



# Currency (FX) Outlook Q3 2023

July 2023

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# FX Market Update

As of June 30, 2023

- Carry was the main driver of FX returns in Q2
- USD was mostly range-bound
- Exposure to China was an important factor for many FX pairs

## Performance Relative to USD

|           | EUR<br>(Euro) | GBP<br>(British Pound) | JPY<br>(Japanese Yen) | AUD<br>(Australian \$) | CAD<br>(Canadian \$) | BRL<br>(Brazilian Real) | INR<br>(Indian Rand) | KRW<br>(Korean Won) | MXN<br>(Mexican Peso) | ZAR<br>(South African<br>Rand) |
|-----------|---------------|------------------------|-----------------------|------------------------|----------------------|-------------------------|----------------------|---------------------|-----------------------|--------------------------------|
| Q2 2023   | -0.1%         | 2.8%                   | -9.3%                 | -0.8%                  | 2.1%                 | 7.5%                    | 0.6%                 | -1.6%               | 7.3%                  | -4.8%                          |
| YTD       | 0.8%          | 4.7%                   | -11.7%                | -2.9%                  | 2.0%                 | 14.2%                   | 1.9%                 | -5.5%               | 18.1%                 | -7.8%                          |
| 12 Months | 1.6%          | 3.6%                   | -10.2%                | -4.6%                  | -3.0%                | 17.3%                   | -1.4%                | -3.3%               | 26.1%                 | -10.4%                         |

- Changing policy expectations partially explain EUR-USD performance
- USD remains historically expensive vs EUR
- High budget deficit, negative current account and reduced demand for US assets may result in further depreciation of USD with EUR being the primary beneficiary

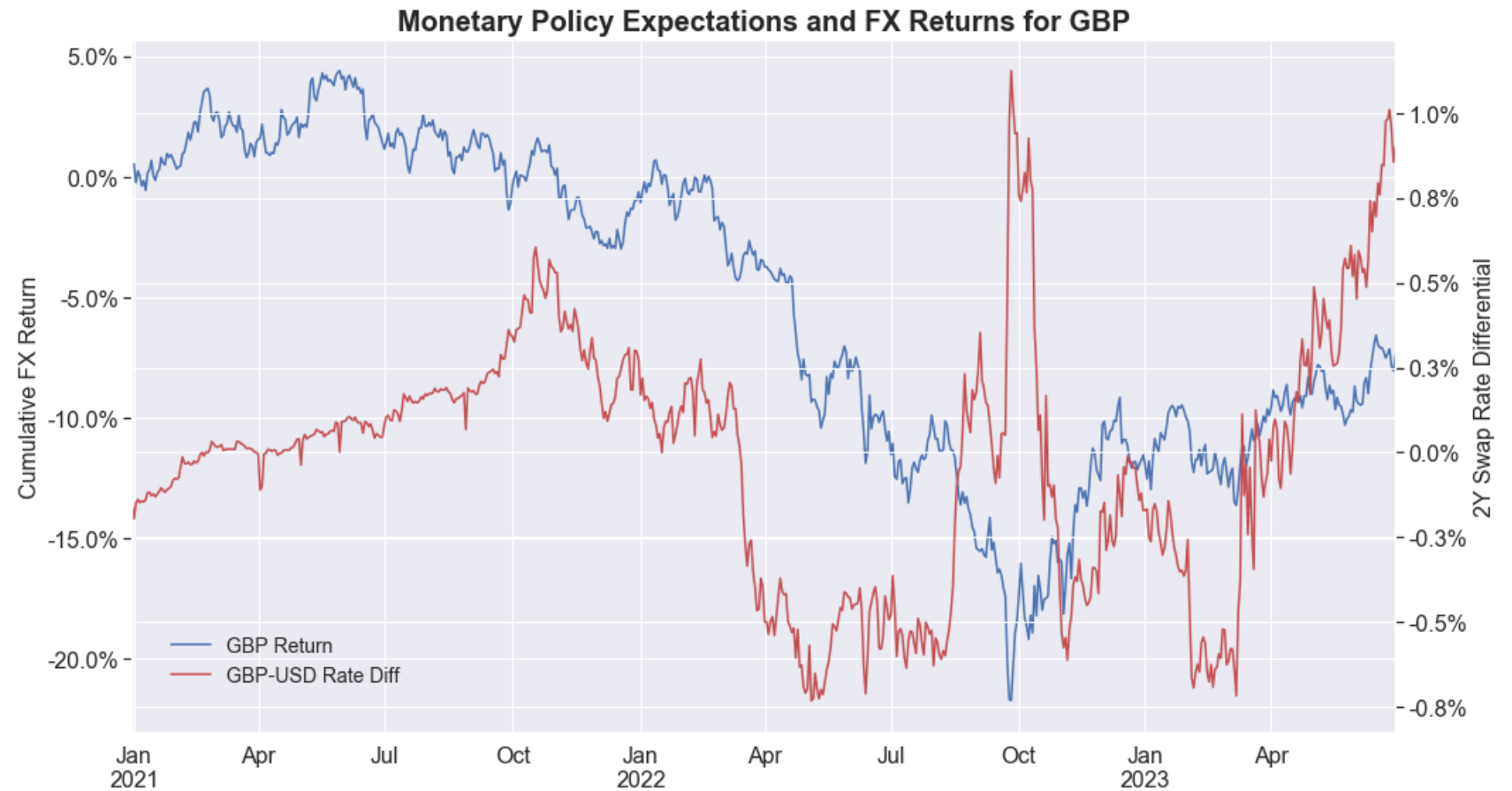
Monetary Policy Expectations and FX Returns for EUR



