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Weekly Report

G10 Weekly FX Update

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23rd October 2023

Relentless rise in US yields fails to boost dollar

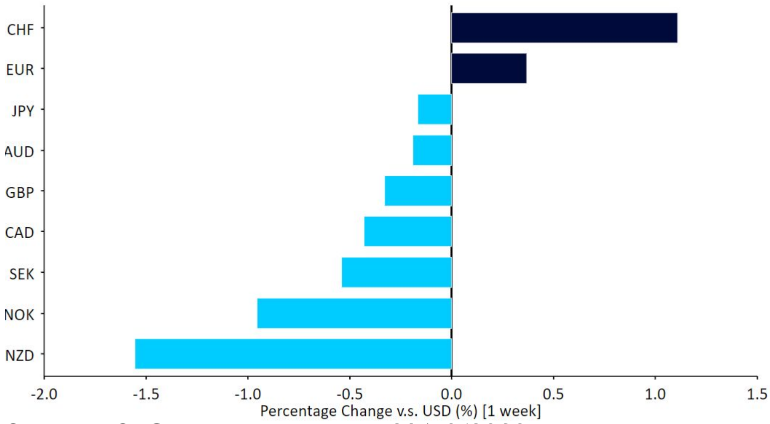
The US dollar traded in a fairly tight range against most of its peers last week, ending slightly lower against most European currencies, save the pound.

The moves were all modest, although it is remarkable that yet another week of rising long-term rates in the US failed again to boost the greenback significantly. This suggests that the dollar already prices in a very positive scenario for the US economy and higher yields for much longer at current levels. Together with stretched trader positioning and a growing long consensus, we think that upside for the US dollar may be limited from here.

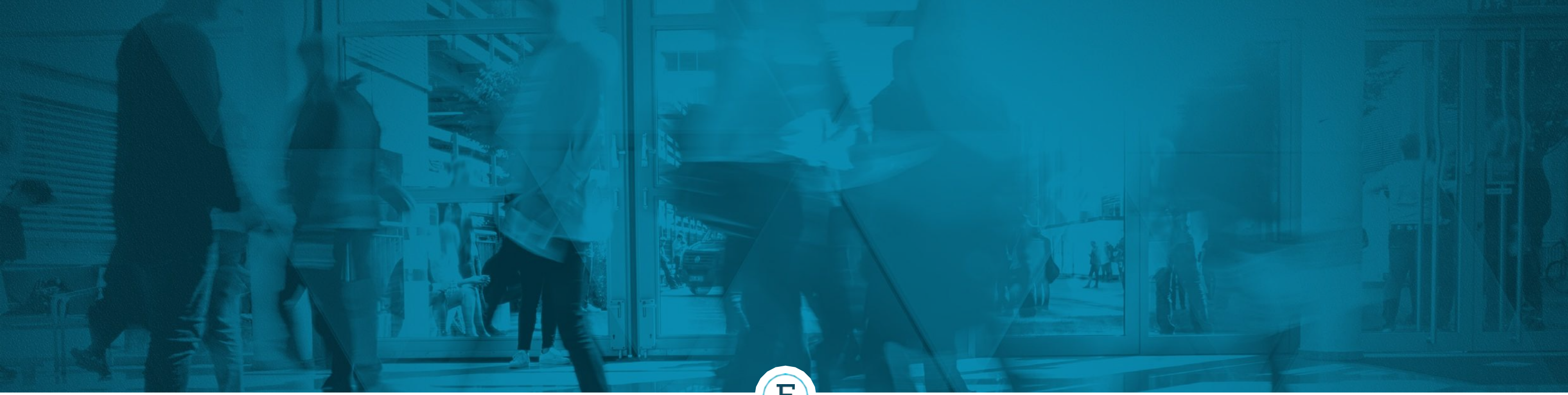
This Thursday's European Central Bank meeting will be the main focus for investors this week. No changes in policy are expected, so attention will be on the communications. On the macroeconomic front, the all important PMIs of business activity could be market moving. The data for the US, Eurozone, and the UK will all be released on Tuesday. Gloomy readings are expected in Europe, contrasting with a more solid tone in the US.

