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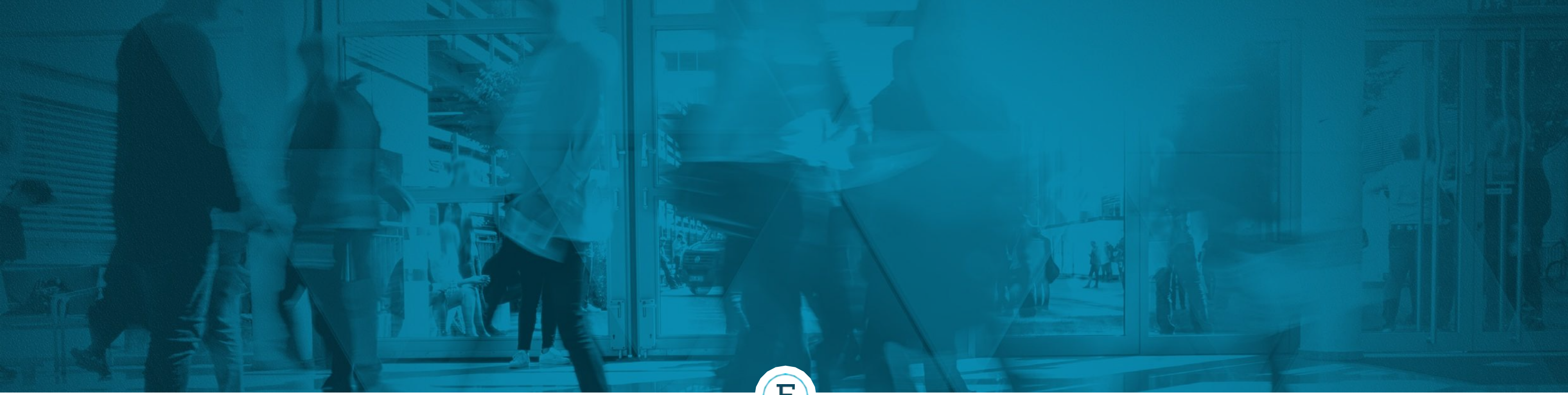
Weekly Report

G10 Weekly FX Update

Written by:

Enrique Díaz-Alvarez, Matthew Ryan, CFA, Roman Ziruk, Itsaso Apezteguia,
Eduardo Moutinho & Michał Jóźwiak

8th January 2024



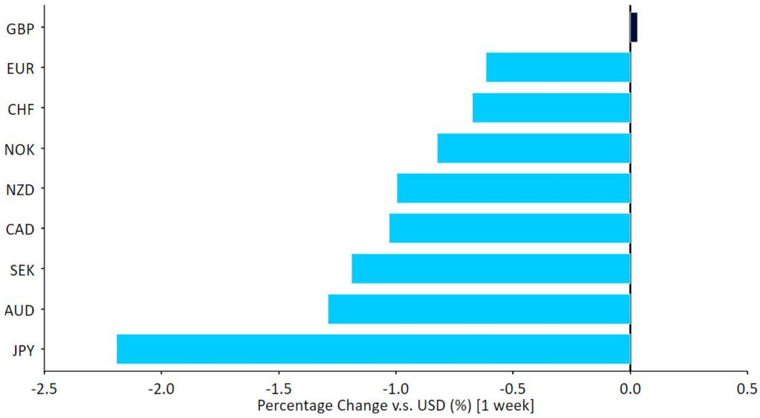
Dollar rallies as markets rethink Fed rate cuts

Currency markets have executed a 180 degree turn so far in 2024, as have financial markets generally.

