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Weekly Report

G10 Weekly FX Update

Written by:

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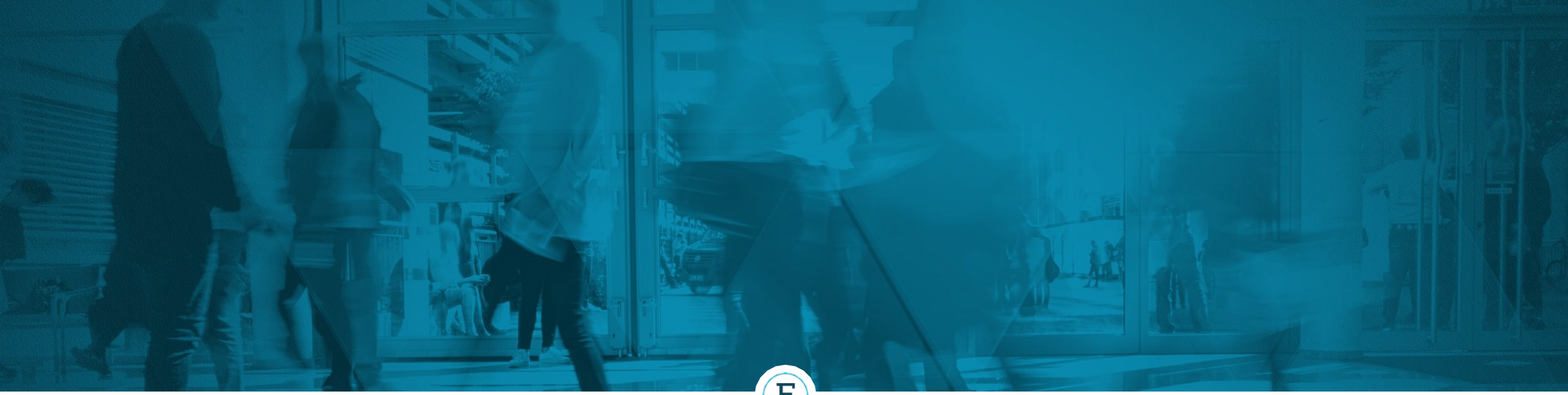
27th November 2023



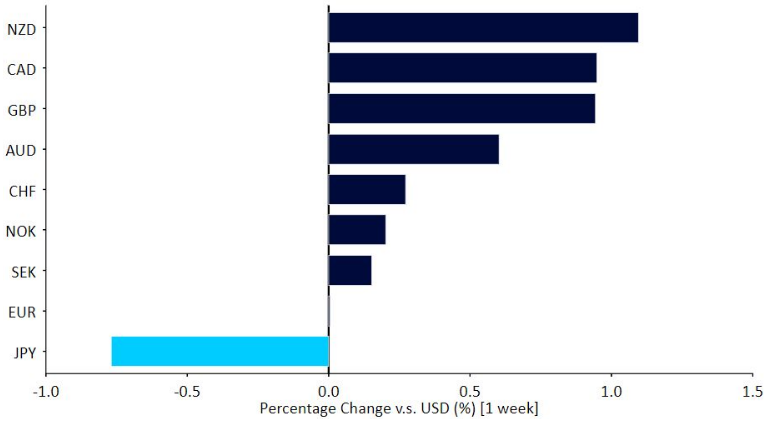
Sterling outperforms on rebound in UK business activity

The Thanksgiving holiday in the US usually makes for quiet markets and a lack of volatility, and last week was no exception.