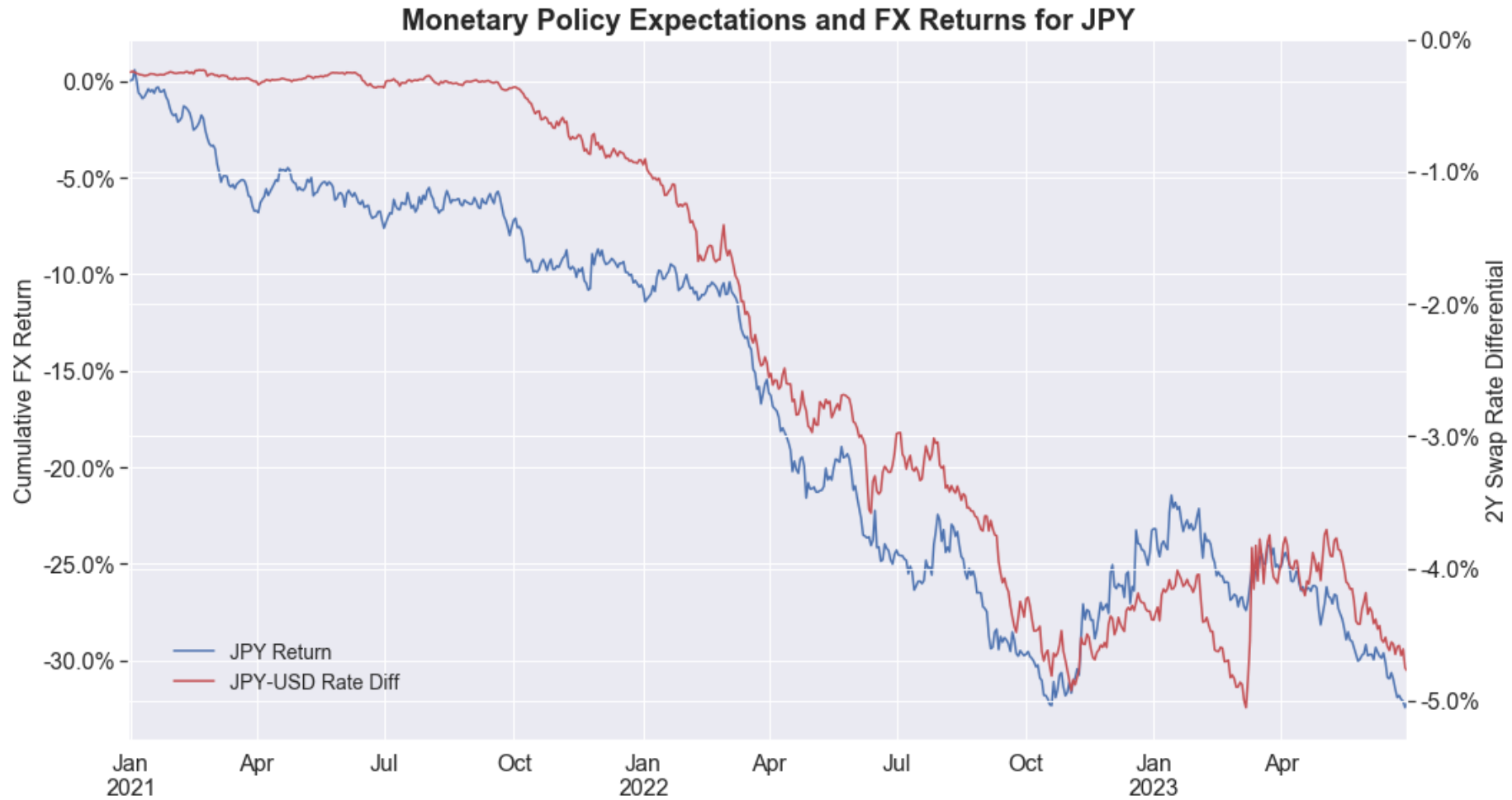
EUR PPP and Carry Valuation



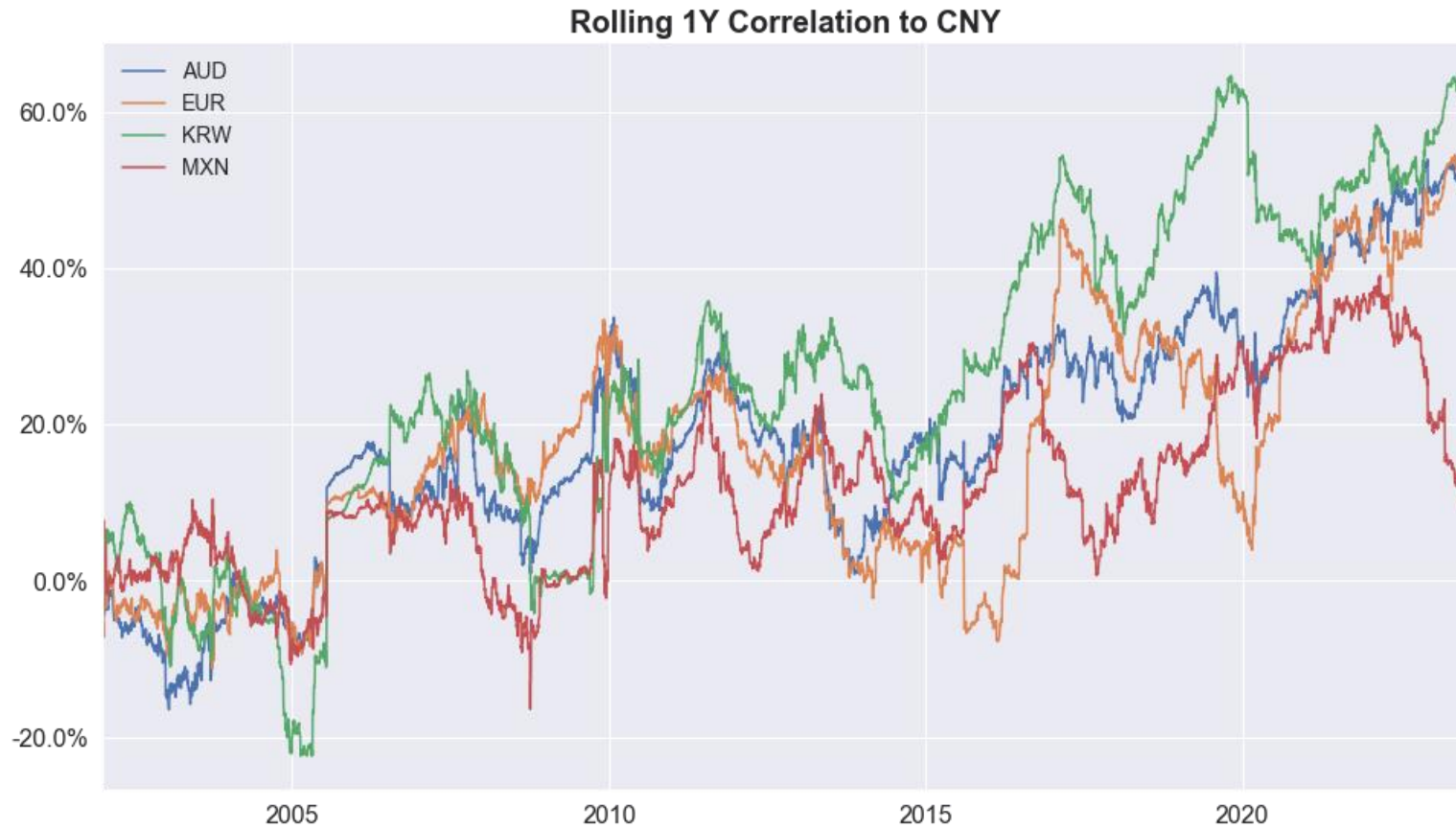
- During the mini-fiscal crisis in UK, bonds and FX sold off together, making its relationships with monetary policy less clear
- GBP appears fairly valued, but it benefitted from rising rates and positive economic surprises



