Insights
Currency & Cash

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Currency Market Commentary

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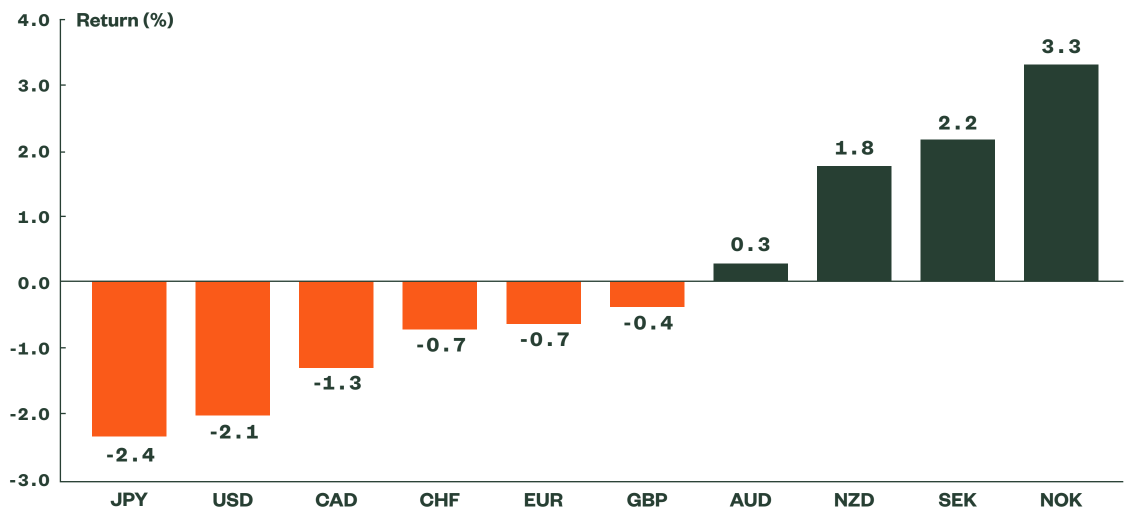
Summary of Views

Soft US economic data and comments from US Federal Reserve (Fed) Chair Jerome Powell — discouraging speculation of another rate hike — set a positive risk tone to the markets. Equities rallied and yields fell back during the first half of May. The US dollar suffered, while the higher-beta (risk-sensitive) currencies such as the Norwegian krone, the Swedish krona, and the New Zealand dollar led the G10. Broadening global growth and positive risk sentiment also kept the carry trade alive, with the low-yielding Japanese yen and Swiss franc underperforming. Aside from the impact of strong macro sentiment, relative expected central bank moves also had an impact on currency markets. Anticipation of June rate cuts from the European Central Bank (ECB) and the Bank of Canada (BoC) weighed on the euro and the Canadian dollar, while a dovish tone from the Bank of England (BoE) likely stifled the British pound.

Figure 1
May 2024 Currency Return vs. G10 Average



Source: Bloomberg and State Street Global Advisors, as of 31 May 2024. **Past performance is not a reliable indicator of future performance.**

Figure 2
May 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 31 May 2024.

We anticipate that US economic data will continue to soften as labor markets loosen and consumers feel the squeeze from modest, albeit positive, real income growth. This should keep modest pressure on the US dollar — though not enough to decisively break lower out of its range. The US remains among the highest-yielding and fastest-growing economies among the G10 countries, benefitting from safe-haven behavior in potentially volatile equity and credit markets, which we anticipate may see choppier performance.

As we head through the summer, US election risk is also likely to provide US dollar support. With the dollar range-bound, we expect most other G10 currencies to follow suit. June is expected to bring a low-conviction environment, with only a slight negative US dollar bias and volatility in specific currencies driven largely by idiosyncratic surprises in economic data or central bank action. However, we do not foresee a major shift in current trends that would change the prevailing macro narrative, only modest positive or negative shifts in growth outlooks and timing of expected central bank policy changes.

