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Weekly Report

G10 Weekly FX Update

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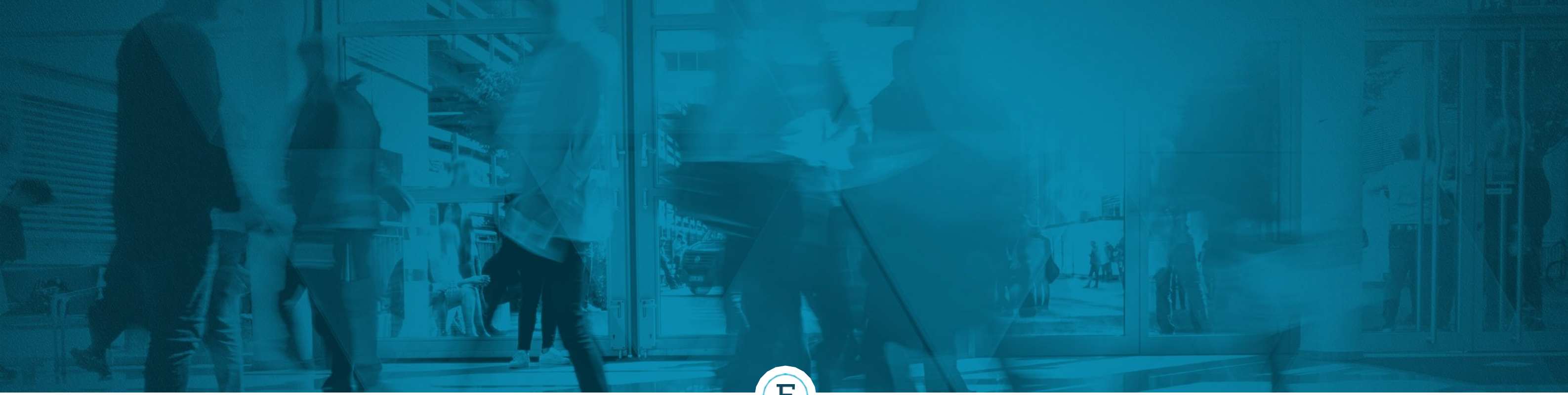
4th September 2023



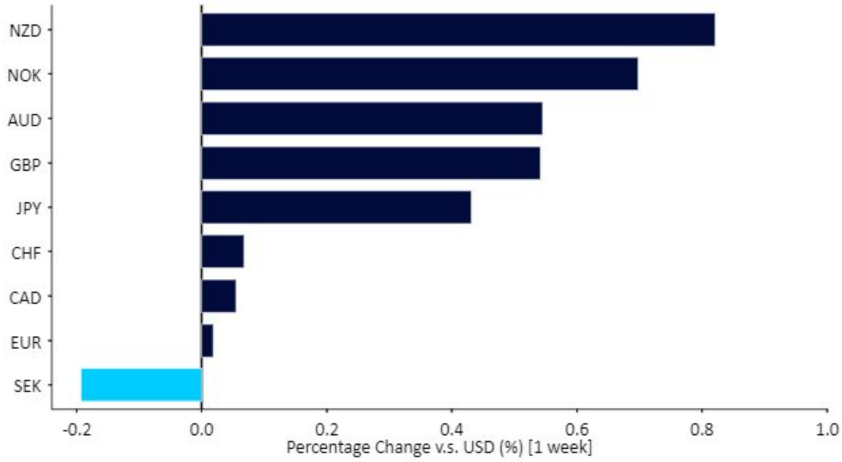
G10 currencies in holding pattern as markets try to guess central bank moves

The macroeconomic story did not change much last week, and most major currencies ended not too far from where they started.

