Ebury What borders?®

Weekly Report

G10 Weekly FX Update

Written by:

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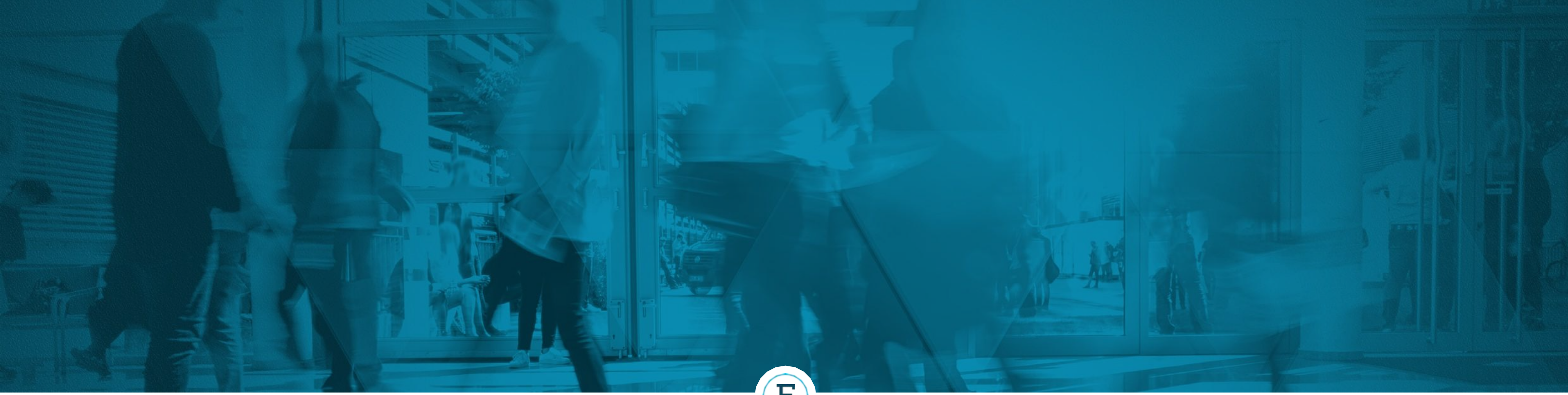
25th September 2023



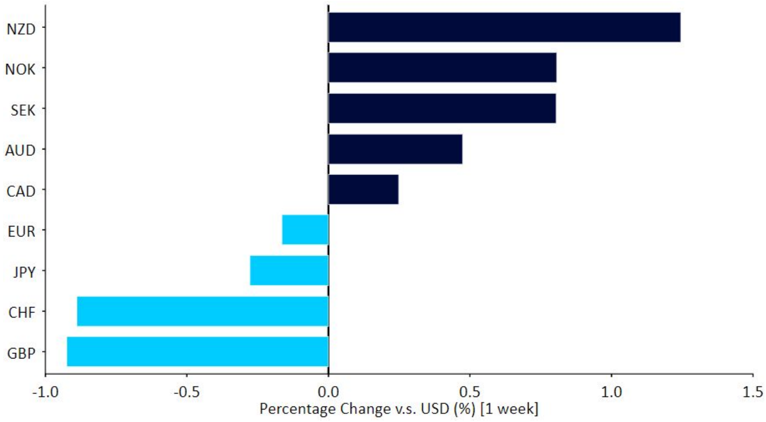
US dollar rally continues on Fed's "hawkish pause"

Hawkish Fed communications, which suggested that the FOMC could hike further and is in no hurry to cut rates, sent interest rates worldwide higher yet again.

The key US 10-year Treasury rate led the way, breaking to fresh multi-decade highs. Risk assets worldwide tumbled, stocks and commodities fell, and credit spreads widened. The impact on currency markets was mixed. The dollar rallied for the most part, but traditional safe-havens like the Swiss franc and the Japanese yen stumbled on dovish surprises from their respective central banks. Sterling also underperformed, after the Bank of England unexpectedly voted in favour of keeping interest rates unchanged, after a surprise miss in the August UK inflation report.

