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Weekly Report

G10 Weekly FX Update

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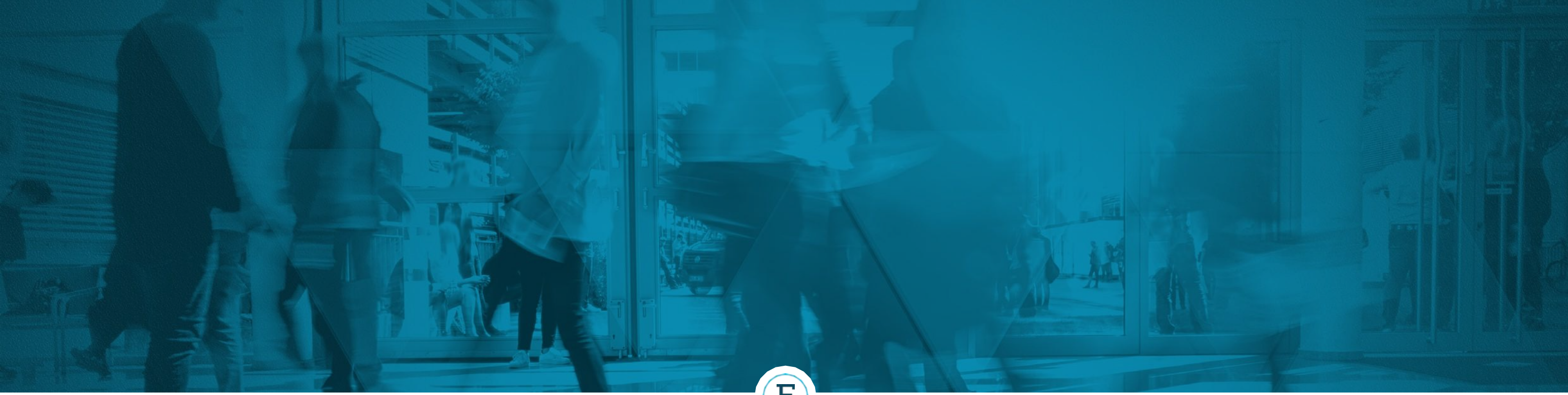
13th November 2023



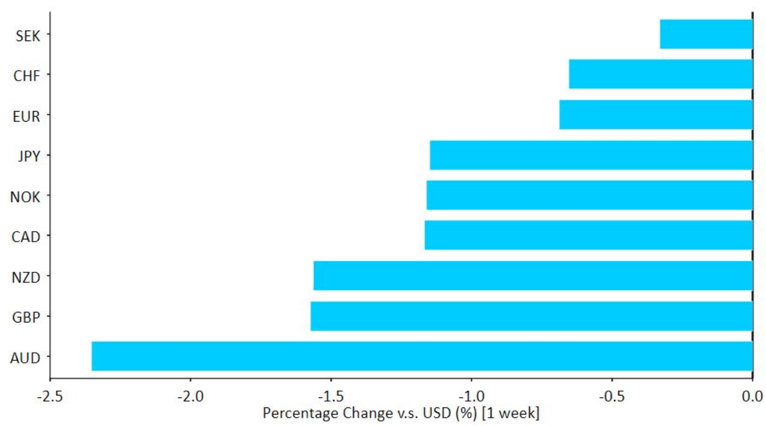
Hawkish Federal Reserve halts dollar sell-off

Financial markets were becoming increasingly comfortable with the idea that the worldwide hiking cycle was over and were beginning to look forward to rate cuts, until Fed chair Powell sounded less convinced at a speech last week.

In response, bond rates increased again and currencies partially reversed recent moves, as the dollar rallied against almost every major currency. The big underperformers were the Australian and New Zealand dollars, which struggled amid the general risk off mode and concerns over the state of the Chinese economy, after Asia's largest economy fell back into deflation. Sterling also ended the week near the bottom of the FX performance tracker, despite a beat in the latest UK GDP report. Uncharacteristically, stock prices generally held up well, in a sign that market conviction for more rate hikes was not high.

The monthly US CPI inflation report has become the most critical piece of economic data worldwide, and Tuesday data for October is, if anything, even more critical in light of Powell's hawkishness. Markets are pricing in a core monthly number in line with a 3-4% annualised inflation rate, but any positive or negative surprise will have an outsized impact in currency markets. The UK will see an unusually data intense week with the labour report out on Tuesday and October inflation released on Wednesday. An important, albeit lagged, September reading on Eurozone industrial production on Wednesday will round out the trading week.

