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Weekly Report

G10 Weekly FX Update

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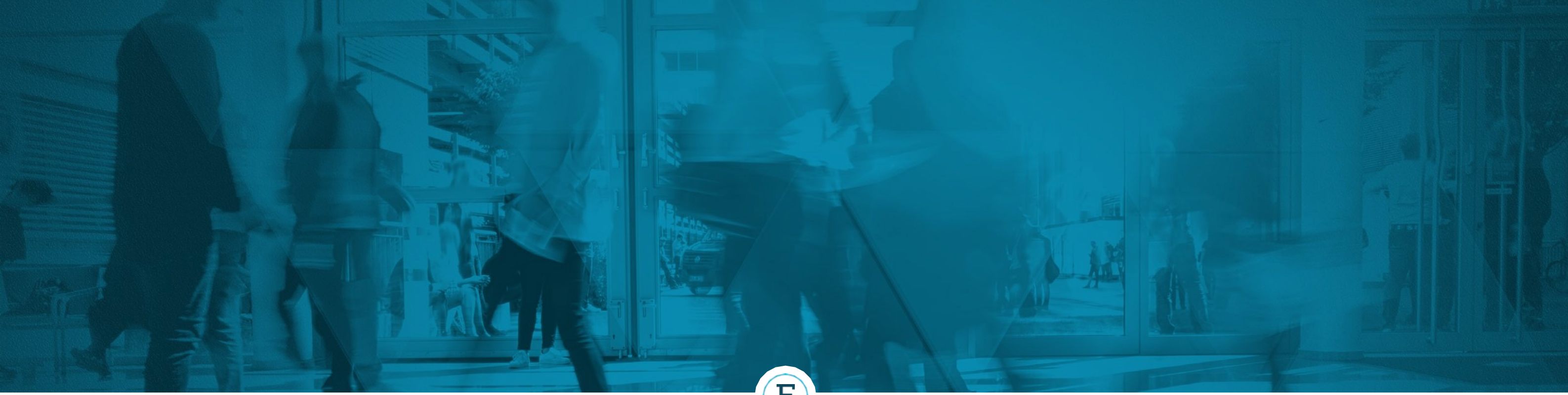
20th November 2023



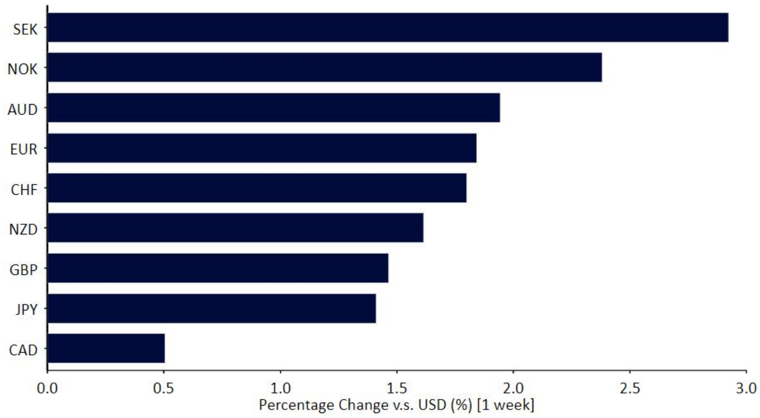
Dollar sinks as markets celebrate mild US inflation report

The Federal Reserve received yet another positive surprise from the October US inflation report.