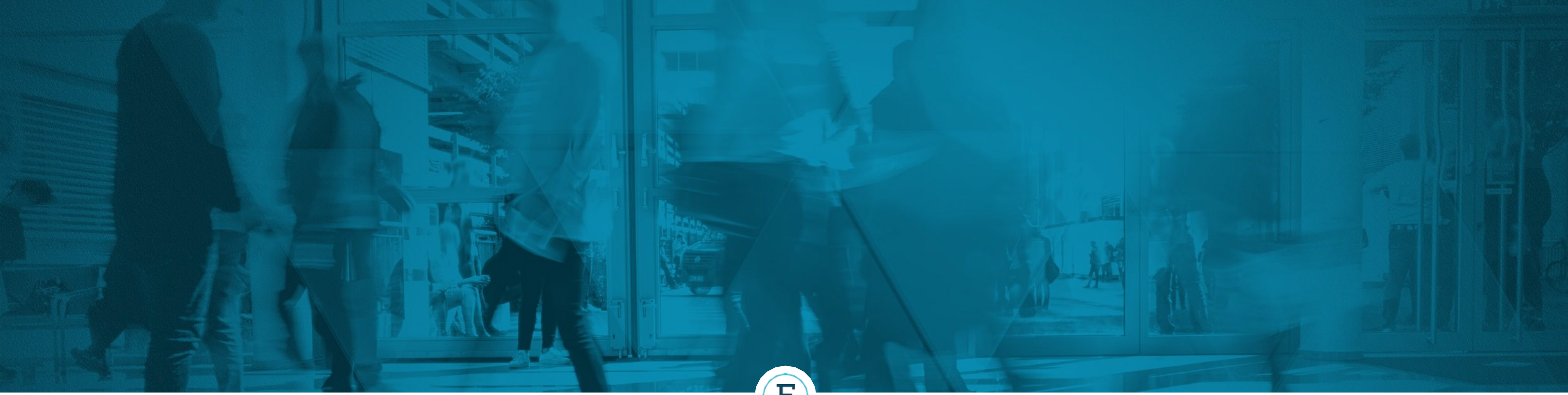
The furious bond rally in the last few weeks in 2023 has stopped in its tracks and reversed, as markets pare back expectations of Federal Reserve interest rate cuts in 2024. Markets dutifully followed the leads from interest rates: risk assets and commodity fell, and the dollar rose against every major currency with the notable exception of the Mexican peso, which built on its stellar 2023 performance to end up higher against every other major currency.

Attention this week is focused on the most important number for markets worldwide: the monthly CPI inflation print in the US, out on Wednesday. Markets are expecting a further moderation in the YoY core number, and any upward surprise will make it hard for the Fed to ease in March, adding fuel to the recent dollar rally. The monthly GDP print out of the UK and a number of speeches by Federal Reserve and ECB officials will round out the week, as trading volumes pick up from the holiday torpor.

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



Source: LSEG Datastream Date: 08/01/2024



GBP

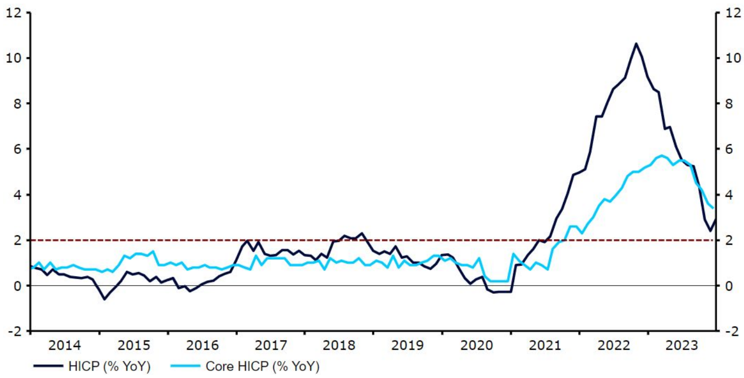
Sterling was the only G10 currency that managed to match the dollar's rise last week, ending higher against every other major currency. Two factors are contributing to the pound's outperformance: resilience in consumer demand, evidenced in recent economic activity data, and Bank of England relative hawkishness, which results in the highest interest rates in the G10 and a comparatively slow timetable for cuts in 2024.

This week the focus will be on the November GDP report, out on Friday. Economists expect to see a healthy rebound relative to October's contraction, which would be consistent with the rebound witnessed in the business activity PMI numbers. A technical recession as early as the final quarter of last year remains a possibility following the downward revision to the Q3 data, although we are quietly confident that this will be avoided once the official data for Q4 is released in the middle of February.