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

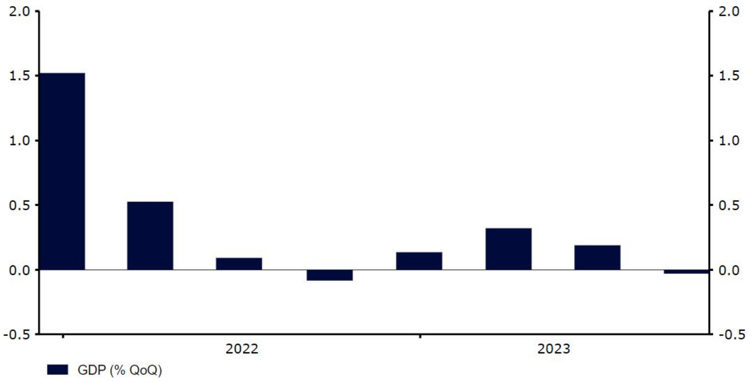


Source: LSEG Datastream Date: 13/11/2023

GBP

Third-quarter GDP figures released last week confirmed that the UK continues to avoid a recession, but only just. The economy stalled last quarter, posting flat growth in the three months to September, but at least avoided the contraction that had been market consensus. The monthly numbers were slightly more positive, and we remain confident that the UK economy will be able to eke out modest growth in the last quarter of the year.

Figure 2: UK GDP Growth Rate (2022 - 2023)



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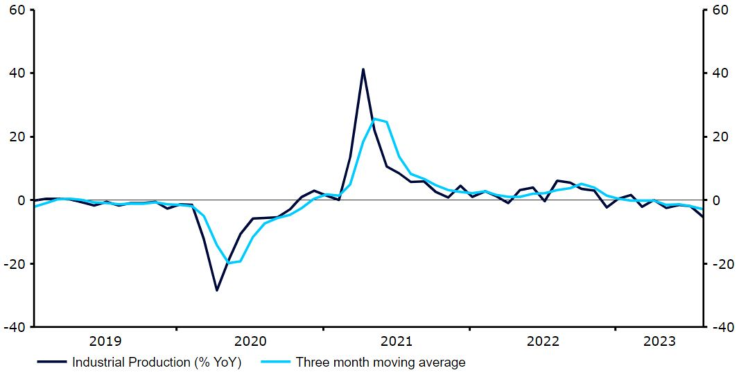
Labour data and inflation out this week are key. Markets are expecting another significant fall in core inflation, to a still high 5.8%. As with the dollar, sterling can be expected to react quite strongly to a surprise in either direction, as this remains key for Bank of England monetary policy. MPC members Bailey and Pill largely reiterated recent communications last week, stressing that interest rate cuts remain a long way off.

EUR

Last week was a quiet one in the Eurozone, with little news of note either on the economic or the policy front. News that we did receive was largely bearish for the common currency so the relative resilience shown in the euro, which outperformed most of its major peers, is notable. Both retail sales out of the Euro Area and German industrial production contracted more-than-expected in September, while the revised composite PMI remained well below the level of 50. This has done nothing to ease concerns over the possibility of a recession in the bloc, which remains a real possibility in the second half of the year.

Figure 3: Euro Area Industrial Production (2019 - 2023)



