Ebury What borders?®

Weekly Report

G10 Weekly FX Update

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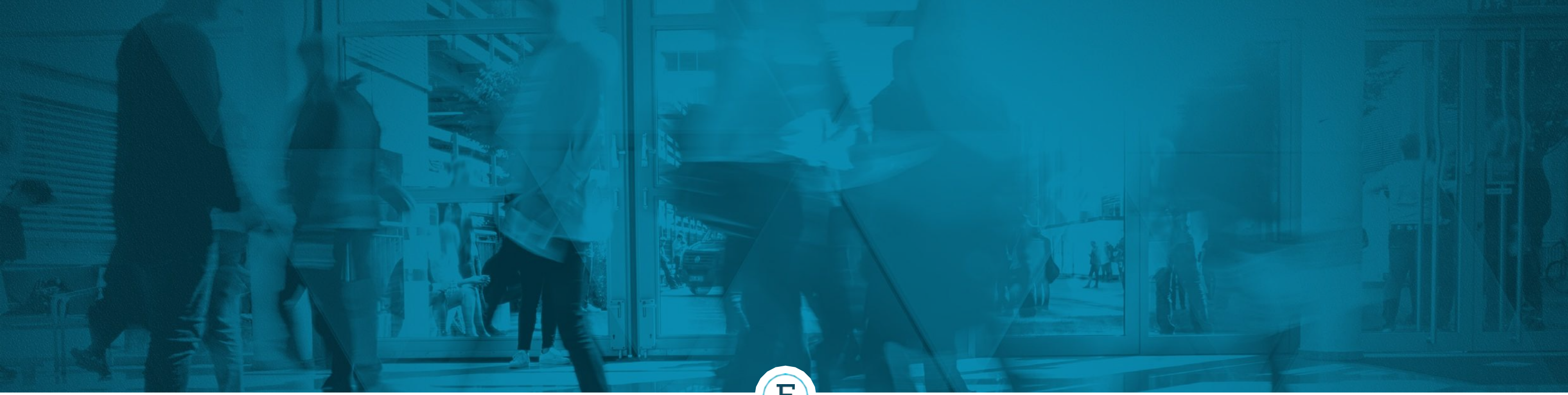
29th August 2023



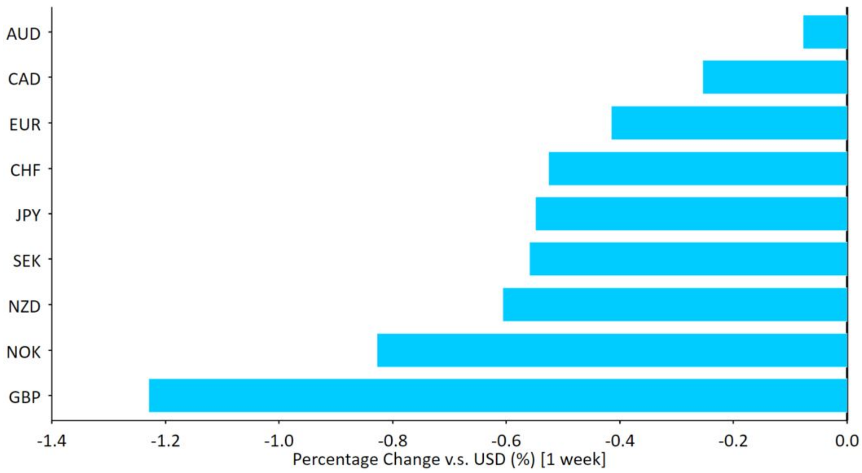
Dollar rally continues as markets come to terms with higher US rates for longer

The Jackson Hole annual conference of central bankers delivered few surprises. The Federal Reserve is less convinced than markets appear to be that inflation has been beaten, and rates are likely to remain at or above 5% for an extended period of time.