EUR

The tug of war between the European Central Bank's apparent hawkishness and the poor economic performance in the Eurozone continues. December inflation numbers were mixed. The headline index rebounded as energy subsidies were removed, although the more important core index continued on its downward trend, and is now squarely below the ECB's repo rate.

Figure 2: Euro Area Inflation Rate (2014 - 2023)



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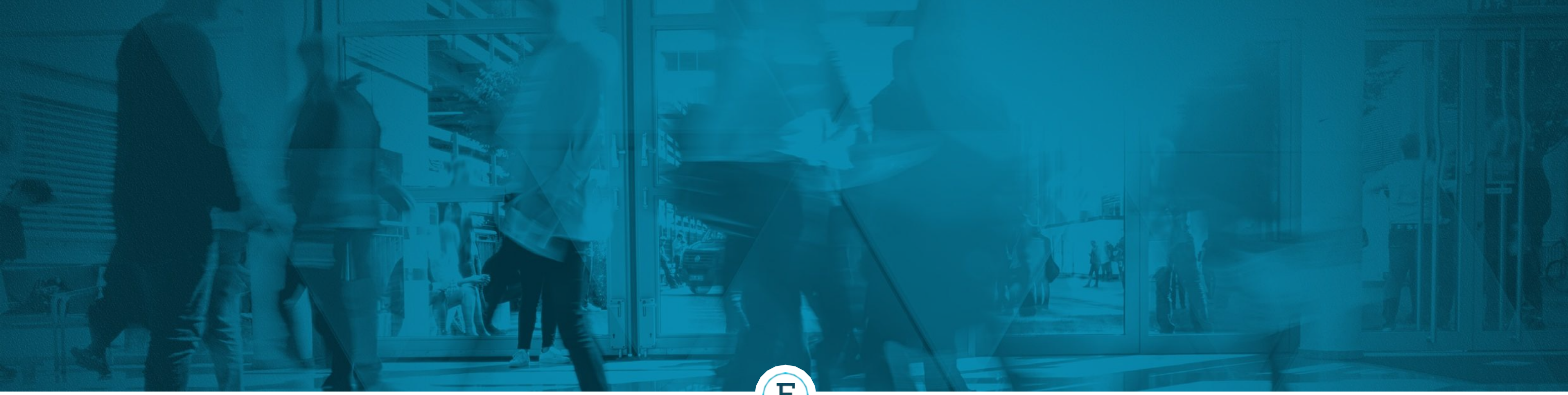


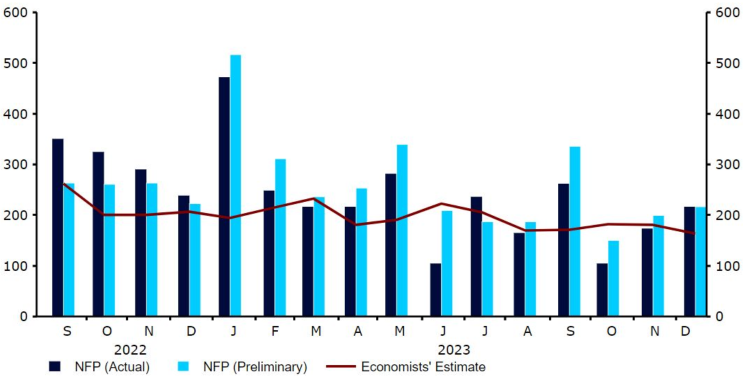
This week, there is not a lot of economic data on the docket. Focus among investors will be on speeches by ECB officials, specially chief economist Lane, who is expected to provide clarity on the ECB´s view of recent Eurozone economic weakness and its impact on monetary policy. Financial markets continue to see a decent chance of a start to easing in the Eurozone in the first quarter, although these expectations continue to be pushed further into the future in line with the broad repricing globally.

USD

A mixed payrolls report for December offered some contradictory signals: steady job creation and healthy wage growth in the establishment survey, contrasted with a sizable drop in labour force participation in the household one. Investors initially reacted to the strong December job creation number by sending the dollar higher, although the greenback quickly reversed course on realisation that the 71k downward revision to the October and November data more than made up for the upside surprise in the final month of the year.