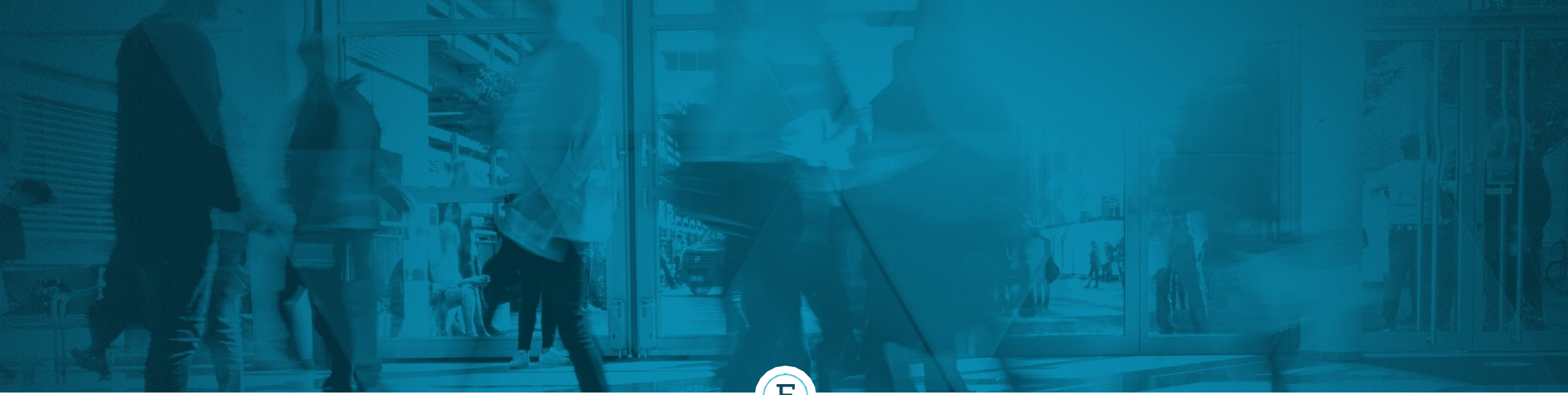
Source: LSEG Datastream Date: 13/11/2023

Markets are pricing in almost a full ECB interest rate cut by April of next year, although policymakers continue to push back against this narrative. Lagged data points continue to point to a stagflationary environment, which will make it very difficult to cut rates in the Eurozone any time soon, in our view. Data on Euro Area GDP (Tuesday) and October inflation (Friday) will be very closely watched this week.

USD

With little macroeconomic news of note last week, Powell´s perceived hawkishness grabbed traders attention and drove market action in currency markets. Inflation data this week will be a key test for the deflationary narrative that expects Federal Reserve cuts as early as the second quarter of next year, a notion against which most Fed officials themselves are pushing back.

In addition to the inflation report, we will be closely following the fallout from the news that Moody's has cut the outlook for US debt to 'negative', on general deficit and governance concerns. These downgrades have usually had very little impact in the past, although this news comes at a time when the US Federal interest bill will top one trillion dollars, with no end in sight or prospects for fiscal tightening.



JPY

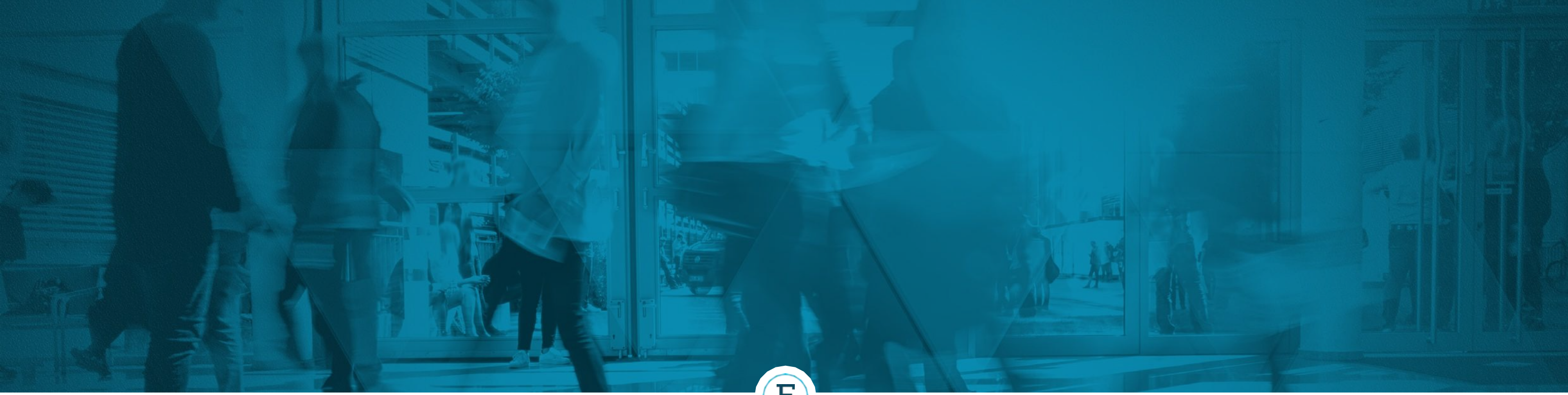
The yen continued to trade comfortably above the 150 level on the US dollar last week, as investors remain bearish on the currency due to the Bank of Japan's timid approach to policy normalisation. BoJ governor Ueda warned late-last week that unwinding the bank's ultra-loose policy was a 'serious challenge', and that it was too early to lay out a path towards higher rates. Swap markets are still largely pricing in the first hike in Q1 2024, although the recent hesitancy shown by policymakers to end the YCC policy suggests that the bank may be reluctant to signal higher rates are imminent just yet.