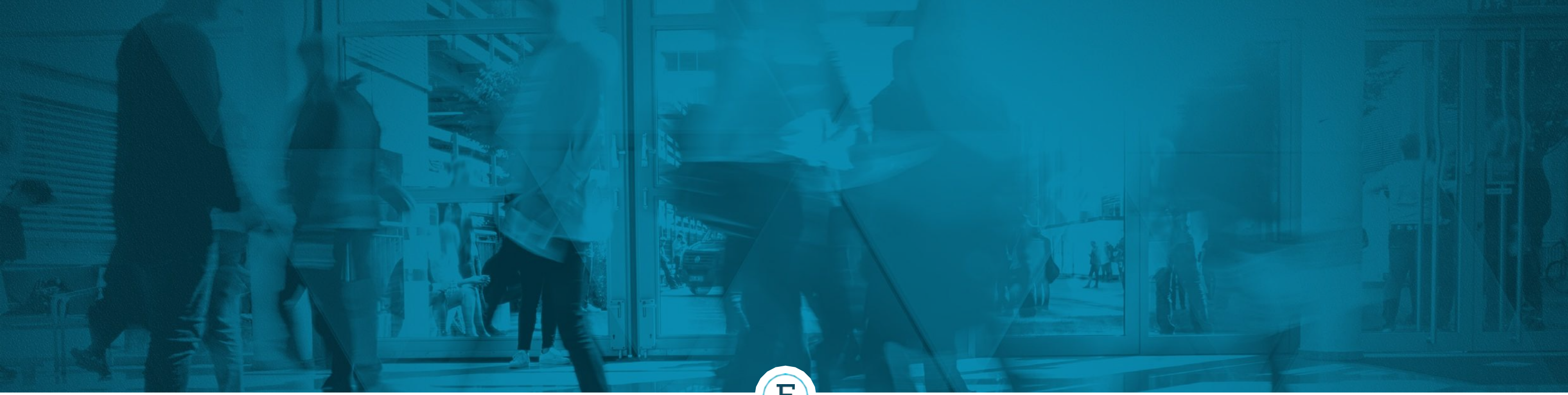
By contrast, the European Central Bank is caught between a rock and a hard place. The leading indicators of economic activity are weakening, although there are few signs yet that the key core inflation measure is on a meaningful disinflationary trend. Fuelled by expectations that US rates will stay higher for longer, and safe-haven flows induced by ongoing concerns over the state of the Chinese economic recovery, the dollar has rebounded against every other G10 currency in the past month. Emerging market currencies have also sold-off across the board of late, albeit they put in a stronger showing last week, particularly commodity currencies on the back of increasing commodity prices.

This week's data-packed calendar on both sides of the Atlantic should shake any remaining summer torpor off currency markets. On Thursday, there are two crucial inflation numbers: the August flash CPI report in the Eurozone, and the somewhat lagged, but still important, July PCE inflation report out of the US. Then, on Friday, it is payrolls day in the US, with all eyes on the wage growth print.

Figure 1: G10 FX Performance Tracker [base: USD] (1 week)



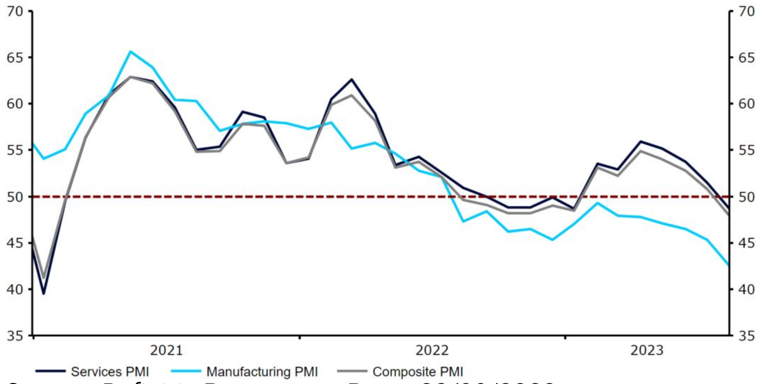
Source: Refinitiv Datastream Date: 29/08/2023



GBP

The UK PMIs of business activity came out considerably worse than expected last week, and are now consistent with an actual contraction. We note that recent hard data numbers have not been nearly as dire as these surveys indicate, but the latter are more timely and a reason for concern. This disappointing economic news weighed rather heavily on GBP, which ended last week at the bottom of the G10 FX performance dashboard.