All in all, the US labour market continues to enjoy full employment, but signs of cooling are accumulating. All this will be overshadowed by the key December CPI inflation report on Wednesday. A two-in-three chance of a March cut from the Federal Reserve currently priced in by markets still strikes us as too high, and this week's inflation number will go a long way towards settling the debate.

Figure 3: US Nonfarm Payrolls (2022 - 2024)



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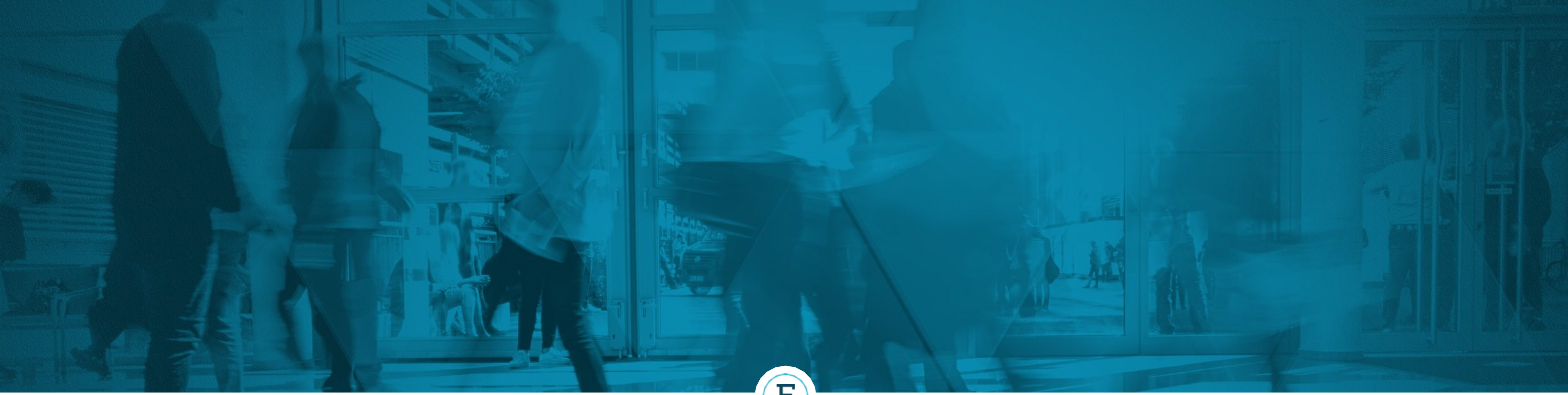


JPY

The worst performing major currency in 2023 has begun the New Year in a similar fashion, with the yen once again trading lower against pretty much every other currency globally so far this year. Expectations for the first interest rate hike from the Bank of Japan continue to be pushed further into the future following the earthquake on New Year's Day. Indeed, last week was the worst for the yen against the dollar since 2022, as investors bet that the powerful 7.6 magnitude quake would weigh on domestic economic activity and cause the BoJ to adopt an even more cautious stance to normalising policy.

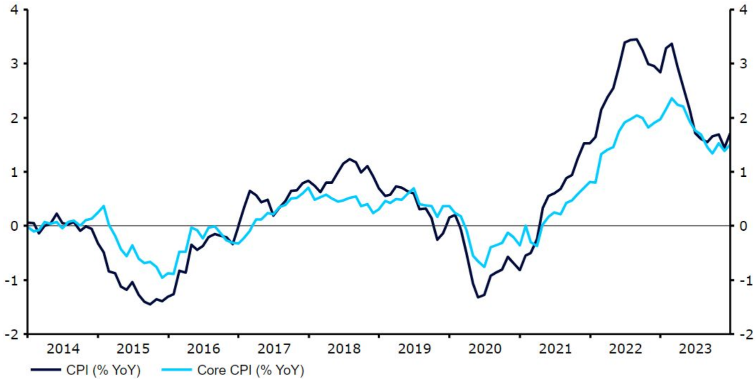
Communications from BoJ members over the holiday period were mixed. Governor Ueda hinted that a change in policy could soon be on the way during his speech on 25th December, although he somewhat tempered these remarks by saying that a policy change would not be forthcoming in January. This Tuesday's wage growth figure could be highly important for the yen, as this data point appears to be the one that BoJ members are watching the closest when it comes to the timing of tightening. Evidence of solid earnings pressure would be welcome news for JPY, and could lead to a sharp snap back in the currency.