Attention this week will be firmly on the preliminary estimate for third quarter GDP, which will be released on Tuesday. Economists are expecting a mild contraction in the quarterly number that would equate to around a 0.6% downturn in annualised terms. Trade data will also be released on Thursday, albeit this tends to have a relatively limited impact on the yen.

CHF

The broad risk-off mode exhibited in markets last week, particularly amid renewed concerns over the state of the Chinese economy, allowed the franc to outperform most of its major counterparts. The EUR/CHF pair appears to have halted its ascent towards parity, for now, trading almost entirely within the 0.960-0.965 level so far this month. We continue to contest that a move upwards in the pair is on the cards, although we would need to see clearer signs of a shift away from the Swiss National Bank's preference for a stronger currency for that to be the case.

SNB chairman Jordan will be speaking on Tuesday and Saturday this week. Any indication that the SNB is happy with the progress on inflation, and may shift its attention back towards supporting the growth outlook, would be bearish for the franc, as this could pre-empt a return to SNB currency intervention.



AUD

As expected, the Reserve Bank of Australia raised rates by another 25 basis points last week, although AUD underperformed following the announcement, with markets seemingly of the opinion that this was the last in the current cycle. Another hike was not entirety priced in by markets prior to the meeting, which made the sell-off in AUD following the decision all the more notable. The RBA left the door open to more hikes should inflation not evolve as hoped, although it also flagged 'significant uncertainties' to the outlook, which may perhaps explain the market reaction.

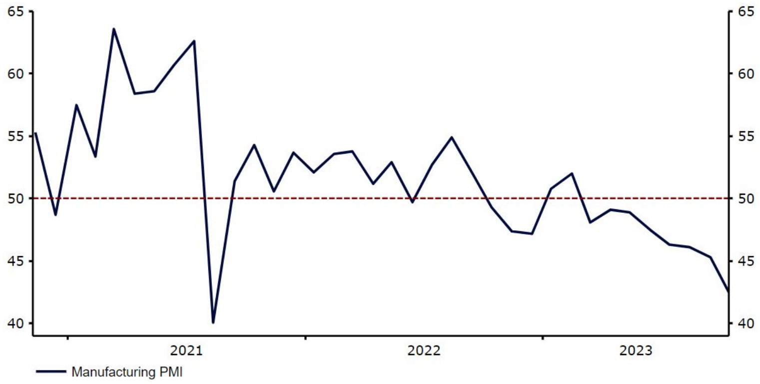
Swap markets continue to price in a much greater chance that the next move in RBA rates will be higher than lower, albeit this remains highly dependent on upcoming data. November inflation expectations and the latest labour report on Thursday will be the main data releases this week. Economists are expecting a mixed jobs report, and are eyeing a solid month of job creation to be accompanied by a modest uptick in the jobless rate.

NZD

The New Zealand dollar outperformed its Australian counterpart last week, although it still lagged behind just about every other major currency. Last week's soft Chinese inflation data was bearish for the kiwi, and lingering concerns over the state of demand in Asia's largest economy may continue to cap gains for NZD in the coming weeks. We have, at least, seen somewhat of a stabilisation in global dairy prices, a key source of New Zealand export revenue, which are now trading more than 10% off the September lows.

Business activity PMI data out last week was disappointing, with main composite index from S&P collapsing to just 46.1 in October, its lowest level since late-2021, while the manufacturing number fel to just 42.5. The New Zealand economy posted solid expansion in Q2, although the PMI numbers suggest that another contraction may be on the way in the third quarter, which presents yet another downside risk to the New Zealand currency.

