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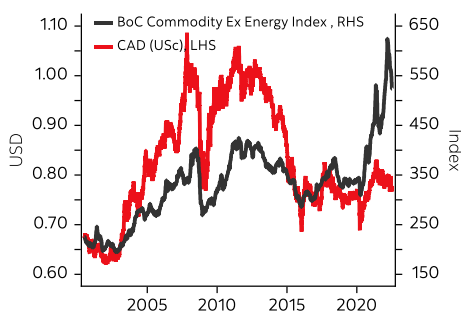
FX Forecast Update

USD strength is persisting for longer than we anticipated as the Ukraine conflict drags on, prompting us to make some quite significant changes to our near-term expectations for the major currencies. The CAD's performance (against the USD) remains disappointing, from our point of view, and we have to concede that the sort of gains we anticipated for H2 now look highly unlikely to materialize. The EUR's persistent softness, proximity to parity and energy supply concerns leave it prone to more weakness. The cost of living crisis may impede the Bank of England's ability to confront soaring inflation, weighing on the GBP. Rising US yields and a clear lack of urgency to adjust BoJ policy settings will keep pressure on the JPY. See full forecast table on page 3.

USD—The USD is poised to stay stronger for longer than we had anticipated. While tighter Fed monetary policy amid more persistent inflationary pressure remains an important driver of USD demand, interest rate swaps do suggest that much of the anticipated tightening is already reflected in market rates and, presumably, the USD. Rather, we think support for the USD in the coming months may be derived from more persistent risk aversion as equity markets face a backdrop of higher global rates, slowing growth and weaker corporate earnings (that may also be related to the strong USD itself). Additionally, geo-political concerns are helping underpin the USD. We expect a little more USD strength (maybe another 2-3% on the DXY over the next 3-6 months) but the trend is extended and some of the major currencies are starting to look very “cheap” from an historic perspective we believe. It’s a “heads I win, tails you lose” situation for the USD right now and USD bears will have to remain patient until clearer, negative catalysts emerge.

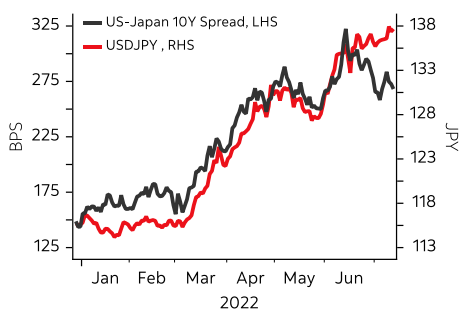
CAD—On the face of it, the CAD's 2.5% drop against the USD so far this year suggests that it has not been rewarded for a resilient economy, positive terms of trade and a hawkish central bank. The CAD is, however, the top-performing G10 currency in YTD terms behind the USD. Strength has been reflected on the crosses, where it has reached multi-year highs against the EUR, GBP, JPY etc. We continue to anticipate a hawkish BoC (relative to the Fed, even) and Canadian economic out-performance over the US this year and next. That should limit CAD losses against the big dollar but it is unlikely now to deliver the sort of appreciation we have patiently anticipated—and still think is merited to a large degree, given strong (if somewhat weaker in the past couple of months) commodity prices.

CAD Misses Out on Commodity Price Boom



Source: Macrobond, Scotiabank FICC Strategy

Weak JPY May Stabilize With Spreads



Source: Macrobond, Scotiabank FICC Strategy

	Q4 2022	Q4 2023
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Old forecast	1.20	1.23
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New Forecast	1.27	1.23
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EUR—Energy security concerns represent a clear and present danger for the EUR. Access to vital Russian natural gas supplies remains in question for the Eurozone. Power prices have surged since the start of the Ukraine conflict and any curtailment in power supply is likely to slow economic growth materially and in short order. The ECB is poised to join the global monetary tightening bandwagon but rate lift off is expected to be measured (+25bps this month) and future hikes are unlikely to match the aggressive pace of the Fed. The ECB may not be too concerned about EUR weakness as the EUR has only weakened around 3.5% on a trade-weighted basis this year, compared to a 11% decline against the USD. The EUR just has to find its own level. We think that will be a little below par.

	Q4 2022	Q4 2023
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Old forecast	1.10	1.12
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New Forecast	0.95	1.05
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GBP—The pound is as much a victim of persistent USD strength as its own short-comings.