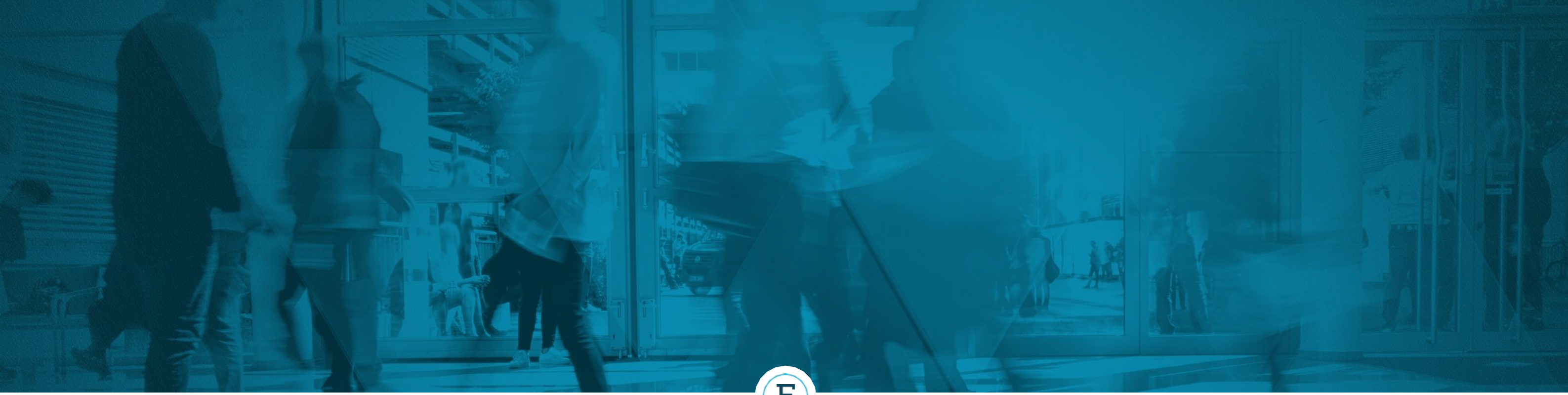
Inflation surprised again to the downside, and financial markets celebrated the likely end of rate hikes by sending stocks and bonds soaring worldwide. The resulting fall in US rates, and the flight away from safe-havens and into risk assets, slammed the dollar, which fell sharply against every other major currency worldwide.

Now that disinflationary trends seem to be firmly in place worldwide, the focus should shift to the economy. The key data point will be the flash PMIs of business activity for November, out on Thursday in the Eurozone and Friday in the UK and US (the latter due to the Thanksgiving holiday). The expectations for this index in the UK, and especially in the Eurozone, are quite gloomy. A positive surprise here could ease the pessimism around the European economies and add fuel to the recent rally in the euro and the pound.

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



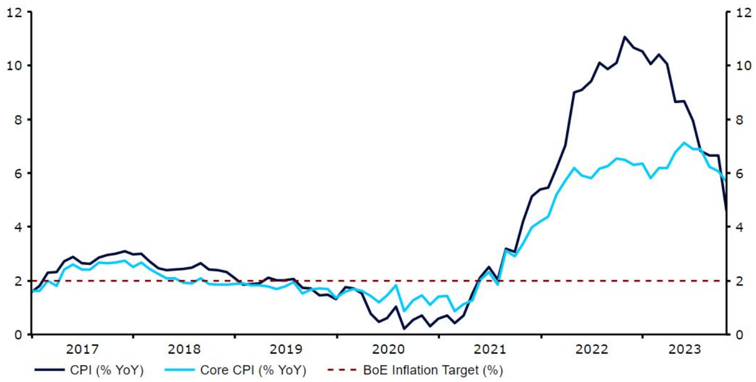
Source: LSEG Datastream Date: 20/11/2023



GBP

Inflation data also surprised to the downside in the UK, providing welcome respite to the Bank of England. While both the headline and core rates remain at very high levels, the disinflationary trend is now clear, most notably in the latter, which fell below 6%. The labour market report numbers generally printed better-than-expected, added to the general cheer in financial markets and partly offsetting some of the bearish connotations surrounding Wednesday’s inflation print.

Figure 2: UK Inflation Rate (2017 - 2023)



Source: LSEG Datastream Date: 20/11/2023

All eyes are now on the advance business activity PMI numbers for November, the timeliest read on the current state of the UK economy. Last month's PMIs, and Friday’s October retail sales for that matter, were consistent with an economy in recession or, at best, stalling. We probably need to see an improvement there before sterling makes further gains.

