Maybank

FX

Global

FX Insight

Focusing on FX Reactions to Central Bank Actions

What happens to FX when Central Banks Moves in 2024?

We assessed the broad general USD and key DM FX average moves when the Fed cuts since 1995. Inevitably, if we control for other non-Fed factors such as crisis, growth disparities and portfolio flows, there is expectation for the USD to hold true. However, these central bank decisions and the currency do not exist in a vacuum. The start of the Fed's easing cycle could spur a broad USD move but it does not necessarily bring about USD weakness.

We looked at easing episodes since 1995 and found that the state of the global economy, the launch of extraordinary measures (such as QE) and to some extent the presence of a crisis (GFC/Covid pandemic) and the nature of it could swing the greenback. The USD could strengthen even as rates were slashed in an environment of a global growth slowdown due to its countercyclical nature and the presence of late cycle risks (as seen in the easing cycles which began in 1995 and 2001). In 2007 and 2019, global growth was still holding up relatively well and the USD softened once Fed cuts rates. **For this year, a global growth recovery is expected alongside a US soft-landing. Such an environment should see a mild decline in the USD.** We also note a contrast in USD behavior in the easing cycles before and after GFC. We note that recent easing cycles (since GFC) saw more USD weakness as markets are likely more confident that governments and central banks are prepared to deal with crises swiftly. Episodes of risk aversion could thus be shortened.

Based on FX reaction in past easing cycles of regional banks, we found that early movers may not necessarily put their currencies at risk. However, aggressive movers will deal the greatest damage to their currencies. Currencies with lower yields will also tend to be under pressure more compared to peers. **At this point, central banks who start easing later are likely to maintain carry advantage. As such, INR, IDR, PHP, SGD and AUD could outperform CNY, THB, CHF. The CHF in particular could remain under pressure since the SNB has started to ease. Its interest rate is not high to begin with and further cuts (we expect another two) could keep the CHF on the backfoot.**

At the same time this year other central banks such as the BOJ and Central Bank of Taiwan have hiked rates. **The BOJ move in particular will have an impact on the JPY and currencies which are sensitive to it. The BOJ with one swoop had ended NIRP, YCC and ETF/JREITs purchases on the 19 Mar 2024.** Whilst Ueda had not hinted at further tightening, we would not take this at face value and **actually believe that the central bank could raise rates by 25bps each in Oct 2024 and Jun 2025. On the regional currencies, we see that the KRW, THB and IDR are the currencies which are likely to benefit most from the JPY strength although we also note that DXY has a bigger effect on these currencies.** Any DXY strengthening can risk offsetting the benefits from a JPY appreciation. Overall, we take a cautious view on the USDJPY, seeing that the upside on it maybe limited, especially beyond the 150.00 level. Overall, we do though see more downside potential for the USDJPY than there is upside.

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FX Reactions to Central Bank Actions

This report is mainly split into three sections. The first section answers the pertinent question of what happens to currencies when the Fed cuts and do currencies necessarily weaken when their respective banks start to ease. In the second section, we took the opportunity to elucidate our base case for ECB, BoE, and SNB. Given that BoJ has started to buck the trend with a rate hike recently. We take a deep dive in our last section on what is the likely path ahead for this major central bank, its impact on the JPY and regional FX.

Since the start of the year, markets have been stuck in a calibration mode with the Fed now only expected to deliver -75bps cut for 2024 vs. -140bps at the stasrt of the year and with persistent pushback from Fed officials on rate cut expectations. While the Fed remains the most closely watched, monetary policy trajectories for other central banks are also worth monitoring. It is widely expected that whichever central bank that moves first would probably see more short-term pressure on their respective currencies. That could partially explain the recent plunge of the CHF after SNB became the first rate major DM central bank to ease policy.

Fed's Easing Cycles Have Different Effects on Currencies in Past Episodes

We first look into the past few decades to find out whether the Fed's easing cycles have always been positive for non-USD currencies.

We found that since 1995, there have been four episodes of Fed easing cycles, and the start of the Fed's easing cycle does not necessarily translate to gains for non-USD currencies. It is worth noting that the rate cut by the Federal Reserve in Jul 1995 and Jan 2001 saw the DXY strengthen by +4.1% and +8.6% in the next 180 days that follow respectively. Major currencies (including EUR, GBP, CHF, JPY, CAD, AUD and NZD) mostly clocked losses against the greenback, especially in 2001. Asia ex Japan FX also mostly treaded water in those period.

However, **when the Fed started easing in Sep 2007 and Jul 2019, the DXY index fell over the 180 days after.** The USD decline was more pronounced in 2007. Looking at the individual currency pairs, the major currencies also strengthened against the greenback then. Impact on the Asian currencies were more muted, albeit still positive. **Looking at these historical patterns, there seem to be a broad-based move in the greenback that happens but the underlying reason could be more nuanced than just a rate cut.**

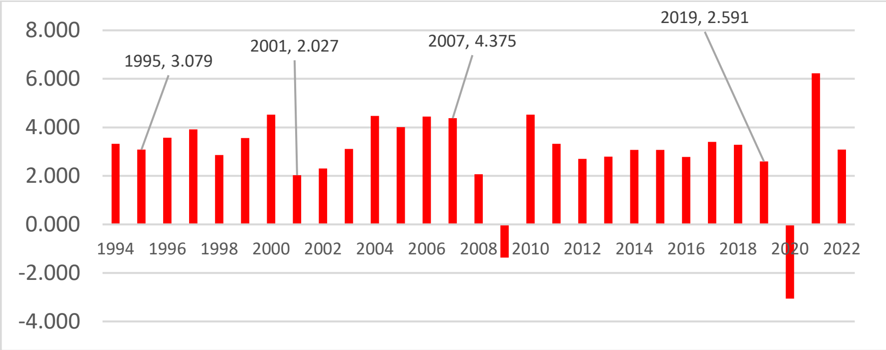
Table 1: FX Changes 180days after the start of each easing cycle since 1995

Date of the First Rate Cut by the Fed	DXY index	Major Currencies	Asia ex Japan Currencies
31-Jul-19	-0.57	1.12	0.96
18-Sep-07	-9.53	10.31	3.62
3-Jan-01	8.62	-6.77	-3.96
6-Jul-95	4.13	-3.23	-3.52

Note: Currency performances are taken as % change against the USD (except for the DXY index) 180 days after.
Source: Bloomberg, Maybank FX Research & Strategy

A quick look at the macro environment in those 4 periods highlight the fact that global GDP growth slowed modestly in 1995, 2001. In 2007, global growth was rather strong when the Fed delivered its first cut of its easing cycle. That is when the DXY index clocked the steepest decline. In 2019, global growth was also only starting to slow and that could explain why the USD was less moved. **The counter-cyclical nature of the USD was one of the key determinants of its direction during those period given late cycle risks.**

Chart 1: GDP growth (annual %) - World

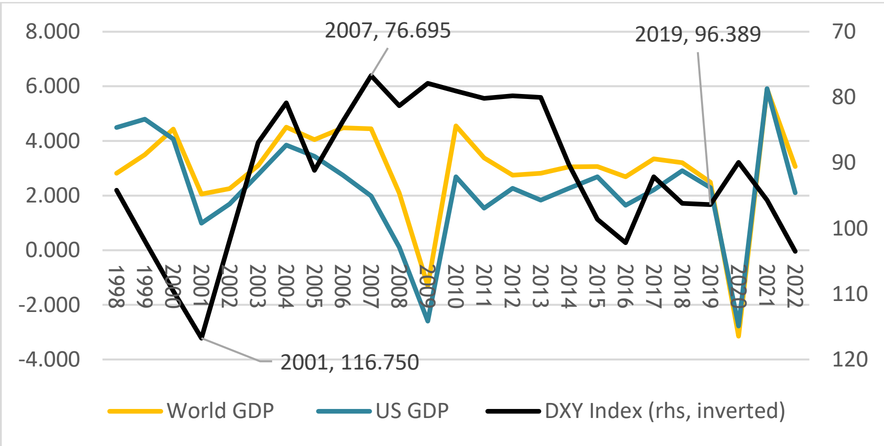


Source: World Bank, Maybank FX Research & Strategy

Chart 2 shows a clearer growth momentum of the world as well as the US since 1998. Most of the time, the global growth slowdown is in tandem with the US. When global growth slows (along with the US), the USD will strengthen, except when Fed unleashes quantitative easing (2008 and 2020).