If the USD were not so strong, the unsettled domestic political backdrop and unresolved issues over Brexit would perhaps not count for that much. In this environment, these factors just add to the GBP-negative load of weak growth/high inflation amid a severe cost of living crisis that may impair the BoE's ability, or willingness, to tighten monetary policy aggressively moving forward—and especially not at the hiking pace of the Fed or BoC. Sterling's tendency since Brexit to act like a high beta currency has also left it susceptible to the recent (and potentially ongoing) volatility in global stocks. GBPUSD is trading close to the Brexit vote low around 1.18, leaving the pound looking quite “cheap” in our opinion, but it might get a little cheaper still before a durable base is found.

	Q4 2022	Q4 2023
Old forecast	1.25	1.29
New Forecast	1.15	1.22

JPY—Policy differentials remain the primary negative for the JPY, and not just against the USD. The JPY has accumulated a 16% drop against the USD so far this year, mostly since March when US yields started to rise meaningfully. But the JPY is also the worst-performing major currency in year-to-date terms. Japanese policy makers are showing no desire to join the global monetary policy tightening wave and, in fact, the Bank of Japan strongly reaffirmed its yield curve control policy in April, capping 10Y yields at 0.25%. The continuation of easy policy settings means there is little or no chance of intervention action in support of the JPY—not that it would do much good, in our opinion. Weak terms of trade resulting from high imported raw material prices are another JPY-negative and the deterioration in Japan's external accounts position has undermined the JPY's traditional safe-haven appeal. We look for USD strength to persist and extend somewhat towards 140 but we do feel that yen losses are starting to look very stretched and the 140 zone may offer some value for bargain hunters, particularly if long-term US-Japan yield spreads are near a peak.