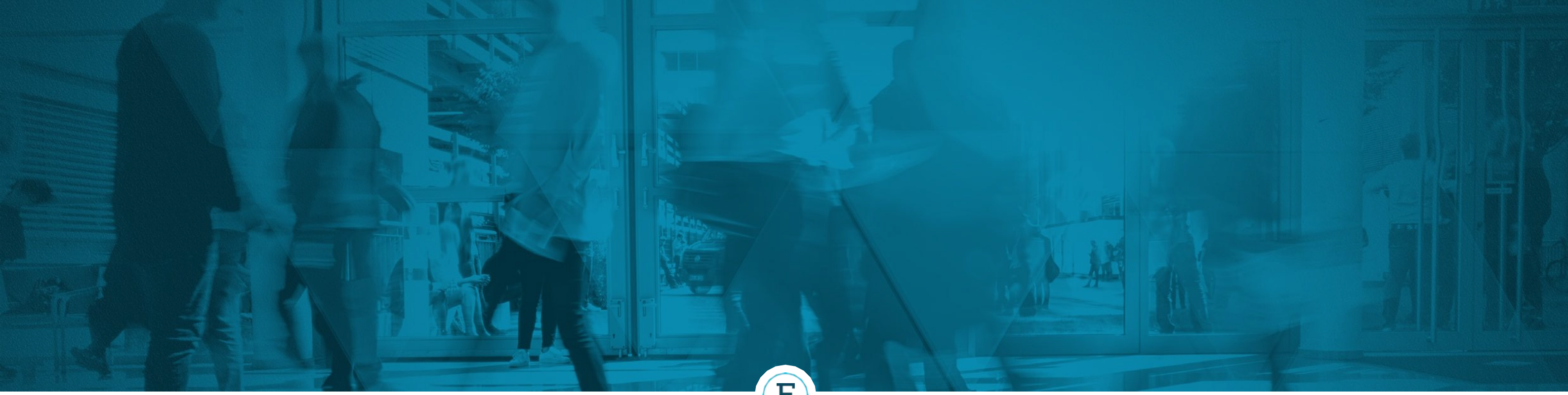
The US and the European economies continue to diverge. The former is experiencing solid growth and moderating inflation, while the risks of stagflation are rising on the other side of the Atlantic. Inflation data out of the Eurozone and the latest US nonfarm payrolls report, both reflecting August developments, are consistent with this narrative. The euro´s relative resiliency in the face of this negative data flow is remarkable, and the dollar, euro and the pound both ended the week almost exactly where they started it.

Currency markets may be relatively quiet this week, in preparation for the fireworks expected later in September as the main central banks meet. In the Eurozone, July retail sales will provide a read on the state of the consumer there, albeit a lagged one. Elsewhere, the macroeconomic data on tap is mostly second tier and should not have any dramatic effects on currency trading.

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



Source: Refinitiv Datastream Date: 04/09/2023



GBP

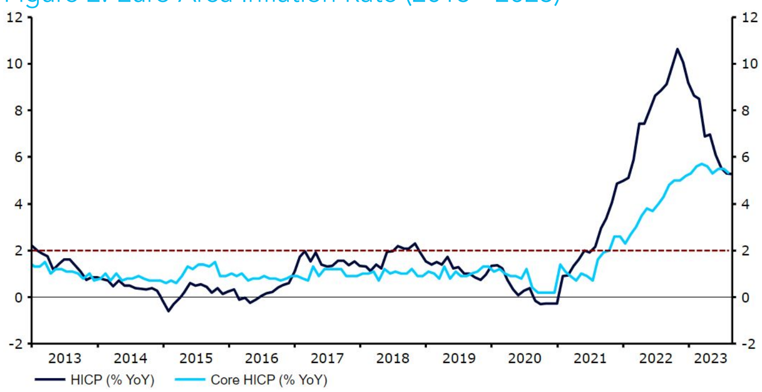
Continued gloom over the previous week's bad PMI numbers, as well as lower expectations for Federal Reserve interest rate hikes, have reduced market expectations for the terminal Bank of England base rate. Rate traders now expect two more hikes, down from three the week prior, and are currently assigning around a one-in-ten chance that the MPC opts for no change at the next meeting in a little over two week's time.

Sterling shrugged off this repricing, however, and is trading roughly where it was three months ago in trade-weighted terms. As elsewhere, there is not much data on tap in the UK this week, so attention will be centred on the MPC testimony at the Treasury select committee on Wednesday. We expect communications to continue to stress that further tightening may be required should inflation prove persistent, and for the language to be consistent with at least a couple more rate increases.

