

Weekly Report

# G10 Weekly FX Update

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Written by:

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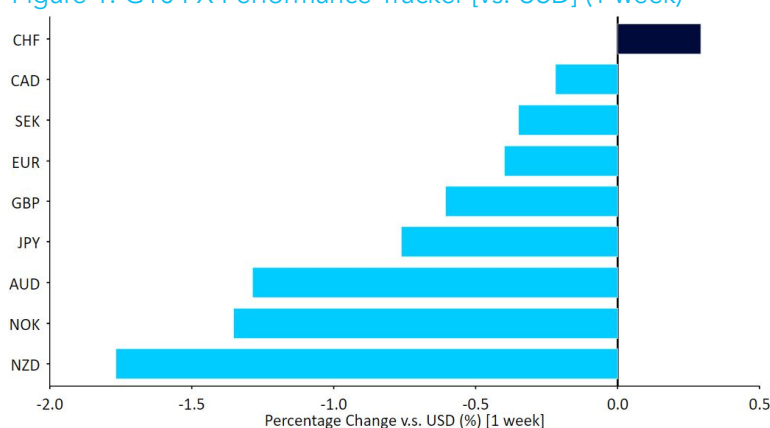
## Dollar bounces back as US inflation worries return

The crisis in the Middle East is for now having a muted impact on major currency trading, which continues to be driven primarily by inflation numbers and central bank communications and decisions.

The September inflation report out of the US showed signs that the downward trend is stalling, and US rates rebounded, dragging the dollar up with them against most world currencies. The main exception were Latin American currencies, which are continuing to benefit from higher oil prices. Meanwhile, the Polish zloty jumped on Sunday night following results of the elections that were won by the opposition parties that are preferred by the European union.

Both the central bank and economic release calendar look rather thin this week. UK labour market data (Tuesday) and inflation (Wednesday), and inflation out of Japan (Friday) will provide the main points of focus for G10 currencies. Speeches by central bank officials from the Federal Reserve, the European Central Bank and the Bank of England may also provide some much needed insight on central bank thinking this week.

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

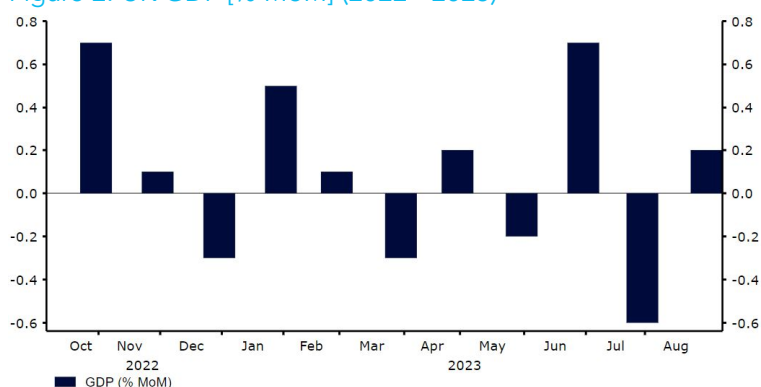


Source: LSEG Datastream Date: 16/10/2023

## GBP

Last week was largely void of any market-moving news out of the UK, aside from the monthly GDP data, where the July number was revised downwards and deeper into contraction. This presents a difficult balancing act for Bank of England officials. Communications from MPC members were rather vague last week, although governor Bailey and chief economist Pill both kept the door open to additional policy tightening, noting that upcoming decisions would be finely balanced.

Figure 2: UK GDP [% MoM] (2022 - 2023)



Source: LSEG Datastream Date: 16/10/2023

This week we will get a wealth of economic data and insight on the Bank of England's views. Labour market data Tuesday will set the stage for the critical inflation report on Wednesday. Market pricing of the terminal rate in the UK has shifted dramatically on the assumption that a disinflationary trend is now firmly in place. Any disappointment on this score, particularly as regards to core inflation, could lead to a sharp repricing of future Bank of England moves and buoy the pound.

