

June 2024

Currency Market Commentary

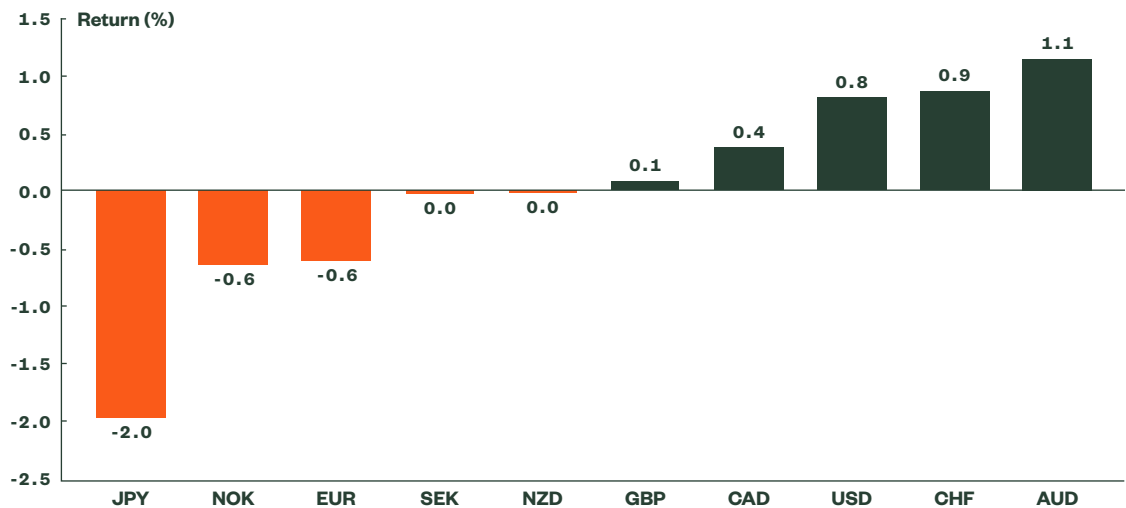
Aaron R Hurd, FRM
Senior Portfolio Manager

Summary of Views

Political risk and central bank divergence drove currency markets during June. Mexico's new President-elect, Claudia Sheinbaum, achieved a surprisingly strong victory — raising concerns about potential constitutional changes that could threaten fiscal stability and foreign direct investments. This led to an early-month unwinding of currency carry trades, which weighed on higher-yielding currencies and supported the low-yielding Swiss franc and Japanese yen.





















On 9 June, French President Emmanuel Macron surprised markets by calling a parliamentary election. The far-right Rassemblement National (RN) party is expected to win, though perhaps not with an outright majority. The RN platform leans populist and is European Union (EU)-skeptical, introducing investor fears of fiscal deterioration as well as reduced pan-EU cooperation; these concerns could hinder long-run growth prospects. In response, the euro weakened throughout the month, while the Swiss franc, a regional safe haven, emerged as the second-best performer among G10 currencies.

Figure 1
**June 2024
Currency Return vs.
G10 Average**



Source: Bloomberg and State Street Global Advisors, as of 30 June 2024. **Past performance is not a reliable indicator of future performance.**

Figure 2
June 2024
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 June 2024.

The Australian dollar outperformed the politically driven Swiss franc to finish as the top-performing G10 currency — thanks to a hawkish tone from the Reserve Bank of Australia (RBA) and higher-than-expected inflation. The US dollar finished in the top three, benefitting from a strong headline employment report, safe-haven demand in response to heightened political risk, and a hawkish shift in Federal Reserve (Fed) rate cut projections, despite weaker-than-expected inflation.

The euro, Norwegian krone, and Japanese yen were the bottom three performers, with the yen being the worst. As mentioned before, the euro was dragged lower by French election risk, while the krone suffered a sharp pullback early in the month due to the beta/carry unwind but regained most of its lost ground thanks to a tighter-for-longer monetary policy outlook. The yen bounced early in June during the carry unwind but then continued its slide as the lowest-yielding currency in the G10.

We expect the US dollar to remain well supported — it is hard to beat a high-yielding, safe-haven currency with decent growth. This is particularly true given the rising political risk in France, Mexico, and US as the autumn election draws closer.

However, weaker US inflation data and decelerating growth suggest that US dollar upside should be limited; there is a rising risk of a temporary pullback over the summer.