Later in the week will see the release of the personal consumption expenditures inflation (PCE) report in the US, the Federal Reserve's preferred measure of consumer prices. Traders will also be closely following the developments in Israel and Palestine, although the impact of the crisis in financial markets in general, and currencies in particular, has so far been rather limited, and contained the modest safe-haven flows into the likes of the Swiss franc.

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



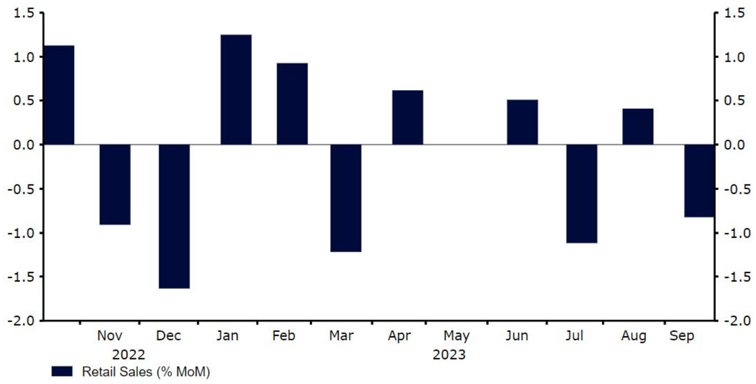
Source: LSEG Datastream Date: 23/10/2023



GBP

Higher than expected UK inflation numbers and weak retail sales in September were unwelcome news for the Bank of England last week. Stubbornly high core inflation readings and a certain loss of economic momentum are consistent with stagflation, and very high wage increases raise the risk of second-round effects and a solidification of inflation expectations at current high levels.

Figure 2: UK Retail Sales (2022 - 2023)



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While the pound is trading at undeniably attractive valuation levels, the Bank of England's dovish messaging and reluctance to hike rates any further may delay any sustained rally in the near-term. Upcoming data on unemployment (Tuesday) and the October PMIs (Wednesday) will be important for sterling this week. Investors will also have one eye on next week's MPC meeting for November. No change in rates is expected, although investors will be hoping for more clarity on the bank's near-term plans for policy.

EUR

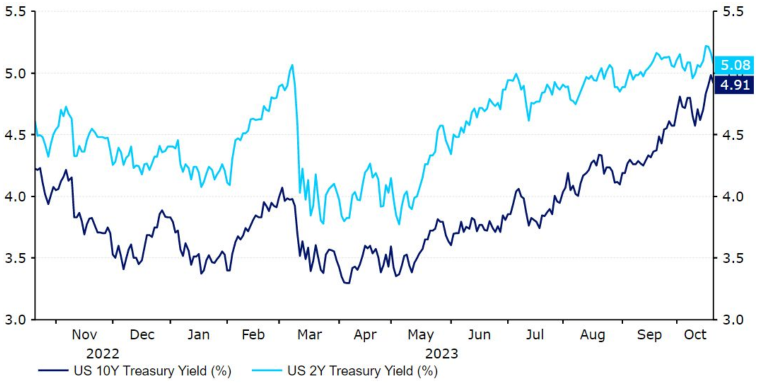
The stabilisation in Chinese macroeconomic data should have provided a positive backdrop for the common currency, but the Middle East crisis may be another headwind for growth, mainly through higher energy prices. The ECB has to navigate these stagflationary risks, and on Thursday we expect the central bank to leave policy unchanged. Indeed, swap markets see effectively no chance of any change in rates, and believe that the next move in rates will be to cut at some point towards the middle of 2024.

President Lagarde will have to walk a fine line, as risks to growth have materially increased, but core inflation remains stubbornly high and its downward trend remains very tentative. Should Lagarde voice heightened concern over the state of the bloc's economy, then the euro may come under fresh selling pressure towards the end of the week. Conversely, any form of push back against market expectations for rate cuts would be unambiguously hawkish for the common currency, and could trigger a knee-jerk rally from currently suppressed levels.