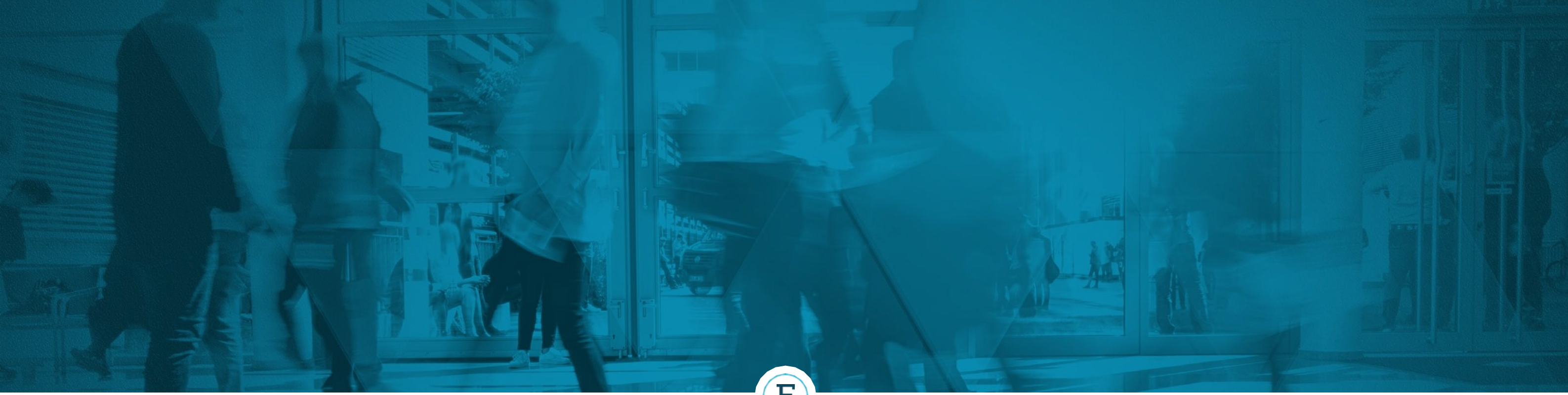
The main market movers were the PMIs of business activity in the Eurozone and the UK, the former remained weak, while the latter was stronger than expected and moved back into expansionary territory. As a result, sterling traded higher against both the euro and the US dollar, while outperforming most other G10 currencies. Emerging market currencies flopped around without any clear trend or themes, mostly ending the week within 1% or less of where they had started it.

This week, attention should shift back to data, particularly upcoming inflation prints. The Eurozone Flash inflation numbers for November will be released on Thursday, the same day as the US personal consumer expenditures (PCE) inflation report for October. In the absence of major central bank meetings, we'll get a slate of speakers from the Federal Reserve, the Bank of England and the ECB. The question for the FX market is whether the sharp sell-off in the dollar can continue in the absence of clearer signs of economic strength outside of the US. We think it may have fallen too much, too quickly.

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



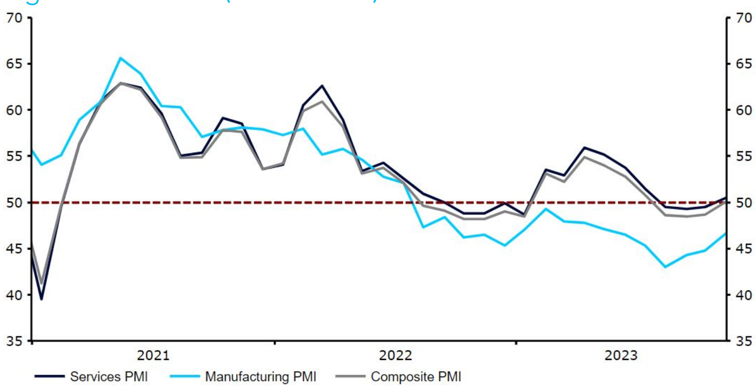
Source: LSEG Datastream Date: 27/11/2023



GBP

The PMIs of business activity posted a significant positive surprise in the UK last week. The overall index rebounded above the 50 level that indicates business expansion, a marked contrast with the gloomier numbers published across the Channel. Modest expansion, sticky inflation and the fiscal stimulus announced by the government's recent announcements probably means that the Bank of England will be reluctant to lower rates any time soon.

Figure 2: UK PMIs (2021 - 2023)



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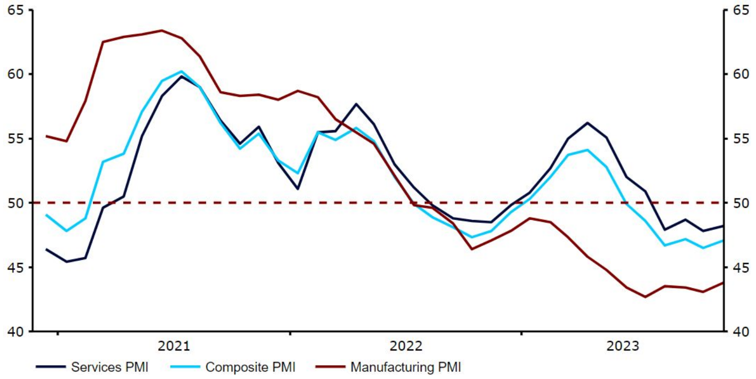
As tends to be the case, last week's budget announcement yielded little volatility in markets, as the policy tweaks unveiled were either largely as expected, or seen as having little to no impact on the outlook for the UK economy. The latest OBR growth forecasts for 2024 and 2025 were, however, revised rather sharply lower from March, suggesting that the period of rather fragile expansion is here to stay. Sterling largely ignored these gloomy projections, and rose against most major currencies last week. We think that it has room to continue to do so against the euro.

