NAVIGATING CURRENCY VOLATILITY IN

Q2 2024

Insights for CFOs

THE BIG QUESTION: WHEN AND HOW QUICKLY WILL CENTRAL BANKS CUT RATES

The path of interest rates has held currency markets in a vice-like grip since central banks embarked on an unprecedented streak of consecutive rate hikes in 2022 amid red-hot inflation - stirring a torrent of monetary policy speculation that has pulled currency markets back and forth. For instance, when the Bank of England (BoE) left interest rates unchanged in September, breaking its prolonged rate hiking cycle as the British economy slowed, the pound tumbled to a six-month low - dropping by as much as 0.9%.

Having lifted borrowing costs to multi-year highs in the UK and US, and a record high in the Eurozone, to combat runaway price growth, policymakers paused interest rate hikes in the second half of 2023 as inflation began to cool.

These conditions have extended into 2024, as the BoE, Federal Reserve and European Central Bank (ECB) consider their next move against a backdrop of sticky inflation that remains above their shared 2% target. This begs the question: at what point - and how quickly - will these central banks start to cut rates to avoid plunging their respective economies into a downturn? The answer to this question is being hotly debated on both sides of the Atlantic.

Inflation has been on a downward trend in the UK, US and Eurozone in recent months but has become sticky of late, pushing back interest rate cut bets.

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BANK OF ENGLAND

HOLD

The BoE voted to keep borrowing costs at their 15-year high of **5.25%** in **March** for the fifth time running. The central bank signalled that Britain's economy is moving towards the point where it can start cutting interest rates.

EUROPEAN CENTRAL BANK

HOLD

The ECB left interest rates unchanged at a record-high **4%** in **March**, but acknowledged that inflation is easing faster than once thought, potentially opening the door for rate cuts later this year.

FEDERAL OPEN MARKET COMMITTEE

HOLD

Following its **March** policy meeting, the Fed kept interest rates steady in a range between **5.25%-5.5%** - where it has held since **July 2023** - and signalled it still plans multiple cuts before the end of the year.

With interest rates in stasis during Q1, currency volatility was largely tepid as the market attempted to second-guess the outcome of future central bank policy meetings and the path of inflation.

Inflation has been on a downward trend in the UK, US and Eurozone in recent months but has become sticky of late, pushing back interest rate cut bets. The clock is ticking in the UK and US, where the respective central banks will prefer not to take action during election campaigns.

FX FORECASTS

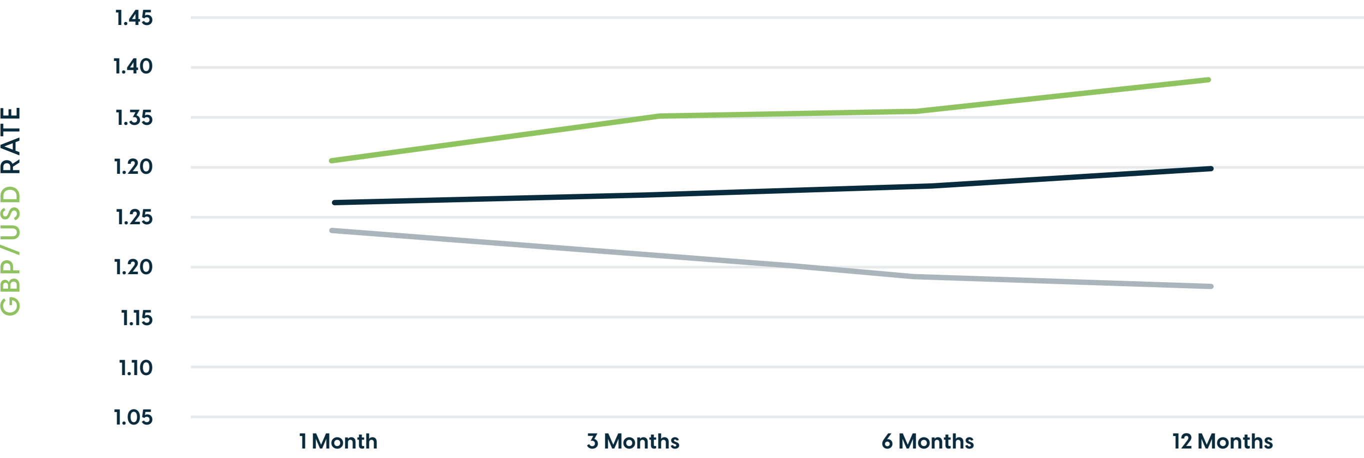
The forecasted trends of GBPUSD, GBPEUR and EURUSD will be circumstantial depending on various outcomes such as the global economy, rate decisions from central banks and geopolitical factors. This means that there is a variety of contrasting views from respected institutions, highlighting the difficulty in trying to call the markets.

