Ebury What borders?®

Weekly Report

G10 Weekly FX Update

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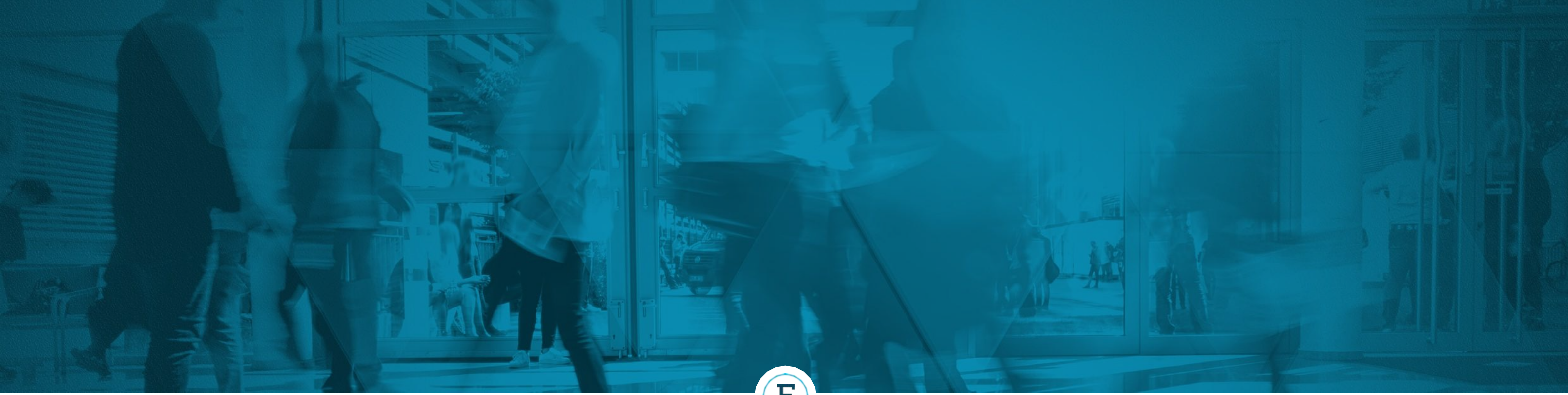
15th January 2024



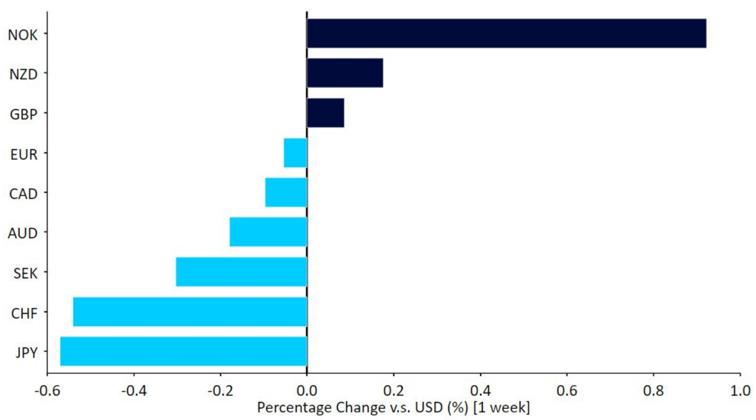
Currencies in tight ranges as markets insist on March Fed cut

Last week was remarkable in how little major currencies moved.