Figure 2: UK PMIs (2021 - 2023)



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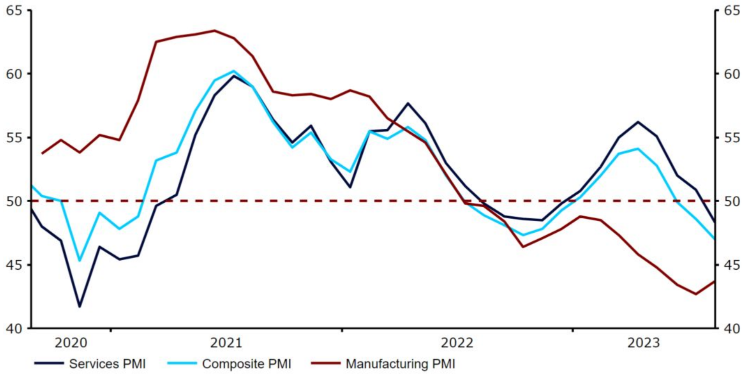
Market pricing still assigns a near certainty to another interest rate increase from the Bank of England in September, and expects almost three hikes more before the end of the cycle. These are the highest rates in the G10 and explain why sterling is still the second best performing currency in the G10 so far in 2023. We remain cautiously optimistic on the pound, although are really looking closely to see whether economic data validates the plunge seen in business confidence over the next few weeks.

EUR

Economic data out of the Euro Area last week heaped further pressure on the ECB to wrap up its hiking cycle before there are any clear signs that core inflation is on its way down. The PMIs for August were even more dire in the Eurozone than in the UK. Both the services and manufacturing indices are now printing below the level of 50 representing contraction, with the composite index languishing at 47.0, which is the lowest level since the first winter pandemic lockdowns.

ECB President Lagarde scrupulously avoided any precommitment for the September meeting at the Jackson Hole conference. Markets remain split almost 50/50 on the possibility of a September hike, as recent data seems to suggest that a pause may be on the way. This week's crucial inflation report for August will probably seal the deal one way or the other, and the impact on euro trading should be significant.

Figure 3: Euro Area PMIs (2020 - 2023)



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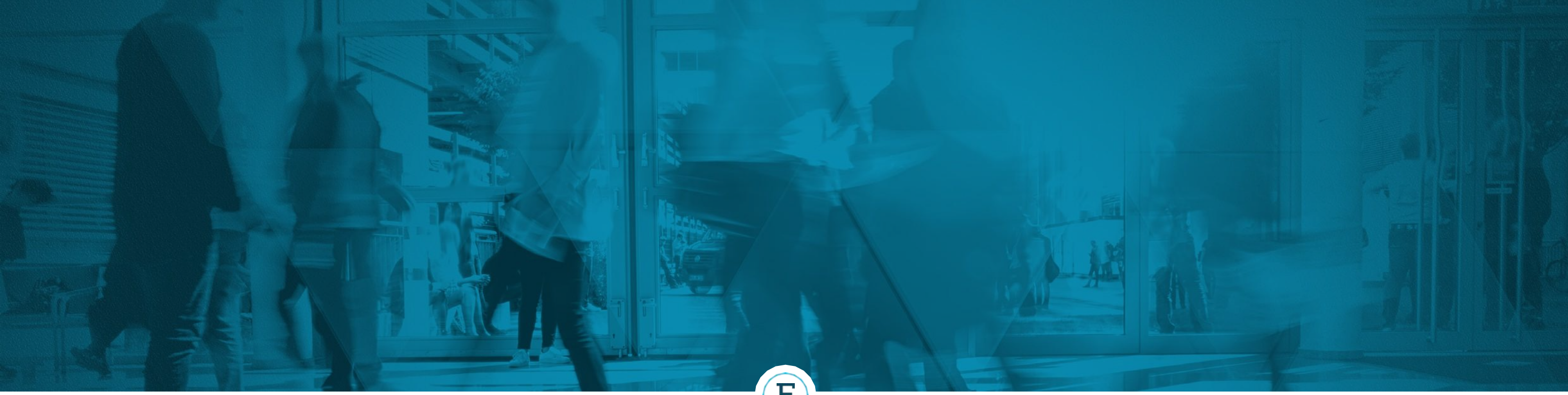
USD

The US economy seems to be diverging sharply from those across the Atlantic, experiencing a late cycle acceleration instead of slowing down. Retail sales are surging, as is industrial production, and the labour market has barely weakened at all. The Federal Reserve continues to sound rather hawkish, and while we may be one hike away from the end of the cycle, or there already, we expect that it will be a long time before we see any rate cuts, particularly given limited scope for fiscal easing.