The following data has been taken from LSEG Data & Analytics and interpreted from forecasts from over 40 financial institutions. Rather than showing individual forecasts, we have taken the high, the mean and the low. Whilst the data is subjective, it does highlight the vast divergence of views based on the current environment.

GBPUSD	1 Month	3 Months	6 Months	12 Months
High	1.3100	1.3500	1.3600	1.3850
Mean	1.2668	1.2707	1.2812	1.2977
Low	1.2400	1.2200	1.1900	1.1800

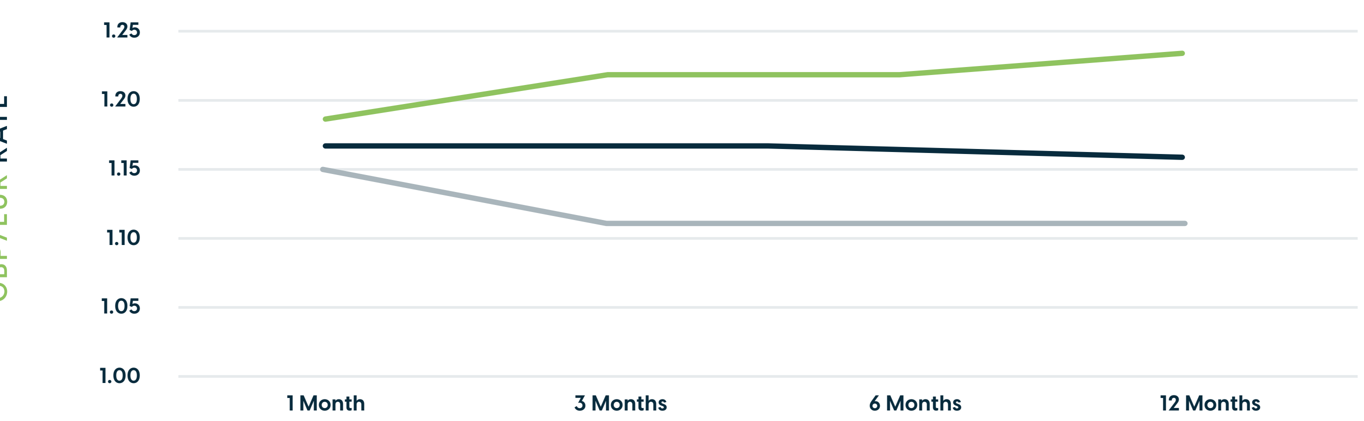
EURUSD	1 Month	3 Months	6 Months	12 Months
High	1.1200	1.1600	1.1700	1.1900
Mean	1.0838	1.0894	1.0995	1.1159
Low	1.0600	1.0500	1.0300	1.0400

GBPEUR	1 Month	3 Months	6 Months	12 Months
High	1.1886	1.2195	1.2195	1.2346
Mean	1.1674	1.1680	1.1656	1.1587
Low	1.1494	1.1111	1.1111	1.1111



The forecast for **GBPUSD** indicates a moderate level between high and low projections over one month, with a potential peak at **1.3100** and a low of **1.2400**. Looking ahead, the three-month forecast suggests a wider potential range, while the twelve-month outlook shows a cautiously optimistic mean trend.

GBPEUR FORECASTS



The **GBPEUR** forecast illustrates an upward trend in high estimates, reaching a peak of **1.2346** after twelve months. However, the range widens notably from three months onwards, suggesting increased volatility. Additionally, while the mean values remain relatively stable in the short term, they trend slightly downwards over longer periods, indicating potential shifts in market sentiment, with a high low range of **0.1235** in 12 months.

EURUSD FORECASTS

EUR/USD RATE
1.25
1.20
1.15
1.10
1.05
1.00
0.95
0.90
1 Month
3 Months
6 Months
12 Months

The **EURUSD** forecast offers insights into potential movements over different time frames. Over one month, the pair may fluctuate between **1.0600** and **1.1200**, with a mean estimate of **1.0838**. As we extend to three, six, and twelve months, the estimates indicate a gradual increase in both high and mean values, suggesting a cautiously optimistic outlook for EURUSD amidst potential fluctuations, with a range of **1.0400** to **1.1900** over the year.