USD

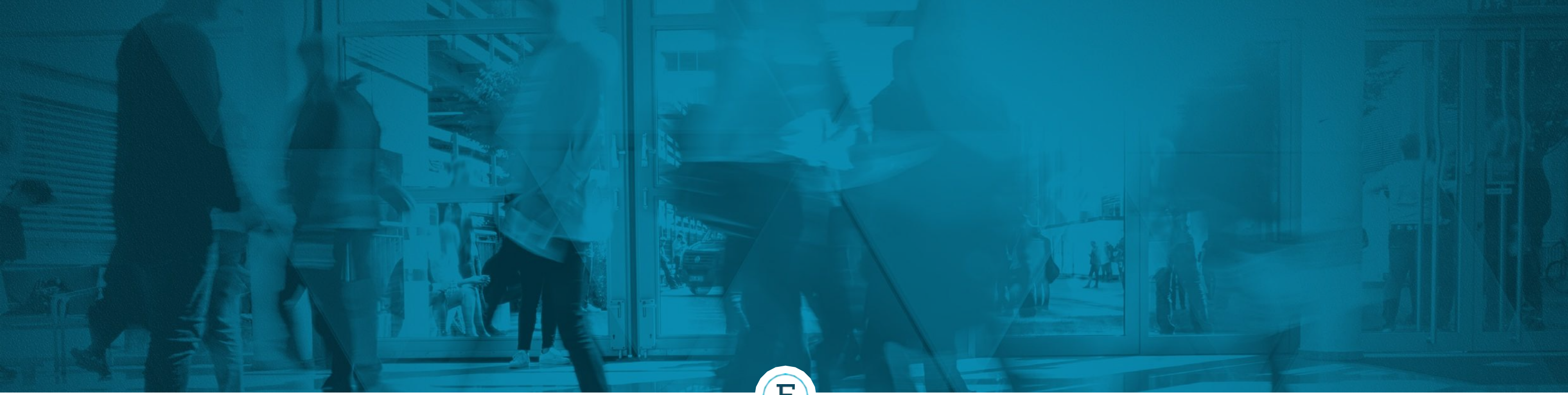
The US economy continues to shrug off the effect of relentlessly rising interest rates. In spite of Treasuries above 5%, and mortgage rates above 8%, economic news continues to surprise on the upside more often than not, including last week's retail sales report for September. FOMC chair Powell delivered a mixed set of remarks during his speech last week and, following some choppy trading, the impact on the dollar was rather neutral. While Powell kept the door open to further hikes, and noted that policy was 'not too tight', he also flagged signs of a cooling in the labour market and the impact of higher yields on a tightening in financial conditions.

Figure 3: US Treasury Yields (2022 - 2023)



Source: LSEG Datastream Date: 23/10/2023

This week's quarterly GDP growth number is expected to print above 4% in annualised terms, which is consistent with nominal GDP growth of around 8%. The gap with the economies across the Atlantic could not be starker, and the question is to what extent this gap is already reflected in both high dollar levels and market consensus about further dollar appreciation.

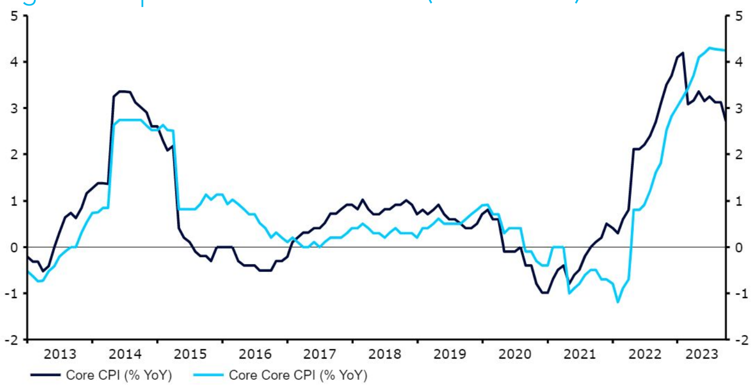


JPY

The 150 level in the USD/JPY exchange rate continues to provide stubborn resistance, amid a combination of technical factors, algorithmic trading and intervention speculation. While JPY has lost much of its safe-haven appeal in light of the Bank of Japan's ultra-dovish policy stance, we may also be seeing a modest flight to the relative safety of the yen as the conflict in the Middle East continues.