The euro is enjoying a modest relief rally following the first round of French election, but it was short-lived. The outcome points towards a hung parliament, and there will likely be a prolonged period of policy uncertainty. This extended euro uncertainty will also likely continue to weigh on regional currencies as they are sensitive to EU growth — namely the Scandinavian currencies, and to a lesser extent, the British pound — while supporting the Swiss franc.

Rising political risk and recent weakness in commodity prices — the Bloomberg Commodity Index finished June, 6.1% off its May high — are likely to cap gains in commodity currencies. Within the commodity group, the more hawkish central banks in Norway and Australia should help limit any losses, provided global risk sentiment and equity markets remain strong. On the more vulnerable side is the Canadian dollar, which is vulnerable not only to weaker commodity prices, but also to monetary easing and slow growth.

Review and Outlook by Currency

US Dollar (USD)

The US dollar was largely directionless through the month but managed to finish with a 0.8% gain relative to the G10 average. The month began with a sharp rally following better-than-expected employment data. That strength reversed the next day, 12 June, on weaker-than-expected inflation. The Fed also met later the same day and was slightly more hawkish than expected — helping to reverse nearly half of the morning's loss.

The dollar then regained its post-employment report high over the next few days until weaker-than-expected retail sales on 18 June brought it back to flat for the month. From there, it gradually recovered into month-end on better-than-expected Purchasing Managers' Index (PMI) data and a recovery of the carry trade — which supported higher-yielding currencies such as the dollar.

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 investors with a horizon of two years or more, we strongly recommend short US dollar positions; just look through this highly uncertain transition period.

For those with a shorter horizon, we believe the US dollar will continue to be well supported in its range — though there is a rising risk of a temporary summer pullback on weaker employment and inflation data. Aside from any temporary correction, over the multi-month horizon, the dollar remains the top-ranked currency in our models due to high interest rates, the fragile global environment (as defined by our macro regime model), and strong US equity market performance. Heightened political risk in France, Mexico, and the US should also provide support — at least through November.

The US election looms large after a poor debate performance from President Biden; the greater prospects of a Trump victory bring the risk of stagflationary policies — such as higher tariffs and sharply reduced immigration. Such policies will likely increase global risk aversion and impede the ability of the Fed to cut rates; in the extreme case, they could force the Fed to hike. The US would win on the back of a safe-haven bid as well as higher yields, at least for a time.

Canadian Dollar (CAD)

The Canadian dollar gained 0.4% against the G10 average in June. Weaker oil prices early in the month, a 0.25% rate cut from the Bank of Canada (BoC) at its 5 June meeting, and strong US employment data on June 7 set the Canadian dollar on a downward path through the first half of the month. The BoC meeting was notable not only because it marked the first rate cut since March 2020, but also because the accompanying statement struck a dovish tone, noting that additional cuts could be expected if disinflation continues.

The sharp drop in the US dollar following weak Consumer Price Index (CPI) data pushed the Canadian dollar to its intra-month low against the G10 average on 12 June — down 1.1%. A subsequent recovery in both the US dollar and oil prices helped the Canadian dollar quickly retrace about half of its loss in the mid-month. This modest recovery turned into a sustained uptrend through month-end following better-than-expected retail sales on 21 June and higher-than-expected inflation on 25 June, which dented expectations of another BoC rate cut in July. By month-end, the Canadian dollar was unable to catch up to the US dollar but ended with a gain against the broader G10 average.

Our models shifted to a negative tactical view on the Canadian dollar in June due to weakness in commodity prices, softer equity performance relative to other currencies, and lower yields. Economic data, while slightly better than expected overall, reveals that the Canadian economy remains well below potential growth, with labor market slack and little sign of recovery. We saw a similar deterioration in forecasts for other commodity-sensitive currencies, with Canada showing the weakest performance; in contrast, Australia and Norway were supported by a combination of better economic growth and expectations for tighter monetary policy for an extended period.

In the long term, however, the Canadian dollar looks more stably attractive against a number of currencies. It is cheap in our estimates of fair value relative to the euro, the Swiss franc, and the US dollar.

Euro (EUR)

The euro was predominantly influenced by French election risk, ending the month 0.6% lower against the G10 average. The European Central Bank's (ECB) meeting on 6 June had little impact on the currency; while it cut rates as expected, it signaled a more cautious, data-dependent approach to future cuts.

