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Currency volatility: Will US dollar strength continue?

In light of improving global growth and repricing of Fed expectations, will the U.S. dollar sustain its strength in 2024? And what's the outlook for other major currencies?

Updated: April 30, 2024

Key takeaways

- The prospect of fewer interest rate cuts in the U.S. has taken the dollar to new highs — and should underpin its resilience going forward.
- If the European Central Bank (ECB) cuts interest rates sooner than the Federal Reserve (Fed), this will widen the rate gap between the U.S. and the Eurozone, putting downward pressure on the euro against the dollar.
- J.P. Morgan Research is taking a more tactical but still bearish stance on the pound in 2024, with sterling somewhat trapped between a potential dovish monetary pivot and better U.K. and global growth data.
- The USD/JPY trend continues to be driven by market expectations for Fed monetary policy, with the yen rallying sharply in April on the back of a robust U.S. March CPI print. JPY intervention remains a risk but would not resolve the underlying issues driving USD/JPY appreciation.

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Introduction

Despite uncertain macro conditions, the dollar has continued to demonstrate strength — largely thanks to sticky inflation, a resilient U.S. economy and year-to-date highs in yields. Indeed, in a display of U.S. exceptionalism, the greenback has gained against just about every other major currency in 2024.

Looking ahead, improving global growth and rising commodity prices look set to create more cross-currents in the FX market. Against this backdrop of heightened forex volatility, what's the outlook for the U.S. dollar, euro, British pound and Japanese yen?

The outlook for major currency pairs

1.22 GBP/USD

1.05 EUR/USD

155 USD/JPY

June 2024 | September 2024 | December 2024 | March 2025

Source: J.P. Morgan

GBP/USD is forecast to reach 1.22 in June 2024 and September 2024, 1.25 in December 2024 and 1.29 in March 2025. EUR/USD is predicted to reach 1.05 in June 2024 and September 2024, 1.09 in December 2024 and 1.12 in March 2025. USD/JPY is expected to hit 155 in June 2024, 154 in September 2024, 153 in December 2024 and 152 in March 2025.

> *"Strength in U.S. activity has been a mainstay of our long-dollar bias, and the persistence of U.S. exceptionalism is a major FX theme. But this has always been in the context of high market conviction that the Fed would invariably begin its easing cycle this year. This is now being challenged, and the corresponding de-pricing of Fed cuts has taken the dollar to new year-to-date highs."*
>
> **Meera Chandan**
>
> Global FX Strategist, J.P. Morgan

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The outlook for the US dollar

The U.S. economy has proven to be remarkably resilient, as underscored by strong inflation and labor market data. Consequently, the prospect of less easing by the Federal Reserve (Fed) this year has taken the dollar to new highs — and should underpin its strength going forward.

"Strength in U.S. activity has been a mainstay of our long-dollar bias, and the persistence of U.S. exceptionalism is a major FX theme. But this has always been in the context of high market conviction that the Fed would invariably begin its easing cycle this year," said Meera Chandan, Global FX Strategist at J.P. Morgan. "This is now being challenged, and the corresponding de-pricing of Fed cuts has taken the dollar to new year-to-date highs. Put simply, the macro market narrative has shifted from 'when' to 'whether' the Fed will ease this year, and has taken the dollar higher commensurately."

However, the ongoing improvement in global growth could temper the performance of the greenback, considering the currency tends to appreciate during times of risk and vice versa. J.P. Morgan Research has raised the odds of a "high-for-long" soft landing to 55%, while Purchasing Managers' Index (PMI) data continue to signal improving breadth and inclusiveness in the global economy.

"There have been several meaningful developments on this front of late, weighing on the dollar given its anti-cyclical properties. This may impede what otherwise looks like a potentially strong U.S.-led dollar environment, though we question whether it can fully offset ongoing U.S. exceptionalism," Chandan added.