EUR

We have pointed out before the lagging nature of Eurozone economic statistics, with the notable exception of inflation. Whereas sentiment numbers are timely, hard data comes out with two months delay or longer, so it is hard to see how reliable the former are. Industrial production for September was pretty dismal, down almost 7% on the year on a work days-adjusted basis. Investors, however, largely overlooked the disappointing data, and the euro actually outperformed most of its major peers, notably sterling, opening London trading this morning above the $1.09 level for the first time since August.

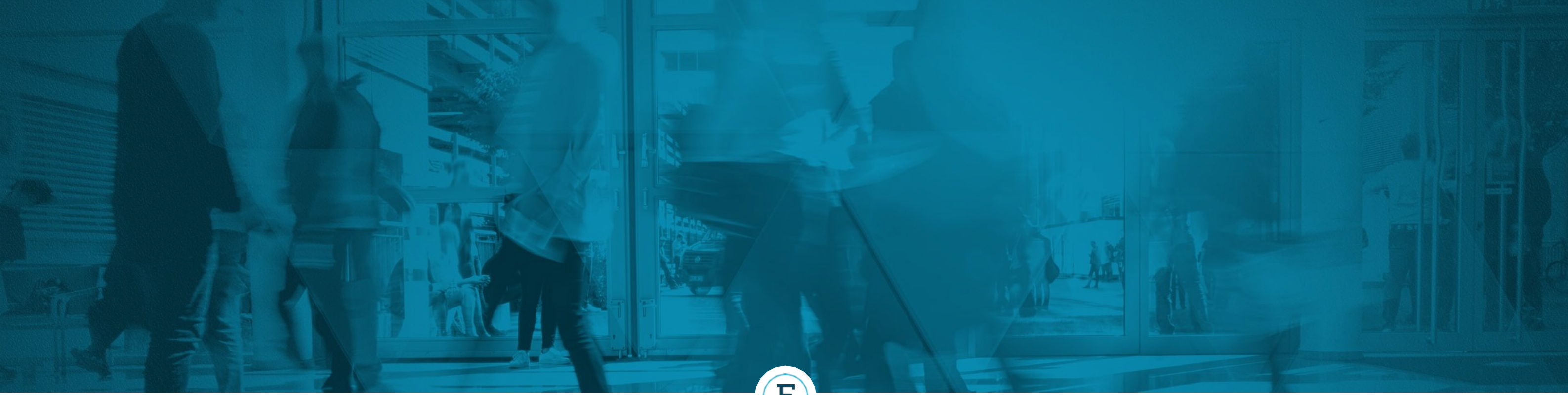
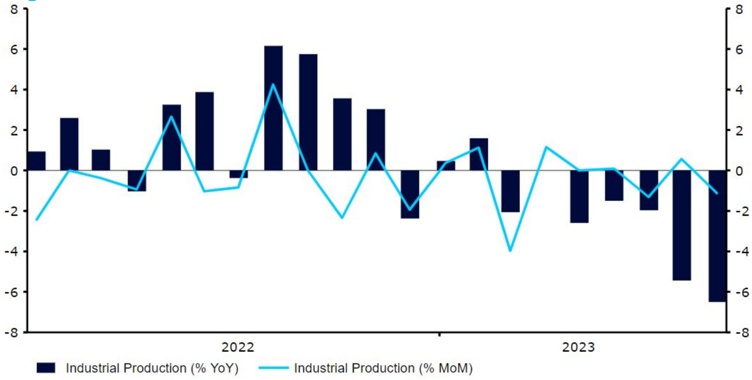


Figure 3: Euro Area Industrial Production (2022 - 2023)



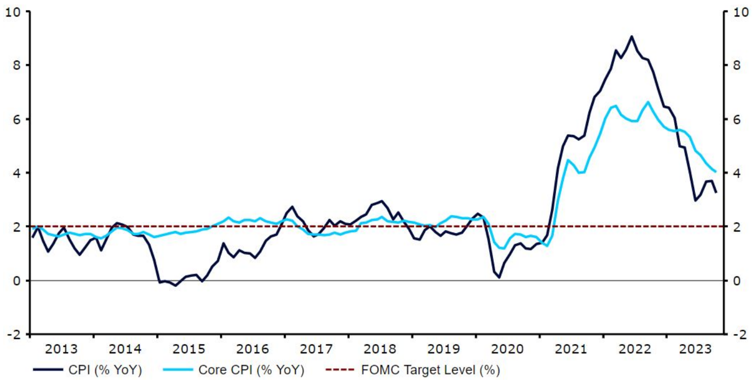
Source: LSEG Datastream Date: 20/11/2023