Review and Outlook by Currency

US Dollar (USD)

The US dollar fell 2.1% versus the G10 average in May. The weakness began early after the 1 May Fed meeting, following comments from Fed Chair Powell that suggested an additional rate hike was unlikely. Downward pressure on the dollar grew stronger after the employment report undershot expectations on 3 May — adding 175,000 new jobs compared to an expectation of 240,000 and showing 0.2% average hourly earnings growth compared to 0.3% expected. The mid-month Producer Price Index was slightly stronger than expected and the Consumer Price Index (CPI) met expectations, but the US dollar sell-off continued as markets appeared to focus more on poor retail sales data. The relatively benign composition of the inflation data also likely added to US dollar pessimism. For example, core CPI remained elevated at 0.3%, almost entirely due to a couple of outlying categories such as auto insurance.

During the second half of the month, encouraging Purchasing Managers' Index (PMI) data and a number of hawkish Fed speakers prompted US yields to rebound; however, the dollar was barely able to reclaim 0.5% of its early-month loss. Then, on 30 May, a downward revision of Q1 gross domestic product (GDP) from 1.6% QoQ annualized to 1.3% and a subdued 0.2% MoM core PCE inflation reading on 31 May pushed the currency back to its low for the month.

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 investment horizon, we believe the US dollar is range-bound, with a slight risk of decline skewed slightly lower in June if employment and inflation data continue to soften. However, over a multi-month horizon, the dollar remains the top-ranked currency in our models due to high interest rates, a fragile global environment (as defined by our macro regime model), and strong US equity market performance. The high likelihood that the ECB, BoC, and perhaps the BoE will cut interest rates before the Fed should also provide near-term support for the dollar.

All of that said, we see some indicators of a more sustained US dollar sell-off on the horizon. Growth appears to be rotating from the US to the rest of the world as the global economy (excluding the US) recovers from a near-stagnant 2023. While the Fed may lag behind other central banks, ultimately over the next 6–12 months we expect the Fed policy easing to catch up. The closing of the growth gap, coupled with a stable to slightly lower US yield advantage, should unlock dollar weakness — barring a pronounced global slowdown, geopolitical event, or other positive shock for the US dollar. Clearly, it is early to confidently predict the timing of a more sustained dollar bear market.

Canadian Dollar (CAD)

The Canadian dollar depreciated 1.3% against the G10 average in May, even though it outperformed the US dollar by 0.8%. Relative to the G10, excluding the US, the Canadian dollar consistently performs in line with the US dollar, given the close economic and financial ties between the two countries. Thus, the US dollar weakness likely explains much of the fall in the Canadian dollar. Local Canadian fundamentals also justified a weaker dollar — with the exception of stronger-than-expected employment numbers. Both manufacturing and services Purchasing Managers' Indexes point to contraction. Q1 GDP disappointed at 1.7% QoQ annualized versus 2.2% expected; both March retail sales and median core inflation surprised lower. The ongoing string of downside inflation surprises and near-stagnant domestic demand growth suggest a June rate cut from the Bank of Canada — further weighing on the currency.

Contrary to the weaker domestic demand data and high risk of a rate cut, our model remains positive on the Canadian dollar over the near term. Much of this optimism stems from the recent uptrend in commodity prices, although this trend has been rolling over with oil prices in the past couple of weeks. Given the weak local demand, the deceleration of commodity price trends, and the likely upcoming rate cut, we see risks to our model's forecast and anticipate the Canadian dollar's performance to skew lower.

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 lost 0.7% against the G10 average in May as investors favored cheaper, higher-beta currencies amid the rebound in global risk sentiment. This trend was evident in the first few days of the month. The dovish reaction to Fed meeting held on 1 May and the disappointing US employment data triggered a surge in risky assets, lifting higher-beta currencies against the euro. Despite this, the euro managed to outperform the US dollar and the defensive, lower-yielding Swiss franc.