EUR

August flash inflation data brought little relief to the European Central Bank. Both the headline and the core indices remain stuck above 5%, and the latter shows little sign as yet of the disinflationary trend that we have seen in the US. Lending data is also stalling, further confirming fears that the Eurozone economy is struggling, following the previous week's dire business activity PMI numbers.

Figure 2: Euro Area Inflation Rate (2013 - 2023)



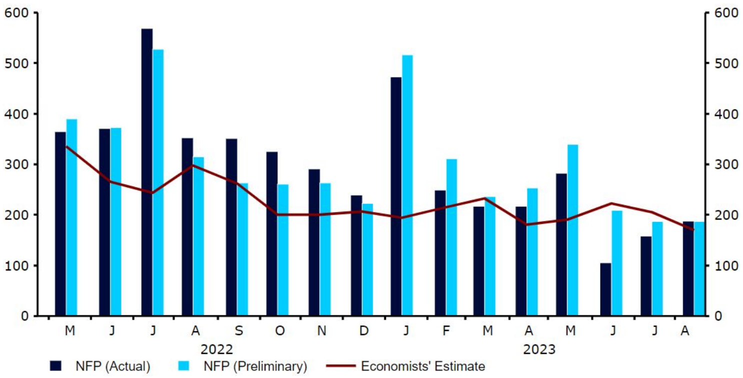
Source: Refinitiv Datastream Date: 04/09/2023

Expectations for ECB rate hikes continue to be unwound, as markets expect the central bank to prioritise supporting the weakening economy over ensuring inflation returns to target. Common currency resilience in the face of these headwinds is remarkable, and the 1.08 level is acting so far as a reliable floor against the US dollar. Aside from this week's retail sales data, revised PMI (Tuesday) and GDP (Thursday) numbers could receive some attention, as will tomorrow's speech from ECB President Lagarde.

USD

The highlight of the week in the FX market was undoubtedly the August payrolls report. While the headline print exceeded expectations and continued to show decent levels of job creation, the sharp downward revisions to the June and July numbers more than made up for this upside surprise. We also saw additional hints that the US labour market is finally loosening. The jobless rate unexpectedly shot up by 0.3 p.p. to 3.8%, while earnings growth eased relative to the previous month.

Figure 3: US Nonfarm Payrolls (2022 - 2023)



Source: Refinitiv Datastream Date: 04/09/2023

Earlier in the week, the JOLTs job openings report also told the same story: modest weakening, albeit still at strong levels compared to any period before the post-pandemic recovery. This loosening seems to be exactly what the Federal Reserve wanted to see, and we do not expect another rate hike at the September meeting, in line with market expectations. Indeed, we continue to believe that the hiking cycle is now over.

JPY

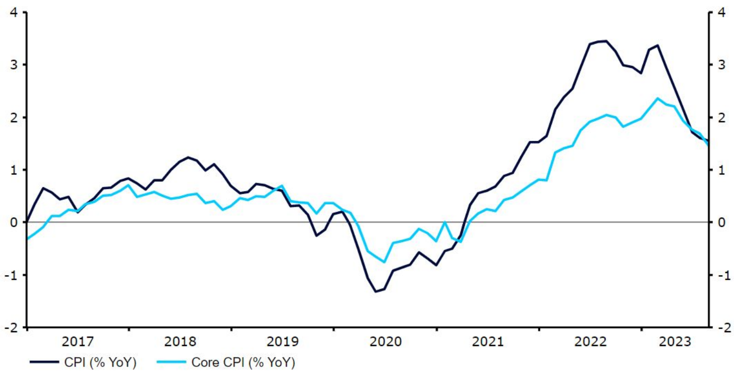
The yen continues to trade largely within the 145-147 range against the US dollar, as investors await key signals on monetary policy from both the US and Japan. The USD/JPY pair fell below this range following Friday's US payrolls report, although it ended the week towards the upper end of it, after some hawkish comments from FOMC member Mester and remarks from Japan's Finance Minister, Shunichi Suzuki. Speaking on the state of the yen, Suzuki dampened expectations that authorities would intervene in the market to protect the currency, saying that while sudden FX moves are undesirable, exchange rates should reflect fundamentals.