So far, hard numbers are confirming the pessimism emanating from the PMI sentiment numbers, and it appears likely that the Eurozone economy is contracting again. As in the case of sterling, it may be difficult for the euro to rally further absent some clear improvement in the November PMI numbers out on Wednesday.

USD

The good news from the October inflation report caused an immediate 20 basis point drop in 10-year Treasury yields and sparked a flight from the US dollar. Not only did the volatile headline number edge back down to 3.2%, but the core measure has also dropped to 4% for the first time in two years. Markets have already removed any lingering chance of additional hikes from the Federal Reserve, which we see as reasonable, and now expect the first cut in rates to happen in May 2024, a less credible assumption, in our view.

Figure 4: US Inflation Rate (2013 - 2023)



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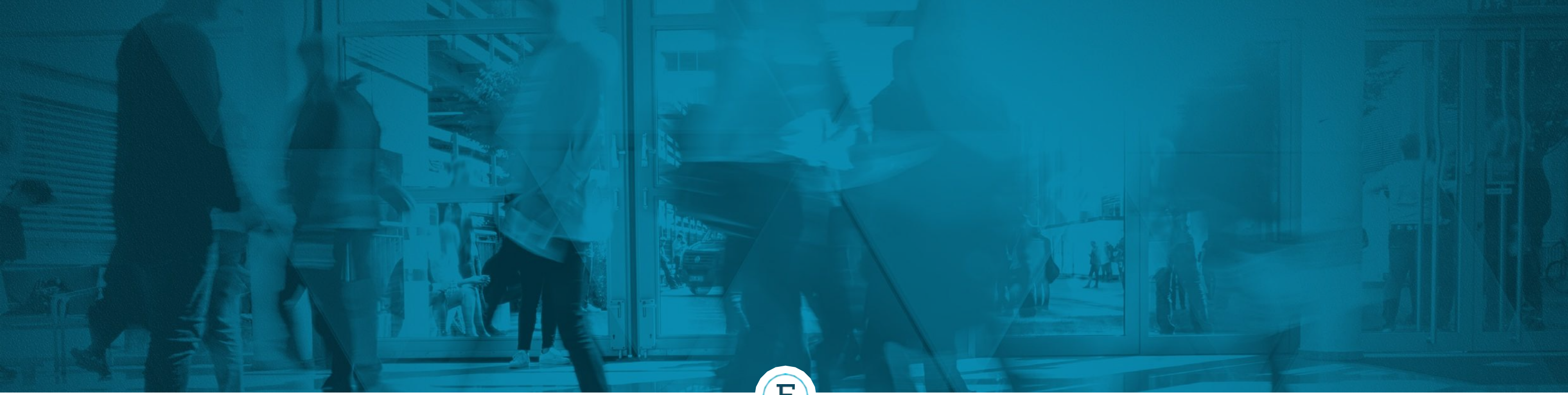


In spite of signs of a modest slowdown, the US economy continues to grow at a good clip and the labour market remains at, or very close to, full employment. It will be difficult for the dollar to sell-off much further until that changes meaningfully, particularly should FOMC officials continue to push back on expectations for policy easing any time soon.