Expectations for BoJ policy remain key for the yen. News that Japan's largest labour union, Rengo, are planning to ask for a 5% pay increase next year supports the call for tighter BoJ policy ahead of next week's central bank meeting. The weak yen, heightened wage pressures and stubborness in the 'core core' rate of inflation, which was stuck at an above forecast 4.2% in September, has raised the possibility that the BoJ could scrap its YCC policy next week. Should the bank do so, then markets would raise bets in favour of a first rate hike in early-2024, which could provide some strong support for the yen towards the end of the month.

Figure 4: Japan Core Core Inflation (2013 - 2023)



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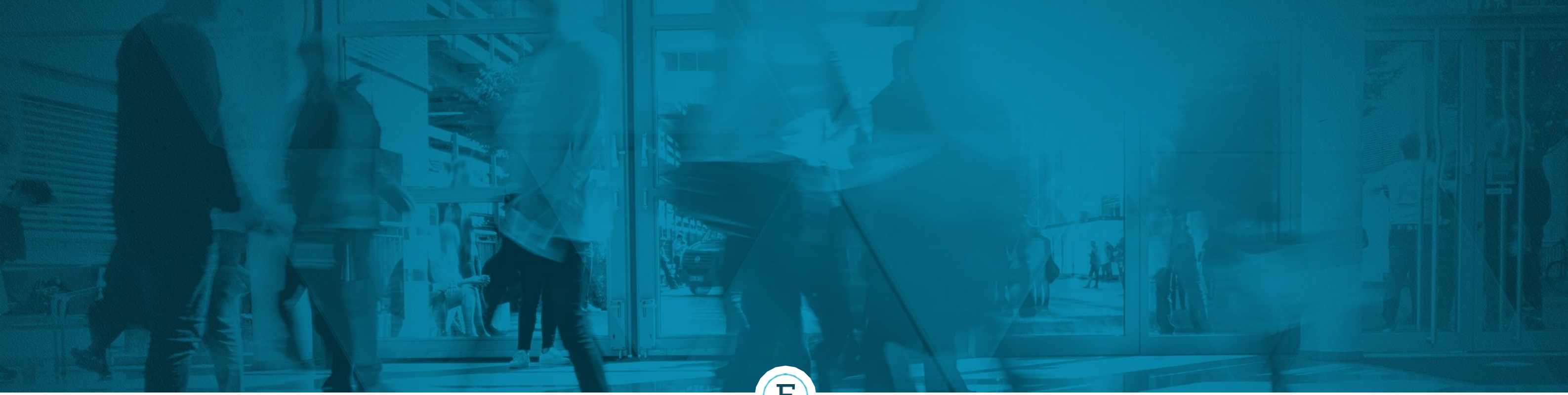
CHF

For the third week in a row, the Swiss franc topped the G10 FX performance rankings, and strengthened its position as the best-performing major currency in 2023. EUR/CHF fell below the 0.95 level, with the franc rallying to its strongest position against the euro in more than a year.



Concerns surrounding geopolitical stability, at the time of the renewed sell-off in long-dated US Treasuries, created a particularly supportive environment for the safe-haven franc. An extension of these trends may provide further fuel for the currency, although the rally seems increasingly stretched. A further appreciation is unlikely to be welcomed by the Swiss National Bank, particularly given the bank's recent dovish turn. Aside from global news, investors will be attentive to any comments from the SNB on the franc in the coming weeks.