With the major central bank meetings in September out of the way, attention now shifts to economic data. Policy making has become more uncertain and unpredictable than it has been since 2021. Central banks are hoping that current rate levels are sufficient to put inflation on a sustained downward trajectory. Incoming inflation data is, therefore, now more important than ever. The flash September CPI report for the Eurozone is the most critical data point of the week, followed by the August PCE inflation report out of the US. Both are scheduled to be published on Friday.

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

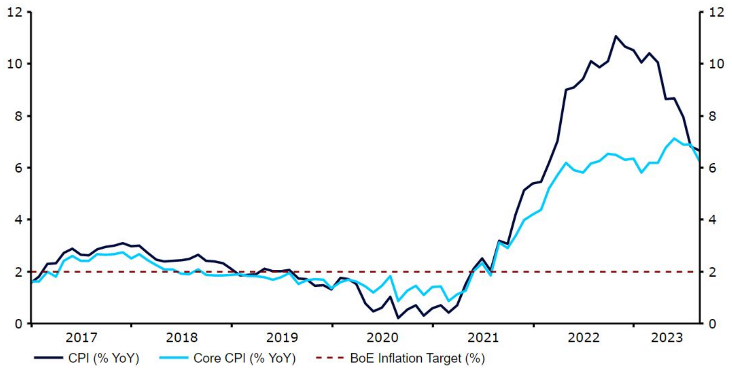


Source: LSEG Datastream Date: 25/09/2023

GBP

The Bank of England took advantage of the positive news on inflation we received earlier in the week to hold rates unchanged, albeit in a very tight vote of five to four. The MPC kept the door alive to additional policy tightening, although there is now a general sense that the bank is looking to wrap up the hiking cycle. Interest rate pricing after the meeting suggests as much, with swaps now seeing less than a 50/50 chance of a final 25bp hike by year-end.

Figure 2: UK Inflation Rate (2017 - 2023)



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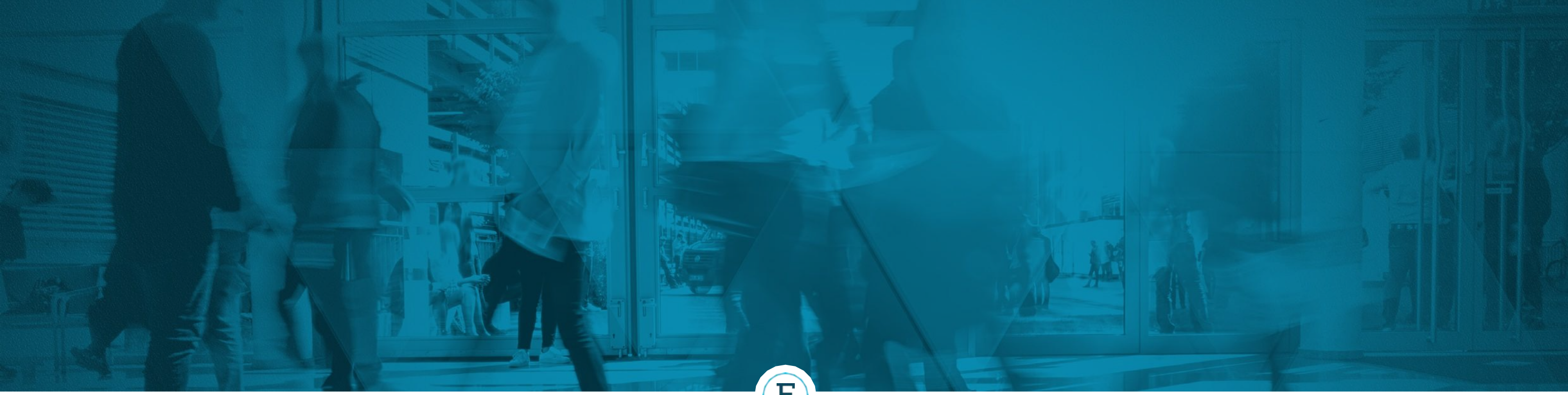
The pound reacted negatively to this dovishness, ending the week down over 1% against the dollar and coming in dead last among G10 currencies. Sterling's performance is clearly tied to expectations for rate hikes in the UK, and these in turn will depend on future inflation data. Policymakers also voiced heightened concerns over the UK growth outlook, while downgrading their Q3 GDP assessment to near flat growth. Revised data on second quarter growth will be released on Thursday, although we would expect sterling to trade largely off developments elsewhere, given the significant time lag in the data.