JPY

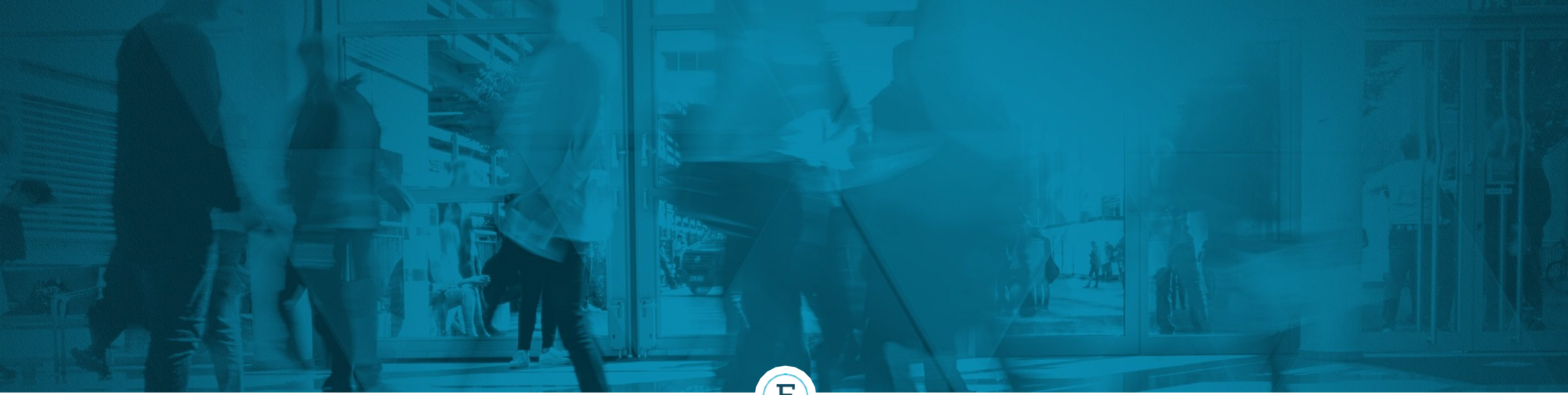
The yen broke to another low on the dollar just shy of the 152 level early last week, before recovering strongly in line with the broad sell-off in the greenback. Some further dovish comments from Bank of Japan governor Ueda did, however, partly act to cap gains, and JPY ended the week lower against most other G10 currencies, with the exception of the Canadian dollar. Ueda said that making strong commitments to ended negative rates could have 'unintended consequences' in markets. Japan's Deputy Finance Minister Ryosei Akazawa also noted last week that authorities would not intervene in the FX market merely because the yen was weakening, rather to smooth out volatility.

Speculation in favour of both FX intervention and higher BoJ rates has managed to partly arrest some of the bearish yen bets in recent weeks, so the dimming prospect of both doesn't bode particularly well. Upcoming October inflation data (Thursday), and PMI numbers (Friday) will be closely watched this week. Any signs of an acceleration in the former could support expectations for a first BoJ rate hike in early-2024, which would likely be bullish for the yen.

CHF

In an environment characterised by 'risk on' trading, the relatively strong performance in the Swiss franc, which rallied against both the yen and the US dollar, was notable. We largely attribute this outperformance to some hawkish communications from SNB chair Jordan, who last week said that the bank could raise interest rates again should current monetary policy be deemed as not restrictive enough to ensure long-term price stability.

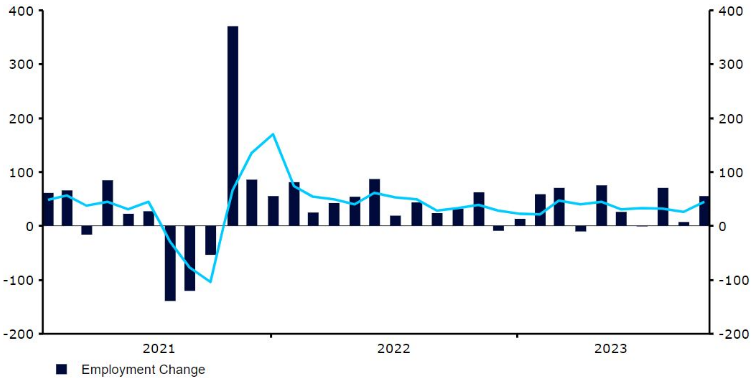
Markets don't necessarily believe that the SNB has more room left to hike, although Jordan's remarks do at least suggest that rate cuts are probably not on the cards any time soon. There's little economic news out this week that could either confirm or allay these suspicions, so the franc could trade in a narrow range. The next big data release will be next week's retail sales print for October.