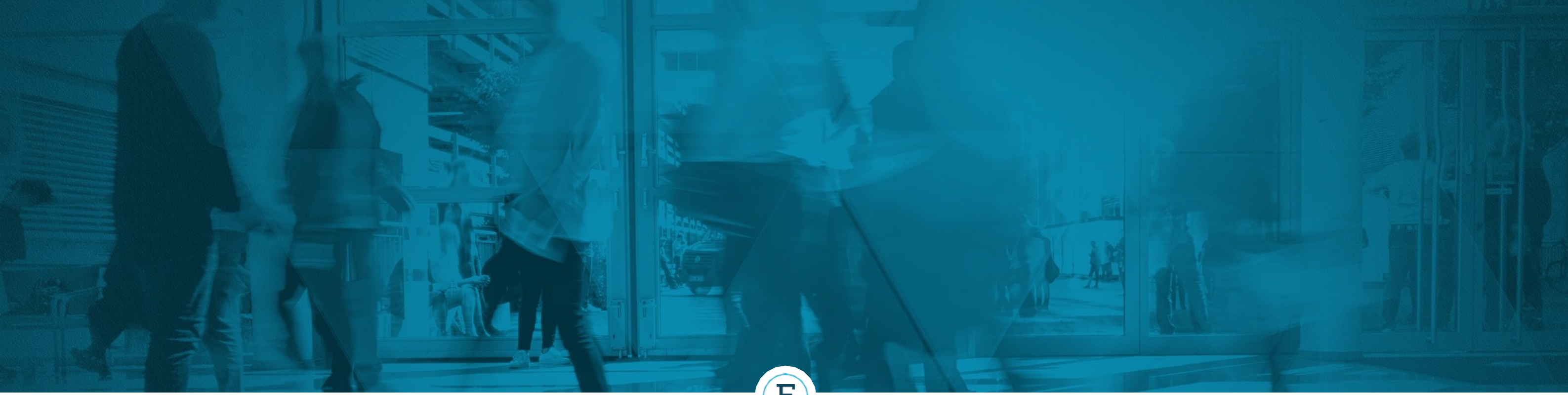
Nearly all of the major ones ended the week within 0.5% of where they had started, an unusual level of quiescence. The hotter-than-expected consumer inflation report out of the US initially made some waves, and helped the dollar rally modestly. By the end of the week, markets were, however, back assigning an implied 80% chance of a March cut in Federal Reserve rates after a miss in Friday's producer inflation report. Government bond yields were lower and risk assets rose upwards in response, while the dollar was essentially flat.

This week is relatively quiet in terms of economic data or policy announcements, although there will be an unusual number of ECB and Federal Reserve speeches on tap. The November Eurozone industrial production data on Monday, and December UK inflation on Wednesday, provide the main economic references. Federal Reserve speeches will be particularly critical to see if the central bank continues to push back against market hopes for a March cut in rates and 165 basis points of cuts for the whole of 2024, which still strikes us as way too aggressive.

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



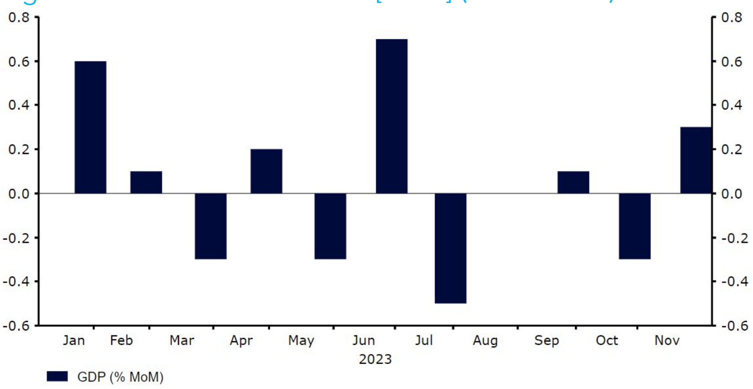
Source: LSEG Datastream Date: 15/01/2024



GBP

November GDP surprised to the upside last week, calming concerns over the possibility of a technical recession in Q4. The economy expanded by 0.3% month-on-month, following a contraction of the same magnitude in October. If the latest PMI data is anything to go by, another modest expansion in activity may be on the way in December, which would likely avoid the confirmation of a technical recession once the quarterly data is released in mid-February. The reaction in sterling to the data was subdued, however.