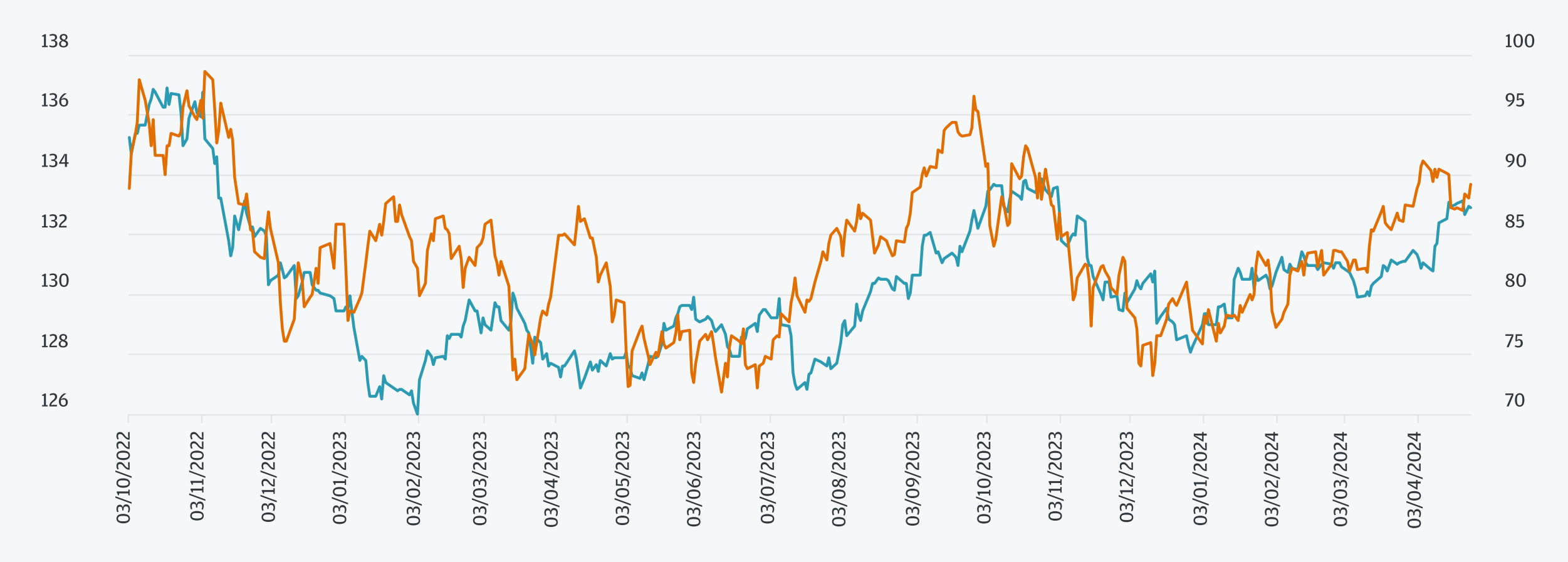
In addition, commodities are once again top of mind for the FX space as the complex has risen almost 7% off February lows. Furthermore, Russia's decision to cut oil production could push Brent prices to $100/bbl in the coming months, which could benefit the dollar.

This is in part due to the dollar's positive correlation with oil. Since late 2022, the dollar has tended to move in tandem with oil, especially during supply-driven episodes in the energy markets. Such episodes fuel inflation while also pressuring growth, thus supporting the dollar. "The potential move to $100/bbl would therefore be dollar-positive through the interplay of the dollar's anti-cyclicality, higher headline inflation and higher yields," Chandan said.

The greenback's fading sensitivity to commodity prices also reflects structural changes in the U.S.'s balance of payments that have taken place over the last two decades. The U.S. now produces around 12 million barrels per day (mbd) of crude and has drastically reduced the amount of oil it imports, which means that its international net energy needs are now flat and its trade deficit no longer mirrors shifts in energy imports. As such, swings in energy prices no longer affect the U.S.'s balance of payments the way they once did, to the dollar's benefit.

Overall, the dollar looks well-placed to withstand a further rise in oil prices. "We also continue to place strong emphasis on yields and the implications of higher-for-longer, and remain constructive on the USD," Chandan said.

The dollar's positive correlation with oil



Source: J.P. Morgan

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The outlook for the euro

J.P. Morgan Research remains bearish on the euro, especially if the European Central Bank (ECB) cuts interest rates sooner than the Fed. This will widen the interest rate gap between the U.S. and the Eurozone, putting downward pressure on the euro against the dollar.

"While the Eurozone may have avoided a recession, the euro has not been able to escape the bearish orbit, with market focus turning to the Fed–ECB policy divergence. This is the first time markets have been able to price in substantively more cuts from the ECB than the Fed," Chandan said.

On the other hand, Eurozone PMIs have been rising in recent months, which could be supportive of euro strength.