Q1 REVIEW
UK SLIDES INTO RECESSION

In mid-February, data showed that the UK economy tipped into recession at the end of last year, following two consecutive quarters of contraction. Hard-pressed households cut back on spending amid the cost of living crisis, causing the economy to contract by a larger-than-expected 0.3% between October and December, having already shrunk between July and September.

While the news initially dented the pound, after investors raised their bets on the BoE cutting interest rates this year in a bid to revive the economy, the UK currency has remained largely resilient.

Market analysts pointed to economic green shoots and an inflation rate double the BoE's 2% target that tempered dovish chatter. For instance, robust UK employment data gave the pound a shot in the arm on 13 February, propelling it to an eighteen-month high against the euro in the 1.17 mid-range.

A quarter of growth indicates an economy has climbed out of recession. The UK could be on course to bounce back after national output figures printed in March suggested the economy is emerging from a short and shallow dip in the second half of last year: GDP rose by 0.2% in January, largely due to a sharp recovery in retail sales after December's slump.

Further economic data releases ramped up interest rate speculation in March. News that wage growth slowed in the three months to January and UK inflation fell to 3.4% in February - the lowest level for two and a half years - added to bets that the BoE will loosen its monetary policy in the summer.

As expected, the BoE left interest rates on hold at its March policy meeting, but the Monetary Policy Committee's (MPC) hawkish tone faded. The accompanying statement said policy would remain restrictive even after rates were cut. A June start date looked increasingly likely after the announcement.

Q2 OUTLOOK
WILL THE UK CUT RATES IN JUNE?

The BoE forecasts that the UK inflation rate will return to its long-term 2% target for the first time in three years in Q2. However, the central bank warned this might only be a temporary dip, with inflation potentially rising back towards 3% later in the year. Factors causing it to heat up again might include the fading impact of lower energy prices, higher shipping costs due to Red Sea disruption, increases to the minimum wage, and higher business rates.

A shift in tone from the MPC in its accompanying statement to its March interest rate decision suggested the committee is becoming more confident that underlying inflation pressures are easing: *"In recent weeks we've seen further encouraging signs that inflation is coming down,"* said the MPC. *"We're not yet at the point where we can cut interest rates, but things are moving in the right direction."*

This dovish outlook prompted money markets to price in a quarter-point interest rate cut in June. If it materialises, it will mark the first change to the central bank's main lending rate since last August when it ended a series of 14 successive hikes by holding it at 5.25% - and could apply pressure to the pound.

Britain's recovery from its minor recession could gather pace in Q2, especially if interest rates start coming down in June. The early signs show that the economy is on track to climb out of its dip within months, powered by a recovery in consumer spending amid robust pay growth and cooling inflation. The UK's economic revival could spell mixed fortunes for the pound, with initial support giving way to headwinds if the BoE begins to dial back rates.

While Britain's current recession is a mild one by historic standards, weak activity is starting to take its toll on the labour market which will be closely monitored by investors in Q2. Average earnings were down and unemployment was up in March, while vacancies fell in three months to February. This reflects a relatively tight labour market that's been curbed by a stagnating economy.

UK

Q1 REVIEW
EUROZONE INFLATION FALLS SHARPLY

January concluded with news that the 20-nation Eurozone narrowly sidestepped recession after its economy flatlined at the end of 2023. Zero growth in Q4 followed a 0.1% economic contraction in Q3, meaning that recession was just averted.

Soaring ECB rate cut bets propelled the pound to a six-month high against the euro in the 1.17 mid-range on 29 January. Confirmation of cooling inflation in the single currency zone continued to sully euro sentiment as the likelihood of interest rate cuts increased. The euro area annual inflation rate was 2.6% in February, down from 2.8% in January - a year earlier, the rate was 8.5%.

Despite a sharp fall in the rate of inflation over the past year, the ECB kept markets guessing in Q1 on the timing and scale of policy easing. Speaking in March, ECB president Christine Lagarde said the central bank will be unable to commit to a particular path of interest rate cuts once it starts reeling them in.

Q2 OUTLOOK
WILL GERMANY AVOID RECESSION?

A chorus of ECB policymakers have signalled that it will be in a position to discuss an interest rate cut in June. This places the central bank's 6 June meeting on the table for a potential start of policy loosening after it lowered its forecasts for inflation, predicting it will reach its 2% target next year. Despite maintaining its benchmark deposit rate at an all-time high of 4% at its March meeting, it lowered its inflation forecast for this year from 2.7% to 2.3% and trimmed it for 2025.