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



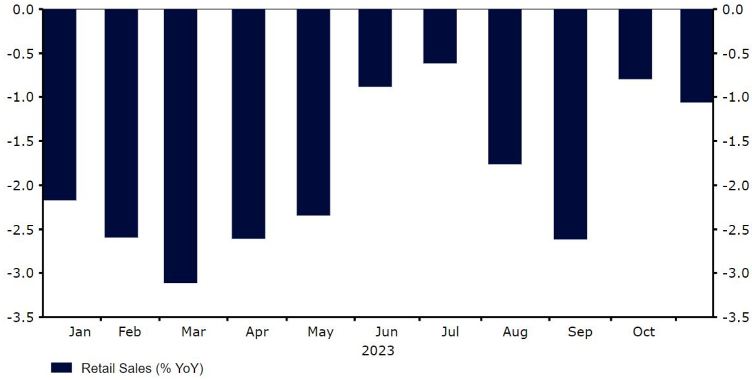
Source: LSEG Datastream Date: 15/01/2024

This week's data will test the Bank of England's recent hawkishness. In addition to the key December CPI inflation report, we will get November wage and December employment figures. While both wage and inflation numbers are expected to show a downward trend, they are both higher than in the Eurozone or the US. Core inflation is still hovering around 5%, and wages are growing at a near 7% rate, and we will have to see substantial reductions in both before the MPC is comfortable with the start of the cutting cycle.

EUR

Economic data out of the Eurozone is not improving and continues to tell a tale of a stalling economy, albeit this has not yet translated into layoffs and employment continues to hold up well. Last week's retail sales report was slightly stronger-than-expected, although we still saw a more than 1% annual contraction and a fourth quarterly downturn in activity in the past five months.

Figure 3: Euro Area Retail Sales (2022 - 2023)



Source: LSEG Datastream Date: 15/01/2024

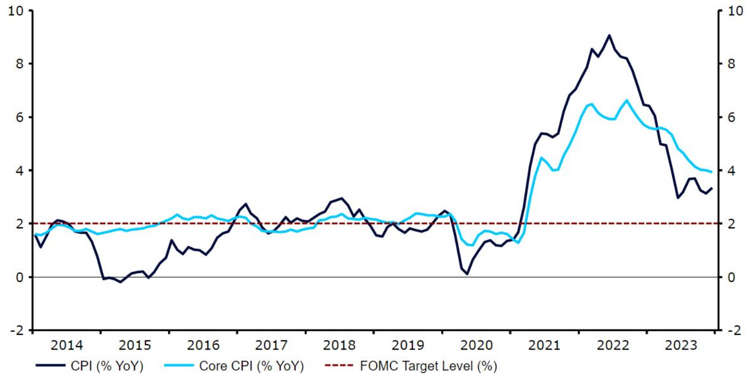
The hawkishness on display at the European Central Bank's December meeting is being diluted slowly by dovish noises coming from various members of the Council. This week's industrial production data for November is expected to be dismal, and more clarity on the ECB's plans should come from a barrage of ECB officials' speeches, including president Lagarde on Wednesday. The bank's latest meeting accounts should also shed some light on the December communications when released on Thursday.

USD

The modest upward surprise in the December CPI report did not sway markets to revise their expectations of a Federal Reserve cut as early as March. The key monthly increase in core prices seems to have stabilised at a level of just below 4%, which is too high for comfort and seems to confirm that the 'last mile' of the fight against inflation will be tougher than markets expect. By the end of the week, markets appeared to have almost completely forgotten about this upside beat, instead placing greater emphasis on the soft PPI inflation report, released on Friday.

High-frequency labour market indicators continue to suggest little or no loosening, and the most reliable indicators suggest that wages are growing at an above 5% rate amid solid growth and very tight labour markets. We continue to expect that hopes of a March rate cut will be dashed, and therefore think the dollar will stay well supported against European currencies in the short-term.