EUR

The euro lost ground against the US dollar last week, yet again, but at least the pace of the decline is slowing, and the common currency may have found a bottom around $1.06. The contrast between the buoyant US economy and the stalling European one, and pessimism on China's economic recovery, are serious headwinds for the common currency. However, we think that current currency levels are already pricing in a pretty gloomy scenario, and Chinese economic data is starting to surprise to the upside.

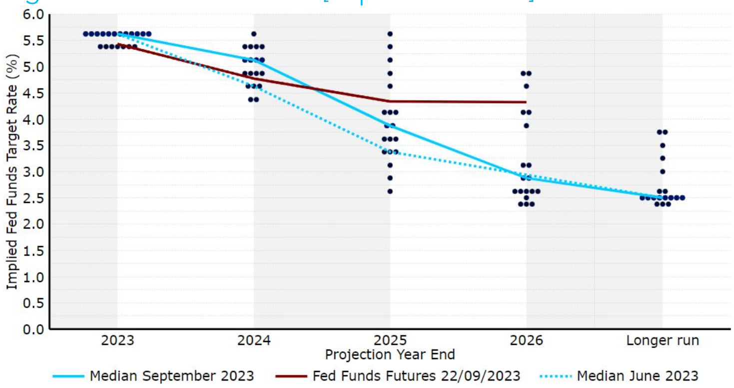


This week's flash CPI report will be key for the euro. Markets are expecting a significant drop in both the headline and core prints. Any disappointment on this front would probably fuel a strong euro rally, as expectations for further hikes are priced in. ECB President Lagarde will be speaking before the inflation data on Monday, although she is unlikely to add anything new from the last Governing Council meeting.

USD

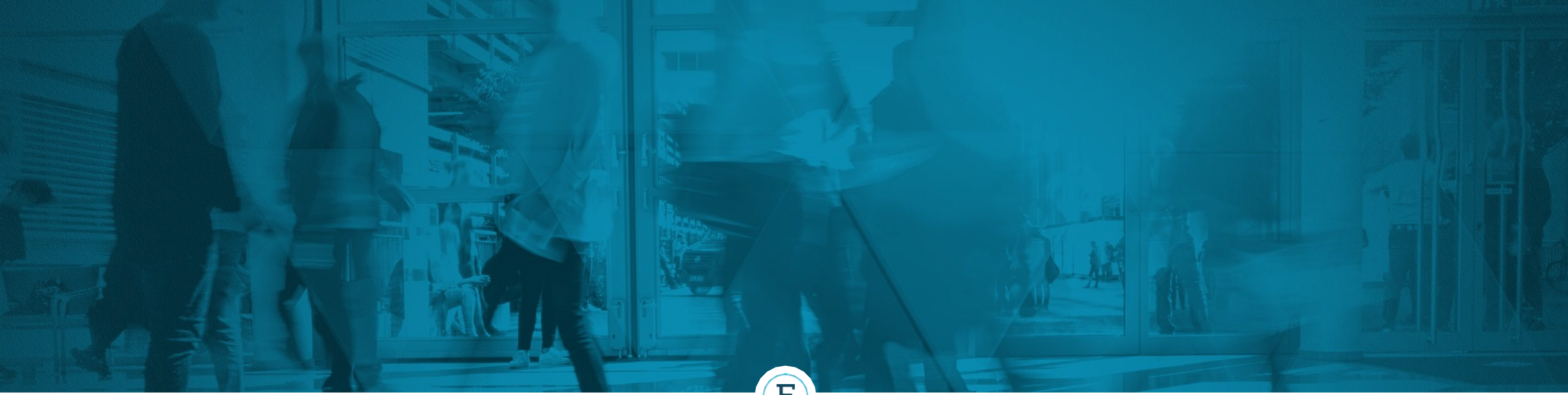
The Federal Reserve refrained from raising interest rates last week, as was universally expected, although it made up for this by revising sharply upward its expectations of future interest rate levels in the "dot plot". The median dot for 2023 was unchanged relative to the June projections, and continued to pencil in one more rate hike this year, while the forecasts for 2024 and 2025 were both shifted up by 0.5 percentage points. This sends a clear message to markets that inflation is far from beaten, especially given the strength of the US economy, and that rates will need to remain high for longer than previously anticipated.

