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Weekly Report

G10 Weekly FX Update

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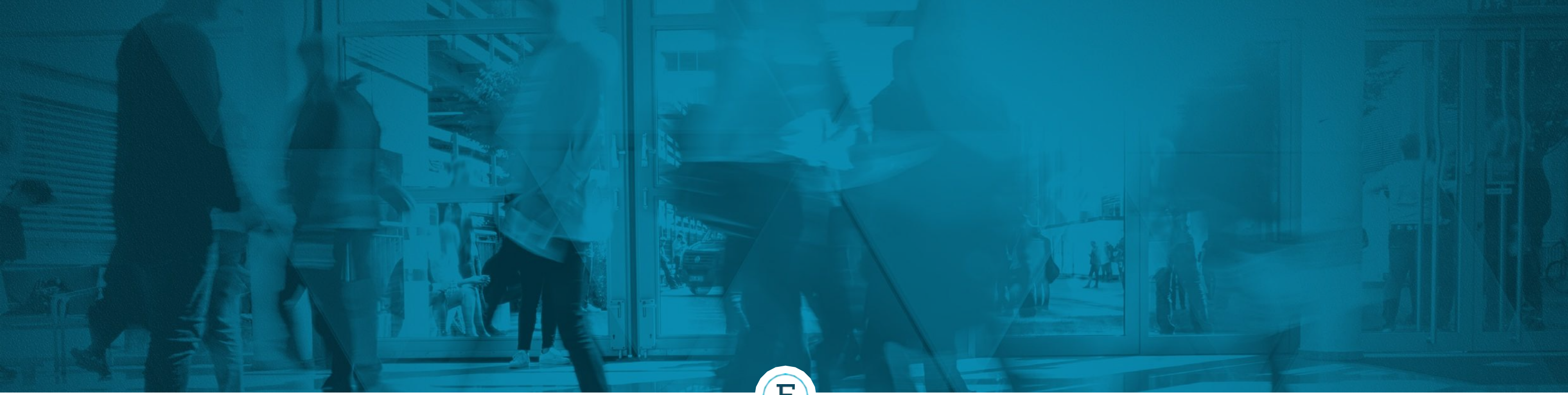


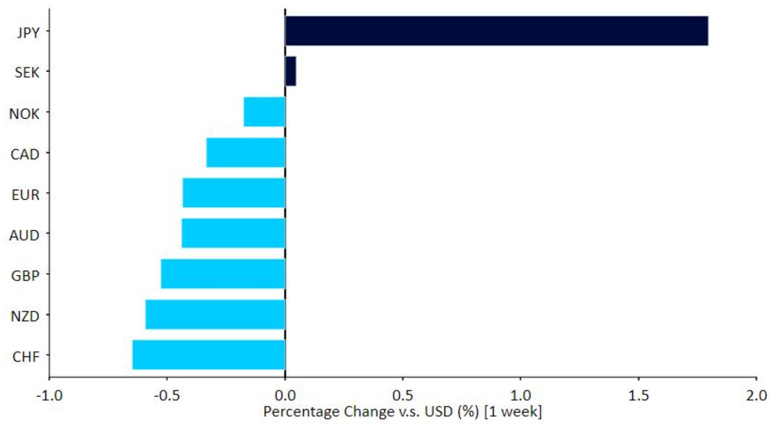
US dollar rebounds on strong jobs data, yen soars

The undisputed winner in currency markets last week was the Japanese yen, which soared as the Bank of Japan finally hinted that it is ready to start normalising monetary policy.

The other theme in FX was the rebound in the dollar, as US interest rates rose on the back of a very strong labour report, which suggests that the Federal Reserve will not be cutting rates any time soon. The dollar subsequently rose against every G10 currency, save the yen. Special mention to yet another strong performance by Latin American currencies, which managed to buck the trend towards a stronger dollar and added to their scorching 2023 performance.

This week promises to be packed with action. We start on Tuesday with the release of the most important economic report worldwide: US inflation for November. The last meeting of the year for each of the major central banks will follow: the Fed on Wednesday, and the ECB and the Bank of England on Thursday. Finally, the PMIs of business activity for November will be released in most of the world on Friday. By the end of this week we should have a much clearer picture of where the economic, inflationary and monetary trends will be going into 2024. Brace for volatility.