Figure 4: US Inflation Rate (2014 - 2024)



Source: LSEG Datastream Date: 15/01/2024

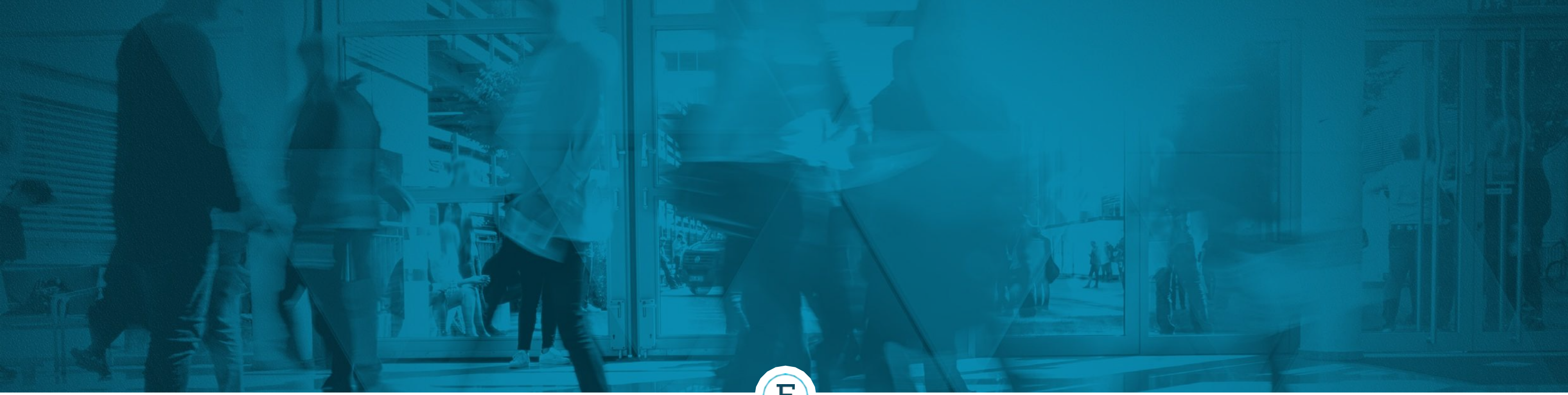
JPY

A disappointing set of domestic economic data sent the yen lower against the dollar once again last week, with the Japanese currency opening trading this week around the 145 level. Expectations for the first Bank of Japan interest rate hike have continued to be pushed further into the future amid signs of an easing in wage pressure and a drop in inflation. Last week's earnings data for November was a massive miss, with wages growing by only 0.2% year-on-year, the lowest rate since December 2021 and well below the +1.5% consensus.

Bank of Japan officials have placed heavy emphasis on earnings data in recent communications. The upcoming annual 'Shuntō' salary negotiations, which conclude in March, will be key in determining the timing of the first hike. As things stand, a strong wage negotiation will likely be needed to convince investors that tightening will commence soon, with swaps now assigning only around a one-in-three chance of a first move in April. National inflation data will be the focus this week, with the December data due on Thursday.

CHF

We recently said that it might be difficult for the franc to hold onto its gains and, indeed, the currency sold off last week and was among the worst performers among the G10 currencies. We continue to view the franc as expensive, and believe that more weakness could be in store in the coming quarters, particularly should the Swiss National Bank begin to shift its attention towards supporting the country's growth outlook.



We don’t view the recent uptick in inflation as something that could potentially prevent the SNB from delivering a dovish pivot, particularly as both measures of inflation remain firmly within target. The focus this week should be on external news, although Thursday's speech by SNB President Jordan in Davos will also be worth following.

