Weekly Report

G10 Weekly FX Update

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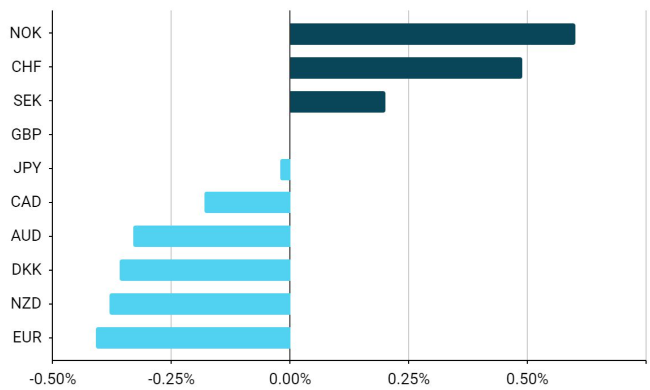
Dollar in waiting mode as traders seek resolution to their March cut dilemma

The ECB left its options open last week. This one will test our view that central banks in the US and the UK need more time before embarking on a rate-cut journey.

In spite of the ECB meeting and a flurry of economic activity data, the volatility in the FX market was relatively muted last week, with G10 currencies registering a maximum 0.6% change against the US dollar.

This week is set to be even busier in terms of economic releases and policy announcements. We would not be surprised to see some pick-up in volatility. On Tuesday, the attention will be on the Eurozone's fourth-quarter GDP data, which may seal the deal on technical recession. On Wednesday morning, market sentiment might be impacted by China's January PMI data. On Wednesday evening, all eyes will be on the Fed, and Thursday will belong to the Bank of England. On the same day, inflation data for the Eurozone will be out. Non-farm payroll report from the US will close this unusually busy week.

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

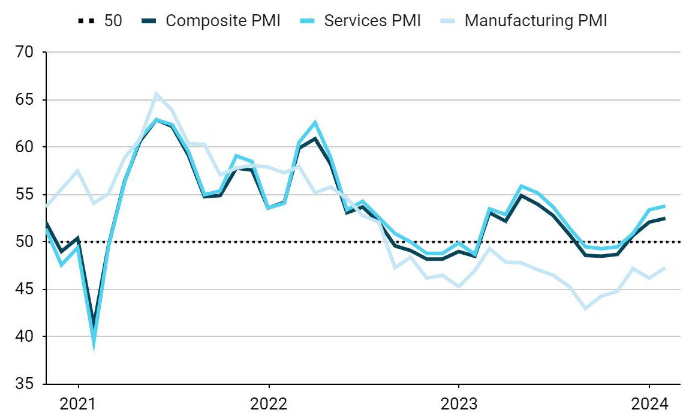


Source: Bloomberg Date: 29/01/2024

GBP

Sterling ended the week unchanged against the greenback and reached its strongest position since August against the broadly weaker euro. PMI data released last week provided for a good start to 2024, with all key indices increasing and composite PMI reaching 52.5, its highest level in eight months. This alleviates some concerns over the prospects of the British economy, which were recently reinforced by particularly bleak retail sales data for December. It also supports our belief that some forecasters may need to rethink their outlooks. This includes the Bank of England, which pencilled in 'broadly flat' growth for this year. It is also worth noting that, similarly to PMIs, GfK consumer sentiment data increased more than expected, with the index now at -19. Brits are still gloomy about their prospects, but the least gloomy they have been in two years. We suspect that progress on inflation, which helps to keep real wage growth back in positive territory and brings about prospects for lower interest rates, is indeed lifting moods. January's cut in national insurance costs must have also been welcomed by households.