## EUR

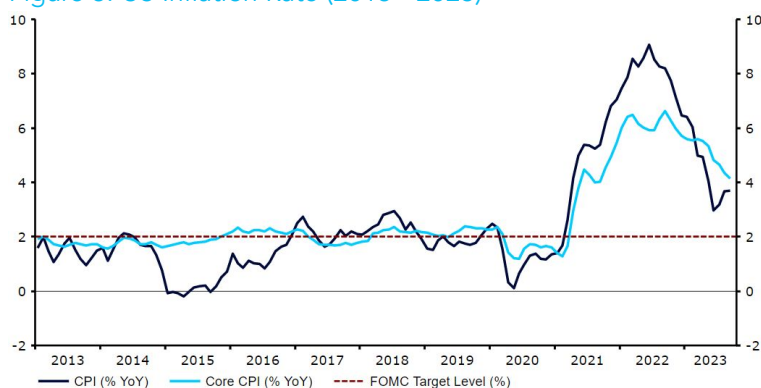
The main news out of the Eurozone last week was yet another dismal industrial production report for August, which showed a sharp contraction. This will do little to dispel the narrative of European stagflation, as output stalls and inflation falls back at a slow pace. The accounts from the latest ECB meeting also struck a rather dovish tone, noting that the September rate hike was a 'close call' and that there was inconclusive evidence to suggest whether further policy tightening is required. All in all, this is not exactly the type of communication that would suggest rate-setters are open to additional hikes.

The euro held up well in spite of the gloom, ending the week nearly flat against the dollar. This would seem to validate our view that current levels price in a very negative scenario for the Eurozone, and that any positive surprises could have a disproportionate effect on the common currency.

## USD

The critical September inflation report was noisy, but overall it provided little comfort to the Federal Reserve. A variety of core services pricing indicators firmed up, the kind of sticky inflation that had shown tentative signs of being clearly on the way down. Our favoured barometer, the three-month annualised core rate of inflation, has also edged back up again, which is a bit of a worry.

Figure 3: US Inflation Rate (2013 - 2023)



Source: LSEG Datastream Date: 16/10/2023

Following the data, yields backed up, in spite of the turmoil in the Middle East and the consequent flight to safety, which is generally supportive of the US dollar. This positive effect was somewhat compensated by a general sense among Fed officials that the recent backup in long-term rates had tightened financial conditions and done some of the work for the central bank, reducing the need for additional hikes. FOMC members Bostic, Jefferson and Logan all indicated that they believed the hiking cycle was over and, by the end of the week, futures was back assigning only around a 1-in-3 implied probability that the Fed raises rates by another 25 basis points by year-end.

## JPY

The yen continues to trade around the 150 level versus the US dollar, albeit this key psychological threshold appears to be providing some stubborn resistance. The modest safe-haven flows that we witnessed at the beginning of last week provided some fleeting support for JPY, following the news of the conflict in Israel and Gaza. These gains were quickly reversed, however, and at the time of writing the USD/JPY pair is trading not too far off its highest level in more than three decades.

Expectations for Bank of Japan monetary policy remain key for the yen, and as long as the central bank continues to stick by its dovish stance, the less chance the currency has of recovering ground. Japanese inflation data for September will be released on Friday, which remains highly important for BoJ interest rates. We will be paying particularly close attention to the 'core core' rate of price growth. Unlike every other inflation metric in Japan, this is yet to show any signs of easing from its peak.

## CHF

The ongoing crisis in the Middle East helped the safe-haven franc reach the strongest position against the euro in just over a year and finish the week on top of the G10 FX performance tracker. Domestic news did not matter much for the franc. The downward rate repricing continued, supported by global trends and further signs that inflationary pressures in Switzerland are contained. Producer and import prices fell by 1% in September, extending their deflationary trend.

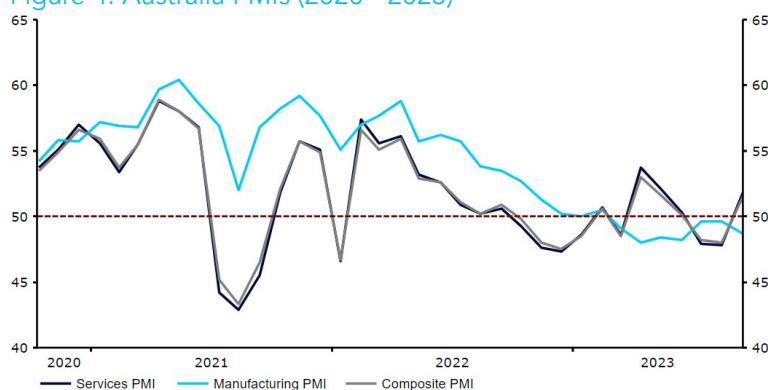
Looking ahead, outside news will likely continue to drive the franc. Thursday's trade data will be worth watching, albeit this is unlikely to be market-moving. It will, at least, provide insight into the situation of one of Switzerland's primary growth engines at the end of the third quarter.