EUR

The flash PMI numbers in the Eurozone continue to point to an economic contraction in the fourth quarter, which would confirm a technical recession after the negative print for the third quarter. The European Central Bank looks for some relief from the gloom in this week's November flash inflation report, which is expected to show yet another significant fall in both the headline and core indices, to just below 4% in the latter case.

Figure 3: Euro Area PMIs (2021 - 2023)



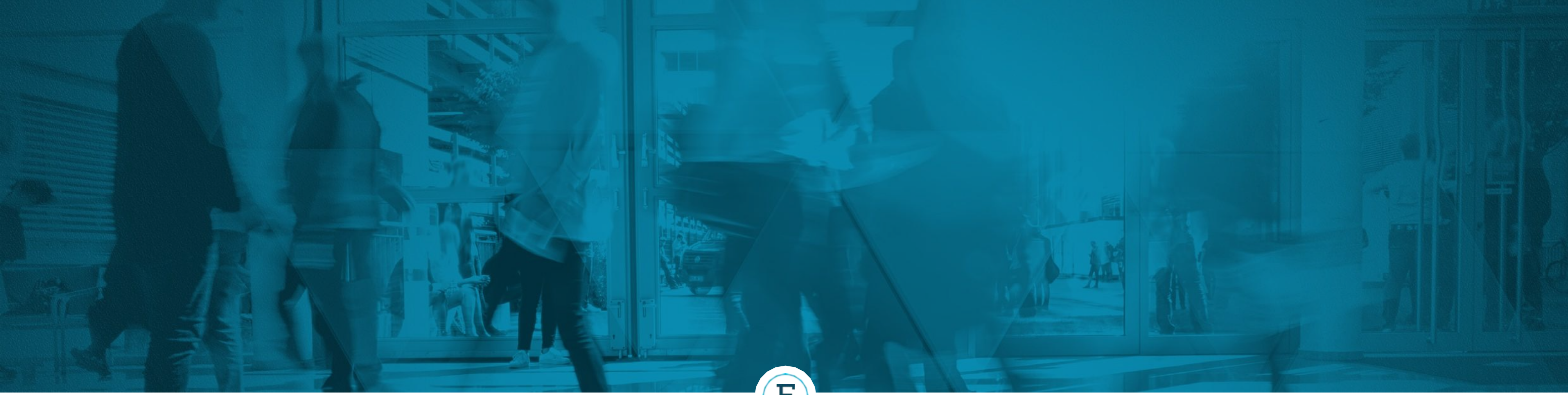
Source: LSEG Datastream Date: 27/11/2023

Regardless of the outcome, the euro's rally against the dollar so far this month will be difficult to maintain unless the Eurozone economy starts showing signs of life. Indeed, concerns surrounding the state of the bloc's economy appear to be the main culprit behind that underperformance in the euro last week, which ended more-or-less unchanged against the broadly weaker US dollar, and depreciated against all of its G10 peers, save the Japanese yen.

USD

The dollar mostly traded off news elsewhere in the data-scarce Thanksgiving holiday week. At the margin, second-tier data published last week may have served to push expectations for rate cuts into the future. Weekly jobless claims fell sharply, belying the narrative of a cooling in labour market conditions, while the November services PMI beat expectations. Durable goods order data was slightly less encouraging with the less volatile measure, which excludes transportation, failing to expand for the first time since April.

Consumer inflation expectations rose again last week. However, this week's PCE inflation data will be a more significant test of whether the disinflation trend remains in place in spite of labour market strength and consumer worries about inflation. Any surprise to the upside here could push expectations for Fed rate cuts further into the future, with the first cut now not fully priced in until June 2024.