Figure 2: UK PMIs (2020 - 2024)



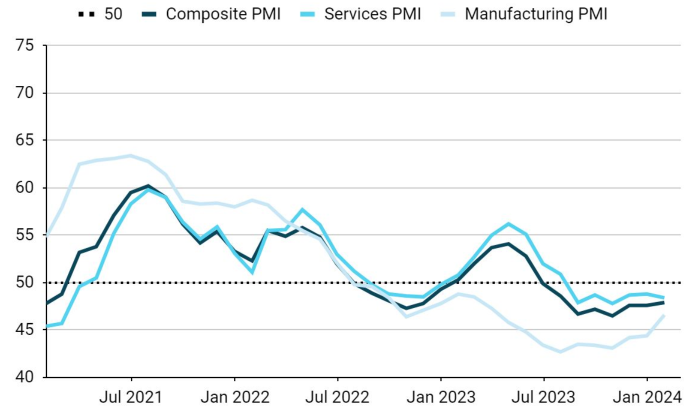
Source: Bloomberg Date: 29/01/2024

This week the focus will be squarely on the Bank of England. We think another 6-3 vote is likely and will be particularly attentive to how the bank handles communications around the possibility of further hikes and prospects for rate reductions. All in all, we think the Bank has valid reasons to lag behind its major peers in cutting rates this year and see the June MPC meeting as the earliest date for the beginning of its rate cut cycle.

EUR

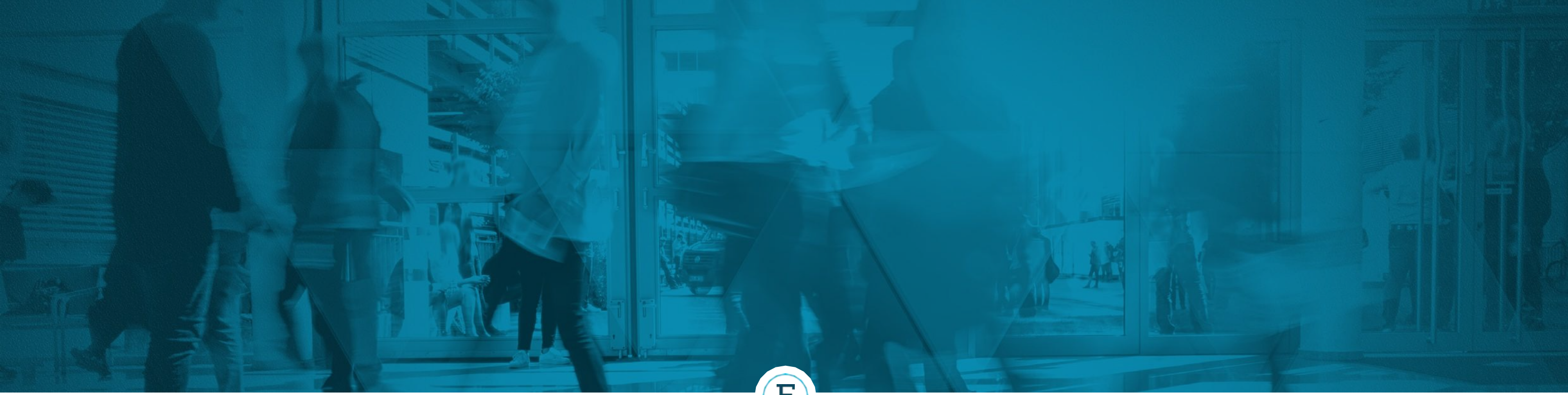
January PMI data was marked by dichotomies: a surprisingly sharp increase in manufacturing PMI was accompanied by a mild, yet unexpected drop in services index. Moreover, a poor showing in the Eurozone's biggest economies - Germany and France - contrasted with positive news from smaller ones. For the time being, the stagnation narrative continues.