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



Source: LSEG Datastream Date: 11/12/2023

GBP

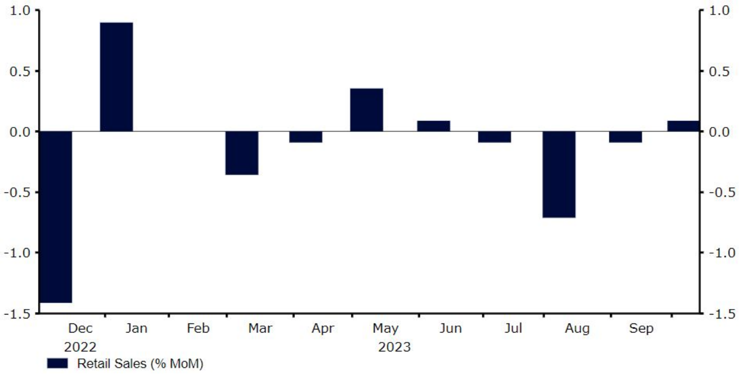
An unusually busy week awaits sterling. The December meeting of the Bank of England will be preceded by two key macroeconomic releases: the labour market report (Tuesday) and the monthly GDP print (Wednesday), both for the month of October. Economists are expecting a modest easing in wages in the former, with the latter set to show modest contraction in the UK economy in October.

The MPC is expected to leave interest rates unchanged on Thursday, although we think that it will try to push back against market pricing of a full cut in the first half of 2024. The voting split among committee members will also once again be key. This vote was split 6-3 in favour of no change in November, and could remain unchanged this time around as the bank reinforces its stance of higher rates for longer. We think both data and central bank communications are likely to be supportive of the pound, underlining the story of demand resilience and high wage growth that should keep UK rates elevated for longer than elsewhere.

EUR

Last week saw yet more dismal news on the Eurozone's economy. German factory data for October underperformed already depressed expectations, as did Eurozone retail sales for the same month. This provides further evidence to markets that a recession in the bloc in the final quarter of the year is increasingly likely, which has acted to hold back the common currency in recent trading sessions. Indeed, EUR/USD ended the week just below the 1.08 level, around its lowest point in about a month.

Figure 2: Euro Area Retail Sales (2022 - 2023)



Source: LSEG Datastream Date: 11/12/2023

The European Central Bank is universally expected to stand pat at its December meeting on Thursday, although the key to the announcement will be the extent of the push back against market expectations for a cut as early as March of next year. While this is much earlier than expectations for other central bank cuts, the bad economic news does seem to justify a cautiously dovish ECB policy, as long as the disinflationary trend continues.