The US labour market report this week should continue to show an economy at full employment that is finally delivering meaningful real wage increases to workers. Economists are pencilling in an easing in the net job creation number to 170k, from 187k, although average hourly earnings are expected to remain unchanged at 4.4% year-on-year.



JPY

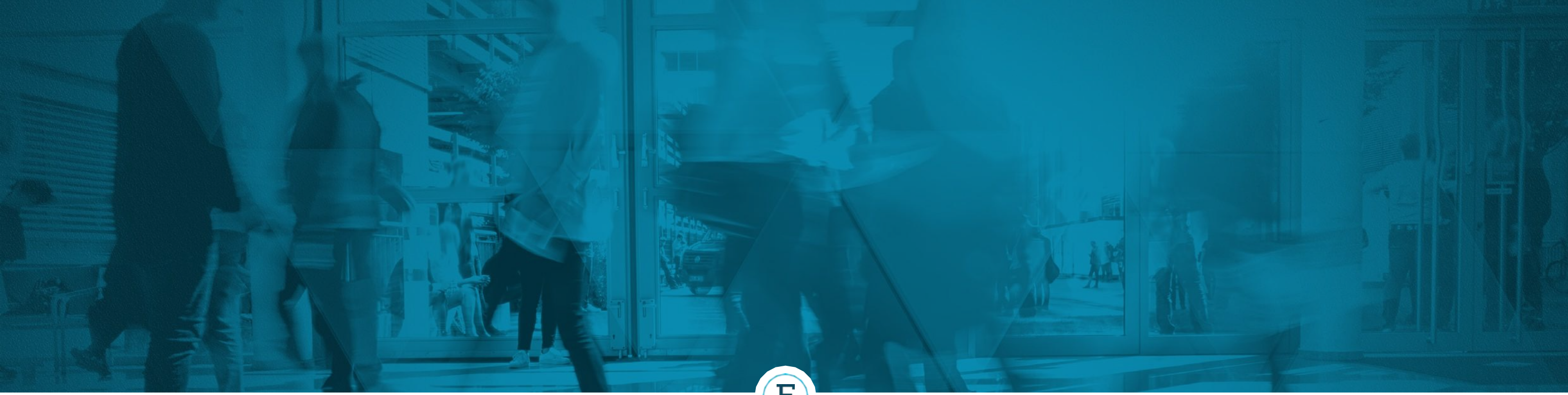
The last few weeks have been relatively mixed for the Japanese yen. JPY has traded around the middle of the G10 pack, albeit the currency hit fresh November lows against the broadly stronger US dollar on Friday. Concerns over the health of the Chinese economy, particularly amidst dour headlines surrounding the state of the country's property sector, have boosted the safe-haven yen during the usually quiet summer months. On the other hand, the Bank of Japan remains the only G10 central bank yet to raise rates in the current cycle, and policymakers have continued to push back against market expectations, notably following the decision to tweak its yield curve control policy in late-July.

We believe that the yen appear to be nearing a tipping point. Economic news has been relatively impressive of late, particularly the Q2 GDP report that came in almost twice as strong as consensus. Inflation also remains elevated, while risks to inflation are skewed to the upside by the weak currency. In our view, this sets the stage for a scrapping in the YCC policy by year-end, potentially in October, which may act as a prelude to higher rates in early-2024. This would be a clear bullish signal for JPY at a time when most other major central banks will either be on hold, or loosening policy.

CHF

The Swiss franc ended last week in the top half of the G10 performance dashboard, rallying to a new ten month high against the euro. Rising concerns over global growth have been bullish for the safe-haven franc, particularly as the SNB maintains its hawkish rhetoric.