CHF

The franc rally after Christmas, which saw the EUR/CHF pair fall below the 0.93 mark to its lowest level since January 2015 (when the SNB abandoned its peg), was followed by some calmness. The pair ended the first week of 2024 little changed, and the Swiss currency landed in the middle of the G10 FX performance dashboard.

There is little to explain the post-Christmas rally in the franc, aside from investor portfolio rebalancing ahead of year-end amid thin liquidity trading. A significant decrease in short CHF positions from deeply negative levels suggests that investors may see the currency as a useful hedging vehicle in the environment of heightened geopolitical uncertainty ahead of a busy year of elections. We believe it may be difficult, however, for the franc to hold onto its gains given the recent dovish turn from the SNB. Data out this morning on a slightly sharper-than-expected uptick in inflation at the end of the year does not change this view, particularly as both measures of price pressures remain firmly within target.

Figure 4: Switzerland Inflation Rate (2014 - 2023)



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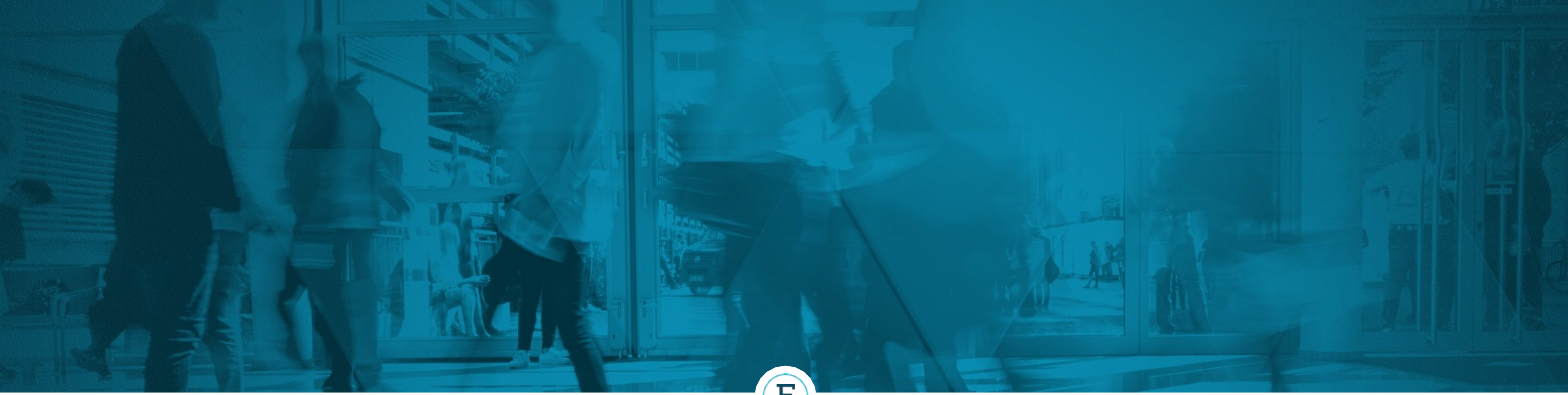
AUD

The Australian dollar has struggled so far this year, as receding bets in favour of Fed rate cuts hammer risk assets, while economic data suggests that the Australian economy contracted at the end of 2023. Last week's preliminary PMI data for December was a disappointment. The composite index edged upwards in the final month of the year, although fell short of expectations and continued to print well below the level of 50 for the third straight month (46.9). Quarterly GDP data won't be released until early-March, although it would be reasonable to assume that a QoQ contraction in activity is a distinct possibility.