Figure 3: Euro Area PMIs (2021 - 2024)



Source: Bloomberg Date: 29/01/2024

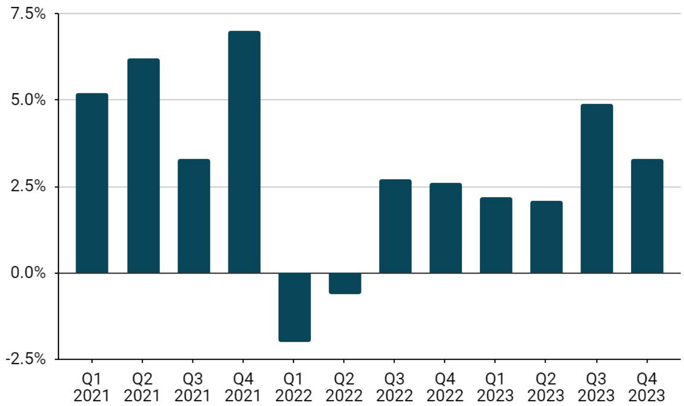
Turning to monetary policy, a lack of explicit pushback against market pricing for cuts from President Lagarde at last week's ECB meeting encouraged markets to ramp up their April rate cut bets. Unsurprisingly, the euro was dragged lower. Investors now see approximately 85% chance of such a move versus 65% prior to the meeting. We also see it as realistic but would be particularly attentive to signals on the inflation and labour market fronts in the period ahead. This week, the attention will be on the Q4 GDP data and the January inflation release. As for the former, the consensus is pencilling in a minimal contraction, sealing a technical recession. HICP data is set to be more pleasing to the eye, with progress on inflation expected to continue: both the headline and core measures should show declines.



USD

The US dollar index ended the week marginally higher, helped by strong economic data from the US and a weaker euro. Latest data surprised positively on nearly all fronts. Particularly worth noting was the upside surprise in the third quarter GDP growth, which showed the economy expanding by 3.3% annualised, far stronger than the 2.0% pencilled in by the consensus. A strong showing, including robust household spending, works to ease some concerns over the health of the US economy. A noticeable increase in both services and manufacturing PMI (with the latter unexpectedly jumping above the 50 mark, separating contraction from expansion) also suggests the slowdown in the US economy could be milder than thought.

Figure 4: US Growth Rate [% annualised] (2023 - 2024)



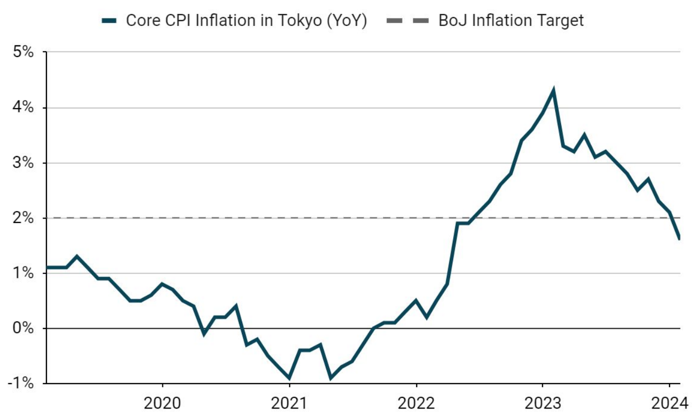
Source: Bloomberg Date: 29/01/2024

This good news, however, makes the job more difficult for the Federal Reserve. This week, the bank is expected to keep rates unchanged, with the market's attention focused primarily on signals regarding the prospects for cuts and, in particular, how realistic a move in March is. Given the strength of the US economy and the resilience of the labour market, where only modest easing is seen, we think the Fed should push back against market bets for imminent policy easing. A mild downward surprise in core PCE inflation from last week (2.9% vs. 3% expected) does not change this view. Given that markets are still pricing in a 50/50 chance of a first cut in March, we would expect the dollar's rally to continue if the decisionmakers pour cold water over prospects for such a move. Other than the Fed, the attention this week will focus on the January payrolls report, which is set to show a slight easing in the number of jobs created.