	Q4 2022	Q4 2023
Old forecast	125	116
New Forecast	140	133

Central Bank Rates													
	2020		2021			2022				2023			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Americas	(%, end of period)												
Bank of Canada	0.25	0.25	0.25	0.25	0.25	0.50	1.50	3.25	3.50	3.50	3.50	3.50	3.50
US Federal Reserve (upper bound)	0.25	0.25	0.25	0.25	0.25	0.50	1.75	3.00	3.25	3.25	3.25	3.25	3.25
Bank of Mexico	4.25	4.00	4.25	4.75	5.50	6.50	7.75	9.00	10.00	10.00	10.00	9.50	9.50
Central Bank of Brazil	2.00	2.75	4.25	6.25	9.25	11.75	13.25	13.75	13.75	12.50	12.00	11.25	10.00
Bank of the Republic of Colombia	1.75	1.75	1.75	1.75	3.00	5.00	7.50	9.00	9.00	9.00	9.00	8.00	7.00
Central Reserve Bank of Peru	0.25	0.25	0.25	1.00	2.50	4.00	5.50	6.50	6.50	5.75	5.50	5.25	5.25
Central Bank of Chile	0.50	0.50	0.50	1.50	4.00	7.00	9.00	10.50	11.00	9.00	7.00	5.00	3.50
Central Bank of Argentina	38.00	38.00	38.00	38.00	38.00	44.50	52.00	53.00	53.50	51.50	49.50	49.00	48.00
Europe													
European Central Bank MRO Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.75	1.25	1.75	2.00	2.00	2.00
European Central Bank Deposit Rate	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	0.25	0.75	1.25	1.50	1.50	1.50
Bank of England	0.10	0.10	0.10	0.10	0.25	0.75	1.25	2.00	2.25	2.50	2.50	2.50	2.25
Asia/Oceania													
Reserve Bank of Australia	0.10	0.10	0.10	0.10	0.10	0.10	0.85	2.00	2.50	2.75	2.75	2.75	2.75
Bank of Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
People's Bank of China	3.85	3.85	3.85	3.85	3.80	3.70	3.65	3.65	3.65	3.65	3.65	3.65	3.65
Reserve Bank of India	4.00	4.00	4.00	4.00	4.00	4.00	4.90	5.50	5.75	6.00	6.00	6.00	6.00
Bank of Korea	0.50	0.50	0.50	0.75	1.00	1.25	1.75	2.25	2.50	2.75	2.75	2.75	2.75
Bank of Thailand	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.00	1.25	1.75	2.00	2.00	2.00
Currencies and Interest Rates													
Americas	(end of period)												
Canadian dollar (USDCAD)	1.27	1.26	1.24	1.27	1.26	1.25	1.29	1.27	1.27	1.25	1.25	1.23	1.23
Canadian dollar (CADUSD)	0.79	0.80	0.81	0.79	0.79	0.80	0.78	0.79	0.79	0.80	0.80	0.81	0.81
Mexican peso (USDMXN)	19.91	20.43	19.94	20.64	20.53	19.87	20.12	20.44	20.97	21.33	21.82	21.84	22.08
Brazilian real (USDBRL)	5.20	5.63	4.97	5.44	5.58	4.74	5.26	4.92	4.72	4.68	4.55	4.58	4.68
Colombian peso (USDCOP)	3,430	3,704	3,752	3,808	4,080	3,771	4,155	3,957	3,960	3,887	3,835	3,884	3,951
Peruvian sol (USDPEN)	3.62	3.74	3.87	4.13	4.00	3.68	3.83	3.90	3.95	4.00	3.95	3.90	3.95
Chilean peso (USDCLP)	712	719	734	810	852	786	918	900	870	850	830	820	800
Argentine Peso (USDARS)	84.15	91.99	95.72	98.74	102.74	111.01	125.22	140.00	155.00	171.00	187.50	203.75	220.00
Europe													
Euro (EURUSD)	1.22	1.17	1.19	1.16	1.14	1.11	1.05	0.97	0.95	1.00	1.02	1.05	1.05
UK pound (GBPUSD)	1.37	1.38	1.38	1.35	1.35	1.31	1.22	1.16	1.15	1.18	1.20	1.20	1.22
Asia/Oceania													
Japanese yen (USDJPY)	103	111	111	111	115	122	136	140	140	138	138	133	133
Australian dollar (AUDUSD)	0.77	0.76	0.75	0.72	0.73	0.75	0.69	0.65	0.65	0.66	0.66	0.68	0.68
Chinese yuan (USDCNY)	6.53	6.55	6.46	6.44	6.36	6.34	6.70	6.70	6.60	6.50	6.50	6.40	6.40
Indian rupee (USDINR)	73.1	73.1	74.3	74.2	74.3	75.8	79.0	80.0	79.0	78.0	78.0	77.0	77.0
South Korean won (USDKRW)	1,087	1,132	1,126	1,184	1,189	1,212	1,299	1,300	1,280	1,260	1,260	1,240	1,240
Thai baht (USDTHB)	30.0	31.2	32.1	33.8	33.4	33.3	35.3	36.0	35.0	34.0	34.0	33.0	33.0
Canada (Yields, %)													
3-month T-bill	0.07	0.09	0.14	0.12	0.19	0.73	2.31	3.25	3.50	3.50	3.50	3.50	3.50
2-year Canada	0.20	0.22	0.45	0.40	0.95	2.29	3.15	3.60	3.60	3.50	3.40	3.30	3.25
5-year Canada	0.39	0.99	0.98	1.10	1.26	2.41	3.11	3.30	3.30	3.20	3.10	3.05	3.00
10-year Canada	0.68	1.56	1.39	1.51	1.42	2.40	3.22	3.35	3.35	3.25	3.20	3.10	2.95
30-year Canada	1.21	1.98	1.84	1.99	1.68	2.38	3.13	3.20	3.25	3.20	3.15	3.10	2.90
United States (Yields, %)													
3-month T-bill	0.08	0.01	0.04	0.03	0.06	0.55	1.73	3.00	3.05	3.05	3.05	3.05	3.05
2-year Treasury	0.12	0.16	0.25	0.53	0.73	2.33	3.09	3.30	3.35	3.25	3.20	3.10	3.05
5-year Treasury	0.36	0.94	0.89	0.96	1.26	2.46	3.04	3.10	3.20	3.10	3.05	2.95	2.90
10-year Treasury	0.91	1.74	1.47	1.49	1.51	2.34	3.01	3.15	3.10	3.05	3.00	2.90	2.75
30-year Treasury	1.64	2.41	2.09	2.04	1.90	2.45	3.18	3.20	3.25	3.20	3.15	3.10	2.90

Sources: Scotiabank Economics, Bloomberg.

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