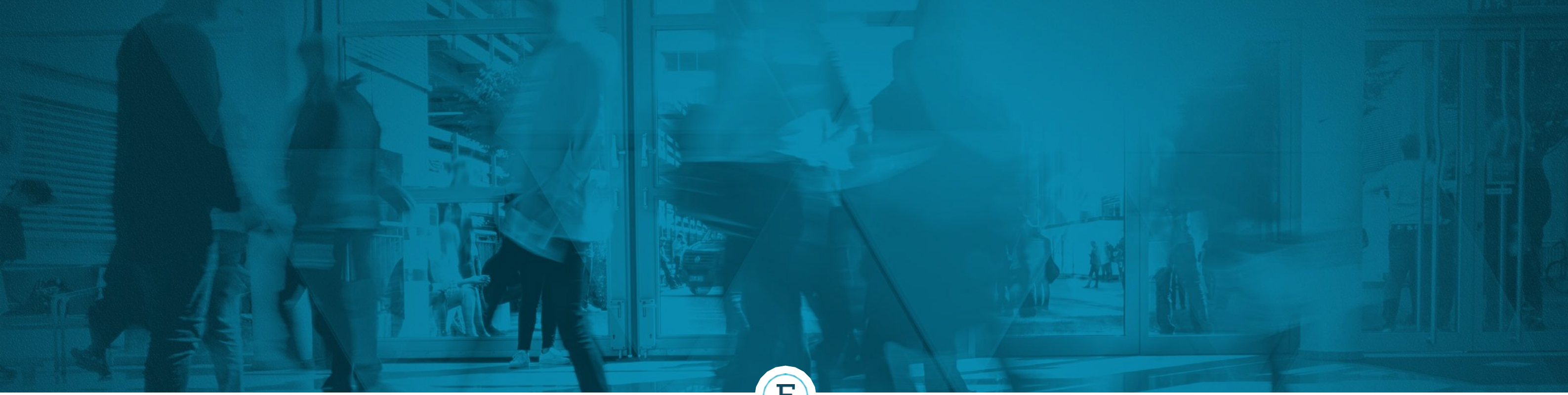
USD

It is hard to exaggerate the extraordinary resilience of the US economy in the face of the fastest hiking cycle in history. The November jobs report surprised to the upside and suggested that the labour market continues to fire on all cylinders, with job creation, unemployment and wage growth all stronger-than-expected.

Figure 3: US Nonfarm Payrolls (2022 - 2023)

Source: LSEG Datastream Date: 11/12/2023

Bond yields backed up moderately and the dollar rebounded after the data, although markets are now focused on this week's inflation report, followed by the Federal Reserve meeting. A pause in the disinflationary trend followed by Fed pushback against market timing for cuts (which is now running well ahead of the Fed's own "dot plot" forecasts) could support the dollar next week. We expect FOMC chair Powell to reiterate the strength of the US labour market, while saying that a period of below-trend growth will be needed for the bank to meet its inflation mandate. This may be enough to suppress market expectations for US rate cuts, which continue to appear excessive.



JPY

The yen was the clear outperformer among all currencies globally last week, as Bank of Japan officials finally appear to be bowing to economic reality, with governor Ueda hinting that a normalisation in the bank's ultra-dovish policy stance was on the way. During communications towards the end of the week, Ueda told Japan's government that setting monetary policy would become 'even more challenging' towards the end of the year and into 2024. While no more than a subtle change in rhetoric, investors have perceived this as the first real change in guidance towards higher interest rates.

The next BoJ meeting on 19/12 is now shaping up to be a highly important one. We expect no change in rates, although the bank could ditch its yield curve control policy and deliver hawkish guidance on rates. This may tee up a first hike in Q1 2024, in line with our long-held expectations. Swaps markets are now back pricing in around a 75% chance of a hike by the end of March, a repricing that last week helped the yen rally to its strongest position since early-August.

CHF

The Swiss franc ended the week a touch weaker against the euro and in the middle of the G10 FX performance dashboard. The currency's appeal may, however, be somewhat challenged by the sharp uptick in the yen, as investors see a Japanese policy reversal getting nearer. We think the franc is likely to lag both of its safe-haven peers in 2024, and are pencilling in a rather substantial depreciation of CHF against the yen, particularly as the monetary policy stances of the SNB and BoJ are expected to diverge.

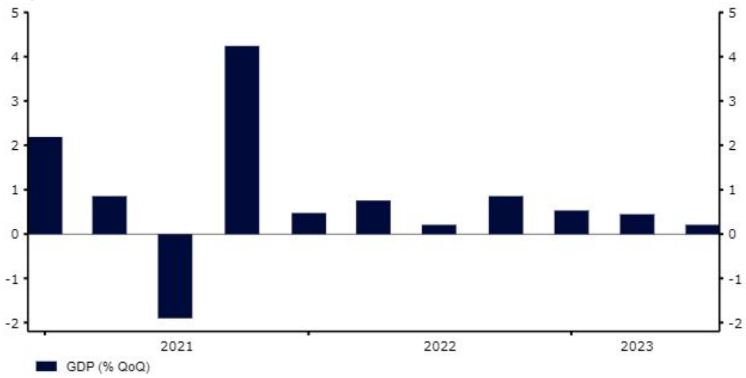
The first test of the above may come as soon as Thursday, when the SNB will be holding its last monetary policy meeting of the year. A change in interest rates seems highly unlikely. Instead, investors will look for clues to help determine whether to expect a rate cut at the next meeting in March. Both the bank's rhetoric and its inflation projections will be heavily scrutinised. Progress on the inflation front is clear, but economic activity data has been surprisingly resilient, which may prompt the bank to refrain from sending a strong signal that a policy reversal is in the offing soon.

