

FX FORECASTS

A New Wave of Worries Undermines the Pound and the Euro

HIGHLIGHTS

- ▶ The financial markets have had several turbulent days recently, which benefited the US dollar again. The greenback has also strengthened on the back of expectations for more monetary tightening in the United States. At its latest monetary policy meeting, the Federal Reserve (Fed) tightened aggressively again and signalled that more rate hikes were to come. According to the latest forecasts from Fed officials, the upper bound of the federal funds rate target range could reach 4.75% in 2023 compared to its current level of 3.25%.
- ▶ The pound sterling has taken a beating recently, falling to US\$1.04, its lowest level since 1985. This came on the back of an ambitious mini budget announced by the UK government that includes tax cuts and support measures to help offset rising energy prices. However, investors are concerned about the impact on demand and inflation, and that the government will have to borrow heavily to fund the plan. The Bank of England had to intervene to stabilize the UK bond market, but that does not change the need to work harder in its fight against inflation, which could exacerbate the economic downturn and keep the pound weak.
- ▶ The euro is under pressure too and is currently trading at US\$0.96, its lowest level since 2002. Eurozone economic indicators for the coming quarters make for depressing reading. In the wake of the far-right coalition's victory in the Italian elections, we may see increased political and financial tension fuelled by resistance to the restrictions imposed by the European Union and the European Central Bank. Interest rate spreads on Italian bonds haven't widened too much yet, but the future is more uncertain.
- ▶ Higher US bond yields have pushed the US dollar/Japanese yen exchange rate near the ¥146 mark, leading the Japanese authorities to intervene on the foreign exchange market to shore up the yen for the first time since 1998. After Japan took action, selling assets in US dollars to buy yen, the exchange rate briefly fell to around ¥142. However, the Bank of Japan is still not signalling any change to its ultra-accommodative monetary policy. Adopting a less dovish monetary policy would probably have a greater, more lasting effect on the yen's exchange rate.
- ▶ The Canadian dollar—trading at under US\$0.73—has depreciated more in recent weeks than in the months before. This is due to increasing concerns about the Canadian economy as well as the fact that investors are expecting the Bank of Canada to soon pause its monetary tightening. Interest rate spreads are therefore less favourable for the Canadian dollar.

MAIN FACTORS TO WATCH

- ▶ Investor risk appetite is expected to remain soft over the next few quarters, which will continue to bolster the US dollar. We'll be keeping a particularly close eye on European currencies, especially if the risk of a deeper recession takes hold and if new political and financial tension emerges.
- ▶ We're still forecasting a mild recession for Canada in our baseline scenario as the housing market correction continues. This will limit the potential for a rebound in the Canadian dollar over the coming months. We now expect the loonie to end the year at around US\$0.72, or potentially lower if the economy deteriorates more than anticipated.

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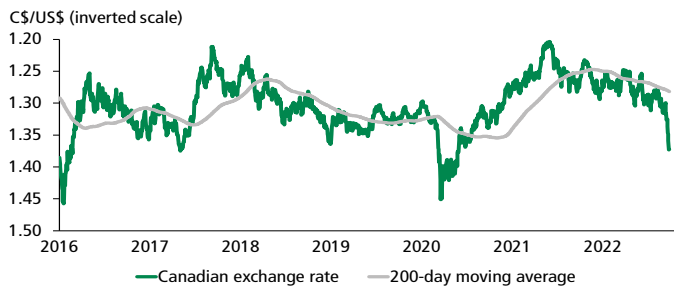
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NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

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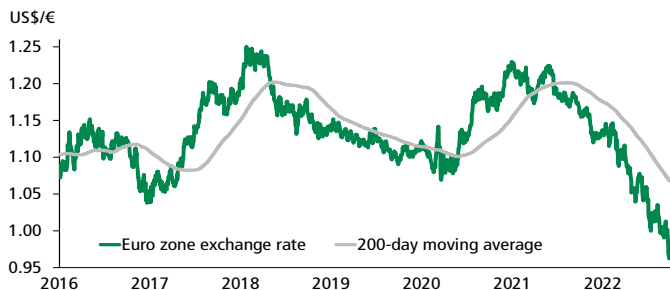
Main Exchange Rates