Investor expectations regarding the state of the Australian economy will be key in determining the extent of any continued rebound in AUD in the coming weeks. This week will be a relatively busy one in that regard, with housing, retail sales and trade data to be released on Tuesday and Thursday. Arguably the most important data point will, however, be Wednesday's monthly inflation print for November. Any downside surprise here could further weigh on AUD this week.



NZD

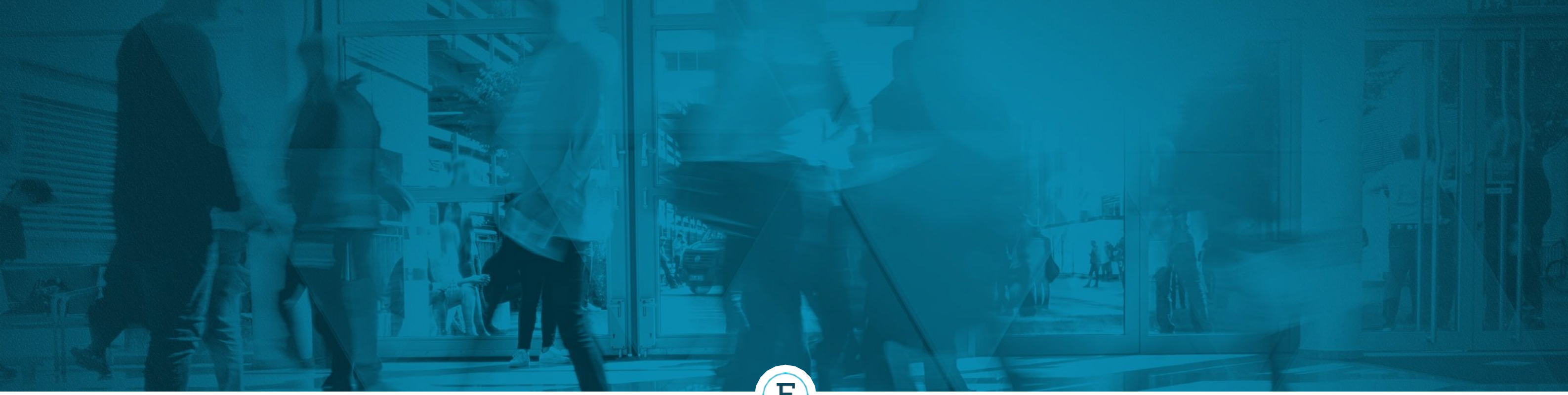
The New Zealand currency has traded in a rather tight range with its Australian counterpart so far in 2024, with both currencies largely driven by global factors, more so than domestic developments. There has been very little news to go off since the first half of December. The New Zealand economy continues to appear fragile, and concerns surrounding the health of Chinese demand remains a significant risk to the outlook.

A solid rebound in global dairy prices, which are now trading at their highest level since March 2023 is, however, bullish for NZD, and has helped keep the currency rather well bid in recent months. The economic calendar remains fairly light in the next week or so, and we will have to wait for PMI figures (18/01) and the Q4 inflation print (23/01) for the next meaningful macroeconomic data.

CAD

Friday's Canadian labour report for December was the dictionary definition of a mixed bag. The unemployment rate unexpectedly remained unchanged at 5.8%, after economists were pencilling in a modest uptick to 5.9%. Wage growth also accelerated, jumping to 5.7% - its fastest pace since January 2021. On the other hand, net employment change came in effectively flat, well below the +13.5k consensus, marking the worst month of job creation since July.

On balance, we tend to focus more on the impressive earnings number, as this is likely to have greater bearing on Bank of Canada policy than anything else. Clear evidence of strong wage pressures may encourage BoC members to adopt a less forceful approach to policy easing, and we see little reason for the bank to rush into cutting rates as soon as the current quarter. Swaps are currently fully pricing in the first cut in April, although this may well change should wages fail to come down in a timely manner in the next couple of labour reports.