Quantitative easing is one of the extraordinary measures utilized by the Fed/ECB/other central banks for the first time in global financial crisis. BoJ started it in 2001. In 2020, there were also a number of extraordinary measures being utilized to support financial markets, banking systems during the pandemic and the great lockdown and they were implemented within days, reacting swifter than they did in GFC and the days of the European debt crisis. It could be of no coincidence that USD tends to display less strength in recent easing cycles simply because governments and central banks are able to deal with late cycle risks faster and risk-off periods are thus not as prolonged as before.

Chart 2: Countercyclical USD Strengthens when Global Growth and the US Slow



Source: World Bank, Bloomberg, Maybank FX Research & Strategy

The movements of the currency blocs on Table 1 suggest that the USD likely had a broad-based move during most of the episodes of Fed cuts. Table 2 shows the impact on individual currencies,

Table 2: Individual FX Changes 180days after the start of Fed's easing cycles since 1995

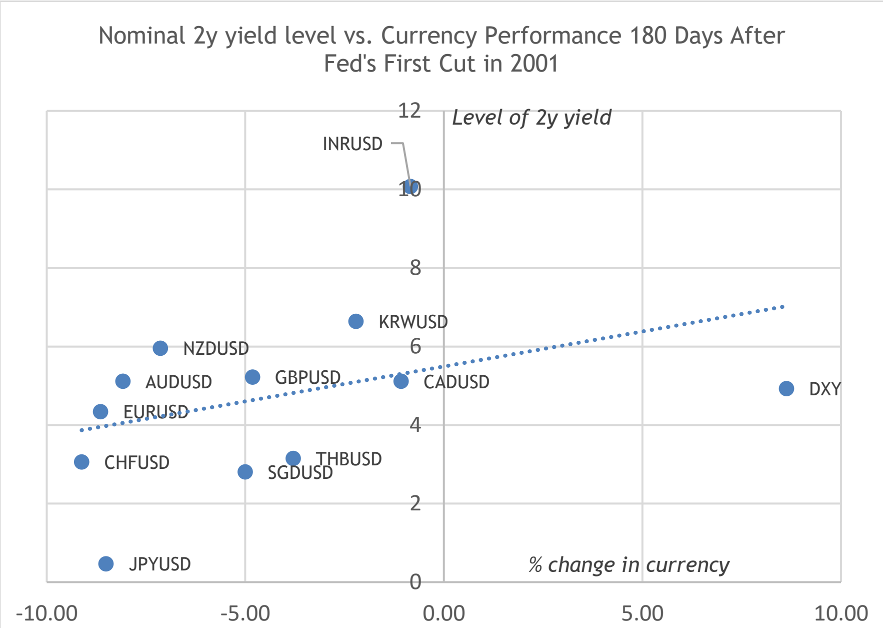
	DXY	EURUSD	GBPUSD	CHFUSD	JPYUSD	CADUSD	AUDUSD	NZDUSD	CNYUSD	KRWUSD	TWDUSD	THBUSD	MYRUSD	SGDUSD	IDRUSD	INRUSD
31-Jul-19	-0.57	-0.51	7.39	2.51	-0.11	-0.01	-1.23	-0.17	-0.39	0.83	3.49	0.67	1.36	1.21	3.69	-3.16
18-Sep-07	-9.53	12.09	0.35	18.30	17.17	2.39	9.92	11.93	6.12	-7.07	7.74	1.66	9.49	9.55	1.46	0.05
3-Jan-01	8.62	-8.64	-4.82	-9.12	-8.51	-1.08	-8.08	-7.14	0.00	-2.21	-4.00	-3.79	0.00	-5.00	-15.86	-0.84
6-Jul-95	4.13	-1.98	-2.91	-1.27	-18.27	1.04	4.37	-3.57	-0.22	-2.41	-5.21	-2.02	-3.74	-1.27	-2.54	-10.78

Note: Currency performances are taken as % change against the USD (except for the DXY index) 180 days after the first cut.
Source: *Bloomberg, Maybank FX Research & Strategy*

The inextricable relationship between exchange rates and their respective interest rates compelled us to look into the 2yr yields of the respective sovereigns' bonds in order to check their effects on currency performances.

If we simply compare the levels of the 2yr yields and currency movements, we found that the level of the 2yr yields at the start of the easing cycle somewhat corresponds with the performance of the currency 180 days from start of the Fed easing cycle in 2001. **This suggests that the higher the carry of any currency at the start of the easing cycle, the likelier the outperformance of the currency in an environment of global slowdown and USD strength.**

Chart 3: Currency movements vs. Level of their nominal 2y yield at the start of the easing cycle in 2001



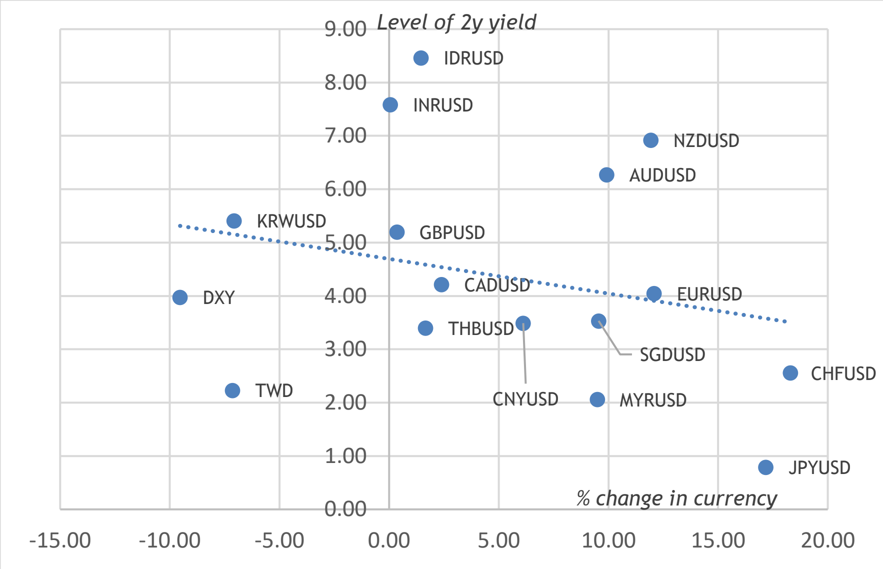
Note: Yield data for MY, ID were unavailable for 2001.

Source: Bloomberg, Maybank FX Research & Strategy

Due to the lack of data, we did not do a similar comparison for the easing episode in 1995.

The next easing cycle of the Fed (2007) was spurred by the Global Financial Crisis – a crisis that was triggered by the bursting of the US housing bubble and led to a meltdown of the global financial sector. Even though it resulted in the Great Recession, the developed economies were impacted more than the developing ones (such as countries in Asia). Given that the nature of the recession was US-centric, the USD declined. In addition, the launch of the quantitative easing programs also weighed on the USD further. We also found that the level of nominal yields no longer predicts the currency performance.

Chart 4: Level of their nominal 2yr yield at the start of the easing cycle in 2007 Cannot Predict the Currency Performance



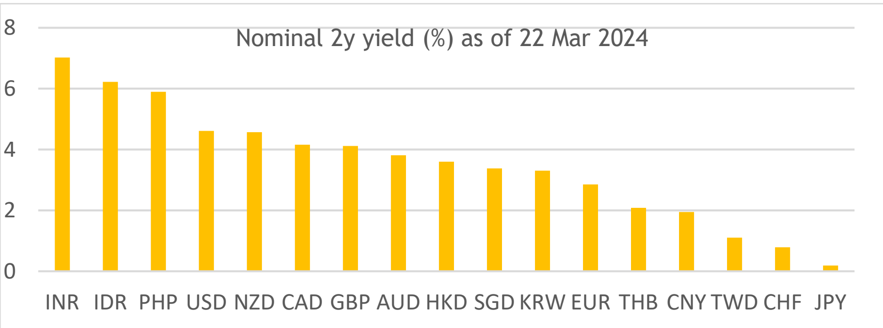
Source: Bloomberg, Maybank FX Research & Strategy

One reason that might have skewed this picture is the fact that during the global financial crisis, the financial markets were more affected for a longer period of time. That led to the outperformance of the safe haven JPY and CHF. A crisis is clearly not what we are looking for this year although we cannot rule out the risk.

The study of the 2001 and 2007 Fed easing episodes reveals that during late phases of economic cycle, growth outturns could still largely determine the currency movements. The US recession as well as the slowdown for the rest of the world was rather sharp in 2001. USD strengthened as a result. In such an environment of USD strength, the respective levels of 2yr sovereign yields at the start of Fed's easing cycle may be able to predict the currency relative resilience for the six months following the first rate cut by the Fed.

If global growth continues to slow throughout 2024, based on the current 2yr yield level, we can expect INR, IDR, PHP could remain relatively resilient vs. JPY, CHF, TWD and CNY. That is if we are stuck in a phase of global growth slowdown.