On 9 June, French President Emmanuel Macron surprised both markets and politicians by announcing a parliamentary election to be held in two rounds — 30 June and 7 July. Early polls indicated a likely victory for the far right, with the far left not far behind, leaving Macron's centrist party with little power. Both leading parties are widely expected to advocate for further fiscal expansion that France can scarcely afford; moreover, the EU-sceptic far right is also likely to erode pan-EU reform efforts needed to improve long-run growth and financial stability. French bond spreads widened sharply compared to Germany, European equities retreated, and the euro dropped 1% over the following four trading days before stabilizing at depressed levels by month-end.

We maintain a neutral view on the euro against the G10 average. On the positive side, we have seen better economic data and a significant improvement in year-ahead growth forecasts for the EU, as well as expectations of a more gradual ECB easing cycle. However, any benefit from those factors is more than offset by French political risk.

We saw a modest recovery after the first round of elections, but it was short-lived. There remained a possibility for the RN party to secure an absolute majority, which could have potentially led to increased fiscal deficits and clashes with EU officials. Even in our base case of a hung parliament, there will be a tendency toward greater fiscal spending, heightened uncertainty as the parties wrangle for power, and decreased cooperation with the broader EU agenda. Most importantly, these issues will almost certainly extend for months or longer.

As a result, we believe that French debt and the euro will require an additional risk premium through most of 2024. This may mean some additional euro weakness, but at the very least a lack of upside, even if we continue to see gradual improvement in growth and fewer ECB cuts this year.

British Pound (GBP)

The British pound rose 0.1% against the G10 average in June. It outperformed the euro following the announcement of the French election but struggled against the broader G10 due to weaker growth prospects and EU political turmoil, which is not good for the UK economy. Weaker UK employment data on 11 June added additional downside pressure.

On 20 June, the Bank of England met and opted to keep rates unchanged, noting that the decision was “finely balanced.” Some members indicated they believed disinflation would continue at a healthy pace despite sticky services inflation. Markets took this message as dovish, increasing the potential for an August rate cut, which slightly pushed the pound down. This marked the intra-month low at -0.3% before better-than-expected PMI data on 21 June and a general improvement in risk sentiment helped the currency climb back into positive territory for the month.

Our models have shifted to a positive tactical view on the pound relative to the G10 average. This change is mostly due to improved scores against the commodity currencies, as commodity prices retreat from their May highs. Additionally, our view is also bolstered by better UK economic data.

Like France, the UK went to the polls in early July. The outcome was far more certain, a convincing Labour Party victory. Labour’s platform is much friendlier for the pound than RN’s stance on the euro. It is fiscally conservative with reasonable attempts to bolster long-term growth and the potential for greater trade cooperation with the EU, something which is sorely needed to offset the negative impacts of Brexit. Thus, the UK election was a moderate positive for the pound.

However, we anticipate continued underperformance against the US dollar. The US offers higher yields, better growth prospects, and serves as a safe-haven hedge in case of greater political risk or a sharp deceleration in global growth.

Our long-term 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. The fair value to the US dollar has fallen from 1.55 to 1.41 since May 2022. Breakeven inflation expectations and the recent trend in productivity differentials suggest that fair value will trend down to at least the mid-1.30s over the next few years. Despite this trend, the pound, currently trading in the mid-upper 1.20s, remains materially cheap, even if fair value trends down as expected.

Japanese Yen (JPY)

The yen fell 2.0% in June relative to the G10 average, bringing its year-to-date loss to 10.8%. The month began on a positive note, with the yen rising more than 1% as political risk in Mexico and a steep commodity sell-off triggered an unwind of the carry trade. The yen’s 0.1% short-term yield makes it the preeminent carry funding currency — an unwind of that trade results in yen buying.

However, the bounce was short lived. After 4 June, the yen steadily sold off for the rest of the month, alongside a recovery in the carry trade and higher equity markets. Investors were disappointed that the Bank of Japan (BoJ) decided not to decrease bond purchases at its 13 June meeting; however, the yen was little changed on that day.

Our model signal for near-term yen performance flipped positive in June. The yen appears to be short-term oversold, particularly to relative interest rates vs. the US dollar. Over the past two months, the 2-year interest rates, two years forward — a proxy for future relative policy rates — have moved 0.57% in favor of the yen. However, the US dollar versus the yen has risen to a new cycle high above 160.

This recent disconnect with interest rates and our base case that US disinflation will resume and US growth will slow back to or slightly below its long-run trend — suggests that the yen is overdue a recovery, at least 5–6% versus the US dollar. We also expect additional intervention from the Ministry of Finance should the yen threaten to move above 165 vs. the dollar; this implies a strong positive skew to the yen over the next 2–3 months.