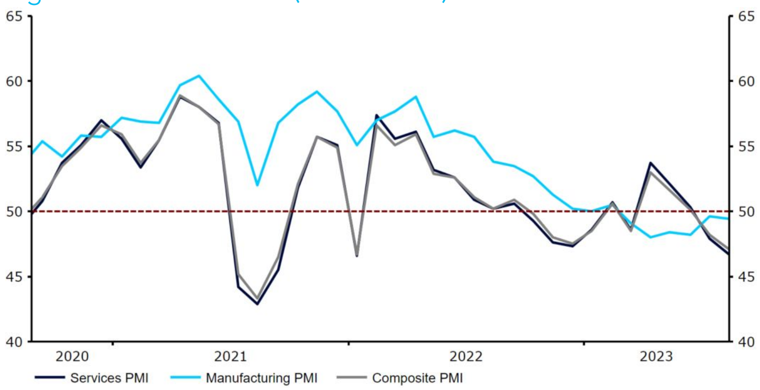
In contrast to the recent uneventful period, the next few days will bring a plethora of economic data releases from Switzerland. Markets will be particularly interested in Friday's August CPI data, considering that it will be the last such print before the next SNB meeting later this month. Headline inflation is expected to drop to 1.5%. Sentiment, business activity and hard data spread out throughout the week will also be worth watching. The data is unlikely to change the outcome of the September SNB meeting, with another 25bp hike appearing almost inevitable. However, it may add to the argument that further tightening is not needed. The recent rally in the franc is also boosting a case for that.



AUD

The lack of negative headlines out of China has been good news for the Australian dollar in the past few trading sessions. AUD has had a tough time of it in recent weeks, underperforming most of its major peers as headlines out of Australia's largest trading partner strike a dour note, and domestic data suggests we are seeing a deterioration in the labour market and business activity. Last week's PMI data was particularly concerning, with the Judo Bank composite index sliding to just 47.1 in August, its lowest level in nineteen months. Headlines of out China, however, remain key for now, and the introduction of a support package from Beijing over the weekend appears to be helping sentiment towards AUD.

Figure 4: Australia PMIs (2020 - 2023)



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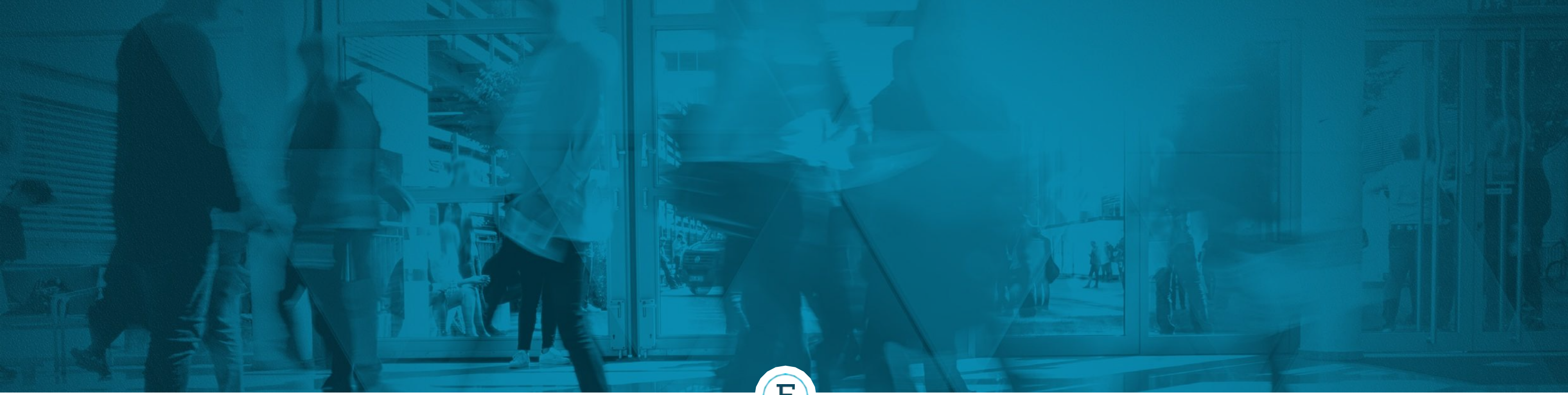
The next couple of weeks will likely be important ones for the Aussie dollar. A public appearance from new central bank governor Bullock later today, and the monthly inflation data on Wednesday, could have an important bearing on the tone of communications from the RBA next week. Investors are still not completely convinced that the RBA is done tightening policy, though recent soft activity data, and further signs of a normalisation in inflation, could be enough to elicit a dovish set of remarks in next week's communications.