By mid-May, the euro's performance improved relative to the G10 average. Upside surprises in European Union (EU) services PMI, retail sales, and the ZEW expectations survey helped the euro erase its loss by 14 May. Additionally, dovish stance by the BoE and Riksbank meetings also helped. However, the second half of the month saw a return to weakness. Strong risk sentiment favoring high-yielding currencies, upside surprises in Swedish growth, UK inflation, better Chinese growth sentiment, and a hawkish Reserve Bank of New Zealand outlook pushed the euro lower against the G10 average.

We maintain a neutral view on the euro against the G10 average and a negative view against the US dollar. On the positive side, we have seen better economic data and a larger improvement in year-ahead growth forecasts for the EU, as well as improved short-run relative equity market performance.

On the negative side, continued disinflationary trends suggest a potential rate cut from the ECB in June, contrasting with the expectations for the US, Australia, and Norway to maintain higher rates for longer. While currency markets have been mostly focused on relative monetary policy outlooks, the expectation of structurally low growth driven by high levels of EU regulation, low productivity, and a difficult outlook for the German growth model is likely to limit enthusiasm to drive the euro higher over the near term.

British Pound (GBP)

The British pound fell 0.4% against the G10 average in May, although it remains the top-performing G10 currency year-to-date. After steady gains in the first four months of the year, the pound ran out of steam in early May. The sharp risk rally and US dollar sell-off from 1–3 May pushed the pound lower in favor of oversold, high-beta currencies. The currency remained depressed through the BoE meeting held on 8 May.

Although the committee did not change the policy rate, the vote shifted to 7–2, with two members favoring a 25 bps cut. BoE Governor Bailey commented that the central bank might have to cut rates "more so than currently priced into the markets." Markets took the dovish policy tone in stride, with the pound only falling a modest 11 bps on the day and losing another 8 bps in the following two days. From there, conditions improved and the currency recovered.

On 10 May, the March GDP and industrial production reports both beat estimates. The next week, average hourly earnings surprised higher — 5.7% YoY versus 5.5% expected. On 22 May, core services CPI registered a big surprise — 5.9% YoY relative to the 5.4% expected. Stronger growth and higher-than-expected wages and inflation pushed market estimates of the anticipated first BoE rate cut to November, helping the pound fully recover its early May loss. However, the currency fell back modestly in the final week of the month following a poor retail sales report and weaker-than-expected May services PMI.

Our factor models have moved back to neutral on the pound from negative at the start of May — driven largely by improved economic data, including a higher one-year-ahead consensus growth outlook. However, we are far from positive on the pound. It has appreciated significantly this year due to positive economic surprises and higher-than-expected inflation. However, positive surprises are increasingly difficult to achieve now that expectations have reset from recessionary fears to modest recovery.

Although inflation has been stubborn, it is trending lower. We see a high probability of an August rate cut, aligning with BoE Governor Bailey's comments more than with market expectations of the first full cut by November. Consequently, we foresee risks of fading yield support for the pound relative to current market expectations.

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 2.4% in May relative to the G10 average bringing its year-to-date loss to 8.8%. After a sharp rally following Japanese intervention to buy the yen on 1 May, it steadily depreciated throughout the month. Much of this comes down to the high-for-longer US interest rate narrative and strong global risk sentiment, which supports the carry trade — buying high-yielding currencies versus low yielders, yen being the lowest yielder in G10 and EM. There was also likely a contrarian psychological impact from the currency market intervention which pushed the yen artificially higher for a day and invited speculative shorts on the idea that underlying fundamentals, particularly large interest rate differentials, would send the yen back lower. We could see evidence of this in various investor positioning measures, which showed a growing short position in yen throughout the month.