AUD

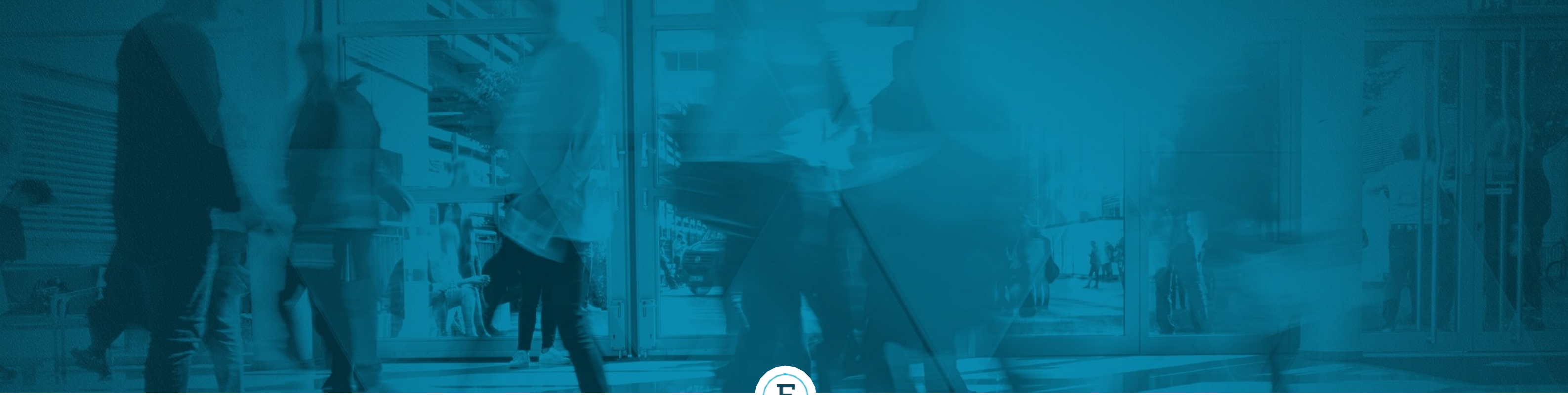
News out of the Australian economy last week was rather mixed, with strong consumer spending offset by soft import and inflation data. Retail sales smashed past expectations in November, growing by 2% MoM (+1.2% consensus), the strongest pace of expansion in two years. Trade balance data for December was encouraging on the face of it, although the sharp drop in imports pointed to weakness in domestic demand. Meanwhile, the November inflation print missed expectations, with price growth easing to 4.3%, from 4.9%.

All in all, the data doesn’t change things too much for the RBA, with the bank likely to remain on hold for the time being. Attention among market participants this week will shift to Thursday’s labour report. A more mild pace of net job creation is expected, with the unemployment rate set to remain unchanged below 4%.

NZD

We remain in the midst of a rather quiet period of macroeconomic news out of New Zealand, with no tier-1 reports out yet in 2024. The New Zealand dollar instead continues to trade on global risk sentiment and news out of China. The PBoC’s surprise decision to hold its 1-year MLF rate unchanged today has triggered a bout of selling in both AUD and NZD this morning, with the New Zealand dollar slipping to its lowest level since mid-December amid fears over the health of Asia’s largest economy.

Domestic activity should begin to pick up pace in the next few weeks, with a handful of economic data releases likely to ramp up volatility in the New Zealand currency. Q4 business confidence (Monday) and the December PMIs (Thursday) will be closely watched by investors. Market participants will also likely have one eye on next Tuesday’s Q4 inflation report, which will be key in determining the direction and timing of RBNZ interest rate changes in the coming few months.



CAD

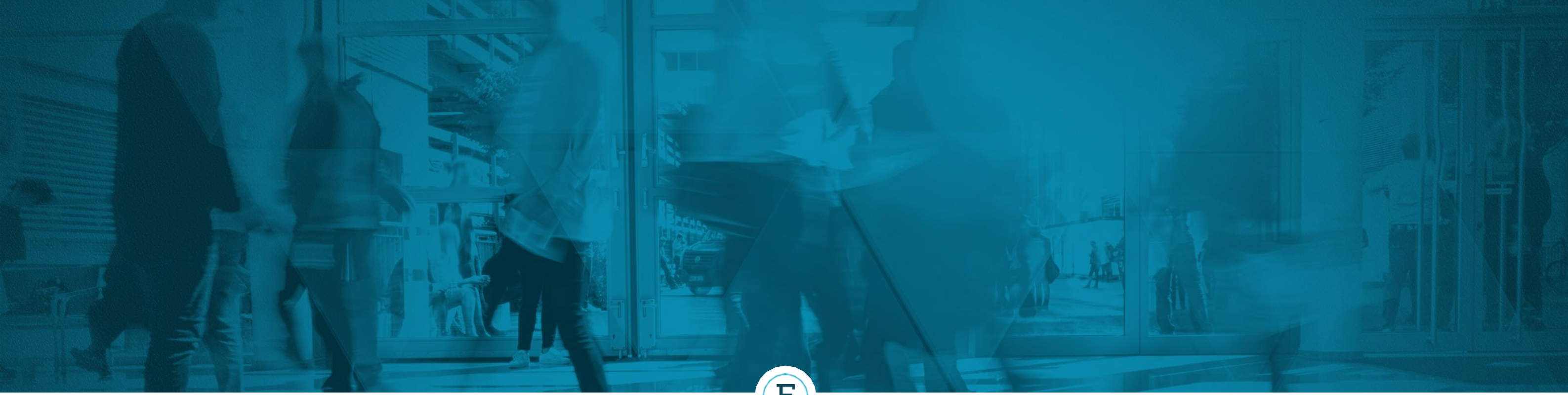
The Canadian dollar has continued to edge lower against its US counterpart since the start of the year, with the USD/CAD pair beginning the week around the 1.34 level, which is around its highest level since the middle of December. We are entering into a highly important couple of weeks for the Canadian dollar. Tuesday's inflation report will be a highly important one in guiding Bank of Canada interest rate expectations. Economists are pencilling in a monthly contraction in headline consumer prices (-0.3% consensus), which would be only the second negative print in the past year.