AUD

The broad improvement in risk sentiment, encouraging data out of China and a strong labour report for October created a cacophony of optimism surrounding the Australian dollar last week, which rose back up to its highest level since early-August on the USD. Last Thursday's jobs data was particularly encouraging. A net 55k jobs were added to the Australian economy last month, well above the +20k consensus, while the participation rate also unexpectedly jumped up to 67%.

Figure 5: Australia Employment Change (2021 - 2023)



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Investors see little chance that the news will encourage the Reserve Bank of Australia to raise interest rates again at its next meeting in December, but markets have not completely ruled out the possibility of additional tightening in the current cycle. Communications from RBA governor Bullock on Monday, and the latest meeting minutes on Tuesday, will shed more light on the subject. The preliminary PMIs for November will also be worth watching on Wednesday.

NZD

A complete lack of domestic economic or policy developments ensured that the New Zealand dollar traded almost entirely off events elsewhere last week. The encouraging retail sales and industrial production numbers out of China should have perhaps ensured that NZD ended the week near the top of the G10 FX performance tracker, although it actually sold-off against most of its peers. This may be due to valuation, as the kiwi had been one of the better performers in the few weeks prior.

Trade balance data for October will be released later today, and could receive some attention among market participants. We will also be paying close attention to Thursday's retail sales data for the third quarter. The data for Q2 was rather disappointing, so we are eyeing a decent rebound in the quarterly number.

CAD

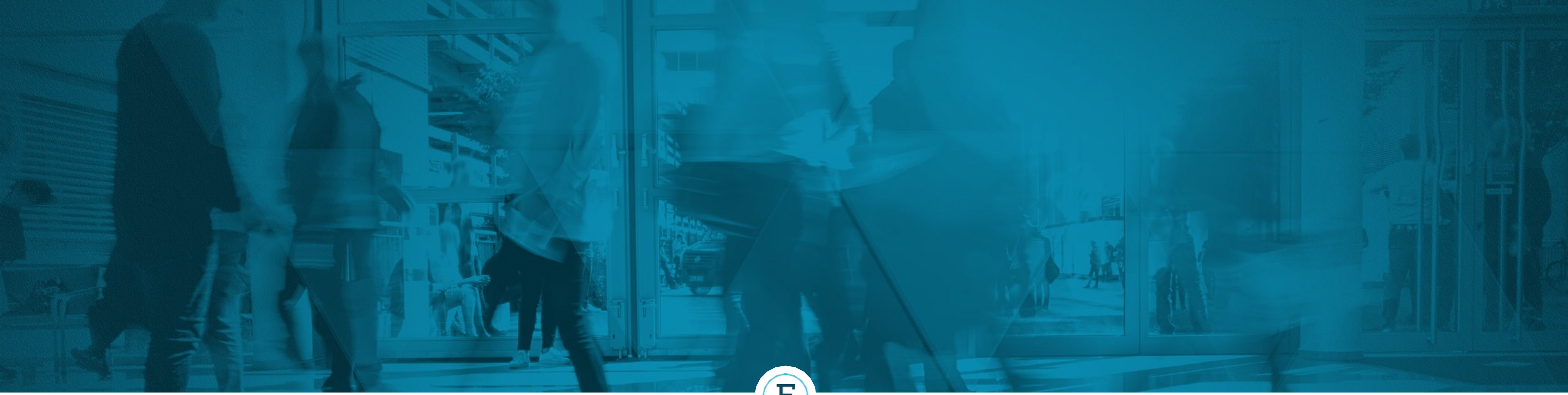
The Canadian dollar traded closer in line with the dollar than its G10 peers last week, as tends to be the case during periods of shifting market sentiment. The USD/CAD pair opened this week around the 1.37 level, which remains not too far away from its June 2020 highs. The easing in global oil prices in recent weeks has not helped the Canadian currency, nor have growing bets in favour of a policy shift from the Bank of Canada.