Figure 4: New Zealand Manufacturing PMI (2020 - 2023)

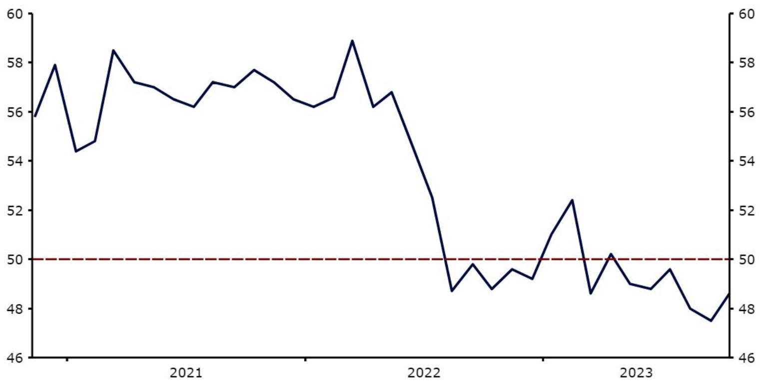


Source: LSEG Datastream Date: 13/11/2023

CAD

A retreat in global oil prices and some slightly disappointing domestic economic news ensured that the Canadian dollar ended last week around the 1.38 level on the US dollar. October PMI data missed its mark last week. While the manufacturing index from Ivey remained in expansionary territory, the data suggested that growth in the sector eased last month.

Figure 5: Canada Manufacturing PMI (2020 - 2023)



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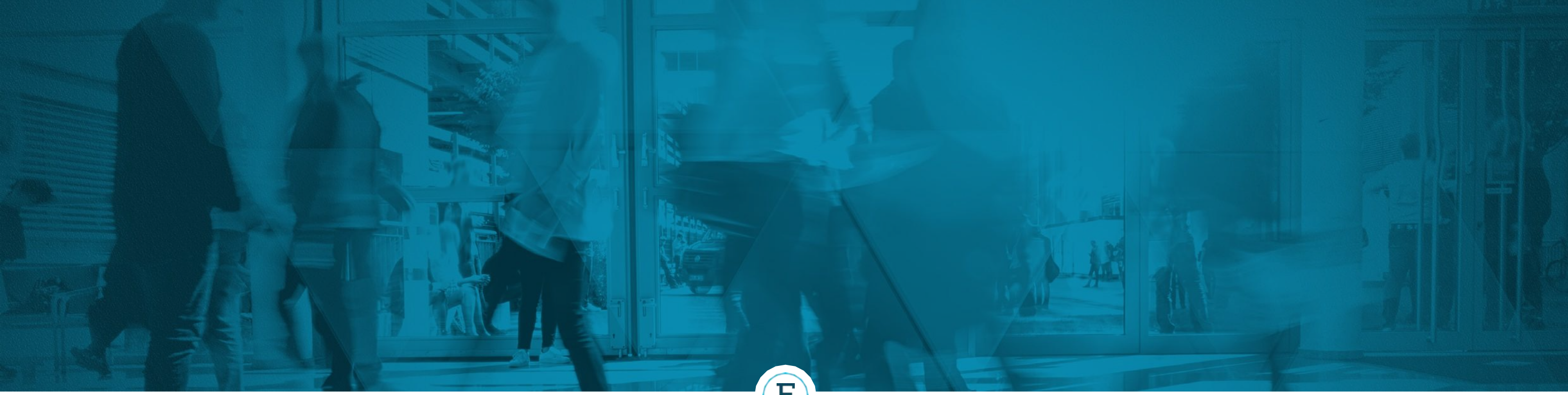
Speeches from Bank of Canada members Rogers and Kozicki didn't add too much last week, so focus now shifts to upcoming communications from fellow member Gravelle (Tuesday) and governor Macklem (next week). With Canadian inflation now returning back towards the BoC's target, there is likely to be little appetite from policymakers to signal that more hikes could be on the way. At a time when the Fed is keeping its options open, this could present some room for some modest CAD downside in the near-term.