Our model signal for near-term yen performance remains negative as high global yields and strong global equity performance weigh on the currency. But our longer-term view on the yen itself has not changed. We expect global interest rates, particularly US interest rates, to be the primary driver of the yen. Because we believe that US disinflation will resume and US growth will slow back to slightly below trend, 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 an anticipated compression in USD/JPY interest rate differential by 200–250 bps, potentially bringing the USD/JPY down to 125–130 compared to its current level of 155. We expect Fed rate cuts to deliver 1.50–2.00% of this interest rate differential reduction, 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 (and an increase in the yen).

The recent strength in US inflation and growth makes the timing of Fed rate cuts and sustained yen appreciation highly uncertain. So, as long as US growth and inflation keep the Fed on the sidelines, we expect the yen to remain weak and weaken further if US yields break to new highs. That said, the ongoing intervention in support of the yen, our expectation of limited additional upside in US yields, and the large short yen positions in the marketplace should limit further yen downside over coming months. In other words, we see the likely distribution of yen returns skewed decisively higher over the multi-quarter horizon.

Swiss Franc (CHF)

The franc depreciated 0.7% in May against the G10 average. Improved risk sentiment and falling volatility favored higher-yielding currencies throughout the month. Despite this, the franc remained nearly unchanged through mid-May as investor focused on selling the yen and the US dollar. Higher-than-expected April core inflation, reported on 2 May (+1.2% YoY vs. +0.9% expected), likely played an important role in defending the franc from investor selling.

This changed as global yields began to rebound in the second half of May. The franc trended steadily lower from 14–27 May, until comments from Swiss National Bank (SNB) Governor Jordan triggered a rally, allowing it to retrace two-thirds of its month-to-date loss. Jordan struck a cautious tone, commenting that the equilibrium interest rate was likely higher than that before the pandemic. While this seems obvious, it called into question a rate cut at the upcoming June meeting, thereby supporting the currency.

We are negative on the franc in both our tactical and strategic models. It remains the most expensive G10 currency as per our estimates of long-run fair value, has the second lowest yields in the G10, and inflation is falling faster than expected. The real trade-weighted franc is still at the upper end of its 30-year range and with the SNB cutting rates and open to intervention to prevent franc strength, we believe we are in the early stages of a prolonged reversion lower toward our estimate of its long-term fair value.

However, there is room for a modest, but temporary recovery in June, due to the recent rebound in inflation and our expectation that the central bank will maintain its current stance at the June meeting.

Norwegian Krone (NOK)

The krone shrugged off weaker oil prices to appreciate 3.3% against the G10 average. The rally began in early May, spurred by the market's dovish interpretation of Fed meeting held on 1 May, the better-than-expected Norwegian manufacturing PMI, a surprise decline in US employment on 3 May, and a hawkish policy statement from the Norges Bank, also on 3 May. The Norges Bank noted that "data so far could suggest that a tight monetary policy stance may be needed for somewhat longer than previously envisaged." An upside surprise in Norwegian CPI on 10 May further fueled the rally, as did the persistent uptrend in equity markets.

The krone's rally stalled on 27 May as equity markets pulled back, and Norway's retail sales report on 28 May came in below expectations — showing a decline of 0.3% versus an expected decline of 0.1%.

Despite lackluster growth data, our models maintain a neutral-to-slightly positive view on the krone — it is the third strongest signal behind the US and the Canada. Core inflation remains uncomfortably high at 4.4% YoY. At that level, we expect the Norges Bank to remain hawkish longer than the ECB, BoE, Riksbank, and BoC.

Our economic growth-based models remain pessimistic on the krone, but from the perspective of both short-term valuation relative to commodities and expected yields, it is more of a buy than a sell against most G10 currencies. 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 rebounded nicely in May, ending the month up 2.2% against the G10 average. Much of the krona's strength appears to be due to strong global risk sentiment, which lifted risky assets and higher-beta currencies. Beyond that, it is tough to pinpoint specific fundamental factors supporting the rally.

During the first half of the month, the services PMI sharply dipped into contractionary territory at 48.1, and the Riksbank cut policy rates from 4.0% to 3.75%. Despite these events, the krona moved sideways. Mid-month, the currency began to trend higher, although this was contrary to Swedish fundamentals.