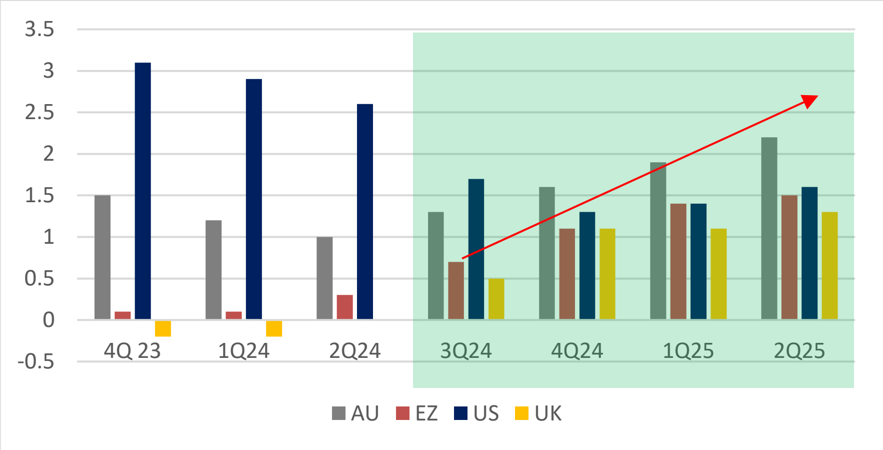
Chart 5: Higher Yield Could Provide Buffer in a World of Stronger USD



Source: Bloomberg, Maybank FX Research & Strategy

However, that is not our base case scenario. The current macro environment could be slightly different from what we witnessed in past rate cut years. US economic' exceptionalism has been keeping the USD supported on dips thus far. However, as we get further along in 2024, we are looking for the potential for a recovery in major economies (especially in 2H) based on the consensus forecasts of Bloomberg survey of private analysts.

Chart 6: Bloomberg Median Forecasts of Real GDP (%y/y)



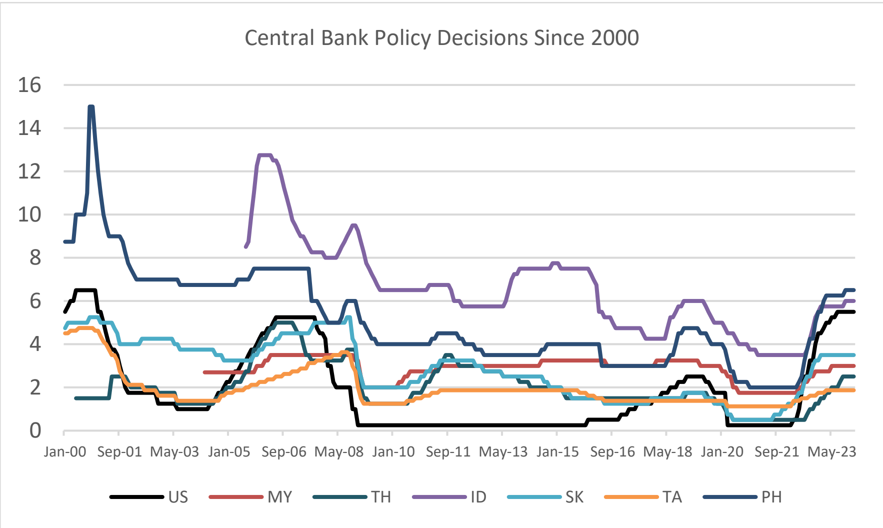
Source: Bloomberg, Maybank FX Research & Strategy

Such an environment of recovery could mean that the USD should weaken against most currencies when the Fed cuts this time.

The effects of Rate Cuts in the Region on Currencies

We then took a look at the easing cycles of regional central banks to see whether easing cycles are normally in sync with the Fed. It is apparent on Chart 7 that since 2000, regional central banks do tend to hike and cut rates together with the Fed.

Chart 7: Regional Policy Rates Do Rise and Fall with the Fed's Most of the Time in Recent History



We looked for episodes where there are divergences between the Fed and specific regional banks possibly due to domestic idiosyncratic factors. Since we are on the cusp of easing monetary policies with higher-for-longer narrative still a risk for regional currencies, we focus on instances where regional banks cut and Fed hikes or instances where regional banks cut ahead of the Fed.

Chart 8a: Fed and BNM Policy Actions

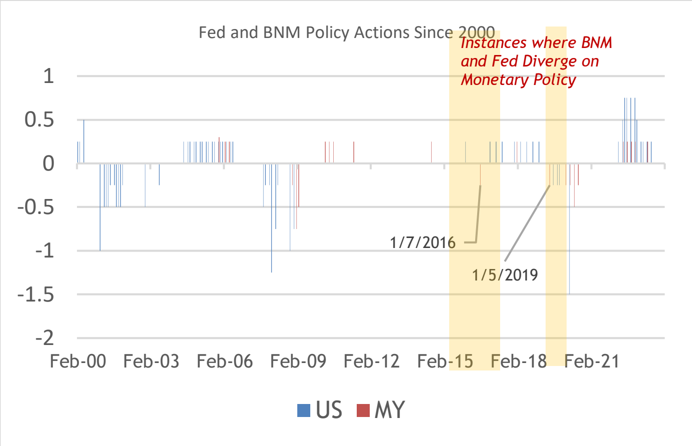


Chart 8 b: Fed and BI Policy Actions

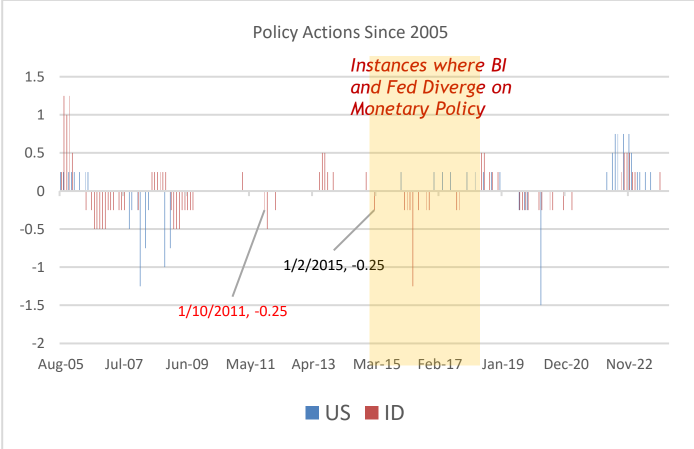


Chart 8c: Fed and BoK Policy Actions

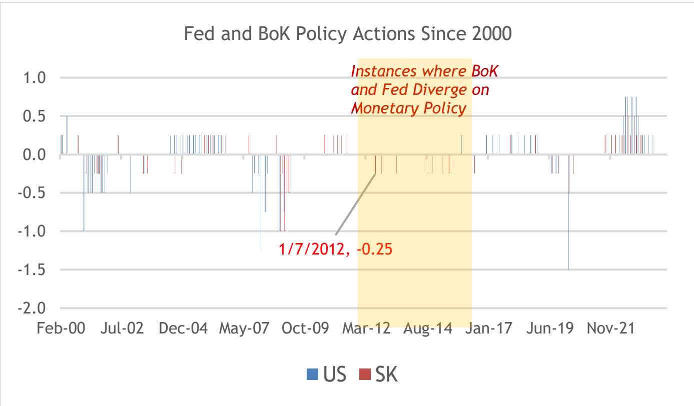


Chart 8d: Fed and CBC Policy Actions

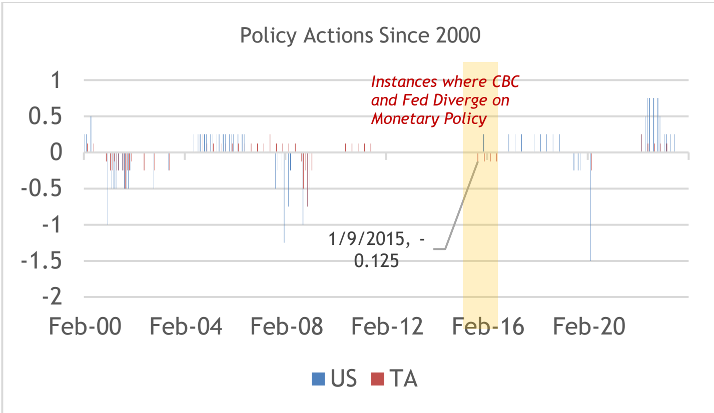
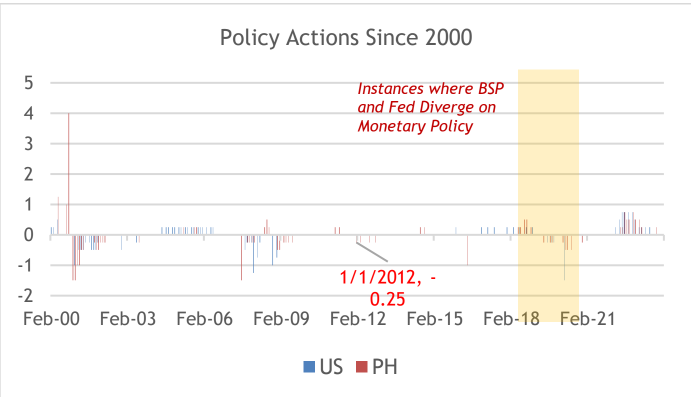