# JPY Has Been Moving In Sync with Interest Rate Differentials

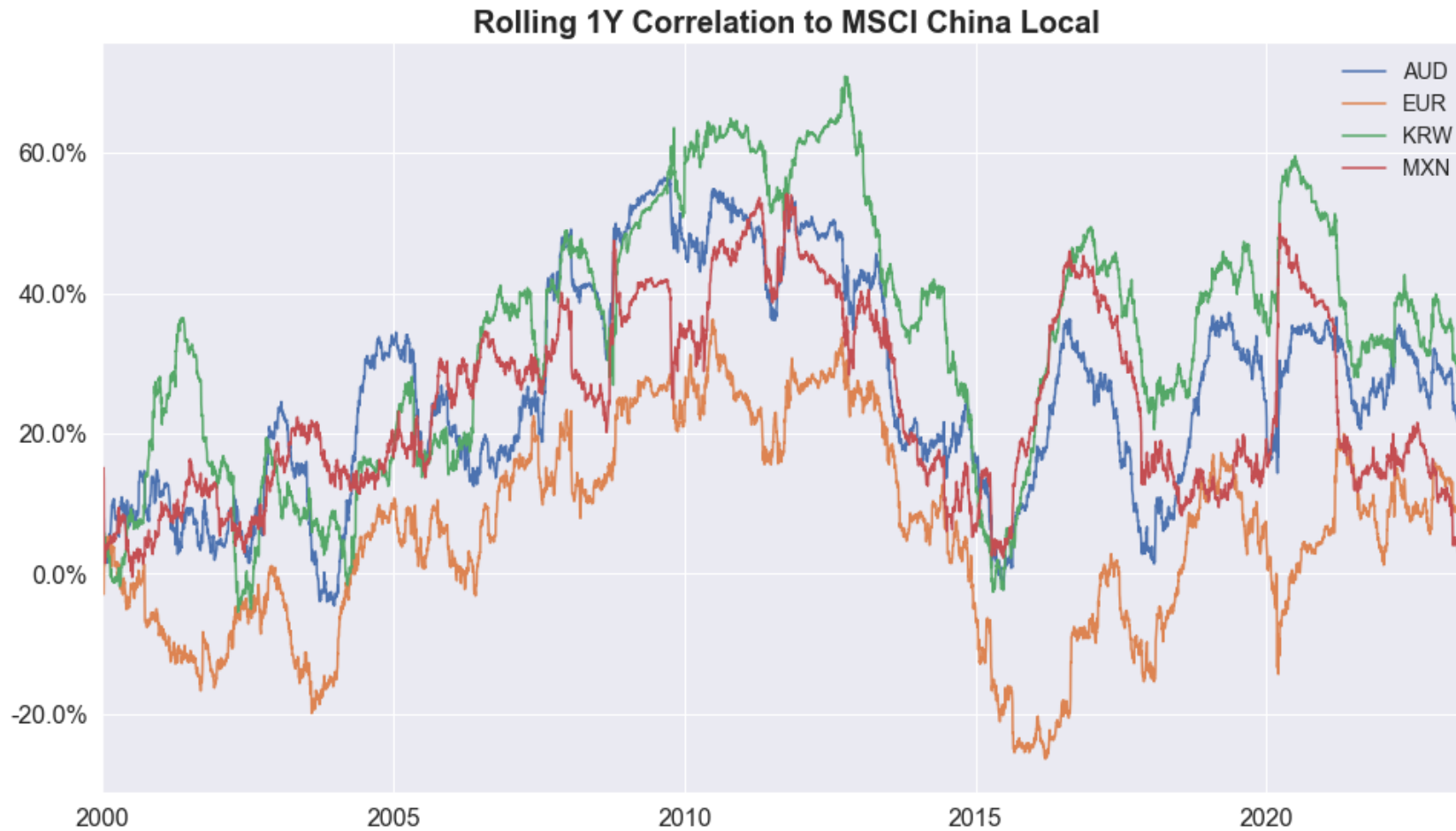


# Exposure to China has become an important driver of FX returns



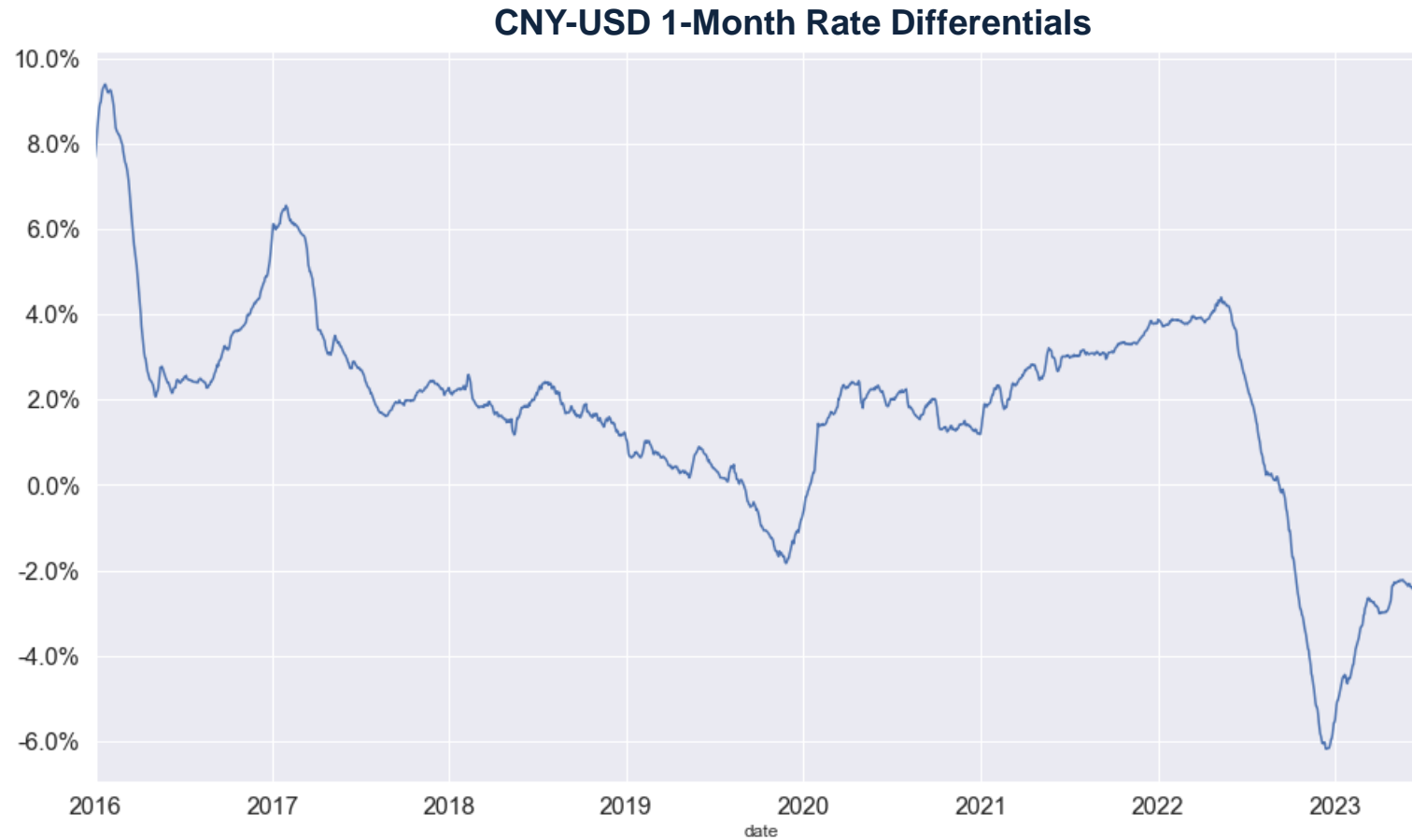
- Currencies of countries with large trade relationships with China have become more correlated with CNY
- Mexico is currently treated as a beneficiary of the China-US decoupling