JPY

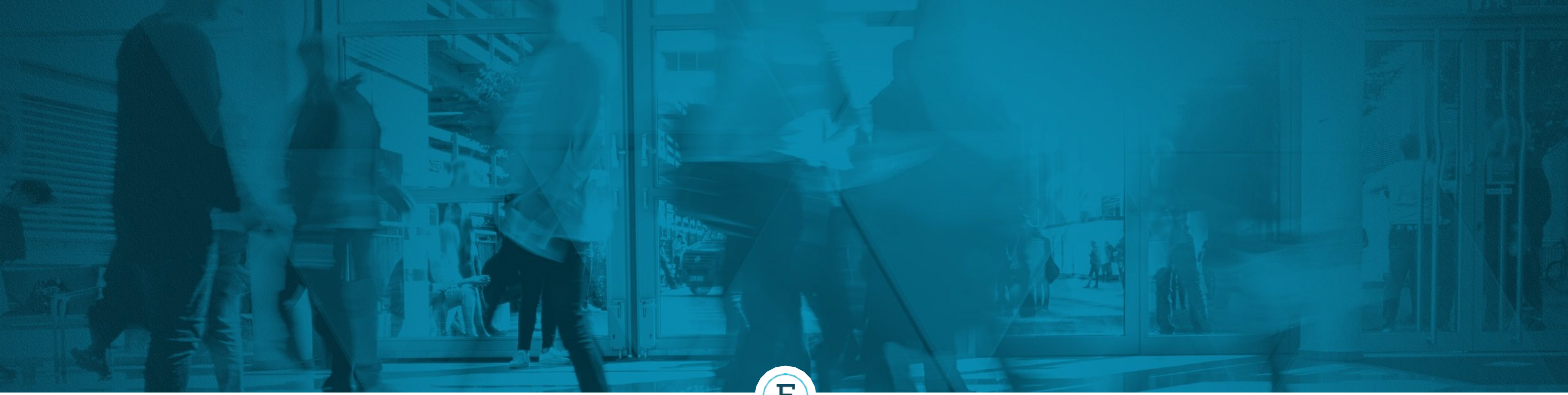
Yen's appreciation following the BoJ meeting proved short-lived, with the currency ending the week almost unchanged against the US dollar. Governor Ueda's tone on Tuesday was more hawkish than in December. Instead of stressing uncertainty, he signalled that the inflation target is approaching, mentioning the impact of higher wages on services costs. Should the wage-inflation cycle continue, the decisionmakers are set to examine the ultra-loose stance of the central bank, as he emphasised. Following the mild hawkish turn from the BoJ, markets have slightly ramped up their rate hike bets. A 10bps increase in April is now 70% priced-in as compared to 50% prior to the meeting. Their further increase seems to have been blocked by surprisingly soft inflation data from Tokyo. Core inflation in Japan's capital fell from 2.1% to 1.6%, below the 1.9% pencilled in by the consensus.

Figure 5: Tokyo Core CPI Inflation (2019 - 2023)



Source: Bloomberg Date: 29/01/2024

Similarly to markets, we continue to consider a move in April as realistic, particularly if the economic readings released in the meantime prove strong and we see further signs of a brawny labour market. There is plenty of data to look out for this week. The emphasis will be on the first half of the week when the labour market, retail sales and industrial production data for December will be out.



CHF

The franc recovered some of its earlier losses last week and secured a second spot in the G10 currency dashboard, trailing only the Norwegian krone. In his comments last week, SNB president Jordan reiterated that a stronger franc helped bring down inflation but acknowledged that an appreciation in the real effective exchange rate has been difficult for companies. At the same time, he confirmed that the bank does not pencil in a recession. Although this does not add much new context, any comments from SNB officials regarding the exchange rate should be closely watched, given the bank's move in the dovish direction and away from supporting the franc.

This week's economic calendar is looking particularly busy. The attention will be both on hard data, including trade (Tuesday) and retail sales (Wednesday), as well as more current and forward-looking indicators: the KOF index (Tuesday), forecasting the economy's direction in the next 6 months, and business activity PMIs (Thursday).