In the long term, we see a rally in the yen of around 20% over the next 2–3 years versus the US dollar (a fall in the USD/JPY exchange rate). This move is consistent with a compression in USD/JPY interest rate carry of 200–250 basis points and would take USD/JPY down to a level of 125–130 versus the US dollar from its current level of north of 155. We expect Fed rate cuts to deliver 1.50–2.00% of that carry compression and BoJ rate hikes to account for an additional 0.5% between now and mid-2026. A hard landing in the US would send US rates and USD/JPY even lower (yen higher).

Swiss Franc (CHF)

The franc was the second-best performing G10 currency in June, up 0.9% versus the average. But it was a tale of two halves — a pronounced 2.1% rally through 19 June, followed by a steady downtrend thereafter.

The month began on a positive note following the unwind in global carry trades triggered by political uncertainty in Mexico, benefitting low-yielding currencies such as the franc. That unwind subsided after only a few days, but the franc then received a second boost following the announcement of the French election. The franc remains the currency of choice in the face of EU political uncertainty.

An unexpected second consecutive rate cut from the Swiss National Bank (SNB) on 20 June changed the dynamic, sending the franc lower. In addition to the SNB rate cut, the ongoing recovery in the global carry trade — alongside rising equity markets — further weighed on lower-yielding currencies into month-end.

Our models turned slightly positive on the franc versus the G10 average, entirely due to a negative flip in our commodity signal. Additionally, we hold a slightly positive view on the franc versus the euro, driven by better growth prospects and a persistent risk premium related to the French election.

Aside from the euro and commodity currencies, we are broadly negative on the franc in both our tactical and strategic models. It remains the most expensive G10 currency per our estimates of long-run fair value, has the second-lowest yields in the G10, and inflation is falling faster than expected.

With the real trade-weighted franc still at the upper end of its 30-year range — and the SNB both cutting rates and amenable to intervention to prevent excessive franc strength — we believe the franc is in the early stages of a prolonged reversion back down toward our estimate of its long-term fair value. This reversion will be only temporarily interrupted by a political risk premium.

Norwegian Krone (NOK)

Following a stellar 3.3% gain in May, the krone lost 0.6% relative to the G10 average in June. It was a difficult and volatile month, though the currency managed to close well above its intramonth low of down 1.6%. Despite an upside surprise in Norwegian CPI, the sharp drop in oil prices, the carry trade unwind, the strong US employment report, and the initial reaction to the French election news all conspired to send the krone to its low by 11 June.

After a period of consolidation mid-month, rising oil prices and anticipation of a hawkish Norges Bank policy meeting began to provide support. On 19 June, that meeting occurred and as expected, the Norges Bank signaled that it expected to keep rates on hold at 4.5% through the remainder of the year — versus previous guidance pointing a Q4 rate cut. The krone recovered all of its early-month losses before tracking a bit lower toward month-end on little news.

In fact, late-month news was krone-positive. On 28 June, May retail sales came in much better than expected — 3.2% MoM versus 0.5% expected — and the Norges Bank reduced planned July krone sales by 150 million per day relative to June — yet the currency failed to respond.

Our tactical model signals flipped negative on the krone due to weaker commodity prices and poor local equity market performance. While economic indicators and the monetary policy outlook improved somewhat, they were not sufficient to maintain a positive signal. The fundamental growth outlook and expectations of higher for longer rates should help to limit downside risks. However, the krone is likely to remain volatile due to rising political risk, poor summer liquidity potentially triggering temporary corrections in equity markets, and consolidation in commodity prices.

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

Swedish Krona (SEK)

The krona was flat in June versus the G10 average. An uptick in PMI data on 5 June and the early-month unwind of the carry trade appeared to have helped the krona early in the month. This was likely due to investors trimming back long Norwegian krone versus krona positions, which had been accumulated to take advantage of the monetary policy divergence between the Norges Bank and Riksbank. The krona also responded positively to the downside US CPI surprise and likely enjoyed a positive knee-jerk reaction to the French election news, which bolstered its appeal versus the euro.

As carry trades rebounded and the reality of the French election set in — where weaker EU growth probably hurts Swedish growth — the krona quickly sold off, losing all of its gains by the 14 June. From there, a positive inflation surprise — core CPI up 0.8% MoM vs. 0.5% expected — allowed the krona to recover until the theme of central bank divergence reemerged. The hawkish Norges Bank meeting on 19 June followed by a dovish Riksbank meeting on 27 June, pushed the krona back to flat to end the month. The Riksbank held rates steady at 3.75%, but indicated that there could be 2–3 more 0.25% rate cuts this year, more than expected.