Figure 3: FOMC 'Dot Plot' [September 2023]



Source: LSEG Datastream Date: 25/09/2023

The consumer inflation report earlier in the month provided a hint that inflation is not completely contained. This Friday's PCE inflation report, the Fed's preferred gauge, will be highly important. Markets are expecting another subdued number, which should allay concerns about further Fed hikes and perhaps cap the dollar rally for the time being.



JPY

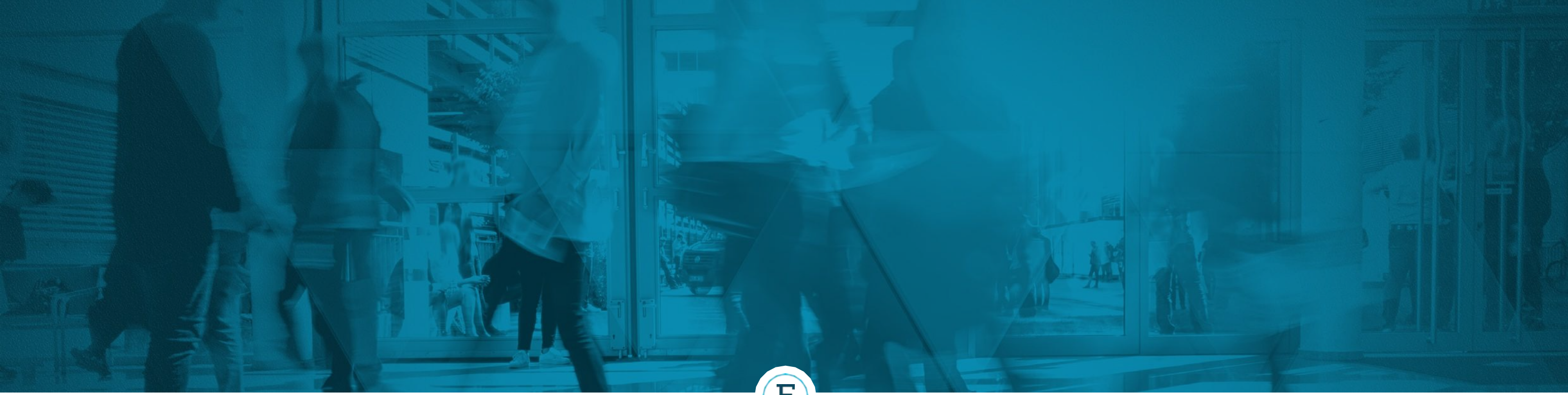
The Bank of Japan once again stuck by its ultra-dovish policy stance following its meeting on Friday, defying some expectations that it could hint at a possible end to its yield curve control policy. Seemingly intent on quashing market speculation that higher rates could soon be in the offing, the BoJ said that the outlook for Japanese inflation was ‘highly uncertain’, and that policymakers would need to see more evidence before being able to express confidence that inflation is on a stable and sustainable path towards the target level.