## AUD

The antipodean currencies were the big underperformers in the G10 last week, with the Australian dollar trading lower against all of its major counterparts in the past month. Lingering concerns surrounding the Chinese economy, and the slight risk-off mode that we've seen in markets since the start of Hamas attacks in Israel, have worsened investor sentiment towards AUD. Investors also continued to see additional RBA rate hikes as unlikely, at least at the next couple of central bank meetings.

Attention this week will be on the latest RBA meeting minutes, a speech from the new central bank governor Bullock (both on Tuesday), and the September labour report (Thursday). Any signs of hawkishness in RBA rhetoric would likely support the Australian dollar, given relatively suppressed market pricing for rates. Meanwhile, Thursday's labour report is expected to show a rather sharp slowdown in job creation relative to the previous month. Again, the bar for an bullish surprise here is quite low, so there appears room for AUD upside.

Figure 4: Australia PMIs (2020 - 2023)



Source: LSEG Datastream Date: 16/10/2023

## NZD

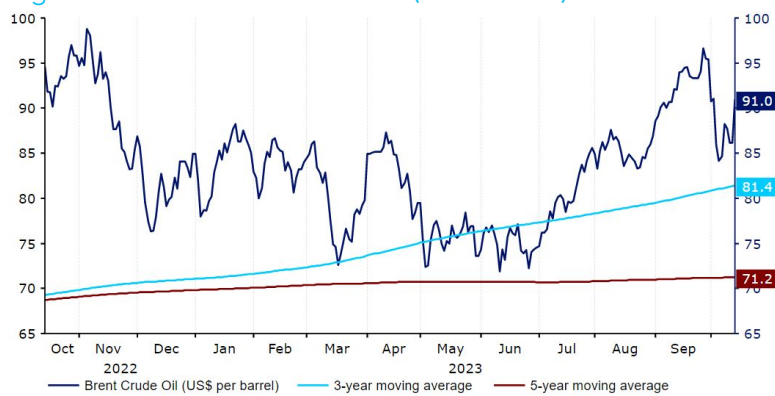
Macroeconomic news out of New Zealand in the past week has been rather mixed. Last week's manufacturing PMI sank to just 45.3, its lowest level since August 2021, although the business activity PSI, a lesser known measure that tracks output in the services sector, rose to a 4-month high 50.7. The overall growth picture continues to generally improve, particularly following the news that a recession earlier in the year was avoided after all, though the economy is far from firing on all cylinders.

Focus in New Zealand this week will be on the latest inflation data for the third quarter. An upside surprise here could bring another RBNZ interest rate hike into view, which would no doubt provide some much needed support for NZD.

## CAD

The rebound evident in global oil prices in the past week is clearly bullish for the Canadian dollar, which ended last week as one of the better performers in the G10. Indeed, perhaps the biggest risk from the Israel-Hamas conflict to financial markets could be the impact on commodities, as a wider war in the Middle East would jeopardise oil supply and could push up prices, particularly should major oil producers Saudi Arabia and Iran take up arms.

Figure 5: Brent Crude Oil Futures (2022 - 2023)



Source: LSEG Datastream Date: 16/10/2023

Aside from the developments in oil, this week in Canada will be all about the latest inflation data for September (Tuesday). This critical data point has surprised to the upside in each of the past two months, and another beat this week would undoubtedly cause officials at the Bank of Canada to take note. As things stand, there seems a greater possibility that the BoC delivers another rate hike than the Fed, which may lead to a lower USD/CAD exchange rate in the near-term.