# Exposure to China has become an important driver of FX returns (cont'd)



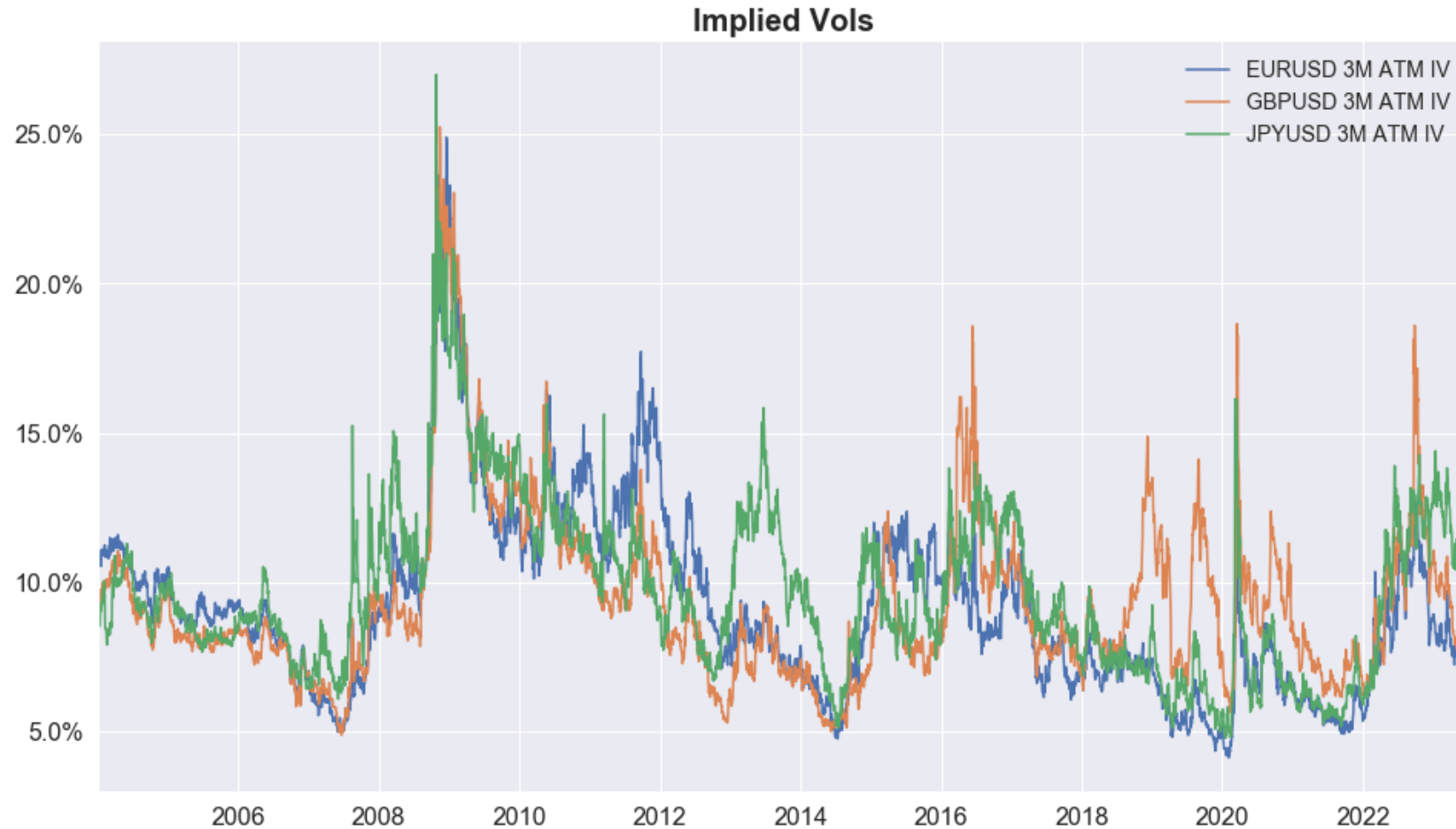
# CNY appears unattractive historically

- CNY is an expensive currency relative to history with negative interest rate differentials