Our krona models shifted back into positive territory versus the G10 average due to improved economic data and a better outlook compared to commodity-sensitive currencies. However, this positive trend appears fragile. While it is promising to note better PMI numbers following last month's upside surprise to Q1 gross domestic product (GDP). However, household consumption remains depressed, suggesting the upside inflation surprise may not persist. We believe the Riksbank's projection of additional rate cuts should weigh on the krona.

Thus, we stress that the current positive signal is likely short-term (tactical), and we continue to see the krona lag against the US dollar over the next 1–2 quarters. The currency is very cheap to long-run fair value and cyclically depressed, but at this point we struggle to see a catalyst to provide a sustained rally.

Australian Dollar (AUD)

The Australian dollar was the top-performing currency in June, gaining 1.1% relative to the G10 average thanks to a stellar late-month rally. Even in the first half of June, the dollar held up fairly well despite being down, as higher-yielding currencies sold off. This makes sense considering the positioning: Australian nominal yields are above 4% but below the top 4 in G10, and real yields remain near zero. Ongoing stress in the Chinese yuan also weighs on the Australian dollar's outlook. Indications suggest that Australia was not a favored high-yielding currency, which helped insulate it from the unwinding of carry trades. Thus, the currency experienced a mild sell-off as commodities fell and carry positions were liquidated, followed by an equally mild recovery mid-month as those trends reversed.

Almost all of the dollar's gains came following the higher-than-expected CPI report on 25 June — 4% YoY versus 3.8% expected. In response, the probability of a Reserve Bank of Australia rate increase in August jumped from 3% on 24 June to 26% by month-end and the Australian dollar rallied in sympathy.

Our models shifted from near neutral to firmly negative due to a shift in our commodity signal. Rising global political risk, the weak Chinese Renminbi, and the strong US dollar all limit upside potential for the Australian dollar. The recent downturn in our commodity model is a marginal negative, but its impact may be overstated at the moment. Over the past couple of years, broader risk sentiment and global monetary policy factors have been a much more influential currency driver than commodity markets.

In addition, there are positive factors that should mitigate downside risks for the Australian dollar. Despite sluggish economic growth, the economy is sluggish, but growth remains positive, inflation is higher than expected, and a large tax cut in the second half of year should provide support to domestic demand. This increases the chance of another rate hike supportive of the dollar in August. Therefore, while we are negative on the currency, we are not dramatically so and see potential for some additional upside should the official Q2 inflation print released in July surprise to the upside.

In the long-term, the Australian dollar outlook is mixed. It is cheap against 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. The Chinese story is less positive, with a structural downtrend in growth and a shift towards domestic consumption and higher value-added industries, which may gradually reduce the growth rate of Australian commodity export demand.

New Zealand Dollar (NZD)

The New Zealand dollar traded sideways in a choppy range to finish flat versus the G10 average in June. In the absence of major economic data releases or central bank policy meetings, price action was largely determined by global events. The dollar shrugged off the global decline in high-yield currencies to start the month, likely thanks to lingering support from the more hawkish-than-expected message from the Reserve Bank of New Zealand (RBNZ) on 21 May.

The strong US employment report and US dollar rally sent the New Zealand dollar lower on 7 June before it rebounded the following week on lower-than-expected US inflation, only to falter and move back to flat mid-month. The Q1 GDP report released on 19 June beat expectation — at 0.2% QoQ vs. 0.1% expected — providing some support. However, 0.2% growth is hardly impressive and had only a temporary impact, leaving the currency to languish nearly unchanged through the remainder of the month.

Our tactical model remains negative on the dollar. The benefit of New Zealand's high yields is fully offset by ongoing challenges to growth and the weak external balance — the current account is -6.8% of GDP — and weaker commodity prices. The more hawkish tilt of the RBNZ is supportive, but that was largely reflected in the May rally. Meanwhile, poor growth and the medium-term trend of disinflation suggest that monetary easing will likely be necessary at some point this year. Thus, current policy rates at a healthy 5.5% should help limit the downside for the dollar, but they are not enough to prevent softness.

In the long term, our New Zealand dollar outlook is mixed. Our estimates of long-run fair value suggest that it is cheap versus the US dollar and the Swiss franc and has ample room to appreciate, but it is expensive against the yen and the Scandinavian currencies.

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Marketing communication

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