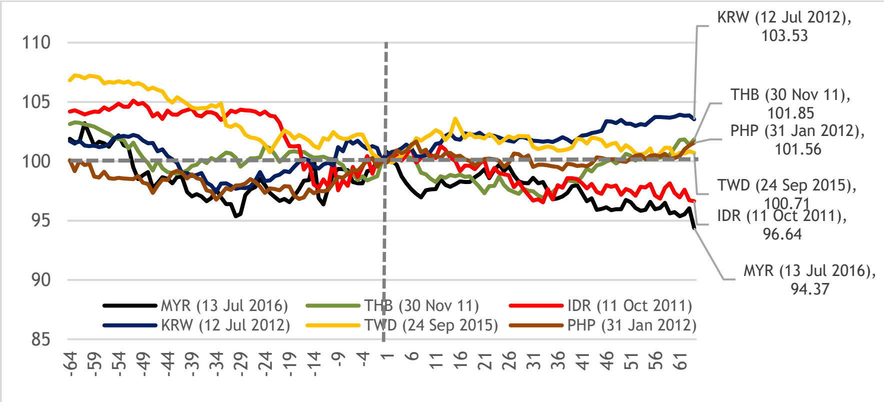
Chart 8e: Fed and BSP Policy Actions



Source: Bloomberg, Maybank FX Research & Strategy Estimates

So based on the episodes teased out in the charts above, we looked at the currency performance in the region and found that rate cuts that are done ahead of the Fed or without a Fed cutting rates in tandem do not necessarily result in weakness in the respective currencies. KRW, THB, PHP strengthened in varying extents when BoK, BoT and BSP cut policy rates then. On the other hand, TWD, IDR and MYR declined after their respective central banks cut policy rates.

Chart 9: When Regional Central Banks Deviate from the Fed in Cuts



Source: Bloomberg, Maybank FX Research & Strategy

Note: Day 0 is the day of that the relevant central bank cut policy rate. While period is taken to be 90 calendar days before and after the day of rate cut, only the price action on business days are shown in the chart. Currency performances are measured against the USD.

We looked into the reasons for such varied outcomes.

1) KRW strengthened after BoK cut in Jul 2012 as it was one of the latest in the region to ease in that period. Fed kept rates at 0% from Jan 2009 - Dec 2015. So moderate rate cuts by BOT (2011), BSP (2012), BoK (2012) and CBC (2015) did not have a significantly negative effect on their respective currencies. Potential for growth to be boosted as well as bond inflows likely contributed to the strength of these currencies. TWD gains were noticeably lower as Fed had already signalled the end of QE and a potential start of rate hikes.

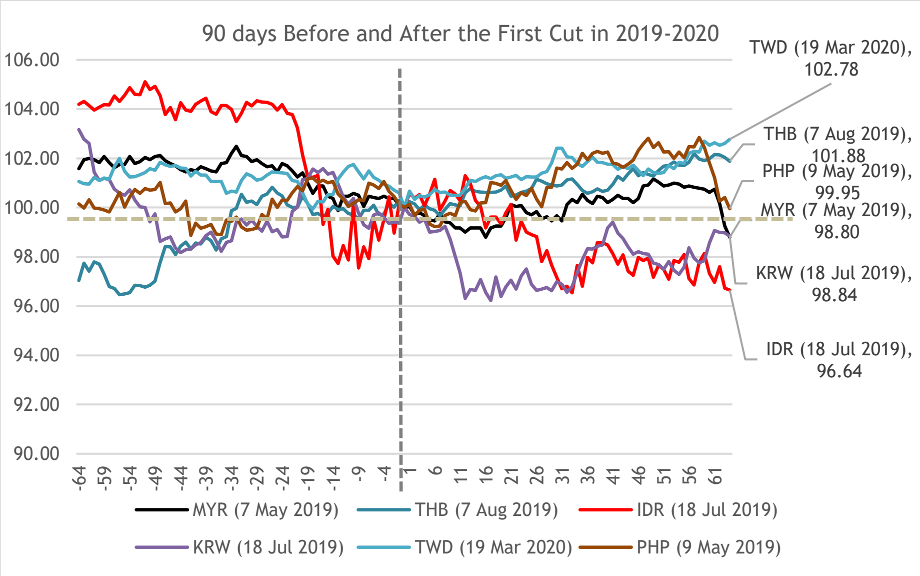
2) IDR was an exception, slumping significantly when BI started easing policy in Oct 2011. Curiously, its policy rate was one of the highest within the region and in addition, there was also sizeable capital inflows for Indonesia then due to the high interest rate. BI was the first to cut amongst regional banks and proceeded to slash policy rate by a steep 75bps over two months. As such, IDR was under pressure and there was outflows as carry unwinds. So what we learn here is that the first mover gives the currency a disadvantage. An aggressive central bank could also hurt the currency a tad more. In addition, the level of foreign inflows before the rate cut matters as there could be a risk of outflows once the policy settings shift drastically.

3) MYR underperformed when BNM eased overnight policy rate unexpectedly in 2016 as the Fed had started to hike in 2015. That policy divergence weakened the currency.

So in all, currencies tend to be more resilient if their central banks are not the first to act, do not cut rates aggressively and have not previously benefitted from carry trades and concomitant capital inflow. However, we note most of the above deviation from the Fed happened when US rates were near zero.

We zoom in on 2019 Fed easing cycle when the US economy was still resilient and policy was at a more elevated level. The first rate cut was a “recalibration” of policy by Powell. This period could be one that is more similar to current environment.

Chart 10: When Regional Central Banks Ease with the Fed in 2019



Source: Bloomberg, Maybank FX research & Strategy

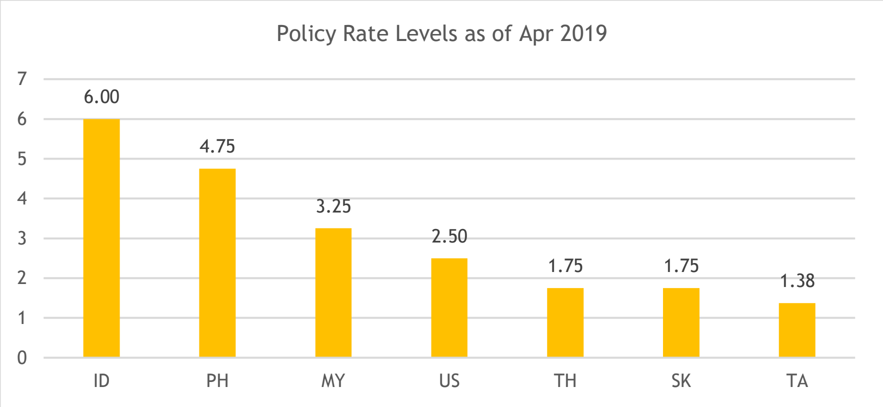
The price action shown in chart 10 suggests that even though BNM and BSP were the first to cut and they did so ahead of the Fed, their currencies were rather stable. In contrast, KRW and IDR were the worst performing even though they acted in the same month as the Fed on its first cut. One reason could be that BI cut rates aggressively thereafter (once per month between Jul to Oct 2019). One thing to note is that the CBC did not ease at all in 2019 and only started easing in 2020, when QE was unleashed and regional peers had already eased substantially. TWD outperformed after its 2020 cut.