SEK

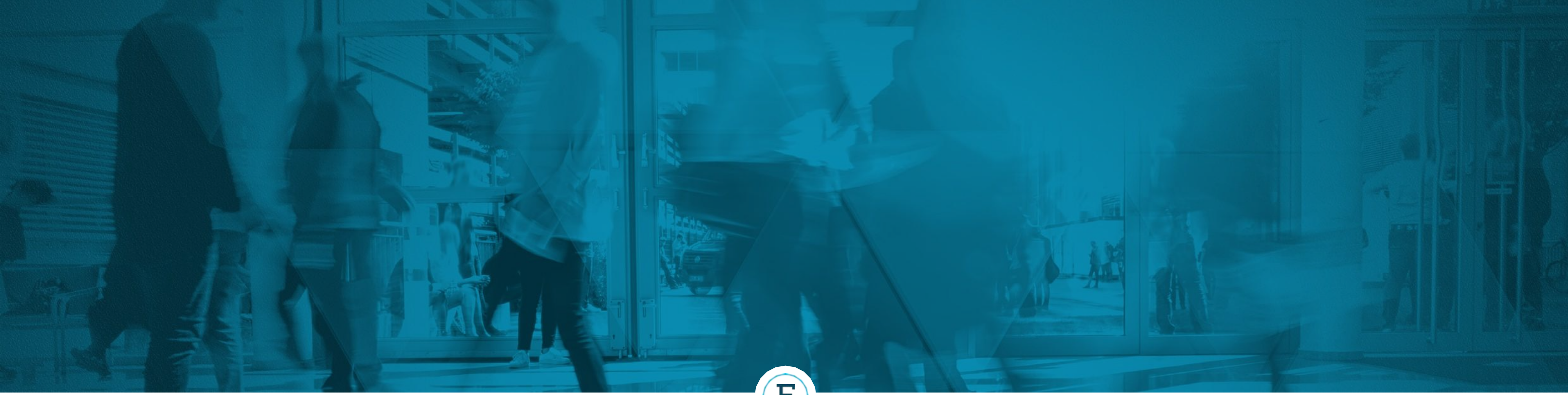
The krona appreciated to its highest level in a year against the euro at the end of December, with the hawkish stance adopted by the Riksbank helping the currency outperform its major counterparts. However, after a strong end to 2023, the Swedish krona has not had a good start to the year and has lost some of its recent gains. We largely attribute this to the lowering in rate expectations of Fed rate cuts in 2024, which has triggered a depreciation in risk assets and pushed EUR/SEK up to the 11.25 level.

This week, markets will focus on activity data, namely retail sales figures for November, which will be released on Wednesday. Sweden is in technical recession after two consecutive quarters of GDP contraction, so any signs that activity is still suffering could weigh on the krona, as this would limit the need for further tightening by the Riksbank.

NOK

Like other risk assets, the Norwegian krone has depreciated so far this year, as markets lower expectations for Fed rate cuts in 2024. The aggressive hawkish tone adopted by Norges Bank at the December meeting has, however, offered some support to the currency.

While major central banks have already paused their hiking cycles, Norges Bank surprised markets with a 25 basis point rate hike at its last meeting of the year. Norges Bank has warned that the interest rate will likely remain at this level for some time. According to the bank forecasts, its key rate will be around 4.5% until autumn 2024, at which point it could start to lower rates. In this respect, the December inflation data to be published on Wednesday will be key. Headline inflation is expected to rise slightly from the previous month that, if confirmed, would reinforce the hawkish tone adopted by the central bank and could provide some support to the krone.

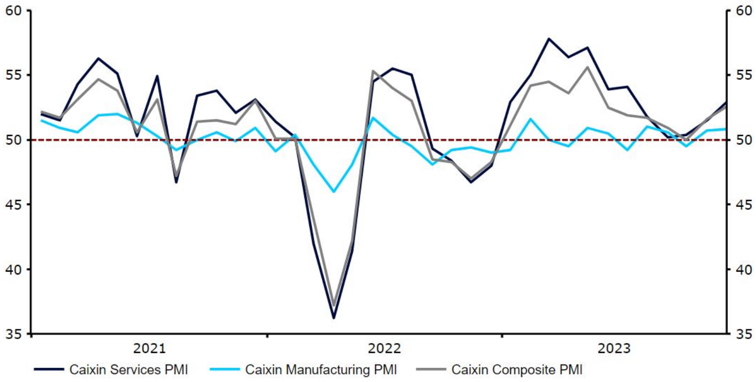


CNY

Recent strength in the dollar has pushed USD/CNY toward the top of its recent trading band (7.10-7.20). News from China has been all over the place in recent days, although negative sentiment still dominates. Late-last week, attention was on the liquidation bankruptcy filing by Zhongzhi, a Chinese wealth manager. This was not a surprise, as the company has been struggling for some time, although it highlights the broader repercussions that the problems of the real estate sector could have on the domestic financial sector.