AUD

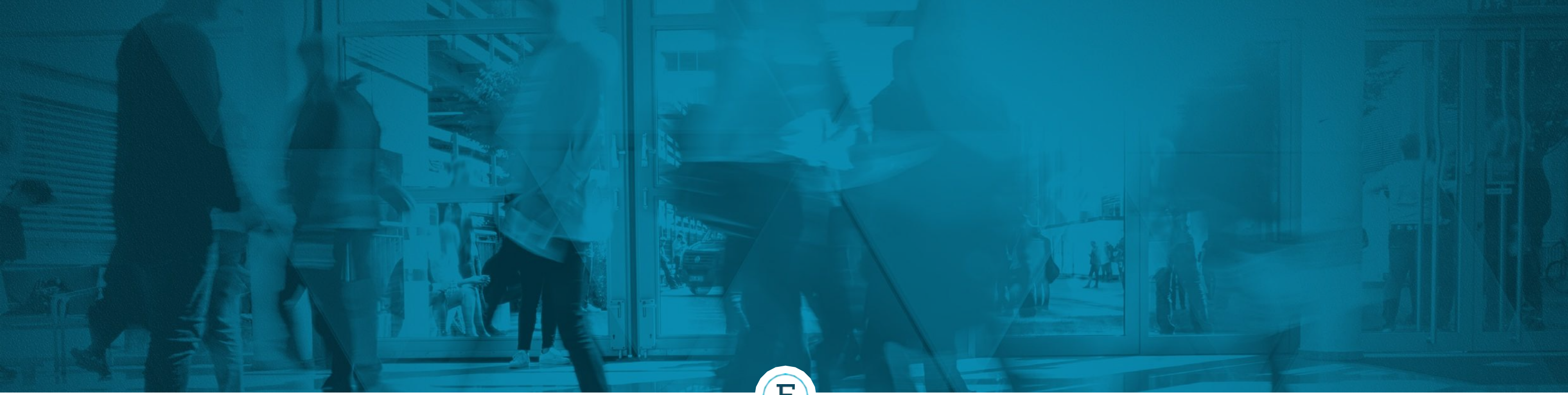
Last week's hawkish set of meeting minutes from the Reserve Bank of Australia provided modest assistance for the Aussie dollar, which comfortably outperformed its New Zealand counterpart. In the minutes, rate-setters voiced concern over upside risks to inflation, while governor Bullock stressed that the bank would respond should inflation remain higher than expected in her speech last week. This heaps added attention onto Wednesday's highly important Q3 inflation report. Economists are eyeing a drop in the headline rate to 5.3%, though any upside surprise in either the annual or quarterly print could trigger immediate gains in AUD.

Aside from Wednesday's CPI data, today's PMI numbers will be worth keeping tabs on. The composite PMI rebounded in September, although last week's rather disappointing labour report suggests that the outlook is not devoid of pessimism. A net 6.7k jobs were added to the Australian economy last month, below the 20k consensus, following the sharpest drop in full-time employment since late-2021 (-39.9k).

NZD

The New Zealand dollar was the worst performing currency in the G10 last week, as a miss in the Q3 inflation report suggested that the RBNZ could adopt a dovish policy stance at upcoming meetings. Headline inflation eased to 5.6% in the three months to September, comfortably below the 5.9% consensus and the lowest print since the third quarter of 2021. At 1.8%, quarterly inflation remains elevated, however, and the data is unlikely to change the RBNZ's opinion that high interest rates are likely to be needed for the foreseeable future.

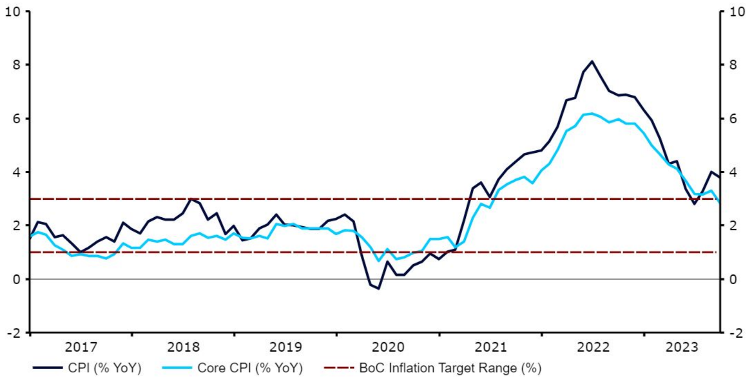
Consumer sentiment data on Thursday looks set to be the only major economic data release of note this week, with the latest labour report for the third quarter not due until a week on Tuesday (31/10). We suspect that risk sentiment will be the main driver of NZD this week, notably headlines out of the Israel-Palestine conflict and the latest on the state of the Chinese economy.