JPY

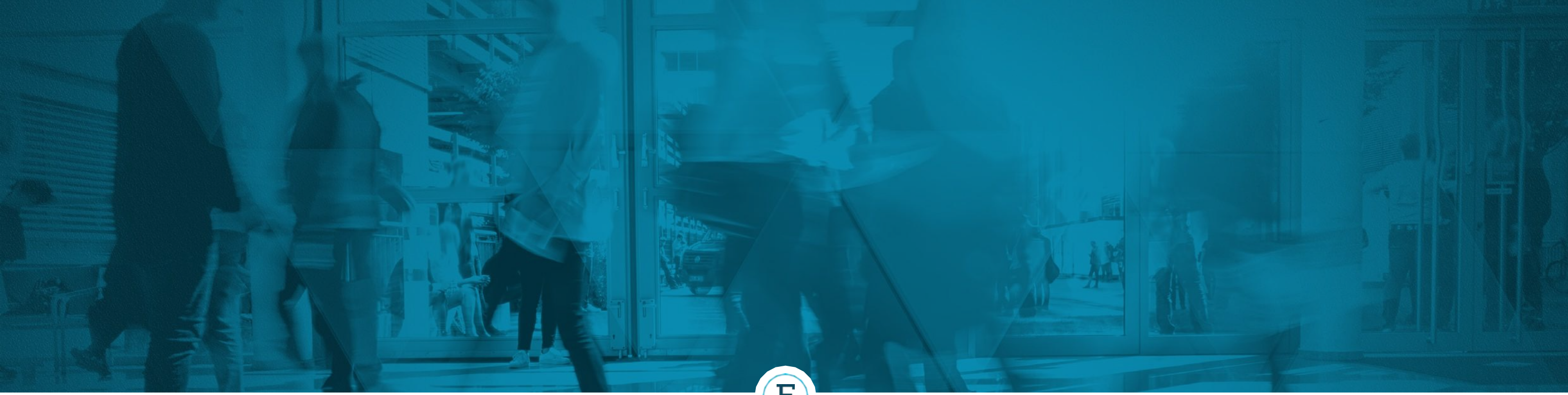
The yen was the clear underperformer in the G10 last week, selling off rather sharply against all of its major counterparts. A push back in market expectations for Bank of Japan policy normalisation continues to weigh on JPY, keeping it pinned just below the 150 level on the US dollar. Communications from BoJ members have remained pretty dovish of late, and swaps are now assigning less than a 50% chance of a rate hike in the first quarter of 2024 following last week's CPI data, which saw a drop in the critical 'core core' inflation rate to a 7-month low 4% (from 4.2%).

We continue to see the yen as oversold, particularly given our expectations for an earlier start to BoJ policy tightening than markets are currently pricing in. This view may change, however, should upcoming activity data surprise to the downside. The October retail sales report will be released on Wednesday, followed by the latest unemployment data on Thursday.

CHF

The Swiss franc ended the week marginally higher against the euro, trading within a narrow range amid an absence of important news from Switzerland. This week promises to be much more interesting in terms of domestic newsflow. Third quarter GDP growth, out on Friday, is set to show modest expansion after a flat second quarter reading. Retail sales will give an indication of the health of consumer spending at the start of the final quarter, and PMI data will close the week by providing the most up-to-date assessment of business activity in Switzerland.

The current state of the economy can be described as close to stagnant, and any recovery is likely to be gradual. On the positive side, this should ease the fight against inflation. Last week, SNB President Jordan suggested that the bank cannot declare a complete victory on that front, although both markets and ourselves have little doubt that things are more-or-less under control. The SNB appears set to leave rates unchanged again at its upcoming meeting in mid-December, with its next move likely to be a cut.