AUD

The Reserve Bank of Australia kept rates unchanged last week, as expected. AUD sold-off following the announcement, as market were pricing in a non-negligible possibility of another rate increase. Communications from the bank were not overly dovish, with the committee keeping open the possibility of further policy tightening depending on the evolution of risks. Markets are, however, now fairly sceptical that additional hikes will be needed, as inflation continues to slow and the economy shows signs of faltering.

Last week's third quarter GDP report was a disappointment, with quarterly expansion slowing to 0.2% versus the 0.4% seen by economists. Thursday's labour report for November will now be eyed by markets, followed by the December PMI data on the same day. Continued signs of weakness here should be enough to completely rule out the possibility of further RBA rate hikes, and may brings cuts into view in the first half of next year.

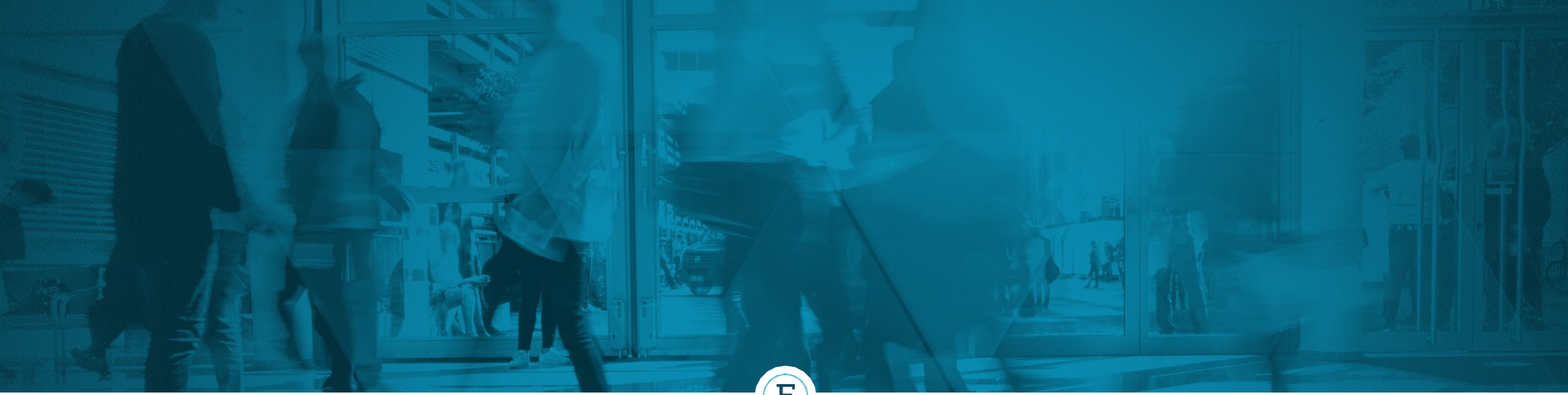
Figure 4: Australia GDP Growth Rate (2021 - 2023)



Source: LSEG Datastream Date: 11/12/2023

NZD

This Wednesday's third quarter GDP report out of New Zealand looks likely to be a rather important one, as this will give markets a good idea as to how the aggressive hiking cycle in the country is continuing to impact domestic demand. Very modest expansion of only around 0.2% quarter-on-quarter is expected by investors, with annual growth set to drop to its slowest pace since the pandemic restrictions were in place in third quarter of 2021. On Thursday, the November business activity PMI data will then be released, with another soft print expected. If confirmed, this data would reaffirm the narrative that fragile growth is here to stay, which may present some near-term downside for NZD.



CAD

CAD outperformed most of its peers last week, as while the Bank of Canada kept interest rates unchanged, it also failed to close the door to more tightening. According to its statement, the BoC is 'still concerned about risks to the outlook for inflation', which in its own words means that it is prepared to raise rates again if needed. This hawkish bias has not changed our view that the BoC's tightening cycle is already over, but it does at least suggest that the first rate cut remains some way off, which would clearly be a bullish development for the Canadian dollar.