Investors reacted to these dovish comments by selling the yen against most currencies, with the USD/JPY pair breaking back above the 148 level. We still think that macroeconomic conditions warrants a reversal in the BoJ’s accommodative stance, though the committee is clearly in no rush, and an end to YCC by year-end is not a foregone conclusion. Swap markets are now not fully pricing in the first 10bp rate hike until March, from January, which could delay the possible start of JPY appreciation.

CHF

In a rare turn of events, the Swiss franc landed at the bottom of the G10 dashboard last week. This was largely a consequence of the Swiss National Bank's surprising decision to keep the key interest rate unchanged, after markets were pricing in a 25bp hike. The SNB appears increasingly concerned over the economic slowdown, while its inflation concerns have eased judging by the downward revision to the 2025 inflation forecast to 1.9%, back within the target range. The bank has not closed the door to further tightening, although the chances of this seem quite slim, in our view.

The SNB’s dovish turn is undoubtedly negative for the Swiss currency, and its immediate sell-off, which was the largest since June, is a testament to this. However, the SNB has not abandoned its intervention commitments, meaning that the franc can continue to receive support from the central bank's sale of foreign currency. Looking ahead, this week promises to be calmer for the franc. However, markets will be keeping an eye on sentiment data, in particular the key KOF index, which will be published on Friday.



AUD

The recent increase in commodity prices, and easing concerns over the outlook for the Chinese economy, have continued to support the antipodean currencies, with AUD able to post modest gains versus the broadly stronger US dollar last week. Macroeconomic news out of Australia has also taken a slight turn for the better, which has partly contributed to the recovery in the Aussie dollar. Last week's Judo Bank PMIs were generally encouraging. While the manufacturing index slipped deeper into contraction, services activity rebounding sharply, lifting the composite number (50.2) back above the key level of 50 for the first time since June.

With the outlook not entirely devoid of optimism, the Reserve Bank of Australia has not completely closed the door to additional policy tightening. Last week's RBA meeting minutes suggested that policymakers considered another hike in September, despite holding rates steady, while stressing that some additional tightening may be required should inflation prove more persistent than expected. Wednesday's monthly CPI number is expected to show that inflation picked up again in July. If confirmed, this could reignite speculation that the RBA could raise rates again by year-end, which would be a clear bullish signal for AUD.

NZD

The clear outperformer in the G10 last week, and the best performing major currency in the world in the past month, has been the New Zealand dollar. As mentioned, the rebound in commodities (the CRB Commodity Price Index has risen to 15-month highs), and somewhat better economic news out of China, have helped support the antipodean currencies. Last Wednesday's Q2 GDP report also smashed past expectations, with the New Zealand economy expanding by 0.9% on the previous quarter and by 1.8% year-on-year, both well above the 0.5% and 1.2% estimates.

The Reserve Bank of New Zealand will be announcing its latest policy decision a week on Wednesday. No change in rates is expected this time around, but the unexpectedly strong growth data has triggered speculation that another hike by year-end wouldn't be the most outlandish thing. An uptick in this Thursday's consumer confidence data would further support this notion, and could provide a further leg up for the dollar leading into the October rate announcement.