The latest economic data was mixed, with the still very weak official PMI figures contrasting with the private data. That said, the rise in the Caixin PMI for the services sector, which expanded at the fastest pace in five months, is somewhat encouraging. Looking ahead, investors will pay close attention to financing, trade and inflation data. The latter (out on Friday) is expected to indicate continued deflation in both consumer and producer prices, the extent of which will be important in guiding further policy action.

Figure 5: China Caixin PMIs (2021 - 2023)



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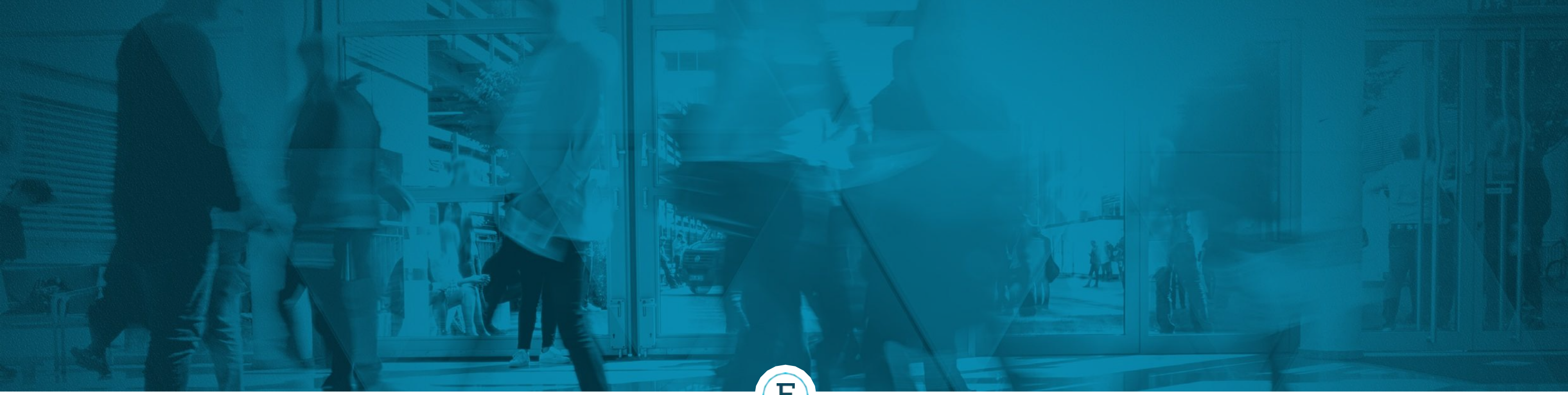

Economic Calendar (08/01/2024 - 12/01/2024)

Economic Calendar	Country	Day	Date	Time (GMT)
Inflation (Dec.)	SWI	Monday	08/01	07:30
Retail Sales (Nov.)	EZ	Monday	08/01	10:00
Retail Sales (Nov.)	AUS	Tuesday	09/01	00:30
Unemployment Rate (Dec.)	SWI	Tuesday	09/01	06:45
Unemployment Rate (Nov.)	EZ	Tuesday	09/01	10:00
Inflation (Dec.)	NOR	Wednesday	10/01	07:00
Retail Sales (Nov.)	SWE	Wednesday	10/01	07:00
Inflation (Dec.)	US	Thursday	11/01	13:30
Inflation (Dec.)	CHN	Friday	12/01	01:30

Ebury

100 Victoria Street, London SW1E 5JL

+44 (0) 20 3872 6670 | info@ebury.com |
ebury.com