"While the Fed-ECB policy divergence is encouraging for euro bears like ourselves, a decisively better outcome would have been if this were unfolding alongside a persistence in EU growth underperformance versus the U.S.," Chandan noted. "However, even if European growth is turning, it isn't happening in isolation. U.S. growth data has also been better than expected, with the added advantage of a stronger starting point."

Overall, J.P. Morgan Research's EUR/USD targets remain unchanged at 1.05, the regional growth upturn notwithstanding. "Lower targets would require U.S. and Eurozone inflation trajectories to diverge further or for Eurozone growth momentum to be disrupted once again, while an upgrade of targets could be considered if the regional growth outlook improves substantially," Chandan said.

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The outlook for the British pound

J.P. Morgan Research is taking a more tactical but still bearish stance on the pound in 2024. "Currently, sterling seems somewhat trapped between a potential dovish Bank of England (BoE) pivot on the bearish side, and better U.K. and global growth data on the bullish side," Chandan said.

The BoE policy meeting in March showed a dovish shift in the vote, while recent PMI data suggests further gains ahead for the U.K. economy. In addition, U.K. gilts have materially outperformed DM bond markets such as the U.S. in the past month — which, somewhat surprisingly, has not translated into commensurate sterling underperformance.

"While some investors might view better growth as inflation-neutral due to a terms-of-trade improvement, it could still jumpstart a wider confidence boost that reduces the downside risk associated, with the BoE maintaining high-for-long rates. This may limit the ability of sterling to underperform," Chandan observed. In light of these factors, J.P. Morgan Research forecasts GBP/USD to reach 1.22 in June 2024, before climbing to 1.25 in December.

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The outlook for the Japanese yen

In 2024, the USD/JPY trend continues to be driven by market expectations for Fed monetary policy, not the Bank of Japan (BoJ). JPY intervention remains a near-term risk but would not resolve the underlying issues driving USD/JPY appreciation.

While the BoJ ended its negative interest rate policy in March, the market impact of this historic move was modest overall. On the back of the announcement, yen depreciation accelerated and USD/JPY adhered to a tight range of 151-152 for several weeks.

Then, the yen rallied sharply in April, driven by broad dollar strength on the back of a robust U.S. March CPI print — indicating that the Fed remains more relevant for USD/JPY than the BoJ.

"After the strong U.S. CPI print, expectations for Fed cuts have decelerated further and the market now only prices in only around 50 bp of cuts in 2024," Chandan said. "As such, we revise up our USD/JPY forecasts to 155 in June 2024, 154 in September 2024, 153 in December 2024 and 153 in March 2025."

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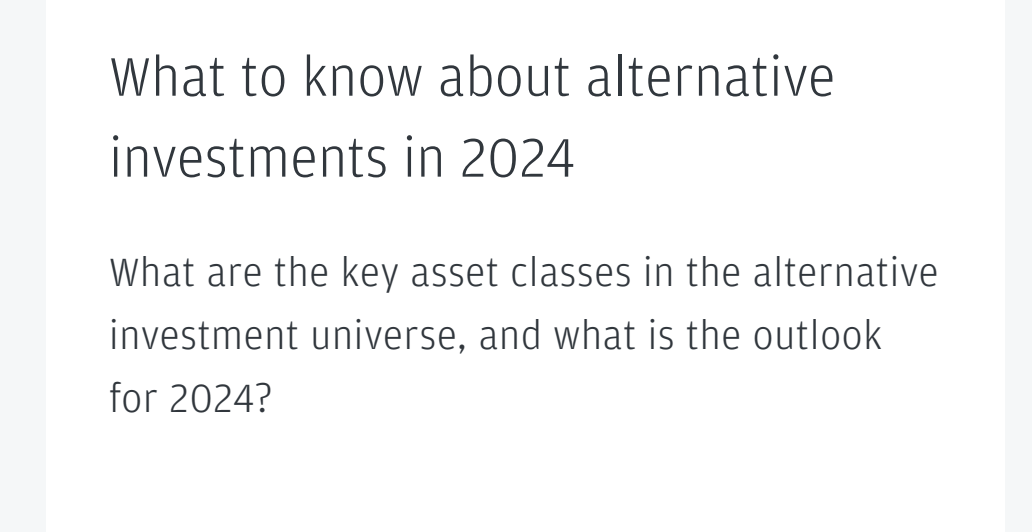

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