Table 3: Rate Action by the Fed and Regional Banks in 2019-2020

	US	MY	TH	ID	SK	TA	PH
Apr-19	0	0	0	0	0	0	0
May-19	0	-0.25	0	0	0	0	-0.25
Jun-19	0	0	0	0	0	0	0
Jul-19	-0.25	0	0	-0.25	-0.25	0	0
Aug-19	0	0	-0.25	-0.25	0	0	-0.25
Sep-19	-0.25	0	0	-0.25	0	0	-0.25
Oct-19	-0.25	0	0	-0.25	-0.25	0	0
Nov-19	0	0	-0.25	0	0	0	0
Dec-19	0	0	0	0	0	0	0
Jan-20	0	-0.25	0	0	0	0	0
Feb-20	0	0	-0.25	-0.25	0	0	-0.25
Mar-20	-1.5	-0.25	-0.25	-0.25	-0.5	-0.25	-0.5
Apr-20	0	0	0	0	0	0	-0.5

Another reason could also be because policy rates for Bank Indonesia and Bank of Korea then were near opposite ends of the spectrum. As such, threat of interest rate differential compressions and concomitant carry trade unwinding might have hurt IDR more while Bank of Korea's rate cut brought its already-low level of interest rate even lower, dimming the allure of the KRW further. In addition, its exports were sluggish that year. BNM was the first to move then but MYR was relatively resilient.

Chart 11: ID had the highest policy rate while South Korea was near the bottom within the study group



Source: Bloomberg, Maybank FX Research & Strategy

Our findings in a summary…

We had two sub-sections within this part of the report – **The impact of Fed's rate cut on currencies and the impact of rate cuts by regional banks on their currencies.** We found that the first rate cut by the Fed could spur a broad USD move in the 180 days after but it does not necessarily bring about USD weakness as it depends on the macro and market context at the time. For instance, the state of the global economy, the presence of extraordinary measures (QE) and to some extent the presence of a crisis (GFC/Covid pandemic) and the nature of it affect the directional bias of the greenback. In essence, relative growth differentials and rates differentials (carry) as well as safe haven (risk premium) considerations affect the currency movements at the same time when the Fed eases and mitigates or accentuates the currency moves. The USD tends to strengthen even as rates were slashed in an environment of a global growth slowdown because of the countercyclical nature of the greenback. In 2019 when global growth was still holding up relatively well, the USD softened slightly upon a rate cut. We also note that more recent easing cycles typically see more USD weakness as governments and central banks are more prepared to react swiftly to any late cycle risks that could unfold. Extraordinary measures such as QE will increase the degree of monetary policy accommodation and weaken the USD.

We then look at regional banks' rate cuts, the timing of their first cut compared to the Fed and their effects on their respective currencies. Fed kept target rate at near zero between the period of 2009-2015 and as such, even if regional banks cut rates, currencies were not affected and sometimes, they even strengthened on bond inflows and stronger growth prospects. We then looked at 2019 - a year when the global growth is still holding up well (including the US). Fed was also not in a hurry to ease and only cut rates thrice in that year, similar to Fed's latest guidance. **We found that central bank monetary policy moves provide the most significant impact to their currencies when they cut aggressively (IDR then) or when the level of interest rates were already low to begin with (KRW).** Other regional currencies were less impacted.

The current environment is somewhat similar to 2019. In a scenario of a modest recovery in global growth in the latter part of 2024 alongside a soft-landing in the US, we could see this being **negative for the USD when the Fed starts to cut in 2H 2024.** This could still be offset moderately by the typical USD strength heading into the US elections in Nov.

We looked at the 12-month rolling sum of net bond flows in Chart 12a and b and found that bond flows into regional sovereigns have mostly pared with the exception of South Korea which seems to be still on the rise, possibly due to the prospect of World Government Bond index (WGBI) inclusion. That could mean some risks that KRW could be undermined by a BoK rate cut. However, continued electronics and exports recovery could offset the weakness in the KRW and the currency could even be given added boost if South Korea is eventually included in the WGBI.

Chart 12a: 12-month rolling sum of net bond flows

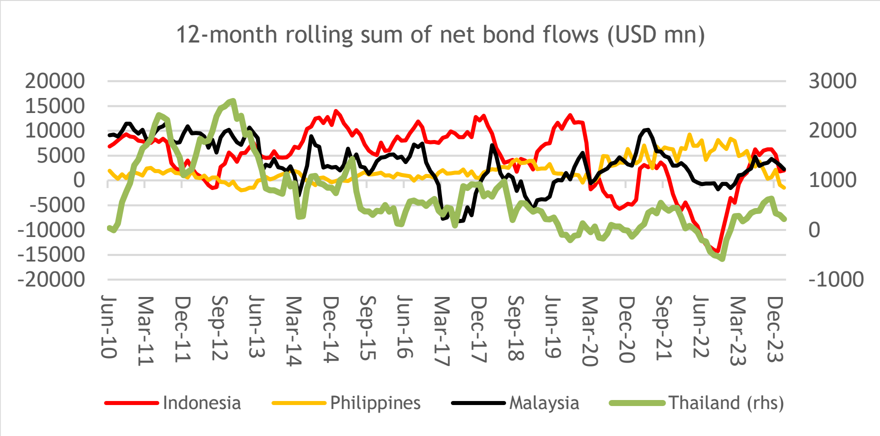
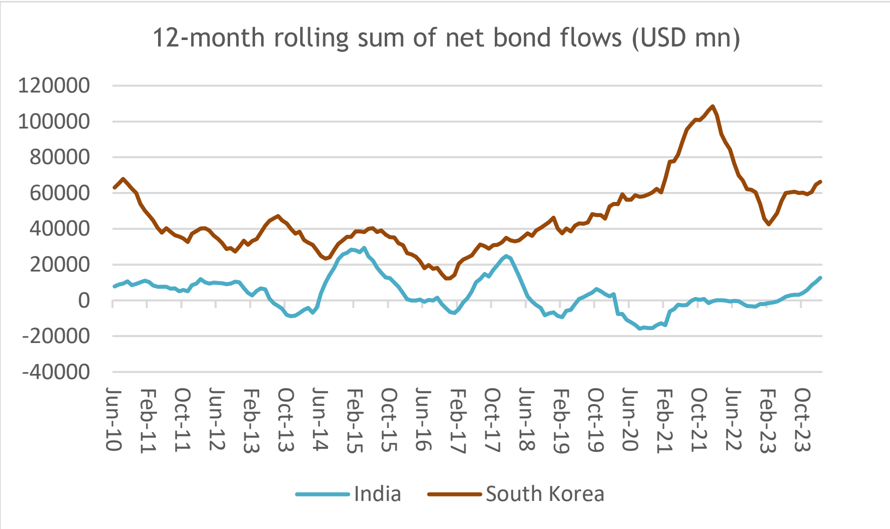


Chart 12b: 12-month rolling sum of net bond flows (India, South Korea)

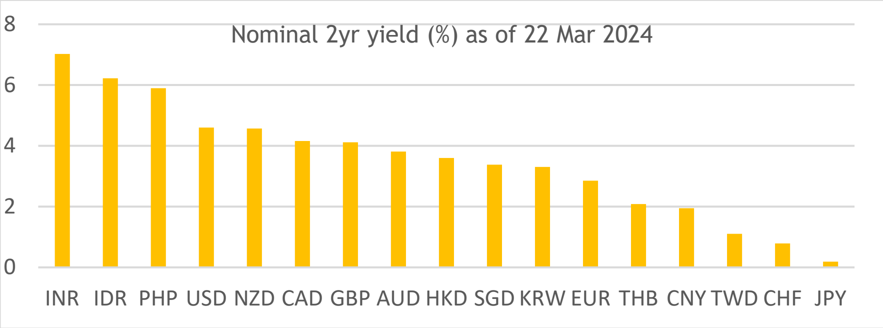


Source: Bloomberg, Maybank FX Research & Strategy

BI has been repeatedly stressing on keeping IDR stable and that could mean that their rate cuts have to be measured this year. Aggressive rate cuts in the past have undermined the IDR. Net bond inflows seem to be trending lower, reducing the chance of a reversal when BI cuts policy rate. As such, IDR may have a chance to retain resilience when BI eventually normalizes monetary policy. The same goes for the PHP.

PBoC is expected to ease monetary policy as well. Our economist expects the central bank to guide 1Y LPR and 5Y LPR lower by 45bps this year. Referring to Chart 13, 2yr yield for China is already low. CNY could remain under pressure alongside CHF (SNB has started to cut first) and to some extent, TWD.