AUD

The Australian dollar traded sideways against the USD throughout last week, with mixed sentiments towards risk currencies, and speculation over the Fed's rate cut timing dominating the FX narrative. On the local front, the focus was on an increase in preliminary PMIs. Both manufacturing and services indices rose in January, with the former significantly beating consensus. The composite PMI covering both sectors jumped to the highest level since September, although remains in the contraction zone.

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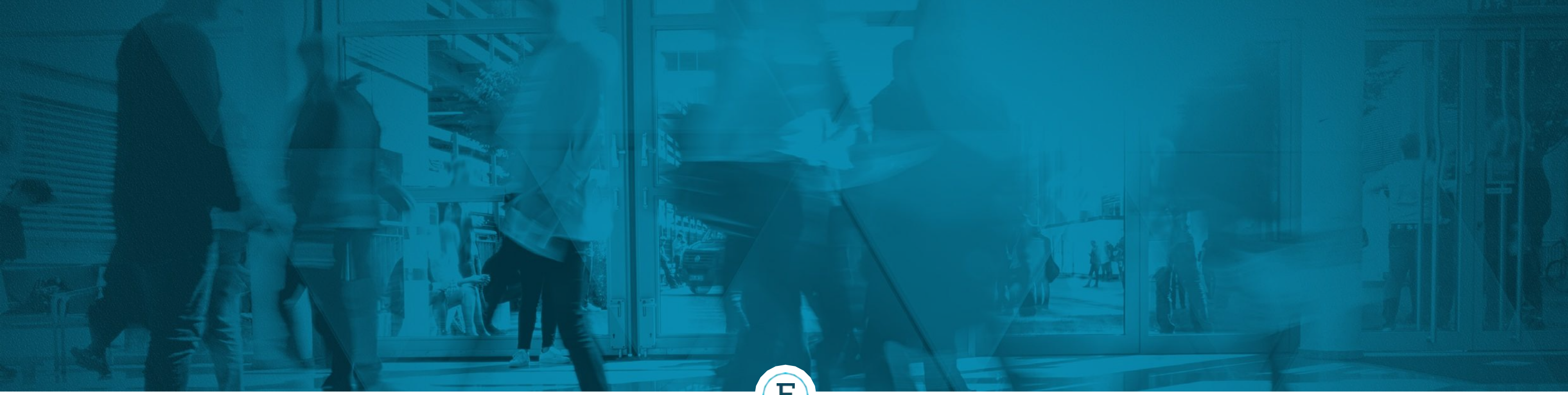
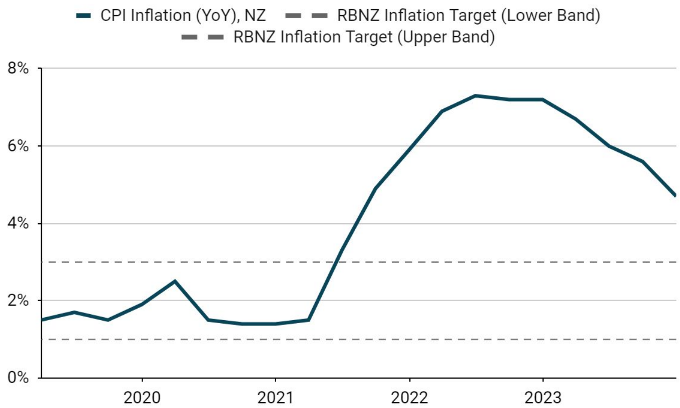


NZD

The Kiwi has weakened by nearly 0.4% against the dollar in the past week, finding itself near the bottom of the G10 table. We attribute the move mainly to global factors, in particular, the strength of the dollar - the key Q4 NZ inflation reading settled fully in line with expectations, placing at 4.7%. This is, admittedly, still significantly above the RBNZ's target (1-3%), looking at the quarterly rate (0.5%). However, we find definite grounds for optimism since it was the lowest rate since Q4 2020, and the annualised measure matches the bank's target.