CANADIAN DOLLAR Exchange rate and trend



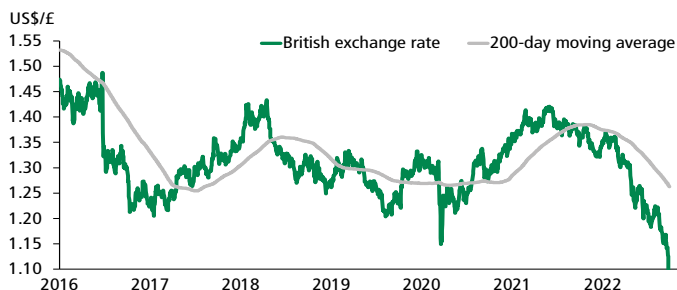
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EURO Exchange rate and trend



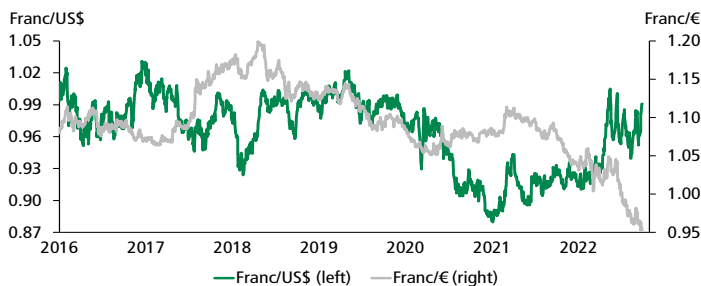
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BRITISH POUND Exchange rate and trend



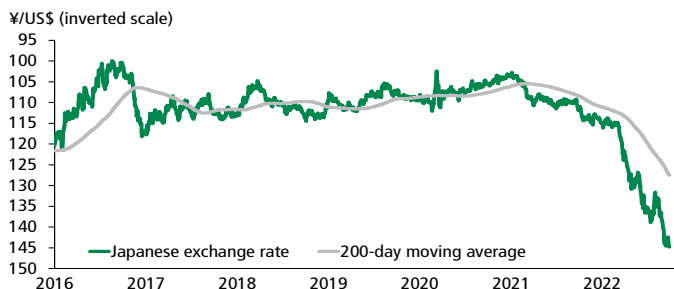
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SWISS FRANC Exchange rate



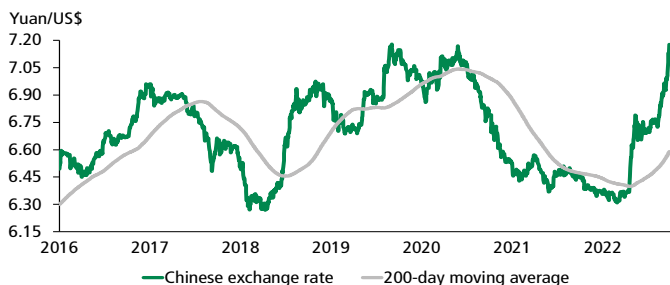
Sources: Datastream and Desjardins, Economic Studies

YEN Exchange rate and trend



Sources: Datastream and Desjardins, Economic Studies

CHINESE YUAN Exchange rate and trend



Sources: Datastream and Desjardins, Economic Studies

TABLE 1
Currency market: Yields

COUNTRY – CURRENCY*	SPOT PRICE	VARIATION (%)					LAST 52 WEEKS		
	September 27	-1 month	-3 months	-6 months	-1 year		Higher	Average	Lower
Americas									
Argentina – peso	146.5575	6.48	17.52	32.76	48.51		146.5575	114.6970	98.6846
Brazil – real	5.3503	5.35	2.61	12.50	0.04		5.7447	5.2480	4.6100
Canada – (USD/CAD)	1.3727	5.68	6.60	9.69	8.61		1.3727	1.2764	1.2320
Canada – (CAD/USD)	0.7285	-5.38	-6.19	-8.84	-7.93		0.8117	0.7835	0.7285
Mexico – peso	20.3215	1.92	2.16	1.90	1.10		21.8163	20.3927	19.4890
Asia and South Pacific									
Australia – (AUD/USD)	0.6435	-6.61	-7.06	-14.34	-11.67		0.7579	0.7127	0.6435
China – yuan renminbi	7.1779	4.46	7.26	12.75	11.16		7.1779	6.5441	6.3093
Hong Kong – dollar	7.8500	0.04	0.04	0.28	0.86		7.8501	7.8216	7.7731
India – rupee	81.7275	2.20	4.19	7.13	10.70		81.7275	76.7111	73.7975
Japan – yen	144.78	5.26	6.89	18.60	30.41		144.78	124.19	110.89
New Zealand – (NZD/USD)	0.5637	-8.12	-10.55	-19.09	-19.68		0.7204	0.6583	0.5637
South Korea – won	1,421	6.78	10.49	16.63	20.78		1,431	1,245	1,168
Europe									
Denmark – krona	7.7519	3.86	10.26	14.42	21.93		7.7519	6.8659	6.3578
Eurozone – (EUR/USD)	0.9621	-3.95	-9.21	-12.41	-17.77		1.1701	1.0865	0.9621
Norway – kroner	10.8247	10.83	10.53	25.66	25.83		10.8247	9.2291	8.3075
Russia – ruble	58.9500	-2.80	8.56	-41.34	-18.79		151.5000	72.4881	53.4500
Sweden – krona	11.3632	6.52	12.73	20.64	30.47		11.3632	9.6252	8.5171
Switzerland – Swiss franc	0.9898	2.76	3.50	6.33	6.89		1.0048	0.9438	0.9103
United Kingdom – (GBP/USD)	1.0775	-8.62	-12.42	-18.33	-21.38		1.3821	1.2833	1.0775