This apparent lack of willingness to intervene present somewhat of a near-term concerns for JPY, as markets appear to be under a general assumption that authorities would step in should the yen approach the 150 mark on the dollar. This could open up some near-term downside for the currency, as investors await any sign of a hawkish shift from the Bank of Japan at its next meeting on 22/09. In the meantime, we will look to Friday's revised Q2 GDP data, where a modest downward revision is expected.

CHF

The Swiss currency ended last week almost unchanged against both the euro and the US dollar and, alongside both currencies, the franc was one of the worst-performers in the G10. The main data release from Switzerland last week was the inflation report. The headline measure stabilised at 1.6%, surprising slightly to the upside after economists had expected a modest decline. The core measure did, however, drop from 1.7% to 1.5%. All in all, the data had a similar flavour to that from the Eurozone and did not encourage markets to expect further hawkishness from the SNB.

Figure 4: Switzerland Inflation Rate (2017 - 2023)



Source: Refinitiv Datastream Date: 04/09/2023

The Q2 GDP data out this morning further supported this notion, as it failed to show any quarterly expansion at all, falling short of the 0.3% growth expected by the consensus. This worrisome trend in economic data supports our call that the SNB will, at some stage, shift its priority back to supporting domestic growth. Aside from the latest unemployment data on Thursday, the Swiss economic calendar is largely empty this week. Attention should, therefore, be primarily on developments elsewhere.

AUD

We expect the Reserve Bank of Australia to leave interest rates unchanged at its upcoming meeting on Tuesday, with markets seeing effectively zero chance of any policy adjustment. In recent weeks, developments have largely supported the case for an end to the RBA's tightening cycle, and a prolonged pause before rate cuts begin at some stage in 2024. On the one hand, Australian inflation is showing signs of easing, with the monthly print for July, out last week, dropping to 4.9%, below the 5.2% consensus and the lowest level since February 2022. On the other, growth is slowing, and the worsening in the Chinese economic outlook present a clear downside risk to the Australian economy.

In our view, this is likely to encourage the RBA to adopt a wait-and-see approach this week, as it neither commits to additional rate increases, nor completely rules out further tightening at this stage. The bank will probably leave the door ajar to more hikes, although China growth worries may mean that the next move in rates will be lower. Aside from this week's RBA announcement, investors will also be keeping tabs on second quarter GDP data, out on Wednesday.

NZD

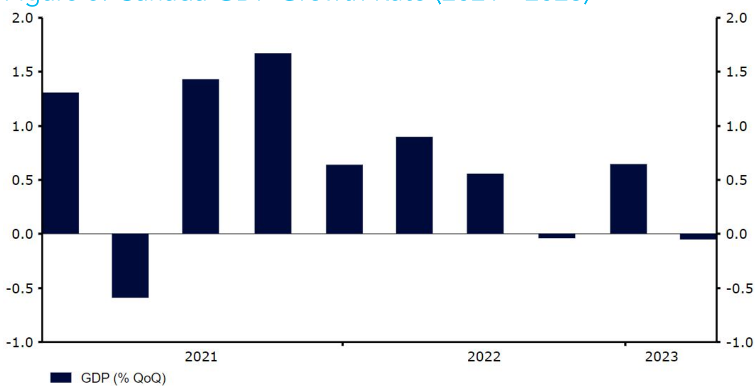
Some slightly more upbeat economic news out of China, namely the August manufacturing PMIs, provided a boost to the New Zealand dollar last week, which benefited from its high-risk status and close economic ties with Asia's largest economy. NZD actually ended last week as one of the better performing major currencies. This may partly be due to valuation, as the New Zealand currency has been the worst performer in the G10 in the past two months, and the retreat in interest rate expectations globally last week, notably in the US.

The latest consumer confidence data for August came in slightly higher last week, although we remain in a relatively quiet period, with little tier-1 macroeconomic data for investors to digest. This week is no different, and we will have to wait until a week on Thursday for the August PMI numbers. That being the case, news out of China will probably remain the number one driver of NZD in the coming days.