Figure 5: New Zealand CPI Inflation (2019 - 2023)



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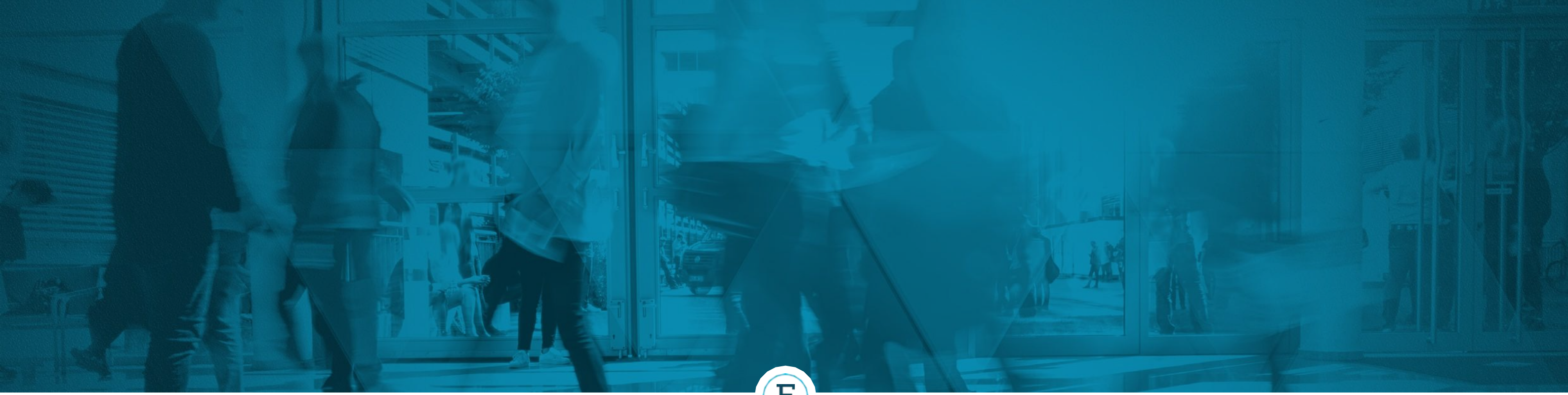
The coming days do not promise to be very exciting in terms of macroeconomic readings from the domestic market, with Wednesday's ANZ Business Confidence for January being the most compelling. Numerous important macroeconomic readings from major economies alongside the FOMC meeting could, however, trigger volatility in the currency.

CAD

The Canadian dollar fell to a one-month low against its US counterpart after last week's Bank of Canada's dovish pivot. The CAD has, however, recovered these losses, aided by higher oil prices.