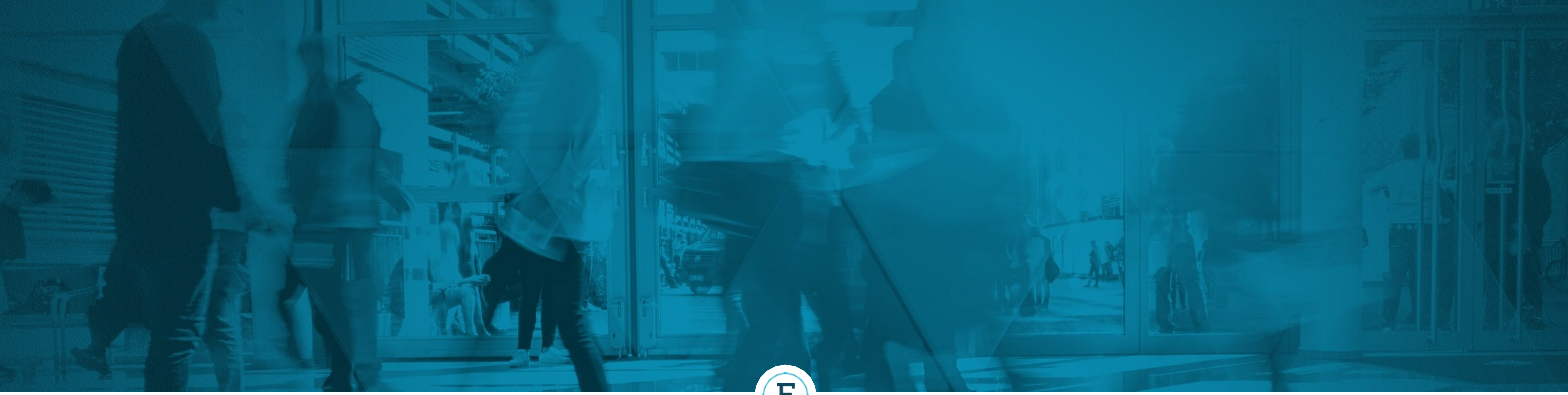
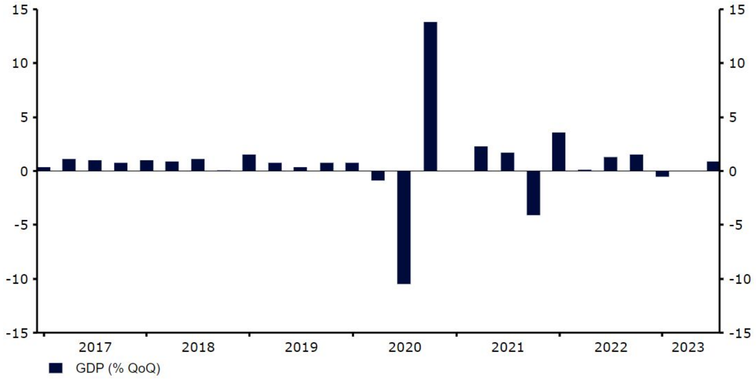


Figure 4: New Zealand GDP Growth Rate (2017 - 2023)



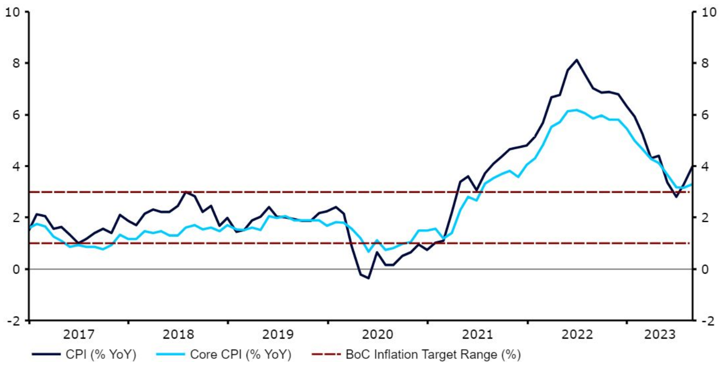
Source: LSEG Datastream Date: 25/09/2023