Chart 13: Nominal 2y yield as of 22 Mar 2024



Source: Maybank FX research & strategy, Bloomberg

With most central banks at the brink of gradual easing and global growth potentially recovering (manufacturing has started to show signs of cyclical upturn), a low volatility environment may keep the higher yielding currencies underpinned on carry advantage. **Central banks who start easing later are likely to maintain that carry advantage. As such, INR, IDR, PHP, SGD (expect slight easing only in Oct) and AUD could outperform CNY, THB, CHF.**

In a scenario where growth disappoints and continue to weaken, the USD is likely to strengthen across the board. We expect this to be the case in 1Q and now likely to continue in 2Q 2024 given latest developments. But if the situation extends into 2H 2024, currencies that have the highest yield at the start of the easing cycle could potentially have better resilience against the USD. **These include the GBP, especially if they also move with a lag after a Fed cut.** We expect BoC to be one of the first central banks to act early and that could reduce the yield allure of the CAD. **INR may also be favoured. We leave out NZD, AUD, CAD in this scenario as their cyclical nature could work against them in such a poor growth environment.**

This section allows us to elucidate our base case view for a few of the G7 central banks

Base Case for the ECB

We see three 25bps cuts for the ECB this year to bring their deposit facility rate to 3.25% (currently: 4.00%), main refinancing rate to 3.75% (currently: 4.50%) and marginal lending facility rate to 4.00% (currently: 4.75%). This is broadly in line with consensus forecasts by economists at 75bps of cuts by year end and slightly more hawkish than current market pricing of roughly 100bps of cuts by year end. In general, we think that central banks are waiting for the Fed to cut rates first to avoid an adverse impact on their currencies and the ECB is no exception to this. As we have previously stated, we think that if the ECB cuts after or alongside the Fed or if Eurozone growth prospects improve, the EURUSD need not weaken and could in fact strengthen or remain supported. This is in line with our narrative for a bottoming of growth prospects in the Eurozone. We have seen evidence of this when EURUSD rallied even as the ECB tilted a bit more dovish. We saw once again that following the 21 Mar FOMC, where the Fed all but confirmed three rate cuts in 2024, EURUSD was one of the better performers. Our models imply that the EUR is slightly overvalued at 1.3% (Maybank BEER) to slightly undervalued at 0.7% (FX short-term tracking).

The ECB has perhaps been the most forthcoming central banks in terms of forward guidance and their considerations related to rate cuts. While the disinflationary path for the Eurozone remains intact, Lagarde offered three considerations for the ECB to be able to cut rates. Firstly, wage growth data needs to confirm if wages are growing in line with inflation sustainably reaching the ECB target by mid-2025. Secondly, whether corporate profit margins compress and allow inflation to reach ECB target without weighing too much on the labour market. Lastly, whether there is meaningful productivity growth which would allow the Eurozone to grow as inflation comes off i.e. an improvement to real growth outcomes. ECB officials and Lagarde have alluded to cuts being considered soon, with Lagarde signalling that Jun was a key month for rate cuts. However, Lagarde also cautioned that decisions will remain data dependent and that the ECB would not be able to commit to a particular rate path even after the first rate cut. Upcoming ECB decisions are on 11 Apr and 6 Jun and both the data in the lead up to the decisions and the decisions themselves should be key.

At this stage, we do reiterate that we see EURUSD gradually higher into 2024 amid Fed rate cuts, the fading of US exceptionalism and a bottoming of Eurozone growth prospects.

Base Case for the BOE

We see three 25bps cuts for the BOE this year to bring the BOE policy rate to 4.50% (currently: 5.25%). This is slightly more hawkish than consensus forecasts by economists of about 100bps of cuts by year end and roughly in line with market pricing of around 75bps of cuts by year end. GBPUSD is a standout performer in the G10 FX space YTD and remains the only currency to be outperforming the USD (as of 21 Mar 2024). The outperformance has been largely driven by the narrative that the BOE may be able to hold off rate cuts and we think that there is a risk that this could reverse and that GBP outperformance could fade amid numerous headwinds. Our models imply that the GBP is about 2% (Maybank BEER) to 3% (FX short-term tracking) overvalued.

The BOE has not been as forthcoming (as the ECB or the Fed) in terms of forward guidance or their considerations on rate cuts. Disinflation is intact in the UK, however certain specific inflation indicators such as services inflation and PPI and RPI measures are mixed in showing that some inflationary pressures remain. A key consideration that the BOE has is also that of wage growth, which likely remains the single largest stumbling block for the BOE to pivot to rate cuts. Both the BOE and private sector economists forecast moderation to wage growth in the coming months. There are also signs of the labour market softening with 133k job cuts in the three months to Jan, where redundancies were at the highest level since 2021. In addition, the unemployment rate in the three months to Jan edged up to 3.9%, the first increase since summer 2023. Both the BOE and private sectotr economists expect a lackluster year for the UK economy. Overall, signs point to an impending pivot to rate cuts for the BOE, although they could also be waiting for the Fed to move first. At the Mar meeting, hawks (Mann & Haskel) on the BOE MPC dropped their call for hikes in an 8-1 vote in favour of holding rates, with a sole dove (Dhingra) voting for a 25bps cut. Governor Bailey said that the BOE was “on the way” to victory over inflation, and that they need not wait for inflation to fully abate before cutting rates. Odds for a Jun BOE cut have risen to 54.2% (prev: 40.7%).

We do maintain our forecasts for the GBPUSD which see the pair at 1.27 by year end. We believe that GBP outperformance can fade and an impending pivot to rate cuts by the BOE could be one of the factors to drive this. Moreover, the GBP faces headwinds such as the loss of the EU common market from Brexit, shrinking fiscal space as taxpayers are made liable for BOE QE losses (£38b transferred to BOE since Oct-22) and political uncertainty with elections due to be held no later than Jan 2025.

Base Case for the SNB

We see three 25bps cuts for SNB this year to bring the SNB policy rate to 1.00% (currently: 1.75%). This is broadly in line with both consensus forecasts and market pricing of 75bps of cuts. SNB was the first major central bank in the world to cut rates on 21 Mar in a surprise move. Some suggested that SNB should not play the waiting game with other central banks and cut on their own next week given that the risk to inflation in Switzerland is no longer to the upside.

The key reason provided for the SNB pivot to rate cuts is the relative strength of the CHF. Dec marked a key pivot in Swiss FX policy with interventions no longer being one-sided in favour of supporting CHF strength. One possible theory is that the surprise cut would help cap CHF strength and reduce the need for intervention to weaken the CHF as such interventions could bloat the SNB's already large balance sheet. Inflation is benign in Switzerland and is expected to remain benign with SNB's official forecasts at no higher than 1.5% through 2026. Historically the SNB has also not been too concerned with surprising the market, with the 50bps hike in 2022 and the 2015 unpegging of the CHF episodes that come to mind.

We expect USDCHF to gradually weaken into 2024 amid Fed rate cuts and the fading of US exceptionalism.

A Maybe Not So Dovish BOJ – The Contrast of Other DM Central Banks

The BOJ with one swoop had ended NIRP, YCC and ETF/JREITs purchases on the 19 Mar 2024. Whilst Ueda had not hinted at further tightening, we would not take this at face value and actually believe that the central bank could raise rates by 25bps each in Oct 2024 and Jun 2025. Our reasoning behind further BOJ increases include 1) stronger conviction on the part of the BOJ for a virtuous wage – price cycle becoming more entrenched, 2) Ueda's comments and the BOJ statement actually left more space for a rate hike, 3) Concerns about JPY weakness and 4) Economic data points to more "normality". However, we would take a cautious view on the USDJPY and see that it be at an elevated level for the rest of 2024 albeit still taking a slower path downwards. Fed rates being too high (even after the cuts) and the BOJ's measured rate increases are likely to make the downward move for the pair slow whilst the upside potential could be limited given intervention risks and the Fed still likely to at least undertake some cuts this year. On the regional currencies, we see that the KRW, THB and IDR are the currencies which are likely to benefit most from the JPY strength although we also note that DXY has a bigger effect on these currencies. Any DXY strengthening can risk offsetting the benefits from a JPY appreciation.

BOJ Does it With One Swoop

The BOJ ended NIRP, YCC and ETF/JREITs purchases in one shot on the 19 Mar 2024 with market expectations for the move having been reasonably strong given the released news reports before the decision. Market focus though was more on whether the BOJ would hint at further tightening beyond that move but it appeared that they did not do so. The statement itself had in fact mentioned – "Given the current outlook for economic activity and prices, the Bank anticipates that accommodative financial conditions will be maintained for the time being". The USDJPY consequently began to climb higher after the decision as markets became concerns about yield differentials especially as the BOJ decision was just before the FOMC, where there was anxiety that the Fed could tilt more hawkish. The USDJPY was later seen coming back down slightly as the Fed continues to maintain a forecast of three rate cuts this year based on the dot plot. The Nikkei has also since released a report pointing to further BOJ hikes. On our part, we believe that the BOJ would hike again by 25bps in Oct 2024 and by another 25bps in Jun 2025. As of 27 Mar 2024, the OIS market is implying a 36% chance of a 10bps hike by Sept. The terminal rate for the BOJ meanwhile could stand at 1.0% - 2.0% at this juncture. In this piece, we would be laying out the rationale behind our forecast in addition to where we believe the USDJPY would head to. Subsequently, we would also be examining the impact of JPY moves on the key regional currencies.