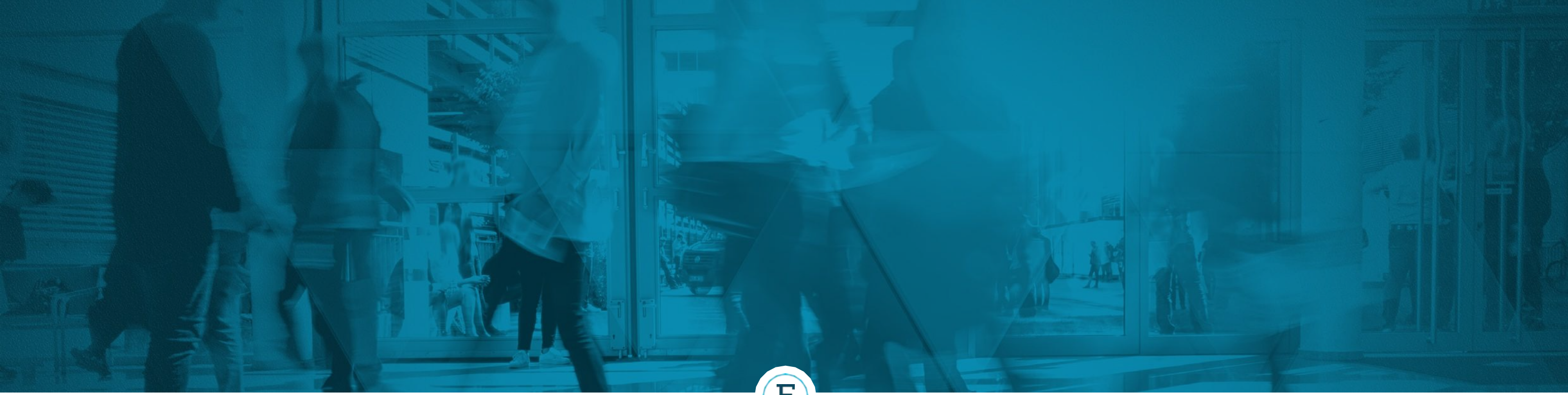


At its meeting last week, the Bank of Canada kept the overnight rate at 5% for the fourth consecutive meeting. We witnessed a visible shift in communications, which has bolstered market confidence that monetary policy easing is approaching. Statements from Governor Tiff Macklem and the accompanying press release made it clear that rates could not remain high for too much longer, especially given worries regarding growth prospects. Markets are currently pricing in a 55% chance of a first cut in April, yet we see the June meeting as a safer bet. Looking ahead, we believe there is room for the CAD to post gains against the US dollar. That said, recent dovish communications from the BoC make the Canadian currency less attractive. With no major data releases in Canada this week, the CAD should react primarily to changes in oil prices and events elsewhere, in particular, the Fed meeting on Wednesday.

SEK

The Swedish krona ended last week higher against the euro, a move that we attribute almost entirely to external factors, notably the somewhat more dovish than expected tone adopted by the European Central Bank at its first policy meeting of the year.

This week will be crucial for the Swedish currency, as the Riksbank will meet for the first time this year on Thursday. At the end of November, the bank unexpectedly kept rates unchanged at 4% (markets had expected a 25 basis point rise), the first pause after eight consecutive increases. The central bank admitted that although it was decreasing, inflation was still ‘too high’. Central bankers said monetary policy should remain contractionary, although it is now ‘appropriate to keep the policy rate unchanged’. Its last statement mentioned that the Riksbank ‘stands ready’ to raise rates further in the near future if the inflation outlook worsens. We believe, however, that economic weakness, together with the recent fall in inflation, could further dissuade policymakers from pushing interest rates into overly restrictive territory. The focus this week will, therefore, be on the bank's rhetoric: if it maintains a hawkish stance and again leaves the door open to further tightening at a time when almost all other central banks have effectively signalled an end to tightening, the krona could receive support. Conversely, if the central bank takes a dovish turn, in which it acknowledges the recent moderation in inflation and the weakness of the economy, suggesting that the tightening cycle has come to an end, we could see a depreciation of the Swedish currency.