CAD

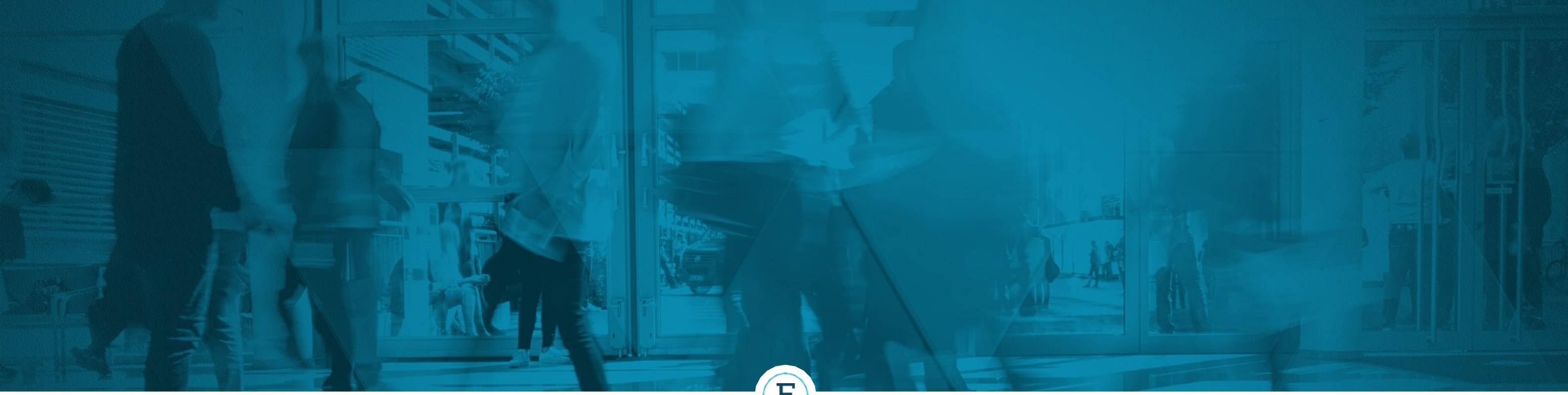
Concerns over supply, and the slightly better Chinese growth outlook, have continued to support global oil prices, which appear to be racing towards the $100 a barrel mark. This has provided strong assistance to the Canadian dollar, which was once again one of the better performers in the G10 last week, ending it just below the $1.35 level. Hotter-than-expected August inflation data can also partly explain the rally in CAD, particularly the sharp uptick in the headline CPI measure, which shot back up to 4% last month, from 3.3% in July. Markets are now pricing in one more 25bp hike from the Bank of Canada in the current cycle, having almost ruled one out no more than a couple of weeks ago.

This week is set to be a relatively quiet one in Canada, with the monthly GDP data for July (Friday) the only real data point of note. Activity should pick up next week, with the release of the latest manufacturing PMI (02/10), and labour report (06/10) likely to generate some market volatility.

Figure 5: Canada Inflation Rate (2017 - 2023)



Source: LSEG Datastream Date: 18/09/2023



SEK

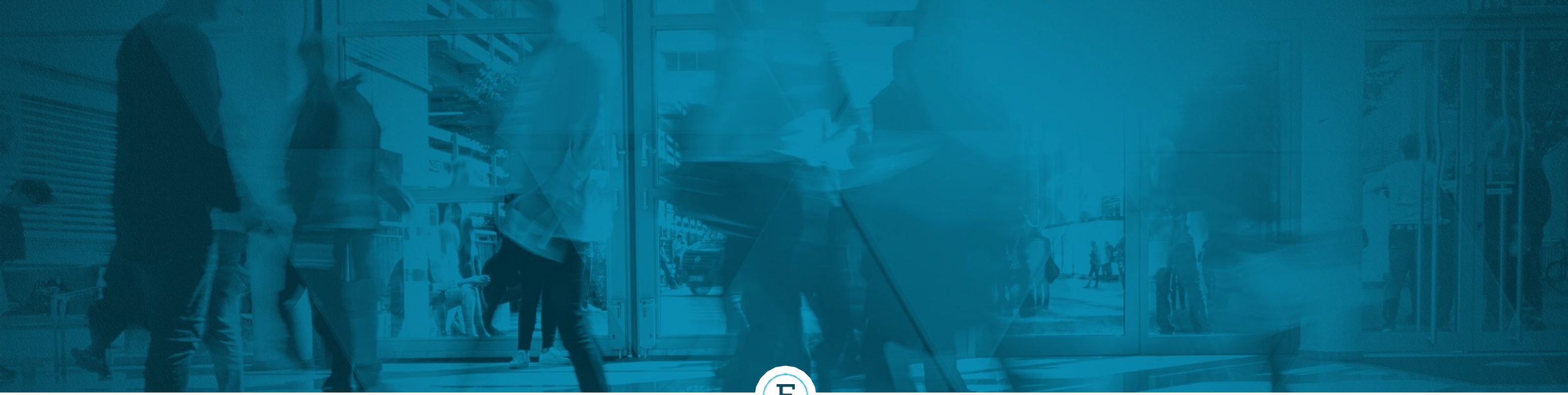
Last week’s Riksbank's decision provided some decent support for the krona, which ended the higher against the euro, and rebounded off it's all-time lows. As anticipated, the Riksbank raised rates by another 25 basis points to 4%, their highest level since 2008. According to the statement, the period of aggressive policy tightening and falling energy prices have contributed to the drop in inflation, and the bank signalled only a 40% chance of another hike.