CAD

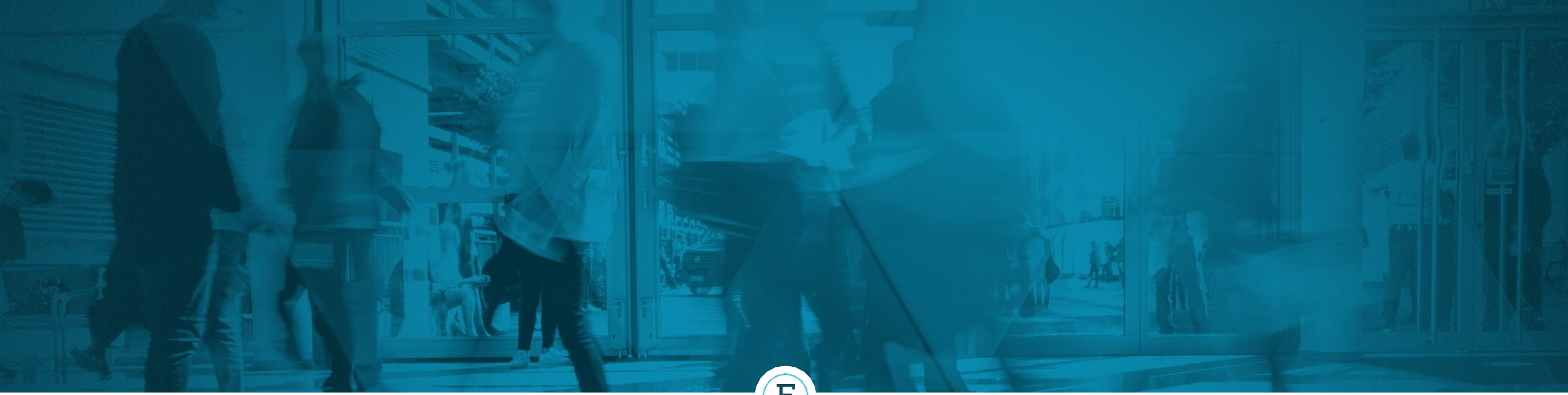
Friday's Canadian GDP report was unequivocally disappointing, cementing our view that the Bank of Canada is likely done tightening policy in the current cycle. Canada's economy posted flat quarter-on-quarter growth, and actually contracted on an annualised basis, albeit only by a negligible 0.2% (+1.2% consensus). The more timely read on economic activity provided by the August manufacturing PMI was equally underwhelming, as this also fell to just 48.0, signifying the largest downturn since the immediate aftermath of the first pandemic lockdowns in the second quarter of 2020.

Figure 5: Canada GDP Growth Rate (2021 - 2023)



Source: Refinitiv Datastream Date: 04/09/2023

This concerning economic backdrop will almost certainly force the Bank of Canada to hold rates steady at its policy meeting on Wednesday. We suspect that policymakers will acknowledge both the recent deterioration in activity data, and the improvement in inflation, though they will unlikely completely close the door to more hikes down the road. In the event of a non-committal BoC, activity in CAD this week could peak around Friday's labour report for August.