Why We Believe the BOJ would Hike Further?

As stated, our expectations is now for the BOJ to hike by 25bps in Oct 2024 and 25bps in Jun 2025. Our reasoning behind this is as follows:

a. Stronger conviction on the part of the BOJ for a virtuous wage – price cycle becoming more entrenched

We believe that there are increasingly signs of this being the case. If anything, the move to have done a one swoop ending of NIRP, YCC and ETF/JREITs purchases appears in our view to reflect stronger conviction on their part that economic conditions are changing such that a virtuous wage – price cycle is becoming more entrenched. We do note that the end of YCC and ETF/JREITs purchases may in some sense have looked redundant but regardless, doing away with them in some sense implies that the situation has evolved more in the direction that they need to.

Looking throughout their statement, we also find evidence of a change in their view given that they have now removed the statement – "assumption that wages and prices will not increase easily have taken hold in society". The statement had also mentioned instead that "the BOJ assessed the virtuous cycle between wages and price, and judged it came in sight that the price stability target of 2 percent would be achieved in a sustainable and stable manner towards the end of the projection period of the January 2024 Outlook Report".

Looking at the BOJ's own outlook report from Jan 2024, the median number implies that they are seeing that inflation still able to keep at target or above it in FY2024 for the headline number. However, they are just slight below target for FY2024 core core number and FY2025 headline and core core number. We would not rule out upwards forecast revisions in Apr 2024 outlook report given their comments in their statement. This in turn can raise speculation of further hikes.

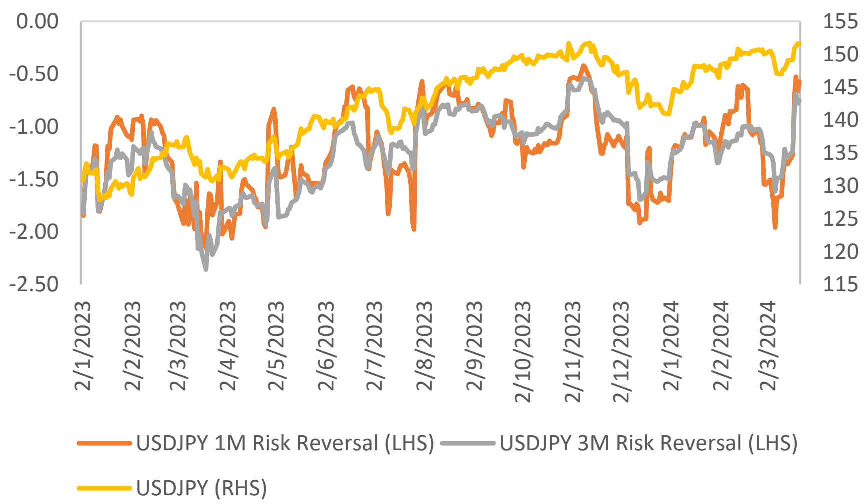
b. Ueda's comments and BOJ statement actually left more space for a rate hike

Quite importantly, during the press conference, Ueda had described his era as "normal". Whilst he had not provided a definition of what "normal", we believe that the use of this word does sufficiently make it clear that the central bank is now dealing with a Japanese economic situation that is no longer extraordinary in nature. The statement itself too had pointed out that the "policy framework of Quantitative and Qualitative Monetary Easing (QQE) and Yield Curve Control and the negative interest rate policy to date have fulfilled their roles". We interprete these comments that the central bank now no longer sees Japan stuck in an extremely low inflation or deflationary environment. Instead, Japan is more likely to behave in a "normal" environment where inflation and growth would move up together. There may be some mention about maintaining "accommodative conditions" in the forward guidance but those words does not mean the BOJ would not be hiking. Instead, it can be seen that they may still push up rates except that they may hold it below the neutral rate. The level of the neutral rate is up for debate but we see the possibility it could be around 1.0 – 2.0%. Also, we do note that Ueda mentioned that assuming the 5-10 year long term inflation expectation is currently above 1%, the real policy rate would be significantly below the real neutral rate. This looks to point to the BOJ having more space to hike.

c. Concerns about JPY weakness

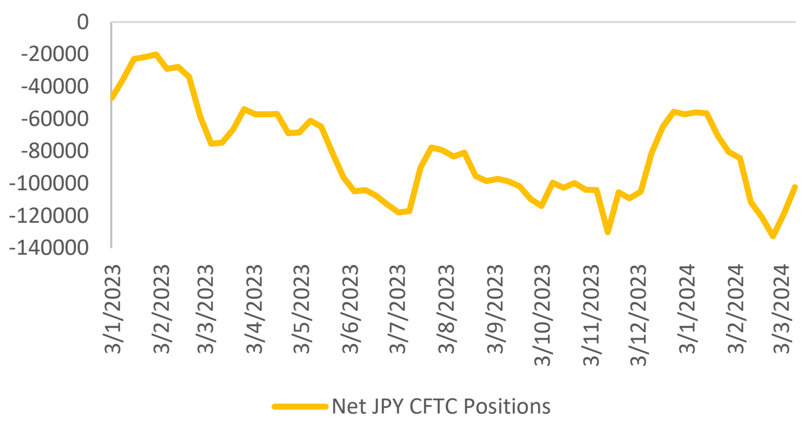
There is some sense that the government and BOJ could be concerned about the extent of the currency weakness. The JPY itself does look vulnerable to more weakness given the risk of the Fed possibly slowing rate cuts if the US data keeps holding up strongly. Ueda himself did comment about the currency during the press conference as he stated that the BOJ would react to FX if it does affect the domestic economic and inflation outlook. This appeared to be an out of the norm comment from the Governor and in our view, it does highlight currency weakness concerns. We do also note the release of the Nikkei report post the meeting, which pointed to further rate hikes coming. The report itself had come out after substantial JPY weakening.

Chart 14: Risk Reversals Imply Market Sentiment is for a Weak JPY



Source: Bloomberg, Maybank FX Research & Strategy

Chart 15: Net CFTC are Still Positioned Deeply Short on the JPY

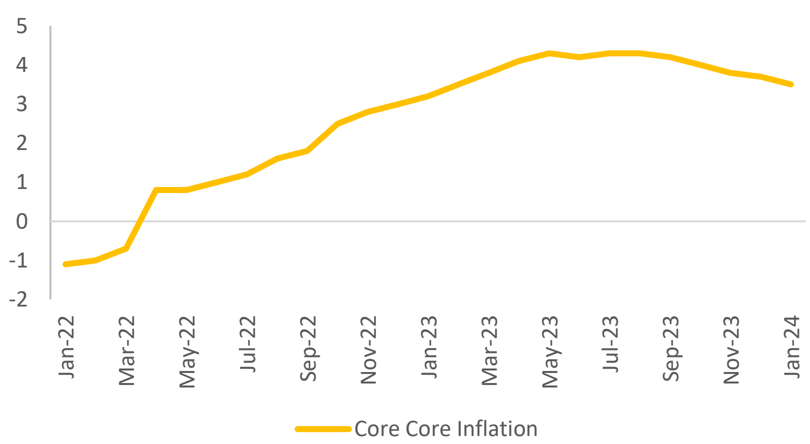


Source: Bloomberg, Maybank FX Research & Strategy

d. Economic data points to more "normality" which can support further tightening

The Japanese economy may be showing weakness recently but the focus is less on the historical numbers and more on whether there is a shift emerging in the economy from one that has been unable to take off to one that has been "normalizing". In some sense, we do believe normalization is happening as the mindset of companies could be changing. This is reflected in the Rengo wage negoatiation results in the last two years, which have been high standing at 3.7% in 2023 and 5.28% in 2024. Companies may now be more ready to raise wages at more substantial level which would allow for inflation to be more demand driven. Ueda did note in the press conference of the possibility of firms' price and wage setting behavior significantly changing as the main upside risk. We are still though importantly waiting for the results of the smaller firms' negotiations results but a good outcome is set to give more support to the possibility of further hikes by the BOJ. Meanwhile, CPI too has also been above the 2% target for a while and whilst we believe it would keep softening, it would still hold above that 2% given the low base last year and the wage increases. However, we also recognize that the process of normalization for now looks gradual and that BOJ would also not intend to raise rates until it chokes demand. However, as mentioned, Ueda sees that they are currently quite off the real neutral rate so hence, they actually have plenty of space to raise rates by quite a bit.