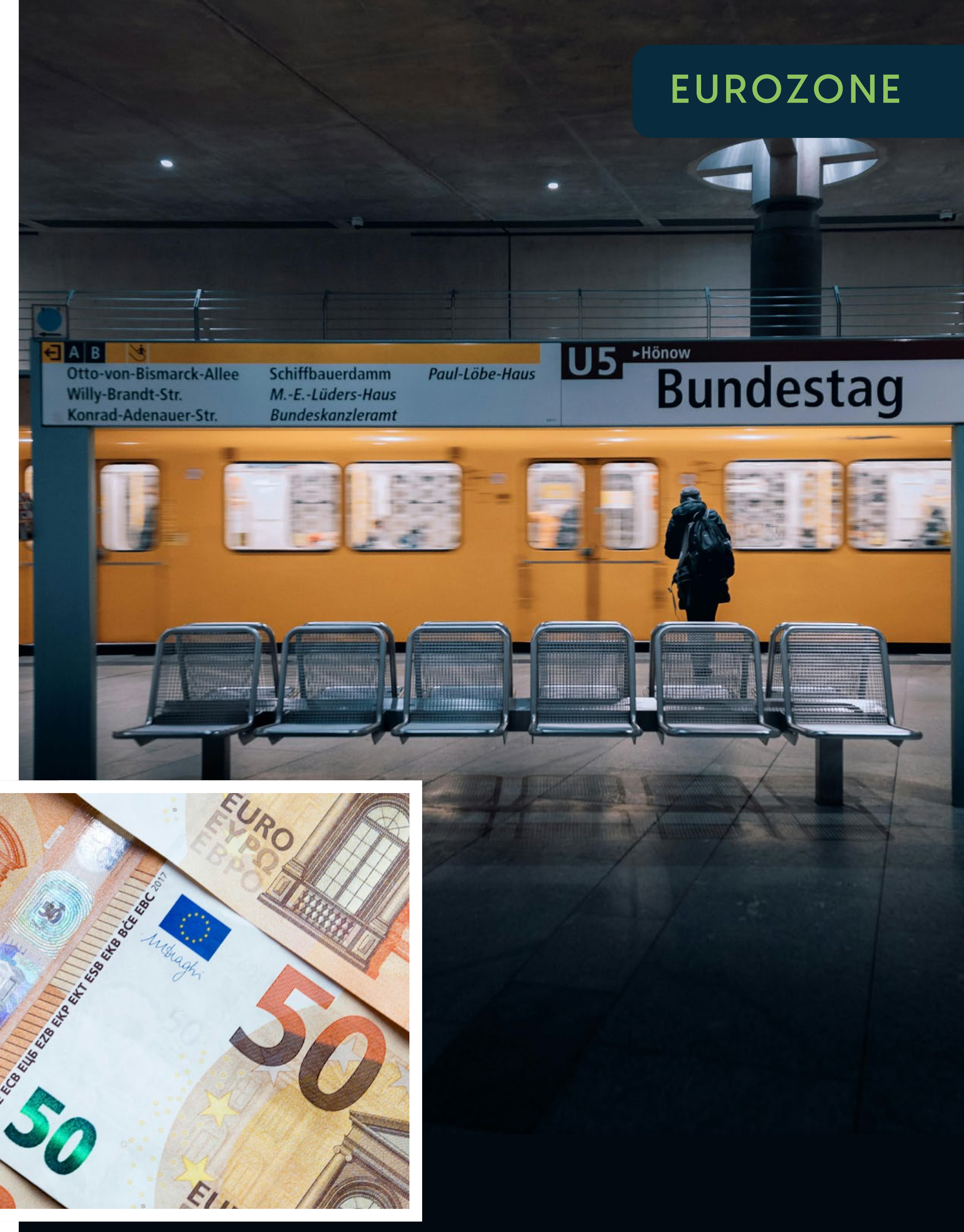
"We are making good progress towards our inflation target and we are more confident as a result," said ECB president Christine Lagarde. "But we are not sufficiently confident. We clearly need more evidence and more data. We will know a little more in April, but we will know a lot more in June."

Market investors still need convincing, however, and a cut is fully priced in only by July as concerns mount that the Fed could delay its initial move amid sticky inflation and the ECB would be hesitant to move on its own.