SEK

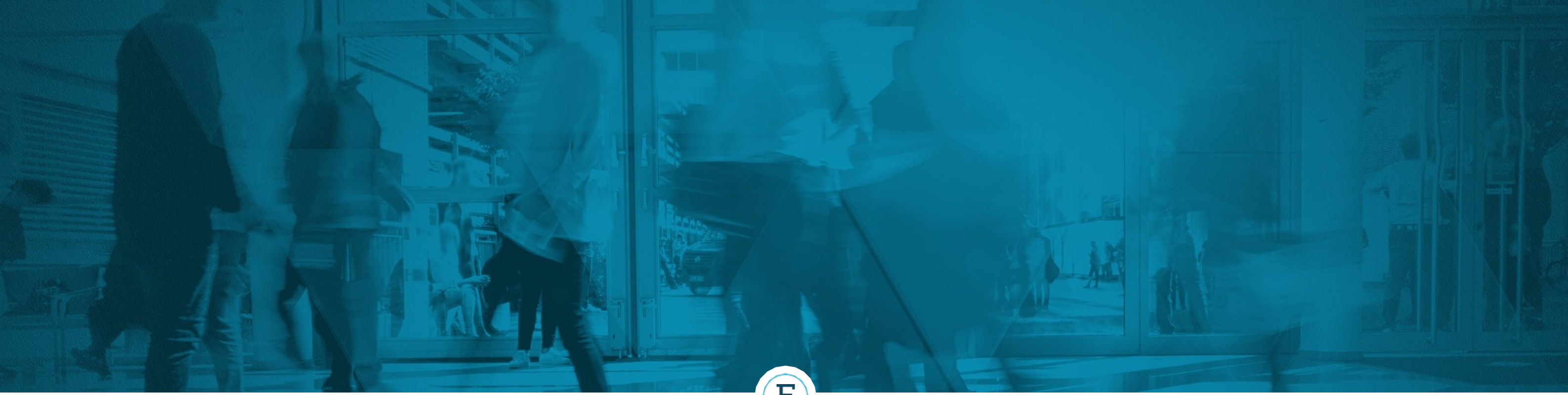
After a relatively up and down week, the Swedish krona ended last week practically unchanged against the euro, although it underperformed every other currency in the G10. We largely attribute this to ongoing concerns surrounding the state of the country's property sector, after a report out last week showed that sales of newly built property collapsed by 25% year-on-year in Q2. Higher central bank rates are also affecting businesses, with bankruptcies rising to their highest level in a decade.

After a week with no major macroeconomic data, this week could be seen as a transitional one ahead of the Riksbank's September meeting in two weeks' time. Markets are mostly pricing in a 25bp rate hike, with another one in November seen as a 50/50 shot according to swaps. While developments in inflation data could encourage policymakers to adopt a hawkish stance, recent signs of a slowdown in activity could reduce the need for further tightening.

NOK

Rising oil prices, which are currently trading around their highest level in nine months, and adjusting expectations for ECB interest rate hikes, allowed the Norwegian krone to appreciate against the euro, and almost all of its major peers, last week. However, recent macroeconomic data from Norway has not been particularly encouraging, which may have partly reduced the extent of the currency's recovery.

According to data released last week, the registered unemployment rate rose to 1.9% in August, its highest level since February. Retail sales contracted more-than-expected in July, while the DNB manufacturing PMI slipped back to 51.4 in August, well below consensus. This latest data adds to a series of recent underwhelming news that suggests high inflation and rising interest rates are weighing on the economy, supporting the notion that the end to Norges Bank's hiking cycle is drawing ever closer.



CNY

Not a lot has changed price-wise with the yuan. The currency rose slightly against the US dollar, although it ended the week marginally lower in trade-weighted terms. Authorities appear determined to prevent excessive weakness in the yuan as we continue to see strong fixings. Moreover, the currency received a boost from the PBoC announcement on Friday, that it would cut the foreign exchange reserve requirement ratio (RRR) from 6% to 4% from 15th September.

China is stepping up its efforts to support the economy. Following recent announcements from authorities to aid stock markets and facilitate property purchases, major Chinese banks announced a coordinated cut in deposit rates, the third this year. It appears that the country is taking the economic slowdown and real estate sector troubles increasingly seriously, which we see as a positive sign. PMI data released last week suggests that things might have taken a small turn for the better. To confirm this, we await the services PMI print from Caixin (Tuesday) and hard data (starting with trade data out on Thursday). Inflation data will also be released on Saturday, and is set to show positive consumer price growth after July's dip into negative territory.

Economic Calendar (04/09/2023 - 08/09/2023)

Economic Calendar	Country	Day	Date	Time (GMT)
GDP (Q2)	SWI	Monday	04/09	08:00
RBA Monetary Policy Meeting	AUS	Tuesday	05/09	05:30
GDP (Q2)	AUS	Wednesday	06/09	02:30
Retail Sales (Jul.)	EZ	Wednesday	06/09	10:00
BoC Monetary Policy Meeting	CAN	Wednesday	06/09	15:00
Unemployment Rate (Aug.)	SWI	Thursday	07/09	06:45
GDP (Q2)	EZ	Thursday	07/09	10:00
GDP (Q2)	JPN	Friday	08/09	00:50
Employment Report (Aug.)	CAN	Friday	08/09	13:30
Inflation (Aug.)	CHN	Saturday	09/09	02:30

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