the prior 1% cap a softer reference level, meaning it would allow yields to move above that level at its discretion. Investors, many of whom had hoped for a more dramatic revision of YCC after a news report the prior day suggested such an outcome, were disappointed.

On 31 October, we also learned that the sharp 3 October rally was not the result of BoJ intervention, because the BoJ had not intervened at 150, suggesting that the yen may be able to cross through that level without an immediate government response. It seems markets were emboldened to express their disappointment by pushing the yen down 1.75% and well through the 150 level vs. the US dollar to wipe out its entire month-to-date gain.

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 the dollar's high 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 this turn in global yields and growth is an issue that requires patience and tolerance for additional near-term losses in long-yen positions. Intervention may also help to limit yen downside. If the yen rises above toward 155+ vs. the US dollar, the risk of intervention to limit/slow further yen losses will increase. Thus, it makes sense to have a long-yen bias at least against non-US dollar currencies now, even though it may take some time before it begins to materially strengthen.

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## Swiss Franc (CHF)

The franc was the best-performing G10 currency in October, where it was up 2.0% vs. the G10 average. The uptrend was steady from the start of the month until 20 October, when the franc was up more than 3% for the month. After that, it stalled and partly retraced into month-end as US yields retested 5% and equity markets stabilized.

The ongoing weakness in EU growth and the heightened geopolitical uncertainty both pushed the franc higher. The Swiss franc tends to behave as a safe-haven currency, a behavior that is particularly strong during times of political risk and weak European economic conditions. The franc did not seem to respond meaningfully to domestic data, which was more consistent with a weaker currency — declining retail sales, downside surprises in core inflation and manufacturing PMI signaling contraction.

We are negative on the franc over both 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. We expect the Swiss National Bank (SNB) to hold rates for at least a couple quarters before shifting to an easing bias. And, importantly, we expect the SNB to curtail currency intervention aimed at supporting franc strength over the next 1–2 quarters.

However, despite the weaker local economic situation and potential dovish SNB pivot, our pessimistic view on the franc may require patience as the rising risk of EU recession and the fragile global macro environment may provide some near-term support, at least vs. the euro and the British pound.

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## Norwegian Krone (NOK)

The krone tracked equity markets closely in October to lose 3.0% vs. the G10 average, the worst performance in the group. The krone has been the most highly correlated with equity markets among the developed market currencies over the past several years.

It is not surprising to see it lower as equities fall. Another key driver is oil prices, which were also down substantially, though the krone did bounce higher alongside oil prices immediately following the 7 October Hamas attack on Israel.

Finally, in addition to equity markets and oil, the krone, like nearly all currencies, has been sensitive to the monetary policy outlook. A downside surprise in core inflation on 10 October — +0.4% MoM vs. +0.7% expected — weighed on the monetary policy outlook and the krone.

Later in the month, the stabilizing equity market helped but the krone struggled to bounce following a negative surprise in retail sales on 27 October and a 31 October announcement that the Norges Bank planned to increase daily oil-tax-related krone sales by NOK 200 million a day in November.

Our short- and medium-term models flipped from positive to negative on the krone in October due to falling oil prices, weaker equity markets, and a less hawkish monetary policy outlook. That said, equity markets have fallen three months in a row, global (and particularly US) interest rates appear to have moved too high too fast, and we expect oil to rebound on constrained supply. We see risks that the factors driving the models negative may reverse yet again and, consequently, we remain cautious on expressing strong short-term views on the krone. In the long term, the story is more positive. The krone is historically cheap relative to our estimates of fair value and is supported by steady potential growth.

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## Swedish Krona (SEK)

The krona lost 1.1% relative to the G10 average and 2.6% vs. the euro in October despite hopes that the new Riksbank policy to hedge 25% of its foreign exchange reserves would support the currency. Hedging 25% of foreign exchange reserves effectively means the bank will buy krona and sell reserves to the tune of about USD 8 billion and EUR 2 billion.

During the first half of the month, the positive bias following the reserve hedging announcement seemed to be intact. The krona rose against the G10 average till 16 October despite both manufacturing and services PMI data disappointing expectations and a weaker-than-expected August GDP print on 10 October (-0.2% MoM compared to -0.1% expected). GDP is on track to be negative for 2023.

On 13 October, core inflation surprised higher — at 0.5% MoM for September — but the krona fell on the day. As equity markets accelerated to the downside at mid-month and the US dollar to the upside, the krona trended lower.

We remain neutral to modestly negative on the krona in response to the weaker economic outlook and poor local equity market performance. However, given the upside inflation surprise and the ongoing Riksbank reserves-hedging program, we see limited downside. 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.

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## Australian Dollar (AUD)

The Australian dollar notably outperformed other commodity and risk-sensitive currencies to only lose 0.2% relative to the G10 average. The month began on the weak side as US yields surged higher and the Reserve Bank of Australia (RBA) held its policy rate steady at 4.1%, albeit with the requisite hawkish warning that it would hike again if needed.

The positive US inflation surprise on 12 October sent the Australian dollar sharply lower, after which it began to recover some lost ground, helped by the hawkish RBA minutes released on 17 October, as well as a better-than-expected Chinese GDP print.

A positive Australian inflation surprise on 24 October played into that more hawkish RBA theme, triggering a sharp rise in both Australian yields and the Australian dollar. Markets gradually priced a greater chance of an RBA rate increase at its November meeting, sending the Australian dollar gradually higher through the final week of October. A jump in September retail sales reported on 27 October also likely helped support the currency into month-end.

We acknowledge the increased probability of another RBA policy rate increase and the relative resilience of the Australian economy compared to Europe and Scandinavia. However, our models continue to see medium-term risks tilted to the downside on weak commodity prices and the ongoing, though gradual, slowing of the economy.

We see potential for a near-term bounce in the Australian dollar as commodities and equity markets appear a bit oversold and are due a recovery. Should that happen, we expect the gains to be limited by a fragile global growth outlook and high geopolitical risk, which conspire to create a poor environment for the Australian dollar, especially when its economy is under pressure and Australian interest rates remain middling compared to the rest of the G10.

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 expensive against the yen and the Scandinavian currencies.



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## New Zealand Dollar (NZD)

The New Zealand dollar lost 1.4% relative to the G10 average in October. Higher US yields at the start of the month pushed the New Zealand dollar lower. The Reserve Bank of New Zealand (RBNZ) met on 3 October and kept the policy rate at 5.5% as expected, noting that the rate would likely have to remain at current restrictive levels for an extended period. Markets were not impressed, and the New Zealand dollar continued to move lower.

A fall back in US yields and a rebound in equity markets though 10 October helped the New Zealand dollar recover back into positive territory for the month. That did not last. The Hamas attack and the US CPI surprise on 12 October sent both the New Zealand dollar and global equity markets lower through mid-month.

A negative inflation surprise in New Zealand's Q3 inflation — 5.6% YoY vs. 5.9% expected — added to downside pressure on the currency during that period. Late in the month, stabilizing equity markets and less regional pessimism following China's upside GDP surprise helped stabilize the currency into month-end but was not enough to trigger a material recovery.

We remain pessimistic on the New Zealand dollar over the near term. Recession risk and the weak external balance — the current account is -8.1% of GDP — more than offset any benefit of high yields, particularly now that the RBNZ has likely ended its tightening cycle. Any further relief from the pessimistic Chinese growth theme is likely to prove temporary. We expect the Chinese growth outlook to remain sluggish over the next few 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 room to appreciate, but is expensive against the yen and the Scandinavian currencies.



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