Retail sales data on Friday should also give policymakers a decent barometer as to how well consumer spending held up towards the end of last year, as we head into the January BoC meeting next Wednesday. No change in rates is seen, although the tone of the bank's communications will held investors gauge whether we can expect a first cut as early as April, which is currently more than fully priced in by swaps.

SEK

The EUR/SEK pair ended last week largely unchanged, although the krona did briefly slip to its lowest level on the euro since mid-December. Swedish activity data released last week was mixed. On the one hand, retail sales fell by 1.7% YoY in November, compared to a decline of 1% in the previous month, the nineteenth consecutive month of annual declines in retail trade. On the other hand, the more important GDP data unexpectedly rebounded in November (+0.2% vs. 0.6% consensus), easing fears that the ongoing recession could extend into Q4.

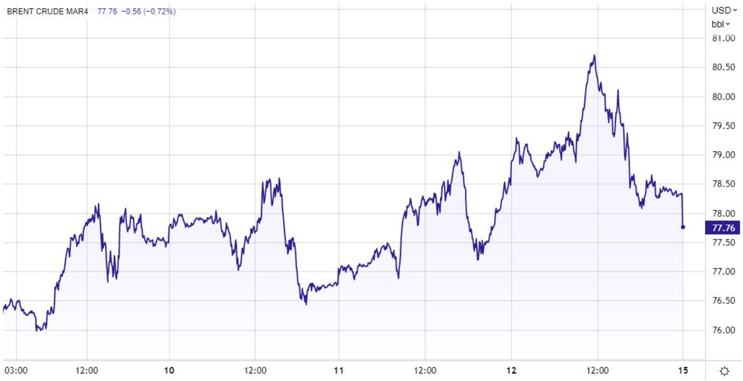
The above data imply a significant divergence from the Riksbank's forecast, which warned of an economic decline of 0.4%. This will undoubtedly be a relief for the Riksbank and should make for an easier task in controlling inflation without damaging the economy. If the good data materialises into a more hawkish stance by the central bank, the krona could receive some support.



NOK

The Norwegian krone appreciated against the euro last week, and was by far and away the best performer among the G10 currencies. We largely attribute this outperformance to the increase in global oil prices. Brent crude futures rose above the $80 a barrel level for the first time this year at one stage last week, which is clearly bullish for the Norwegian currency due to its dependence on the commodity.