SEK

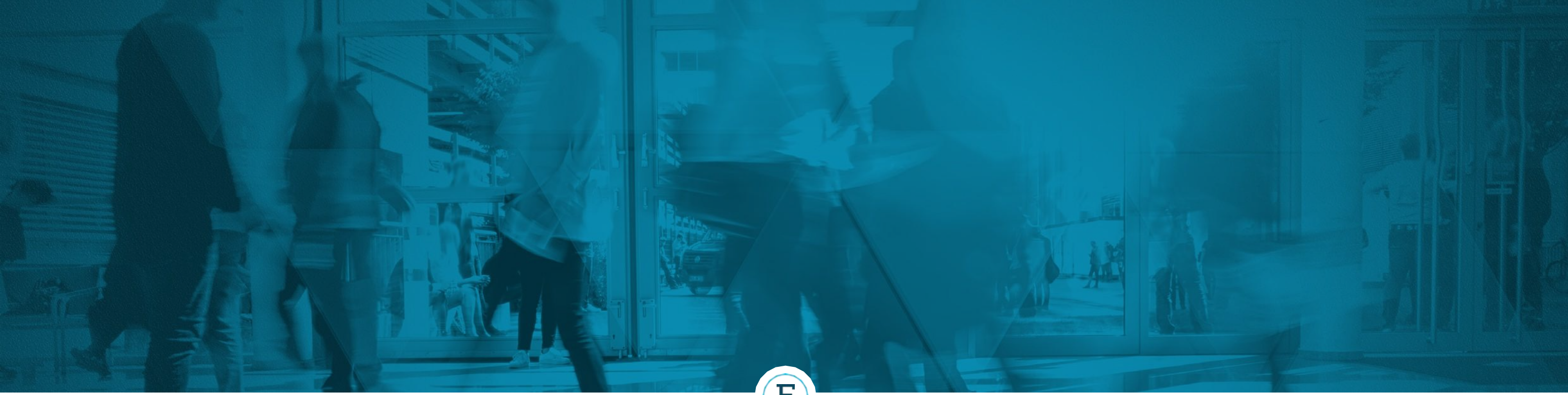
The Swedish krona appreciated slightly against the euro last week and is trading near its highest level since late-September. There was no internal catalyst for the move, so we attribute it to shifts in market sentiment and valuation.

With key data due this week, such as inflation (Tuesday) and the unemployment rate (Friday), both for October, we could see some volatility in the EUR/SEK pair. The data comes just a week before the Riksbank's November monetary policy meeting (23/11). We do not rule out the possibility that the Riksbank will raise rates one last time before the end of its tightening cycle, and this may well come at next week's meeting. Markets are, however, now less convinced, so there remains plenty of room for an upward shift in rate expectations should we see an upside surprise on the inflation front in the interim.

NOK

The Norwegian krone ended last week lower against the euro, as oil prices fell for the third week in a row and are trading near July lows. October inflation data did, however, surprise to the upside, which may lead Norges Bank to adopt a more aggressive policy stance. After four consecutive months of declines, the headline inflation rate rose again in October to 4%, up from a 20-month low of 3.3% in the previous month. Core inflation also rose more than expected to 6%.

At its meeting earlier this month, Norges Bank warned that rates could be raised again in December due to high core inflation. However, policymakers adopted a more dovish tone than expected and, unlike at the previous meeting, said that the December hike was not guaranteed. In our view, the latest inflation data could tip the balance in favour of further tightening, which could support NOK given current market pricing.



CNY

Last week's Chinese inflation data raised fresh concerns over the state of Asia's largest economy. Data released during Asian trading on Thursday showed that the economy fell back into deflation, with consumer prices slumping by 0.2% in the year to October (-0.1% expected). With no external or one-off shock to blame, the main culprit for the softness in domestic prices remains the rather weak state of consumer demand, which has been a key concern for some time.

The rather fragile state of the Chinese economy continues to provide food for thought for market participants. While most indicators of economic strength have generally improved in recent months, there remains signs of softness, which presents a challenging environment for authorities, and the yuan is likely to remain relatively weak until greater monetary stimulus arrives. October data on retail sales and industrial production look likely to be key on Wednesday.

Economic Calendar (13/11/2023 - 17/11/2023)

Economic Calendar	Country	Day	Date	Time (GMT)
Employment Report (Oct.)	UK	Tuesday	14/11	07:00
Inflation (Oct.)	SWE	Tuesday	14/11	07:00
GDP (Q3)	EZ	Tuesday	14/11	10:00
Inflation (Oct.)	US	Tuesday	14/11	13:30
GDP (Q3)	JPN	Tuesday	14/11	23:50
Retail Sales (Oct.)	CHN	Wednesday	15/11	02:00
Industrial Production (Oct.)	CHN	Wednesday	15/11	02:00
Inflation (Oct.)	UK	Wednesday	15/11	07:00
Industrial Production (Sep.)	EZ	Wednesday	15/11	10:00
Retail Sales (Oct.)	US	Wednesday	15/11	13:30
Employment Report (Oct.)	AUS	Thursday	16/11	00:30
Retail Sales (Oct.)	UK	Friday	17/11	07:00
Unemployment Rate (Oct.)	SWE	Friday	17/11	07:00
Inflation (Oct.)	EZ	Friday	17/11	10:00

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