AUD

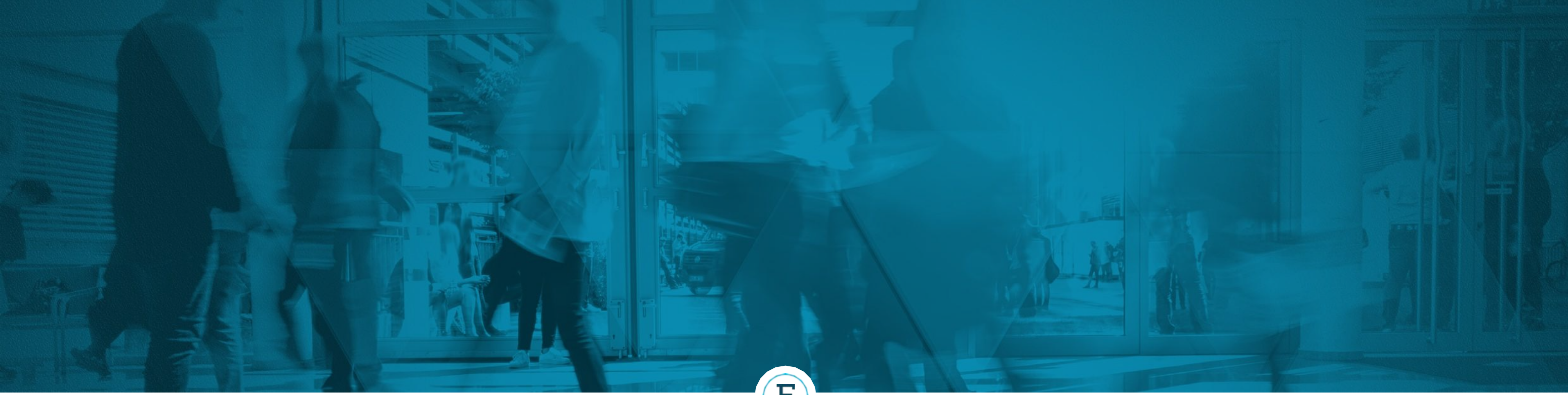
Lingering expectations that the Reserve Bank of Australia could raise interest rates again at an upcoming policy meeting appears to be keeping the Aussie dollar well bid, with the AUD/USD pair now trading around its highest level since early-August. Communications from RBA governor Bullock were on the hawkish side last week, while the latest meeting minutes also warned over rising inflation risks, suggesting that markets may be underestimating the chances of further policy tightening in the coming months.

The monthly inflation data for October will be released on Wednesday, and will no doubt be very closely watched by market participants. Any surprise to the upside here could be rather bullish for AUD, as market may start pricing in another 25 basis point rate increase from the RBA as soon as its February meeting. This possible widening in rate differentials should keep AUD well bid against its New Zealand counterpart in the coming months.

NZD

The release of some rather impressive macroeconomic data helped the New Zealand dollar outperform all of its major counterparts last week, while rallying to a near four-month high on the US dollar. Retail sales unexpectedly posted flat growth in the third quarter of the year, well above the -0.8% consensus and bucking the recent trend that has seen three consecutive quarters of contraction. The core retail sales measure, which excludes autos, also posted solid expansion of 1%, again comfortably above the 1.5% downturn priced in.

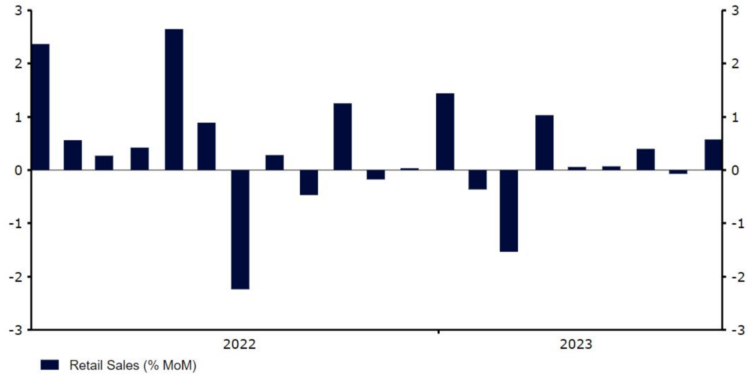
In our view, this evidence of economic resilience is unlikely to prevent the Reserve Bank of New Zealand from delivering a dovish set of communications on Wednesday. The hiking cycle is all but over, and any communications that confirm as much would probably weigh on NZD this week, which appears to have been slightly overbought in recent weeks.



CAD

Further evidence of an easing in Canadian inflation was not enough to hold back CAD last week, as a strong retail sales report allayed fears over the state of the country's economy. September retail sales posted the largest monthly increase since April (+0.6%), after investors had expected flat growth, with an even larger boost expected in October. It may be difficult for the Canadian economy to post anything more than modest growth in the third quarter, although last week's data should, at least, calm fears that a technical recession may be on the way.