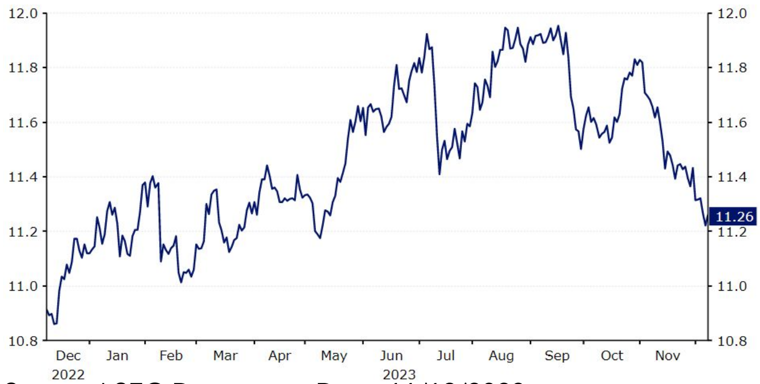
There's no macroeconomic data of note out of Canada this week, so attention will remain on central bank communications. Speeches from BoC members Gravelle (Thursday) and Macklem (Friday) will be closely watched by market participants towards the end of the week.

SEK

The Swedish krona has continued its good run since the beginning of December and has appreciated by more than 1.5% against the euro so far this month. The hawkish stance adopted by the Riksbank, which has remained open to the possibility of further interest rate hikes, at a time when almost every other central bank has effectively signalled an end to tightening, has helped the currency outperform its major counterparts.

This week, the focus will be on the November inflation data due for release on Thursday. Economists expect a moderation in both the headline and core rates, so any surprise to the upside here could further support the krona, which appears to have further room to rally against most currencies.

Figure 5: EUR/SEK (2022 - 2023)



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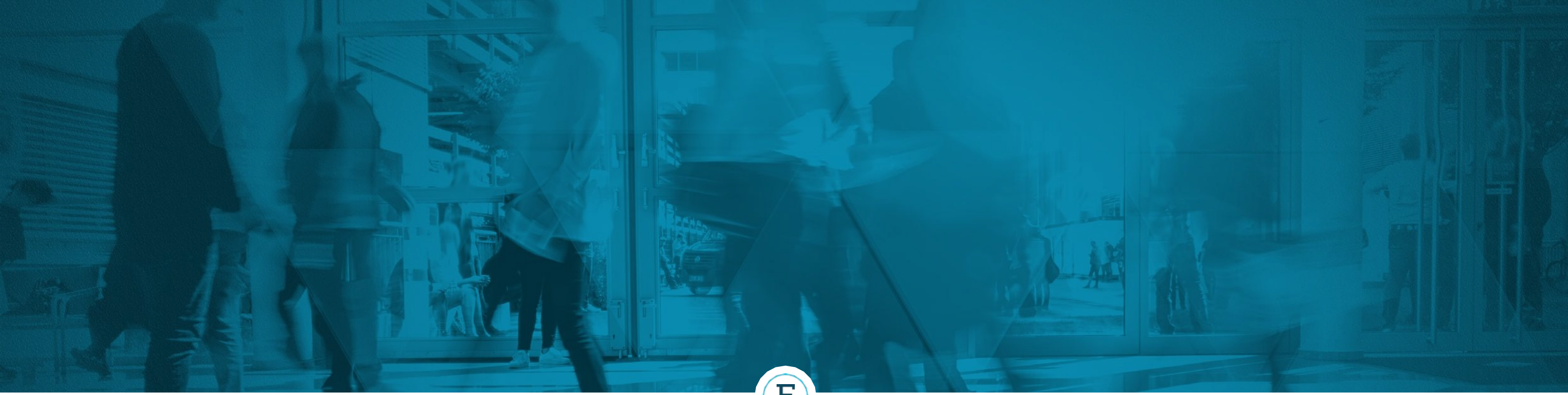