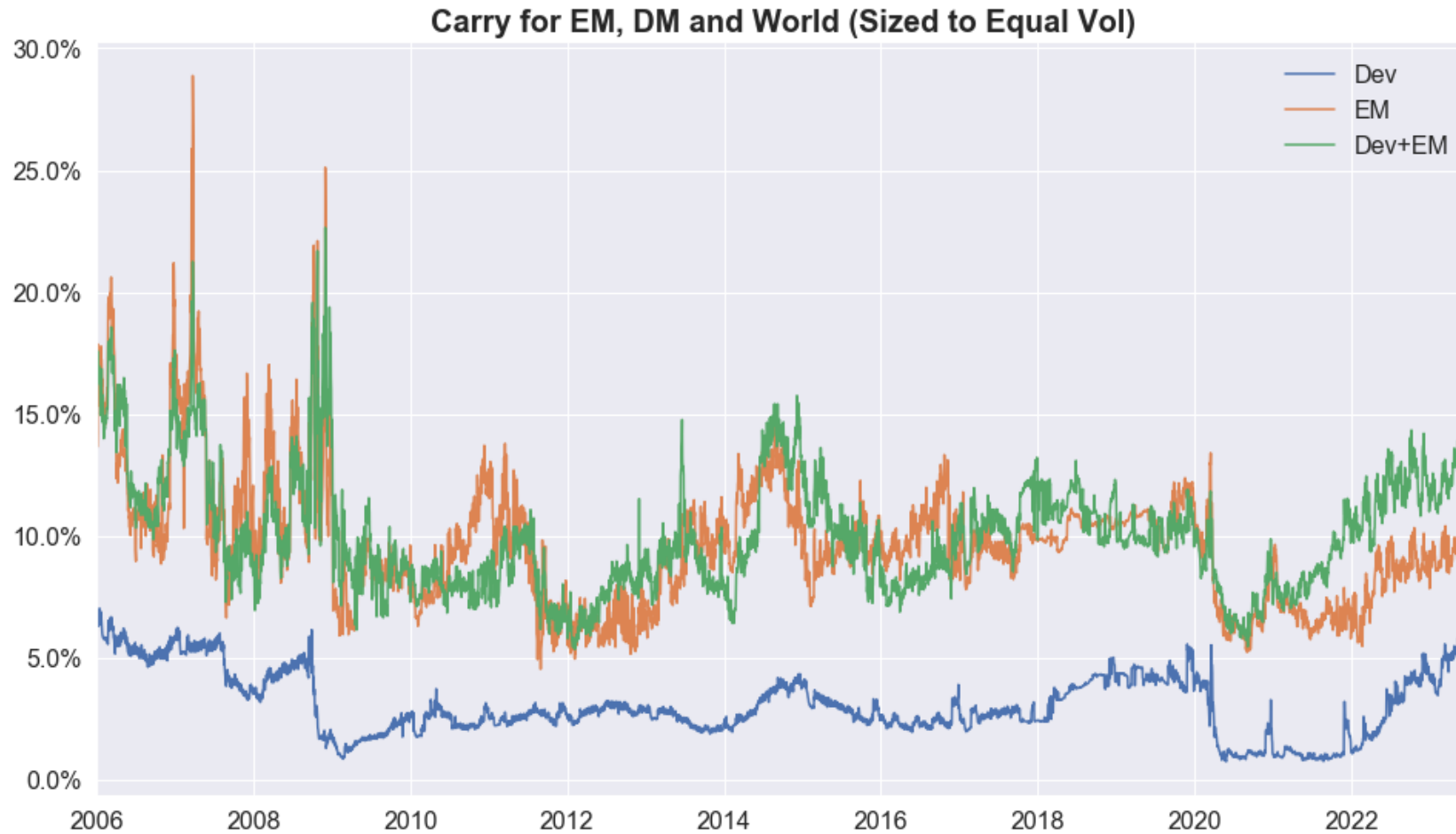




# Implied Volatilities in FX came down recently



# Carry per unit of volatility appears to be historically attractive levels



USD is at risk of further sell-off with EUR being the primary beneficiary

China's economic weakness may continue to weigh on CNY

MXN has been a beneficiary of high Carry and the US-China decoupling

Carry has performed well recently and is likely to consolidate, but long-term prospects are appealing

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