Figure 5: Brent Crude Oil Futures (1 week)

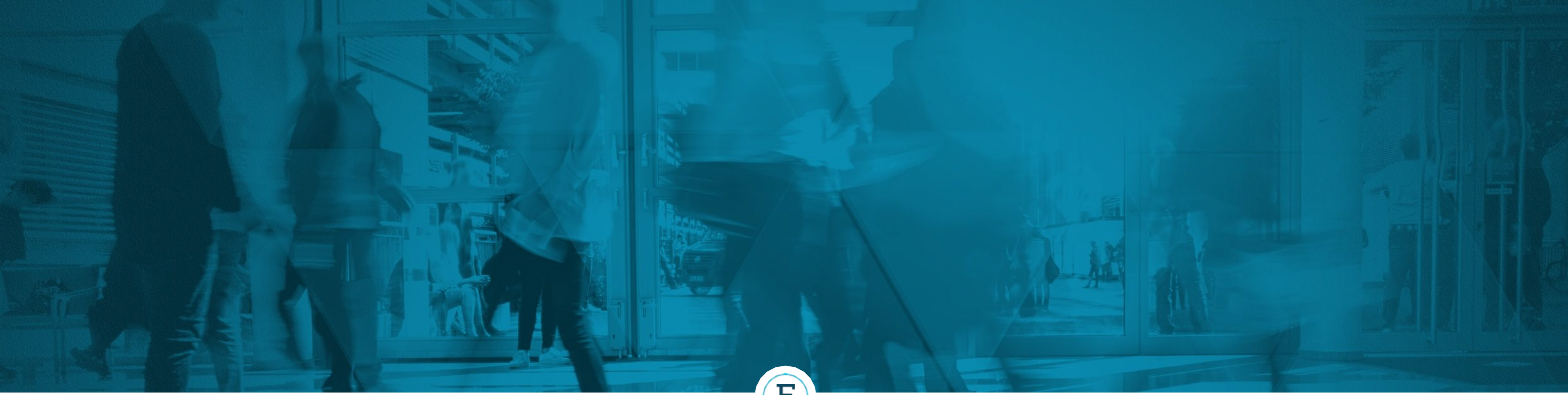


Source: LSEG Datastream Date: 15/01/2024

Wednesday's inflation data also provided some modest support for NOK, as this provided some support for the aggressive stance taken by Norges Bank. Headline inflation remained unchanged at 4.8% in December, remaining at its highest level in three months and in line with market expectations, while core inflation fell to 5.5%. Despite the drop in underlying inflation, it is still too high to be consistent with the central bank's target, supporting the notion that rates are likely to remain high for some time, as warned by Norges Bank in December.

CNY

The Chinese yuan remained under pressure last week and ended it slightly lower against the broadly stronger US dollar. Data confirmed that China experienced the longest deflationary period since 2009, registering three months of declining consumer prices in a row. In December, the CPI index fell by 0.3%. The fact that this was a smaller decline than the month previous (-0.5%), and slightly more limited than expected (-0.4%), has not allayed concerns about domestic demand. Most other releases, including PPI inflation and financial data, also failed to provide optimism, although trade activity did, at least, pick up at the end of the year.



Amid concerns about the economy's weak performance, the PBoC injected CNY 216 billion in fresh medium-term funds into the banking system today, but contrary to expectations it did not lower the 1-year MLF rate. Looking ahead, attention will be on the year-end data package to be released on Wednesday. GDP growth is particularly worth watching, as it could set the tone for sentiment toward China in 2024.

Economic Calendar (15/01/2024 - 19/01/2024)

Economic Calendar	Country	Day	Date	Time (GMT)
Inflation (Dec.)	SWE	Monday	15/01	07:00
Industrial Production (Nov.)	EZ	Monday	15/01	10:00
Employment Report (Nov.)	UK	Tuesday	16/01	07:00
Inflation (Dec.)	CAN	Tuesday	16/01	13:30
GDP (Q4)	CHN	Wednesday	17/01	02:00
Retail Sales (Dec.)	CHN	Wednesday	17/01	02:00
Inflation (Dec.)	UK	Wednesday	17/01	07:00
Inflation (Dec.)	EZ	Wednesday	17/01	10:00
Retail Sales (Dec.)	US	Wednesday	17/01	13:30
Employment Report (Dec.)	AUS	Thursday	18/01	00:30
Inflation (Dec.)	JPN	Thursday	18/01	23:30
Retail Sales (Dec.)	UK	Friday	19/01	07:00
Retail Sales (Nov.)	CAN	Friday	19/01	13:30

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