NZD

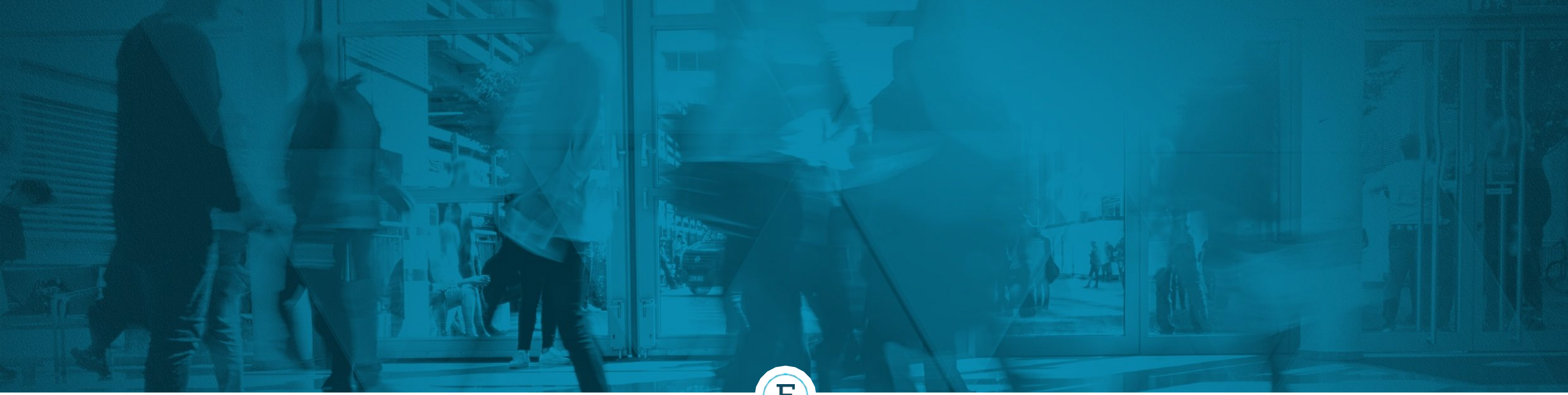
A lack of appetite for additional RBNZ interest rate hikes, and a worrisome barrage of disappointing domestic data, has continued to weigh on the New Zealand dollar in recent weeks. The RBNZ kept policy unchanged earlier this month, and actually struck a slightly more hawkish note, indicating that long-term rates will land higher than they had previously anticipated. However, the prospect of further hikes is effectively non-existent, while recent PMI data suggests that we could see an extension of the country's technical recession in the coming quarters. This has kept NZD on the back foot so far this month, with only the Norwegian krone performing worse in the G10 in August.

This week sees a complete lack of any economic newsflow out of New Zealand. The next data point of any note will be the Q2 GDP report a week on Wednesday. There is a general consensus that we could see a modest rebound in activity, albeit another quarterly contraction is not off the table, with economists fearful that further downturns could be on the way in H2 2023.

CAD

Last week's hotter-than-expected inflation report has reignited expectations that the Bank of Canada could deliver one final rate hike at either of the next few monetary policy meetings. The headline measure unexpectedly jumped back up to 3.3% in July (from 2.8%), while the core number remained unchanged at 3.2%. The BoC is firmly in data-dependent mode, so appears to be prepared to raise rates again should incoming news warrant such action.

We are not getting too carried away by one CPI print, however, particularly as this Friday's Q2 GDP report is set to show that growth more than halved in the three months to July. At any rate, the September BoC meeting (06/09) does not appear to be a 'live' one, even if we do see an upside surprise in growth in the interim. That said, the communications from governor Macklem will be crucial in guiding the market's expectations for rates. Should Macklem pave the way for a another hike before year-end, then we could see some strength in CAD in the coming weeks.