* In comparison with the US dollar, unless otherwise indicated.
Note: Currency table based on previous day's close.

TABLE 2
Currency market: History and forecasts

END OF PERIOD		2021		2022				2023			
		Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
US dollar											
Canadian dollar	USD/CAD	1.2680	1.2636	1.2501	1.2873	1.3699	1.3889	1.3889	1.3699	1.3514	1.3514
Euro	EUR/USD	1.1590	1.1372	1.1127	1.0455	0.9600	0.9500	0.9600	0.9900	1.0100	1.0300
British pound	GBP/USD	1.3484	1.3545	1.3167	1.2145	1.0700	1.0500	1.0500	1.0800	1.1200	1.1500
Swiss franc	USD/CHF	0.9331	0.9130	0.9206	0.9576	0.9900	0.9900	0.9800	0.9800	0.9900	1.0000
Yen	USD/JPY	111.29	115.10	121.68	135.75	144.00	138.00	132.00	126.00	120.00	115.00
Australian dollar	AUD/USD	0.7227	0.7261	0.7481	0.6903	0.6500	0.6400	0.6400	0.6500	0.6700	0.6800
Chinese yuan	USD/CNY	6.4467	6.3561	6.3400	6.6993	7.1500	7.2500	7.3000	7.2500	7.1500	7.0500
Mexican peso	USD/MXN	20.64	20.50	19.87	20.10	20.25	20.75	21.00	20.75	20.50	20.25
Brazilian real	USD/BRL	5.4391	5.5802	4.7375	5.2377	5.4000	5.6000	5.6000	5.5000	5.4000	5.3000
Effective dollar ¹		106.55	107.98	109.17	115.77	125.30	125.90	124.60	121.40	118.50	116.50
Canadian dollar											
US dollar	CAD/USD	0.7886	0.7914	0.7999	0.7768	0.7300	0.7200	0.7200	0.7300	0.7400	0.7400
Euro	EUR/CAD	1.4695	1.4370	1.3909	1.3458	1.3151	1.3194	1.3333	1.3562	1.3649	1.3919
British pound	GBP/CAD	1.7097	1.7115	1.6459	1.5633	1.4658	1.4583	1.4583	1.4795	1.5135	1.5541
Swiss franc	CAD/CHF	0.7359	0.7225	0.7364	0.7439	0.7227	0.7128	0.7056	0.7154	0.7326	0.7400
Yen	CAD/JPY	87.76	91.08	97.33	105.45	105.12	99.36	95.04	91.98	88.80	85.10
Australian dollar	AUD/CAD	0.9164	0.9175	0.9352	0.8885	0.8904	0.8889	0.8889	0.8904	0.9054	0.9189
Chinese yuan	CAD/CNY	5.0841	5.0302	5.0716	5.2044	5.2195	5.2200	5.2560	5.2925	5.2910	5.2170
Mexican peso	CAD/MXN	16.28	16.22	15.89	15.62	14.78	14.94	15.12	15.15	15.17	14.99
Brazilian real	CAD/BRL	4.2895	4.4161	3.7897	4.0689	3.9420	4.0320	4.0320	4.0150	3.9960	3.9220

f: forecasts; ¹ Trade-weighted against major US partners (January 2006 = 100).
Sources: Datastream, Federal Reserve Board and Desjardins, Economic Studies