Figure 4: Canada Retail Sales (2022 - 2023)

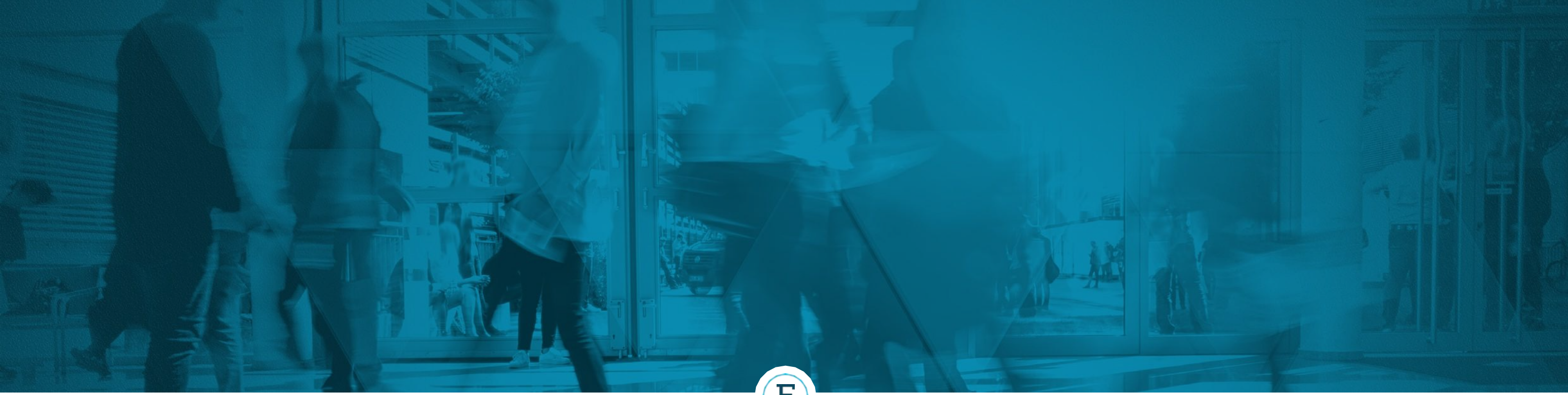


Source: LSEG Datastream Date: 27/11/2023

We won't have to wait long to find out, with the Q3 GDP report set for release on Thursday. A strong GDP report, and a solid month of job creation in Friday's November labour data, appears highly unlikely to be enough to put the possibility of another BoC rate hike back on the table. It could, however, prevent the BoC from signalling that its hiking cycle is completely over at its December meeting, which may be bullish for CAD.

SEK

The Swedish krona ended last week virtually unchanged against the euro, although the EUR/SEK is on track to end the month more than 3% lower. As one of the riskier major currencies, the krona has benefited from the general improvement in risk sentiment, although the pause in the Riksbank's tightening cycle at last week's meeting has limited the currency's upward trajectory.