Developments are moving in the right direction, but inflationary pressure in the Swedish economy are still too high, so we are not fully ruling out the possibility of a further increase in the policy rate. The projection and the statement that 'the outlook for the interest rate indicates that it could rise further' shows a clear hawkish bias. Overall, we continue to suspect that the Riksbank will raise rates by 25 basis points for the last time in November, which remains largely priced in by swap markets.

NOK

A hawkish Norges Bank and elevated oil prices, which have risen by more than 20% since the end of June, supported the Norwegian krone last week, with NOK advancing by around 1% on the euro. Norges Bank raised rates by 25 basis points to 4.25% last week, as expected, although its new guidance on rates was more hawkish than expected.

We were in line with the market, and believed that the September hike would be the last, however, the press release stated that ‘a further increase in policy rates is likely, most probably in December’. Governor Ida Wolden Bache further emphasised ‘there will likely be a need to maintain a tight stance for some time ahead’. Terminal interest rate projections were also revised higher, to 4.5% through 2024. This hawkish shift should be a clear bullish development for NOK, and we see scope for a further strengthening of the Norwegian currency from current levels.



CNY

The Chinese yuan sold off somewhat against the US dollar last week, although it continued to rise in trade-weighted terms. Authorities in China continued to support the currency, and one clear sign of that is firm fixings. News from China was rather scarce last week, and the loan price rates (LPRs) were left unchanged, as expected.

A recent string of positive economic data is a welcome sign, although more of that will be needed to lift investors' spirits, particularly since concerns over the property sector have far from completely gone away. The focus this week will be on the PMI readings, which will be released over the weekend. These are set to show some improvements, and could potentially support the argument that the weakest point of China's economic recovery is now behind us.

Economic Calendar (25/09/2023 - 29/09/2023)

Economic Calendar	Country	Day	Date	Time (BST)
Consumer Confidence (Sep.)	US	Tuesday	26/09	15:00
Consumer Confidence (Sep.)	SWE	Wednesday	27/09	08:00
Retail Sales (Aug.)	AUS	Thursday	28/09	02:30
Retail Sales (Aug.)	NOR	Thursday	28/09	07:00
Consumer Confidence (Sep.)	EZ	Thursday	28/09	10:00
GDP (Q2)	US	Thursday	28/09	13:30
Unemployment Rate (Aug.)	JAP	Friday	29/09	00:30
GDP (Q2)	UK	Friday	29/09	07:00
Retail Sales (Aug.)	SWE	Friday	29/09	07:00
KOF Economic Barometer (Sep.)	SWI	Friday	29/09	08:00
Unemployment Rate (Sep.)	NOR	Friday	29/09	09:00
Preliminary Inflation (Sep.)	EZ	Friday	29/09	10:00
PCE Inflation (Aug.)	US	Friday	29/09	13:30
GDP (Jul.)	CAN	Friday	29/09	13:30

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