CAD

We expect the Bank of Canada to keep rates unchanged at its upcoming policy meeting in Wednesday. Last week's inflation report for September will no doubt take pressure off rate-setters to deliver a hawkish message. The headline rate unexpectedly eased to 3.8%, and actually dropped on a month-on-month basis (-0.1%) for the first time since December. However, Canada's labour market remains strong, characterised by elevated wage pressures, so the BoC is unlikely to completely rule out the possibility of additional hikes, even if this is not our base case scenario.

Figure 5: Canada Inflation Rate (2017 - 2023)

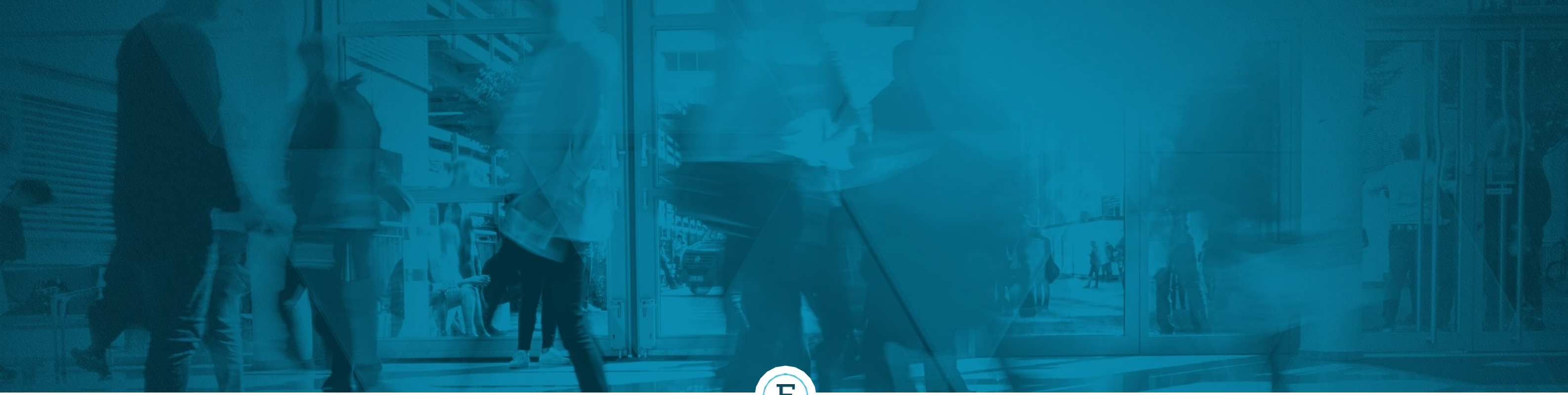


Source: LSEG Datastream Date: 23/10/2023

The tone of the bank's communications will be key for CAD this week. Should the BoC hint at the possibility of another hike by year-end, or say that this week's decision was a close call, then the dollar would likely rally sharply as market pricing for hikes is currently very low.

SEK

The Swedish krona depreciated against the euro last week, as data from the country continued to suggest that rising interest rates are weighing on the economy. In particular, data released last week showed that the unemployment rate remained at 7.7% in September, up from 6.5% in the same month last year.



The September retail sales report due at the end of the week will provide further information on the state of the Swedish economy. Despite the worsening recent data, we do not rule out the possibility that the Riksbank will raise rates one last time before the end of its tightening cycle. Still high inflation, together with the tone adopted by the Riksbank at its last meeting, leads us to believe that the central bank will deliver a final 25 basis point hike at the November meeting, which could provide some upside for the krona given current market pricing.