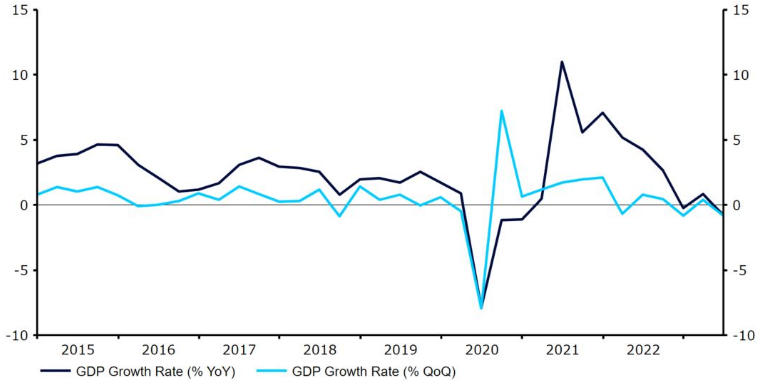


SEK

The Swedish krona has been more or less stable against the euro in the past week, although it remains one of the worst performers in the G10 so far this month. Recent economic data out of Sweden has been rather mixed. On a positive note, the unemployment rate fell to 6.2% in July, its lowest level since December 2019, and retail sales unexpectedly grew by 1% last month.

By contrast, GDP data for the second quarter was not encouraging. The Swedish economy contracted by 0.8% on a quarterly basis, and by 1% on an annual basis, the largest contraction since 2021. This slowdown in activity could influence the Riksbank's future monetary policy decisions. Markets continue to fully pricing in a 25bp rate hike at the September meeting, with another in November possible, particularly should upcoming inflation prints once again beat expectations. However, recent signs of a slowdown in activity will be a concern for policymakers, and further hikes beyond September are far from set in stone.

Figure 5: Sweden GDP Growth Rate (2015 - 2023)



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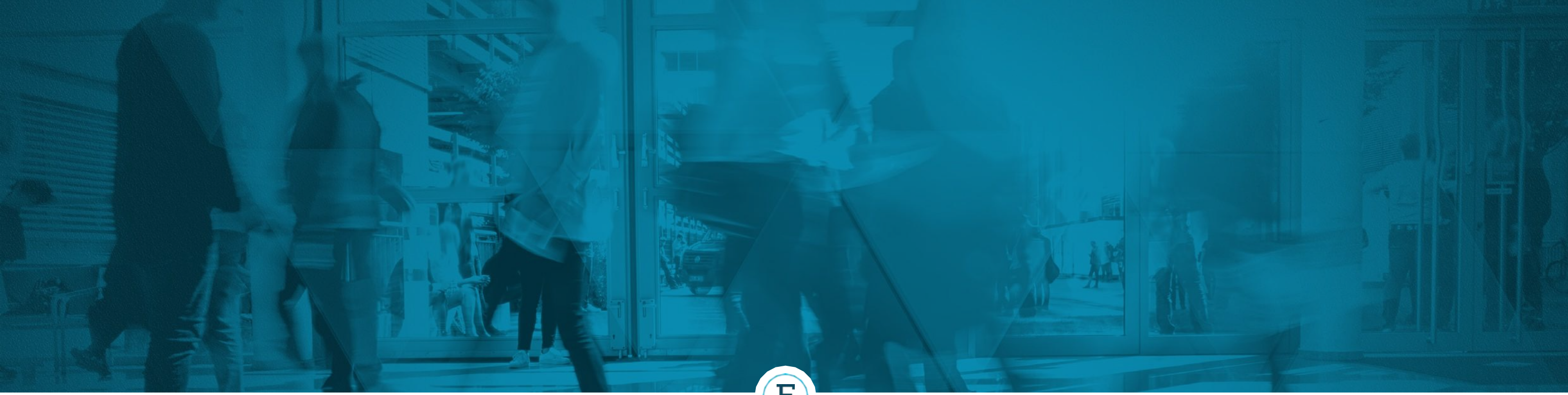
NOK

After a volatile week, the Norwegian krone began the last week of August slightly lower than Friday close. Although economic data out of Norway was worse than expected last week, the increase in global oil prices has limited the currency's losses. Even still, NOK appears on course to end August as the worst performer in the G10.