On 15 May, core CPI came in lower than expected — 2.9% YoY versus 3.0% expected — fortifying more dovish expectations for Swedish monetary policy. It was not until month end of the month that we saw some positive news: retail sales released on 28 May recovered to 0.3% in April from 0.0% in March. Two days later, Q1 GDP report surprised sharply higher, with 0.7% QoQ increase compared to an expected 0.0%. The krona rallied on 30–31 May to finish the month at its high.

Our models shifted negative on the krona in April and remain so going into June. While we welcome the rebound in Q1 GDP, growth continues to look sluggish in Q2. The easier relative Swedish policy monetary outlook favors sustained krona weakness. We believe that the Riksbank will follow its May cut with 2–3 additional cuts this year, which would be very welcome news for the heavily indebted household and property sectors, but not beneficial for the currency over the short run. Although the currency is very cheap to long-run fair value and cyclically depressed, at this point, we struggle to see a catalyst for a sustained relief and extending the May rally.

Australian Dollar (AUD)

The Australian dollar gained 0.3% against the G10 average during May. The dollar started the month strong, buoyed by positive, risk-on investor sentiment, a strong rally in industrial metals, and weaker US economic data. The Reserve Bank of Australia (RBA) meeting on 7 May caused a temporary setback when the governor observed that the policy rate of 4.35% was "at the right level" — contrary to market hopes of another rate hike reintroduction.

The second half of the month was much more difficult in response to an unexpected rise in the unemployment rate, slightly softer wage growth, weaker-than-expected retail sales, the stalling global equity rally, and a steady reversal of the early-month rally in industrial metals prices. By month-end, the Australian dollar forfeited nearly 75% of its early May gains.

Our models remain in the neutral-to-negative range for the Australian dollar, slightly weaker than the signal going into May. On the positive side, our growth signal is improved very slightly and market expectations for a steady monetary policy rate are favorable compared to the growing number of central banks expected to cut rates in Q2–Q3. However, recent commodity prices pullbacks and a sluggish, albeit positive, growth outlook are weighing on the currency.

The Chinese outlook is important for the dollar but presents a complicated picture. We foresee stabilization in China supported by targeted government stimulus, but we do not see a major economic recovery this year. Additionally, the upcoming US presidential election is likely to introduce additional political risks, including the threat of increased tariffs and/or potential tension in the South China sea or regarding Taiwan policy.

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 gained 1.8% against the G10 average in May. During the first half of the month, the dollar rose alongside other high-beta G10 currencies in response to improved terms of trade, weaker US data, and robust global risk sentiment. Unlike the Australian dollar, the New Zealand dollar was able to hold its gains through the second half of the month, although its rally stalled alongside the global equity rally.

The stronger performance in late May can be attributed to a more hawkish-than-expected Reserve Bank of New Zealand (RBNZ) monetary policy decision on 22 May. The RBNZ held rates steady at 5.5% but raised their forecast for peak rates to 5.65%, openly discussed the potential for another rate hike, and indicated that the projected first rate cut would not happen until Q3 2025.

In May, our tactical model signals shifted from neutral to negative. Ongoing growth challenges and the weak external balance — the current account is -6.9% of GDP — more than offset the benefit of New Zealand's high yields. The RBNZ's more hawkish tilt is supportive, but the necessity of holding rates steady until Q3 2025 remains unclear. The rates market continues to price in the first rate cut by February 2025, which appears more consistent with growth challenges and the medium-term trend disinflation.

Despite a muted move in interest rates and growth, the strong rally in the currency has prompted our short-term value value model to suggest that the New Zealand dollar is due a pullback in June–July.

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 is expensive against the yen and the Scandinavian currencies.

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* Pensions & Investments Research Center, as of December 31, 2022.
† This figure is presented as of March 31, 2024 and includes ETF AUM of $1,360.89 billion USD of which approximately $65.87 billion USD is in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.