NOK

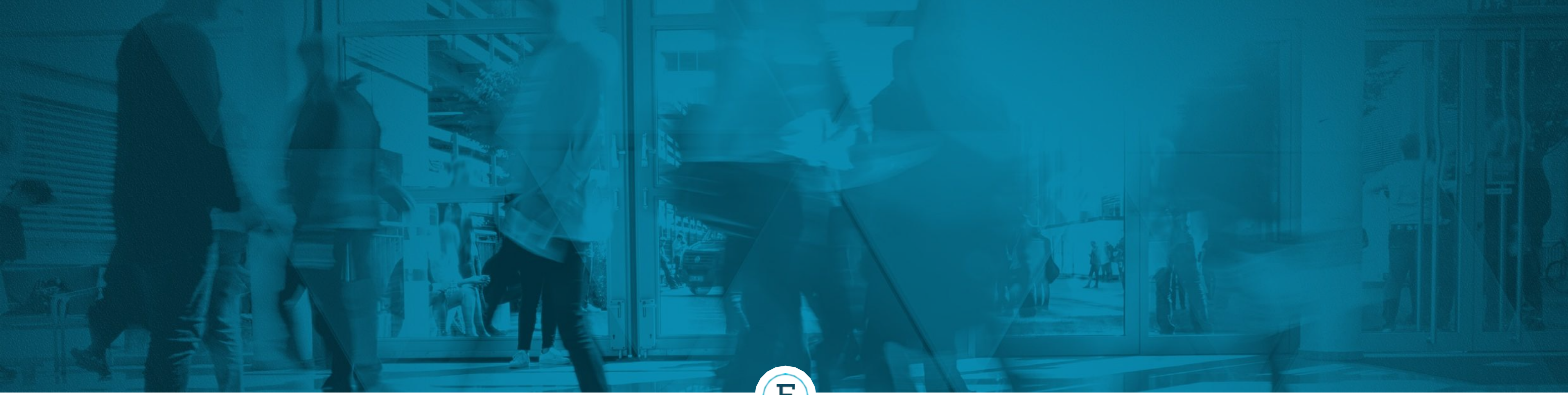
The Norwegian krone has not had a good start to December, losing around 1.5% of its value against the euro. The main reason behind the NOK's poor performance is the sharp fall in oil prices, to which the Norwegian economy is closely linked. Brent crude oil futures have now fallen for seven consecutive weeks, last week falling below the $75 a barrel level.

This week could be decisive for the krone, as Norges Bank meets on Thursday. The central bank is between a rock and a hard place, as the country's inflation is rising again (4.8% in November from 4% the previous month), while activity is stagnating. At its latest meeting in November, 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, and is only roughly 50% priced in by markets. Should Norges Bank decide to raise rates again, then NOK should receive some support towards the end of the week.

CNY

The recent performance of the Chinese yuan has been unremarkable. The currency edged lower against the broadly stronger US dollar, although managed to eke out some gains in trade-weighted terms. The big story last week was the downgrade of China's rating outlook from 'stable' to 'negative' on the back of concerns over economic growth, the property sector and expectations of costly fiscal stimulus. If things do not improve, China may get stripped of its A1 rating.

Economic data released last week was bittersweet. The services PMI from Caixin followed the path of the manufacturing index released earlier, posting an unexpectedly strong uptick in November. The composite index increased to 51.6 (from 50), which while still soft is at least not indicative of stagnant business activity. Other data was much less impressive. Exports performed slightly better than expected last month, although this was overshadowed by signs of fragile domestic demand in the form of contracting imports and deepening deflation in both consumer and producer prices. Investors can hope that this week's November data package, out on Friday, brings more joy, but for now things are not looking good. In addition, the MLF rate announcement will be in focus on Friday.



Economic Calendar (11/12/2023 - 15/12/2023)

Economic Calendar	Country	Day	Date	Time (GMT)
Inflation (Nov.)	NOR	Monday	11/12	07:00
Employment Report (Oct.)	UK	Tuesday	12/12	07:00
Inflation (Nov.)	US	Tuesday	12/12	13:30
Fed Monetary Policy Meeting	US	Wednesday	13/12	19:00
Employment Report (Nov.)	AUS	Thursday	14/12	00:30
Inflation (Nov.)	SWE	Thursday	14/12	07:00
SNB Monetary Policy Meeting	SWI	Thursday	14/12	08:30
Norges Bank Monetary Policy Meeting	NOR	Thursday	14/12	09:00
BoE Monetary Policy Meeting	UK	Thursday	14/12	12:00
ECB Monetary Policy Meeting	EZ	Thursday	14/12	13:15
Retail Sales (Nov.)	US	Thursday	14/12	13:30
Retail Sales (Nov.)	CHN	Friday	15/12	02:00
Unemployment Rate (Nov.)	SWE	Friday	15/12	07:00
Preliminary PMIs (Dec.)	EZ	Friday	15/12	09:00
Preliminary PMIs (Dec.)	UK	Friday	15/12	09:30
Preliminary PMIs (Dec.)	US	Friday	15/12	14:45

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