Incoming data will determine whether the euro remains steady against the dollar and weaker against the pound in Q2. A key theme could be the health of the German economy - the largest in the bloc - which shifted into reverse throughout 2023, making it the worst-performing major economy in the world last year.

The powerhouse German economy shrank by 0.3% in the fourth quarter. Looking ahead, the Bundesbank said that economic output could "decline again slightly in the first quarter of 2024" amid lingering "stress factors". Two negative quarters in a row would plunge Germany into a technical recession - which could weigh heavily on the euro.

EUROZONE



USA

Q1 REVIEW
US ECONOMY DISPLAYS RESILIENCE

US consumer price index (CPI) data from Q1 suggested the Fed could be forced to hold interest rates higher for longer, as it struggles to complete its battle with stubborn inflation - but the central bank didn't conform with the market consensus. The CPI print revealed higher-than-expected inflation which ticked up to 3.2% in February, from 3.1% the previous month.

Despite this, the soft landing that once looked unlikely for the Fed to achieve following the war on inflation remains on track - where it's able to reach its 2% target without sliding into recession. Stronger data on economic growth and the jobs market in Q1 is paving the way.

GDP figures released in January showed the pace of US economic growth slowed in the last three months of 2023, but far less than expected, underscoring the continued economic resilience. The non-farm payroll figures for February surpassed economists' predictions, adding 275,000 jobs and indicating that the US services sector remains strong.

The pound dropped below 1.26 - its lowest level against the dollar since mid-December - on 05 February as hawkish comments from Fed Chair Jerome Powell and strong economic data combined to boost the dollar.

The Fed left US interest rates at a 25-year high following its two-day March meeting as it continues to assess their impact on inflation and the broader economy. The central bank announced rates would be unchanged at 5.25% to 5.5%, where they have been since July - but signposted three rate cuts this year, sparking volatility in currency markets.

USA

Q2 OUTLOOK COULD STICK INFLATION PUSH FIRST RATE CUT TO Q3?

Recent Fed rhetoric suggests the central bank is determined to cut rates sooner rather than later, but the persistence of inflation above target is complicating the issue. Speaking after the Fed's March policy meeting, chair, Jerome Powell, indicated that the central bank may soon start trimming borrowing costs: *"We want to be careful and fortunately with the economy growing, the labour market strong and inflation coming down, we can"*

The statement left the Fed on course to begin dialling back rates as early as the summer, calling time on its mission to stamp out inflation. After Powell took to the stand, investors added to bets on a rate cut in June, putting the odds at about 85%, up from 65% the day before the Fed's March interest rate announcement.

However, with projections for core inflation of 2.6% in 2024, slightly above forecasts, Powell signalled the road to a soft landing may be fraught with danger. Inflation was still on a *"sometimes a bumpy road towards 2%"*, he said. Dollar sentiment will, therefore, be heavily influenced by the pace of deflation in Q2 - assuming it doesn't start heating up again - and subsequent rate cut speculation.

The US economy yet again demonstrated its resilience in the last three months of 2023, posting a sixth straight quarter of growth, confounding predictions that a recession seemed inevitable because of high rates. US households have been credited with propping up the economy as they continue to spend at a solid rate thanks to government stimulus that helped them weather the initial stages of the pandemic and rising inflation. Now pay raises are also helping them keep pace with high prices.

This brings Q1 GDP figures into sharp focus for investors in the dollar - with the numbers hitting the headlines throughout Q2. The Fed sharply raised its forecast for US economic growth this year in its March statement. According to forecasters surveyed by the Federal Reserve Bank of Philadelphia, the US economy will expand at an annual rate of 2.1% in the first quarter, following an increase of 3.2% in the previous three months.

Finally, US President Joe Biden and his rival Donald Trump both passed the delegate thresholds to secure their parties' nominations for the upcoming election - providing the nation with its first presidential election rematch for 70 years. Polling indicates it will be a close-run race that will be decided by fine margins in several key states. A win for Trump could see pressure put on the dollar, not least due to his determination to devalue the dollar in a bid to boost the domestic economy during his first term.

INTEREST RATE OUTLOOK 2024

At the end of last year, the interest rate outlook was as follows.

	Year 2023 End	Likely month of cutting cycle beginning	Implied basis point cuts during 2024	Implied Dec 24 Interest rate
BoE	5.25%	May 24	-109.44	4.09%
ECB	4.00%	April 24	-151.57	2.37%
FOMC	5.25-5.5%	March 24	-148.30	3.85%

Following the recent interest rate decisions from all three central banks in March, we are now seeing an updated market view.