## SEK

The Swedish krona ended last week slightly higher against the euro, as inflation moderated less than expected in September. Headline inflation fell to 6.5% last month, from 7.5% in the previous month. While this is the lowest rate since April last year, it was higher than the consensus (6.3%). Core inflation, which is of greater importance for Riksbank's monetary policy, fell to 4%, albeit this was again above the 3.8% priced in by financial markets.

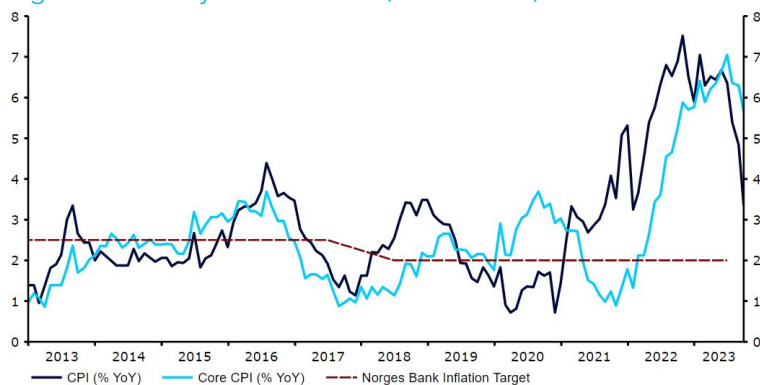
Despite the recent moderation, Swedish inflation remains too high for comfort. This, together with the tone adopted by the Riksbank at its last meeting, leads us to believe that the central bank will carry out a final 25 basis point hike at the November meeting, which could provide some upside for the krona given current market pricing.

## NOK

The Norwegian krone depreciated against the euro last week, as the downward surprise in September inflation reduced bets for further Norges Bank rate hikes and offset upside stemming from the jump in oil prices. Headline inflation fell more than expected to 3.3% in September, its lowest level since January 2022. Core inflation, which excludes volatile items, also declined to 5.7%, its lowest level in almost a year.

At its latest meeting in September, Norges Bank pre-signalized one last rate increase in December, and a terminal rate of 4.50%. This is, however, now not set in stone, and markets are currently pricing in less than a 50% implied probability of another hike following the recent progress on the inflation front.

Figure 6: Norway Inflation Rate (2013 - 2023)



Source: LSEG Datastream Date: 16/10/2023



## CNY

The Chinese yuan ended the week roughly in the middle of the EM FX performance dashboard, and little changed against the US dollar. The latest news from China was fairly mixed. Trade data showed a 6.2% YoY contraction in both exports and imports in September, smaller than the previous month and a noticeable upward surprise in the case of the former, which is an encouraging sign for the outlook. Other data, however, was less rosy. Consumer inflation fell to 0% in September, and financing data was unimpressive. Authorities are keeping their guard up – today, the PBoC kept the MLF rate unchanged (as expected), but injected a net 289bn yuan in medium-term loans, the most in almost three years.

This week, attention will be primarily focused on macroeconomic data, as the third-quarter GDP data and key accompanying readings will be out on Wednesday. In quarterly terms, growth is set to be similarly weak as the 0.8% registered in Q2 – growth above 1% would be considered a success.

### Economic Calendar (16/10/2023 - 20/10/2023)

Economic Calendar	Country	Day	Date	Time (BST)
Inflation (Q3)	NZ	Monday	16/10	22:45
Employment Report (Sep.)	UK	Tuesday	17/10	07:00
Retail Sales (Sep.)	US	Tuesday	17/10	13:30
Inflation (Sep.)	CAN	Tuesday	17/10	13:30
GDP (Q3)	CHN	Wednesday	18/10	03:00
Retail Sales (Sep.)	CHN	Wednesday	18/10	03:00
Inflation (Sep.)	UK	Wednesday	18/10	07:00
Inflation (Sep.)	EZ	Wednesday	18/10	10:00
Employment Report (Sep.)	AUS	Thursday	19/10	01:30
Inflation (Sep.)	JPN	Friday	20/10	00:30
Retail Sales (Sep.)	UK	Friday	20/10	07:00
Unemployment Rate (Sep.)	SWE	Friday	20/10	07:00
Retail Sales (Aug.)	CAN	Friday	20/10	13:30

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