NOK

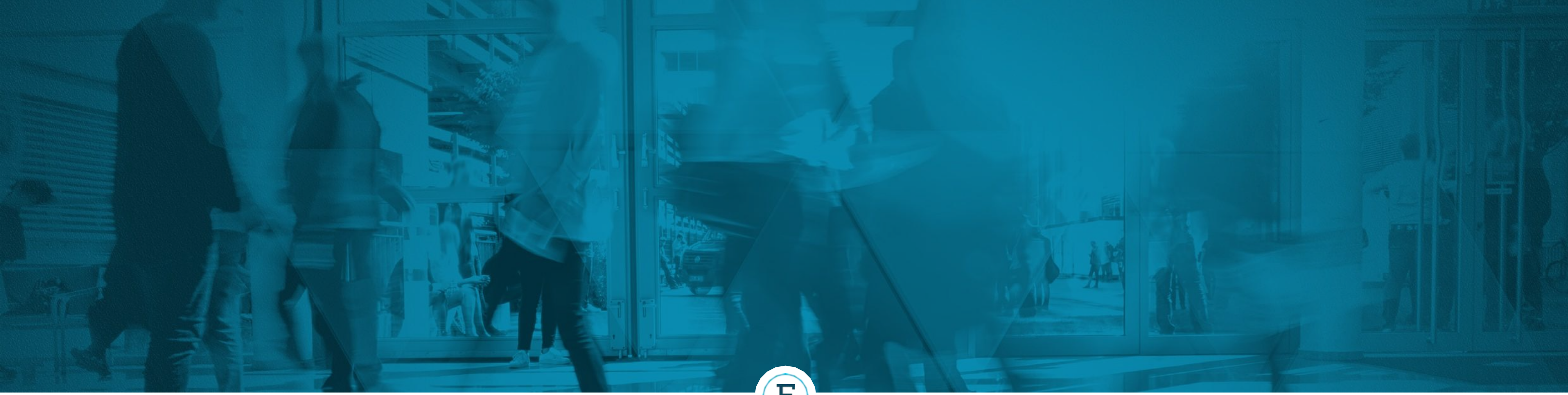
The recent rise in oil prices, which has pushed Brent crude to its highest level in three months, and the aggressive stance taken by Norges Bank supported the Norwegian krone last week.

At its meeting last week, the Norges Bank affirmed its hawkish pivot by keeping the policy rate and guidance unchanged. The bank said that interest rates are now sufficiently high to return inflation to target within a reasonable time horizon. It also acknowledged that the monetary policy is having a tightening effect and the economy is cooling down. What is more, the policymakers mentioned that wage growth remaining at elevated levels and the weakness of the krona are likely to slow the disinflationary process. Therefore, the bank reaffirmed its view that interest rates need to stay high for some time. We expect Norges Bank to keep them unchanged level for a prolonged period, which should be a clear positive for the currency at a time when most other major central banks are preparing to move towards cutting rates.

CNY

Last week brought a long-awaited rebound in sentiment towards Chinese assets. The rally included the Chinese yuan, which outperformed the vast majority of its EM peers and ended higher against the US dollar. The revival in asset prices followed a combination of news pointing to increased authorities' support for the equity market and the economy at large. Bloomberg reported that engaging about 2 trillion yuan in mostly offshore money to prop up stocks is being considered, which was particularly well-received by investors. It was followed by a series of announcements from authorities, the biggest one being an unusual announcement by Pan Gongsheng. who informed the public that the PBOC will slash the banks' reserve requirement ratio (RRR) by 50bps from the 5th of February, freeing up 1 trillion yuan in long-term liquidity.

Macro-wise, last week did only bring industrial profits data, which showed a 2.3% contraction in 2023, marking the second straight year of declines. Looking ahead, attention will be on January PMI data, which may extend - or break - the improvement in sentiment towards Asia's largest economy. NBS PMIs are set to be published on Wednesday, with manufacturing Caixin PMI out on Thursday.



Economic Calendar (29/01/2024 - 02/02/2024)

Economic Calendar	Country	Day	Date	Time (GMT)
Unemployment Rate (Dec)	JP	Monday	29/01	23:30
Retail Sales (Dec)	AU	Tuesday	30/01	00:30
GDP (Q4)	EZ	Tuesday	30/01	10:00
Inflation (Q4)	AU	Wednesday	31/01	00:30
NBS PMIs (Jan)	CN	Wednesday	31/01	01:30
FOMC Monetary Policy Meeting	US	Wednesday	31/01	19:00
FOMC Press Conference	US	Wednesday	31/01	19:30
Caixin Manufacturing PMI (Jan)	CN	Thursday	01/02	01:45
Riksbank Monetary Policy Meeting	SE	Thursday	01/02	08:30
Preliminary Inflation (Jan)	EZ	Thursday	01/02	10:00
BoE Monetary Policy Meeting	UK	Thursday	01/02	12:00
NFP Report (Jan)	US	Friday	02/02	13:30

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