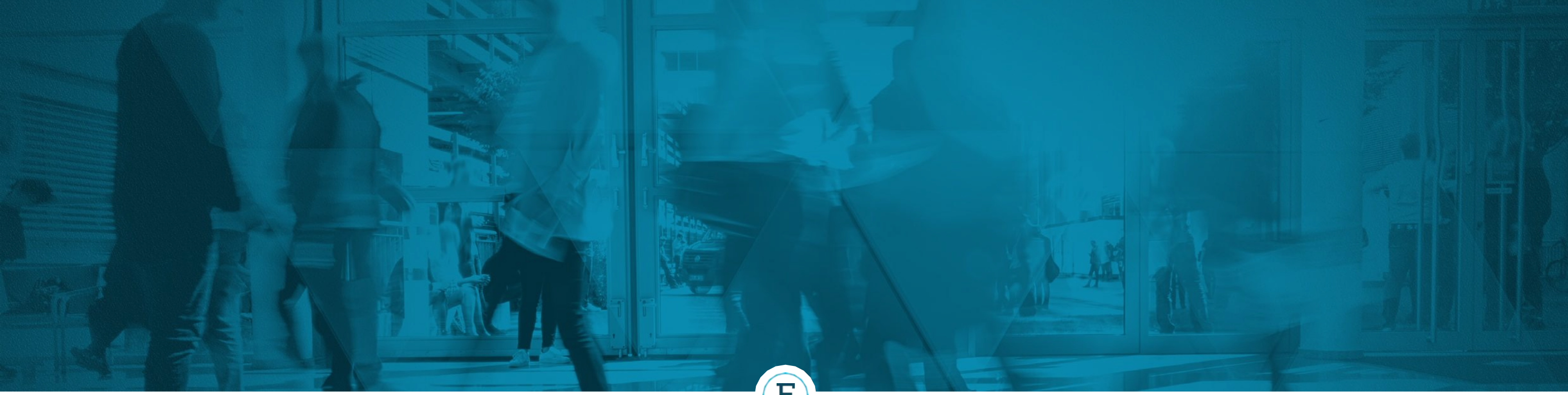


The Norwegian economy stalled in the second quarter of the year, following an upwardly revised 0.3% expansion in the previous quarter and below market expectations of a 0.1% expansion. In addition, retail sales contracted by 0.8% in July, the largest contraction since December last year. This data provides further evidence that high inflation and rising interest rates are weighing on the economy, which could indicate that the end of the Norges Bank's hiking cycle is drawing ever closer.

CNY

Chinese banks surprised investors at the start of last week by delivering a smaller-than-expected cut to the 1-year LPR rate, while not cutting the 5-year rate (reference for mortgage rates). We cannot rule out that significant easing is seen as suboptimal in the current environment. China may wish to avoid adding pressure on the country's banking sector and the yuan, opting for other solutions instead. Indeed, efforts to support the currency and investor confidence have intensified of late. This includes the decision to halve stamp duty on stock trades and cut margin requirements, in addition to other measures, which have triggered a sharp rally in Chinese equities so far this week.

As some Chinese developers struggle to stay afloat, the country has also moved to relax rules on home purchases, permitting local governments to treat more people as first-time buyers. Aside from the real estate and policy headlines, we'll focus on business activity data. A batch of NBS PMI readings for August will be out on Thursday, followed by the Caixin manufacturing PMI on Friday. Economists expect similar readings to July, although given that the data likes to surprise, it could add some volatility to the market, particularly as traders wrap up their holidays and return to desks.



Economic Calendar (29/08/2023 - 01/09/2023)

Economic Calendar	Country	Day	Date	Time (GMT)
Retail Sales (Jul.)	AUS	Monday	28/08	02:30
Retail Sales (Jul.)	NOR	Monday	28/08	07:00
Unemployment Rate (Jul.)	JPN	Tuesday	29/08	00:30
GDP (Q2)	SWE	Tuesday	29/08	07:00
Retail Sales (Jul.)	SWE	Tuesday	29/08	07:00
GDP (Q2)	US	Wednesday	30/08	13:30
NBS PMIs (Aug.)	CHN	Thursday	31/08	02:00
Retail Sales (Jul.)	SWI	Thursday	31/08	07:30
Preliminary Inflation (Aug.)	EZ	Thursday	31/08	10:00
PCE Inflation (Jul.)	US	Thursday	31/08	13:30
Inflation (Aug.)	SWI	Friday	01/09	07:30
Employment Report (Aug.)	US	Friday	01/09	13:30

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