Chart 16: Core core inflation Has Been Softening But Can Still Meet Target 2% Given Low Base and Rising Wages



Source: Macrobond, Maybank FX Research & Strategy

Table 4: BOJ Outlook Expects that Core Core Inflation can Hold Above Target in FY 2024 FY2025 but Headline May Just Fall Below it in FY 2025 Whilst Staying above in FY 2024

	FY2024	FY2025
Headline (all items less fresh food)	2.2 to 2.5 (2.4)	1.6 to 1.9 (1.8)
Core core (all items less fresh food and energy)	1.6 to 2.1 (1.9)	1.8 to 2.0 (1.9)

Source: BOJ, Maybank FX Research & Strategy
Note: 1) Figures in brackets indicate the medians of the Policy Board members' forecasts (point estimates). 2) All figures are % YoY

Risk to Our View:

We do note a few risks to our view as follows:

a. **Ueda had appeared "neutral" and looks in no rush** during the press conference having not committed to any further hikes. In fact, he had stated that there was still "some distance" between inflation expectations and the 2% level whilst also noting that achieving a stable 2% inflation is "not 100% yet". He had also looked to paint the move as just simply an action to scrap extraordinary measures. Also, Ueda has said to parliament after the BOJ decision that the move was made before awaiting complete confirmation of stable inflation to avoid substantial upside inflation risks. Consequently, in his own words, he stated "the possibility would have strengthened for very rapid and large rate hikes after the end of large-scale monetary easing". Regardless, whilst we do note that these words highlight some risk to our view, we also recognize that his comments remain rather open and does not close the door to possibility of additional hikes this year.

b. **There are pockets of economic weakness especially with regard to the domestic consumption.** Consumption has been weak in the recent periods and the BOJ did express caution in its statement regarding this as it is mentioned – "private consumption has been resilient, although the impact of price rises and developments such as a decline in automobile sales….have been observed". The pick-up in wages is something that could finally boost demand in the economy and hence, the BOJ may be wary not to hurt this development with rate hikes. However, again, we would like to mention Ueda recognizes that real rates are quite below the real neutral rate and hence, they may actually have space to raise it without damaging demand substantially.

What Does this all Mean for the JPY?

In essence, we do believe that Ueda is very much putting the BOJ on a path of "normalization" and that rate hike may only be gradual. The summary of opinions for the latest BOJ meeting had also implied that this would be the case. We are expecting at this point that rate hikes would be gradual with a 25bps hike in Oct 2024 and another 25bps increase in Jun 2025. This would mean the BOJ rate would be at 0.0 – 1.0% until end 3Q 2024. It would then be around 0.25% from 4Q 2024 until Jun 2025, where it would then rise to be around 0.50%.

Regarding the USDJPY, we take a cautious view on it. We expect that the upside would be limited simply because the government and the BOJ could be concerned about excessive JPY weakness. The BOJ may intervene or even consider raising rates (as we had discussed earlier) if the JPY weakens heavily. On the former, there has already been heavy jawboning from both Finance Minister Suzuki and Vice Minister/currency chief Kanda amid the USDJPY climb post the BOJ meeting. Intervention risks are currently standing quite elevated.

At the same time, we see the downward move for the USDJPY is likely to be gradual and slow. This is due to the resilience of the US economy and the possibility that the Fed could lag the other DM central banks in cutting rates, leading to USD strength holding up. UST yields may also only gradual decline at a slow pace.

Consequently, we expect the USDJPY to trade at an elevated level for the rest of 2024 albeit still taking a slower path downwards.

We would do like to note some risks to our view. This includes on the upside that the BOJ may move faster than expected, which would embolden JPY bulls, reduce the attractiveness of the JPY carry trade and in turn lead to more downside for USDJPY. The risk of any geopolitical tensions may also guide USDJPY lower given that we have some view the safe haven allure of the JPY could make some return amid the policy divergence of the BOJ versus the rest of the DM central banks. Additionally, we would like to make note that there are other favorable factors that may also support the JPY in a situation of BOJ tightening that includes stronger interest in the domestic equity markets and repatriation of funds back to Japan. On the other hand, if US data holds up so strongly such that the Fed does not move this year, there is a possibility that the JPY could see substantial downside.

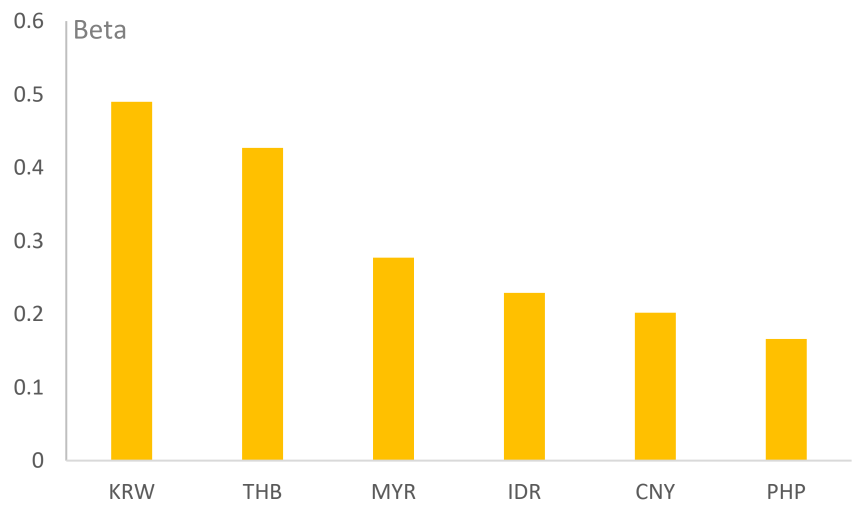
How Would Regional FX be Impacted by JPY Movements?

Based on carrying out a sensitivity analysis, we find that the THB and KRW show a high sensitivity to JPY movements. This THB's sensitivity comes as little surprise given the high investment by the Japanese into the Thai economy. FDI from Japan to Thailand accounted for about 28.8% of total value in 2022. Meanwhile, the strong trade relations between South Korea and Japan can explain the KRW's sensitivity to JPY. For the MYR and CNY, we would like to note that their sensitivity to the JPY may be questionable as Malaysia, China and Japan have been among the regions biggest laggards in catching up with the Fed hikes.

For the IDR, we believe the sensitivity is reasonably strong given the large Japanese investment interest in the Indonesian economy. Whilst FDI into Indonesia from Japan was just at 9.2% of total value in 2023, we do note that FDI into Indonesia from Singapore was at 30.5% of which a lot of that could actually be investment from Japanese companies based in Singapore or transferring funds via Singapore.

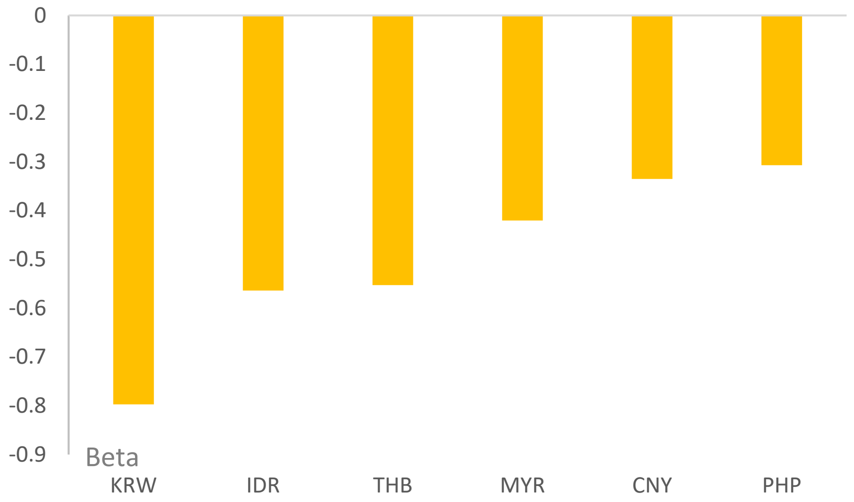
However, we would also like to note a big caveat which is that the effect of the JPY would pale in comparison compared to the DXY. Hence, making a bet on these currencies appreciating based on JPY strength would not be advisable given the DXY is a bigger driver. The move can work especially unfavorably if the greenback starts to strengthen substantially again.

Chart 17: KRW and THB are the Most Affected by JPY Movements



Source: Bloomberg, Maybank FX Research & Strategy
Note: Sensitivity analysis done utilizing weekly data from 1 Jan 2019 – 31 Dec 2023

Chart 18: The DXY has the Much Bigger Effect on ASEAN Currencies



Source: Bloomberg, Maybank FX Research & Strategy
Note: Sensitivity analysis done utilizing weekly data from 1 Jan 2019 - 31 Dec 2023

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