	End of Q1 2024	Likely month of cutting cycle beginning	Implied basis point cuts during 2024	Implied Dec 24 Interest rate
BoE	5.25%	June 24	-68.93	4.49%
ECB	4.00%	June 24	-89.60	3.00%
FOMC	5.25-5.5%	June 24	-79.1	4.54%

Part of the reason for the tepid market conditions in January and February was the readjustments across the board in terms of interest rate expectations. We still believe that the direction of monetary policy is going to be a large driver of price action in 2024; however, as we can see from the table, rate cut expectations for all three central banks have been pushed out and rate cut forecasts for the calendar year have been tapered.

In March, volatility returned to the market following comments from Fed Chair Powell who commented that a rate cut was "close". This came at a time when some institutional investors were readjusting their expectations from cuts to a pause for the remainder of the year.

It will be interesting to see if the cutting cycle begins in Q2 for both the ECB and FOMC as currently forecasted and if we will see another tapering of rate cut expectations as we edge closer to a UK general election and US Presidential race. Typically central banks prefer to avoid changing monetary policy too much during these periods so they're seen as independent and not influencing.

"We're seeing the market move from sharp cuts to sustained, higher rates."

Part of the reason for the tepid market conditions in January and February was the readjustments across the board in terms of interest rate expectations.

2000
Foreign Currency Direct launches

2007
Infinity International launches

2011
Foreign Currency Direct becomes FCA authorised payments institution

2012
Infinity International becomes FCA authorised payments institution

2015
Infinity International becomes FCA authorised investment firm

2018
Pollen Street Capital acquires Foreign Currency Direct and Pure FX

2019
Pollen Street Capital acquires Infinity International

2019
Foreign Currency Direct opens offices in Spain and Portugal

2020
Foreign Currency Direct Europe launches in Dublin, Ireland

2021
Foreign Currency Direct, Infinity International & associated brands become Lumon, trading over £3b in 2021

2022
Lumon moves into a new office space in Farringdon, London

2023
Traded £8.8b in total group currency exchange

£8.8b in total group currency exchange in 2023

Dedicated currency strategist with an average of **12 years' experience**

Offices in **UK**, **Ireland**, **France**, **Portugal** and **Spain**

Backed by Pollen Street Capital with over **£4b** under management

Banking relationships with **tier 1 banks**

Trusted currency partner of over 2,500 businesses across the UK, Europe and USA

As an international payment and currency risk management specialist, Lumon provides bespoke services and a dynamic product suite for businesses, with specialist knowledge across a variety of sectors. Collaborating with you, we design, implement, and monitor a tailored hedging strategy aligned with your operating model and business objectives. Providing excellent service and secure payments is our top priority, which is underpinned with competitive rates and tailored risk management solutions. Our approach to currency risk management is your strategic advantage.

Vic Darvey
Group CEO

Leigh Bridger
Group CFO

Darren Bentley
CCO

Lloyd Eagles
Managing Director Corporate

CURRENCY RISK MANAGEMENT SPECIALISTS

Lumon understands the typical challenges and difficulties encountered by businesses in managing FX risk and international payments. Too frequently, the most basic problems persist without resolution, as companies neglect to adopt straightforward measures to reduce expenses, enhance efficiencies and save time.

At Lumon, we look to remove the burden that FX brings, offering transparency, stability and certainty in what is often an extremely opaque market. Leveraging years of expertise, unparalleled resources, and a human led approach, we look to understand your risk exposures and business objectives, and will collaborate with you to build a resilient approach to manage your FX exposure. Our team of dedicated dealers comprises industry-focused specialists who understand the dynamics and intricacies of managing FX risk within these environments.

We deliver this proactive approach to FX risk management using a structured step-by-step process:

1. **Understand the risk**
Beginning with a FX risk assessment, we meticulously analyse your market exposure, pain points, risk appetite, and any other industry-specific variables that influence your objectives.

2. **Design the strategy**
Next, we craft a tailored risk management strategy, ensuring every aspect of your business is safeguarded from potential currency fluctuations.

3. **Execute the hedge**
Through seamless execution of the hedge, we mitigate any unforeseen financial risks and expedite the transfer of funds, allowing you to focus on your core operations.

4. **Ongoing monitoring**
We provide continuous, vigilant monitoring to swiftly adapt your strategy to market dynamics, ensuring your financial stability remains intact.

GET IN TOUCH

We are always ready to help you with your currency needs.
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