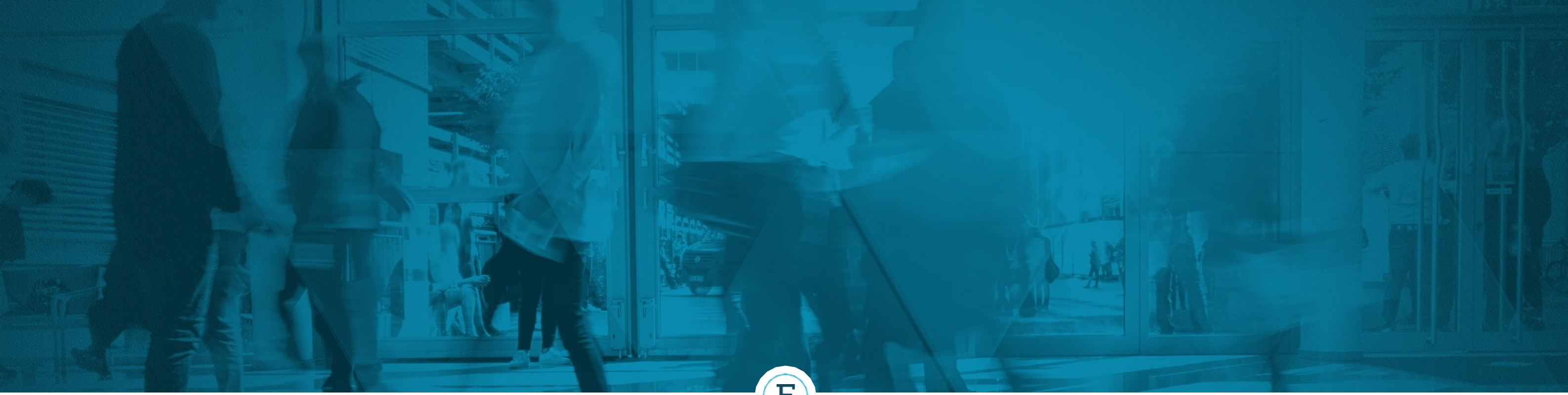
NOK

Rising oil prices, which last week climbed back above $90 a barrel, were not enough to support the Norwegian krone, which ended the week as one of the worst performing major currencies in the world. Indeed, the Norwegian currency is trading at its lowest level against the euro since June.

NOK is one of the highest beta currencies in the G10, so geopolitical uncertainties created by the Middle East conflict, and concerns surrounding the state of the global economy, may be weighing on the currency. In addition, the downward surprise in September inflation is bearish for the krone, due to the adjustment of expectations of Norges Bank rate hikes. At its last meeting in September, Norges Bank pre-committed to a final rate increase in December, with a terminal rate of 4.50%. However, this is not set in stone, and markets currently see less than a 50% implied probability of another hike following the recent inflation news.

CNY

Yet again, the Chinese yuan ended the week little changed against the US dollar and roughly in the middle of the EM FX performance dashboard. Economic data was at the centre of attention last week, albeit it only brought temporary relief for the yuan. Third-quarter GDP growth came in at a solid 1.3% QoQ, although this was marred by a rather significant downward revision to growth in Q2 (from 0.8% to 0.5%). September data, on the whole, was positive, with both retail sales and industrial production surprising to the upside. An unexpected drop in unemployment to 5% is yet another encouraging sign. The data doesn't ease all concerns and the real estate situation remains an issue, although it's an optimistic signal suggesting that the worst of the slowdown could be over.



Contrary to the previous one, this week's domestic economic calendar is nearly empty, aside from Friday's data on industrial profits for September. The Chinese currency may, therefore, react largely to external developments.

Economic Calendar (23/10/2023 - 27/10/2023)

Economic Calendar	Country	Day	Date	Time (BST)
Consumer Confidence (Oct.)	EZ	Monday	23/10	15:00
Preliminary PMIs (Oct.)	AUS	Monday	23/10	23:00
Employment Report (Sept.)	UK	Tuesday	24/10	07:00
ECB Bank Lending Survey	EZ	Tuesday	24/10	09:00
Preliminary PMIs (Oct.)	EZ	Tuesday	24/10	09:00
Preliminary PMIs (Oct.)	UK	Tuesday	24/10	09:30
Preliminary PMIs (Oct.)	US	Tuesday	24/10	14:45
Inflation (Q3)	AUS	Wednesday	25/10	01:30
BoC Monetary Policy Meeting	CAN	Wednesday	25/10	15:00
ECB Monetary Policy Meeting	EZ	Thursday	26/10	13:15
GDP (Q3)	US	Thursday	26/10	13:30
Retail Sales (Sept.)	SWE	Friday	27/10	07:00
Retail Sales (Sept.)	NOR	Friday	27/10	07:00
PCE Inflation (Sept.)	US	Friday	27/10	13:30

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