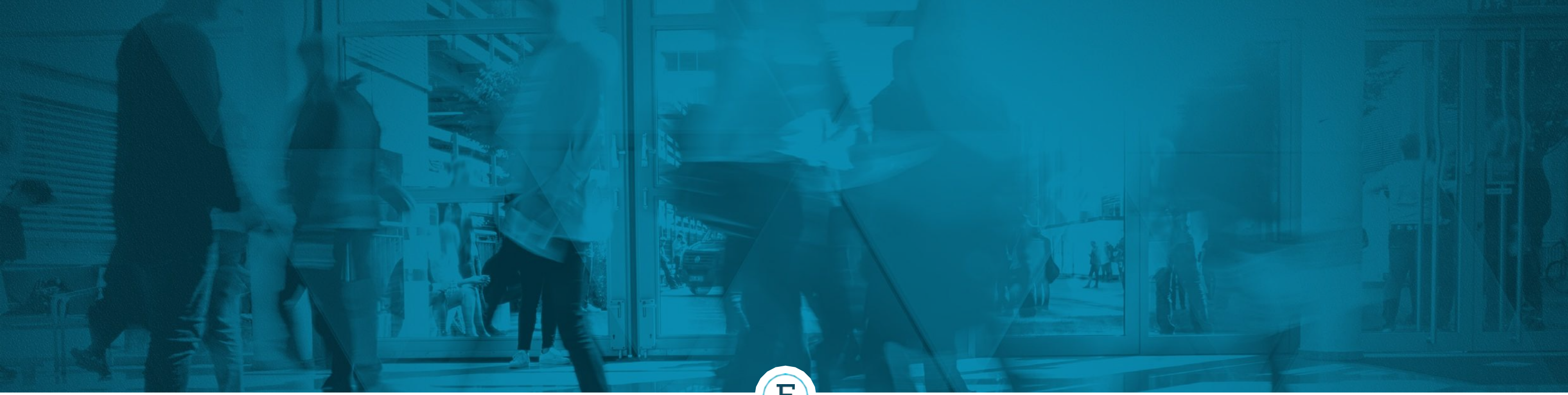


The Riksbank left rates unchanged at 4% last week, compared to the 25 basis point hike expected by consensus, the first pause after eight consecutive hikes. The central bank admitted that inflation is still ‘too high’, despite the fact that it is falling. Policymakers noted that monetary policy must remain contractionary, although it is now ‘appropriate to keep the official interest rate unchanged’. The Riksbank said in its statement that it ‘stands ready’ to raise rates further in the near future should the inflation outlook worsen. However, markets believe the tightening cycle to be over, which would not be a particularly encouraging development for the krona.

NOK

The Norwegian krone depreciated against the euro last week, with the drop in Brent crude oil prices below $80 a barrel, to which the Norwegian economy is closely linked, weighing on the currency. Third quarter GDP data released last week came in worse than expected, which did not help the currency either. However, the ‘risk on’ mode has supported high-beta currencies in the last month, and allowed NOK to appreciate by more than 1% against the euro so far this month.

The Norwegian economy contracted by 0.5% in Q3, missing market expectations of a 0.3% expansion. On a yearly basis, GDP contracted by 1.9%, the largest downturn since Q2 2020. Mainland GDP, which excluded the largely petroleum-based offshore sector, expanded by 0.1% over the same period, although growth was also lower than expected (+0.2%). The latest activity data puts Norges Bank between a rock and a hard place, as the country's inflation is rising again, while activity is stagnating. At its meeting earlier this month, the bank warned that rates could be raised again in December due to high core inflation. However, the rather fragile growth outlook suggests that this is far from guaranteed.



CNY

Last week was one of the best for the Chinese currency in recent months. CNY jumped nearly 1% against the US dollar and outperformed most other currencies, ranking third among the emerging market currencies that we cover. Some of this outperformance could be due to China's own design – the major state-owned banks have been reportedly buying yuans in order to prop up the currency. Even so, sentiment towards China has taken somewhat of a turn for the better of late, as authorities appear to be moving towards providing financing assistance to the distressed real estate developers, while economic data proves somewhat more resilient than thought.

Data releases this week, particularly the PMIs, will test the latter. The statistics bureau will release the business activity data for November on Thursday, with the manufacturing PMI from Caixin to be published the following day.

Economic Calendar (27/11/2023 - 01/12/2023)

Economic Calendar	Country	Day	Date	Time (GMT)
Retail Sales (Oct.)	NOR	Monday	27/11	07:00
Retail Sales (Oct.)	AUS	Tuesday	28/11	00:30
Consumer Confidence (Nov.)	US	Tuesday	28/11	15:00
Inflation (Oct.)	AUS	Wednesday	29/11	00:30
RBNZ Meeting	NZ	Wednesday	29/11	01:00
GDP (Q3)	SWE	Wednesday	29/11	07:00
Retail Sales (Oct.)	SWE	Wednesday	29/11	07:00
GDP (Q3)	US	Wednesday	29/11	13:30
NBS PMIs (Nov.)	CHN	Thursday	30/11	01:00
Preliminary Inflation (Nov.)	EZ	Thursday	30/11	10:00
PCE Inflation (Oct.)	US	Thursday	30/11	13:30
GDP (Q3)	CAN	Thursday	30/11	13:30
Unemployment Rate (Oct.)	JPN	Thursday	30/11	23:30
Caixin Manufacturing PMI (Nov.)	CHN	Friday	01/12	01:45
GDP (Q3)	SWI	Friday	01/12	08:00
Employment Report (Nov.)	CAN	Friday	01/12	13:30

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