



## Home on the Range

We have seen big movements in bond and equity markets so far this year, with considerable volatility in trading also, amid mixed signals from economic data and changes in expectations on the outlook for interest rates. However, while asset markets have been very unsettled, the major currencies have operated within relatively narrow ranging trading ranges, with the notable exception on the continued weakening of the yen.

This in marked contrast to the big currency moves seen in 2021 and 2022 when the dominant theme in forex markets was dollar strength. It gained over 25% on a trade-weighted basis between the end of 2020 and autumn of 2022 on the back of numerous factors, including a rapid rise in US interest rates, elevated risk aversion in markets and heightened geo-political tensions.

It has been much smoother sailing in currency markets in 2023. The EUR/USD rate has been largely confined to a \$1.05-1.12 corridor, compared to the wide \$0.96-1.23 trading range seen in 2021-22. Meanwhile, EUR/GBP has moved in a narrow 85.0-89.5p band to date this year, with sterling much more stable in 2023. Similarly, the Canadian, Australian and New Zealand dollars, as well as the Swiss franc, have been quite range bound this year. The main exception to this has been the continued marked weakening of the yen as the Bank of Japan continues with a very loose monetary stance.

This provides a clue to the stability of the other major currencies in 2023. Their central banks have become far more aligned on monetary policy this year. They all tightened rates aggressively in the first half of 2023, and then put policy on hold during the second half of the year. At the same time, they are warning of the need to maintain rates at restrictive levels for a prolonged period of time to bring inflation down to 2%, ruling out any cuts to interest rates in the near term.

Futures contracts are pricing in that rates will be cut by 100-140bps in the UK, Eurozone and the US by end 2025, indicating that markets expect the monetary policies of the main central banks to remain very aligned over the next couple of years. If central bank policies remain very much in sync, it suggests that the main currency pairs could stay quite range bound in the coming year and in 2025.

However, forex markets don't usually remain within narrow trading ranges for long periods of time. In this regard, the US dollar remains at an elevated level after its big gains in 2021-22, so it may be at the most risk of falling. The US economy has outperformed again this year, but the dollar may be vulnerable if the economy starts to slow sharply, as has already happened elsewhere.



The US would also appear to be ahead of other countries in the journey to bring core inflation back down to 2%. This opens up the scope to cut relatively high US rates more quickly than elsewhere if the economy does indeed turn down. The financing of the large twin US fiscal and balance of payments deficits could also start to get more attention in such circumstances. This would not be good news for the dollar either, but for now range trading seems the order of the day.

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