This week looks set to be a rather busy one in Canada. The main focal point will be Tuesday's inflation report for October. Economists are eyeing a rather sharp drop in the annual headline number to just above 3%, with the core rate expected to decline to its lowest level since early-2021. BoC governor Macklem will be speaking on Wednesday, followed by the September retail sales report on Friday. The latter runs on a bit of a lag so, as usual, may be partly overlooked by market participants.

SEK

The Swedish krona appreciated sharply against the euro last week, rallying to its strongest position since mid-July and ended as the best-performing currency in the G10. As one of the riskier major currencies, the krona benefited from the flight from safe-havens into risky assets. However, last week's October inflation data, which surprised to the downside and reduced expectations in favour of a further rate hike by the Riksbank, may have limited the currency's upward trajectory.

Headline inflation stood at 6.5% in October, its lowest level since April last year, unchanged from the previous month and below market expectations of 6.7%. Core inflation rose to 4.2% from 4%, although this was also below expectations. Despite the recent moderation, inflation remains at elevated levels, with the weak krona likely to exacerbate upward pressure on consumer prices. Another 25 basis points hike, therefore, remains possible at this Wednesday's Riksbank meeting, although pressure will be off, and a hold seems very plausible. With markets only pricing in around a 1-in-4 chance of a hike, there remains plenty of room for SEK upside in the event.



NOK

The Norwegian krone appreciated against almost all of its major peers last week, and is currently trading near its highest level in a month on the euro, as the ‘risk on’ mode supported high-beta currencies. The drop in Brent crude oil prices, which fell below $77 per barrel to its lowest level since July following the release of a better-than-expected inventories report on Thursday, partly held NOK back last week. However, oil prices rebounded by approximately 5% to back around $81 per barrel on Friday, as OPEC said that it was considering whether to make additional supply cuts. This allowed the krone to recover some of its losses at the end of the week.

It will be a quiet week in terms of economic data releases in Norway, so the NOK exchange rate will probably largely depend on oil price developments. If crude oil continues to recover, then the krone could receive some support.

CNY

Renewed optimism surrounding the state of the Chinese economic recovery buoyed the yuan last week, which jumped to its strongest position on the US dollar since mid-August. Data on both retail sales and industrial production surprised to the upside for October. Retail sales, which have barely grown in the past four months, exceeded expectations in annual terms (+7.6% in October). The performance of industrial production, which was less heavily impacted by the zero-covid measures in 2022, also modestly exceeded expectations (+4.6% year-on-year in October).

The Chinese economy remains rather fragile and the recovery has been less than stellar, although this data this does at least provide some reason for optimism. Attention this week will be on the one-year loan prime rate announcement (Monday). The next set of major data, the November PMIs from NBS, won’t be released until Thursday next week.

Economic Calendar (20/11/2023 - 24/11/2023)

Economic Calendar	Country	Day	Date	Time (GMT)
PBoC Monetary Policy Meeting	CHN	Monday	20/11	01:15
RBA Meeting Minutes	AUS	Tuesday	21/11	00:30
Inflation (Oct.)	CAN	Tuesday	21/11	13:30
FOMC Meeting Minutes	US	Tuesday	21/11	19:00
Consumer Confidence (Nov.)	EZ	Wednesday	22/11	15:00
Preliminary PMIs (Nov.)	AUS	Wednesday	22/11	22:00
Riksbank Meeting	SWE	Thursday	23/11	08:30
Preliminary PMIs (Nov.)	EZ	Thursday	23/11	09:00
Preliminary PMIs (Nov.)	UK	Thursday	23/11	09:30
ECB Meeting Minutes	EZ	Thursday	23/11	12:30
Retail Sales (Q3)	NZ	Thursday	23/11	21:45
Inflation (Oct.)	JPN	Thursday	23/11	23:30
Preliminary PMIs (Nov.)	JPN	Friday	24/11	00:30
Retail Sales (Sep.)	CAN	Friday	24/11	13:30
Preliminary PMIs (Nov.)	US	Friday	24/11	14:45

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