Ebury What borders?®

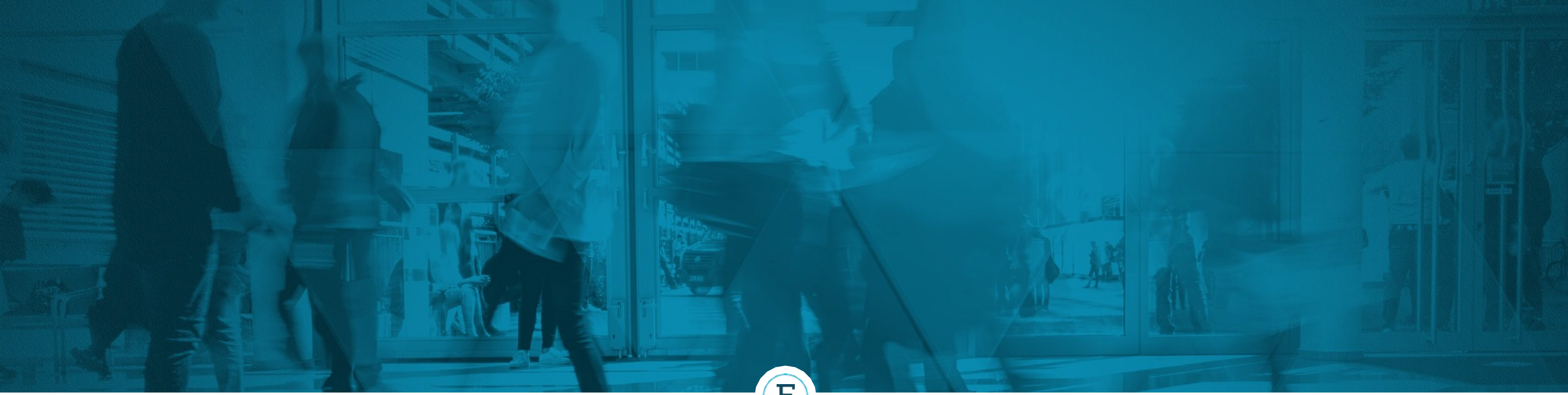
Weekly Report

G10 Weekly FX Update

Written by:

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

5th February 2024



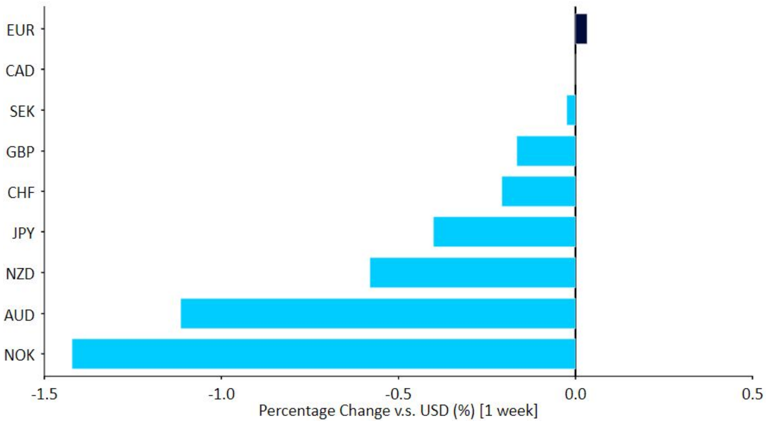
Dollar grinds higher as strong US economy widens gap with Europe

The dominant theme in currency markets in 2024 has been US economic strength, which is forcing markets to push back the timing of Federal Reserve rate cuts and is helping the dollar unwound most of the losses it suffered in late-2023.

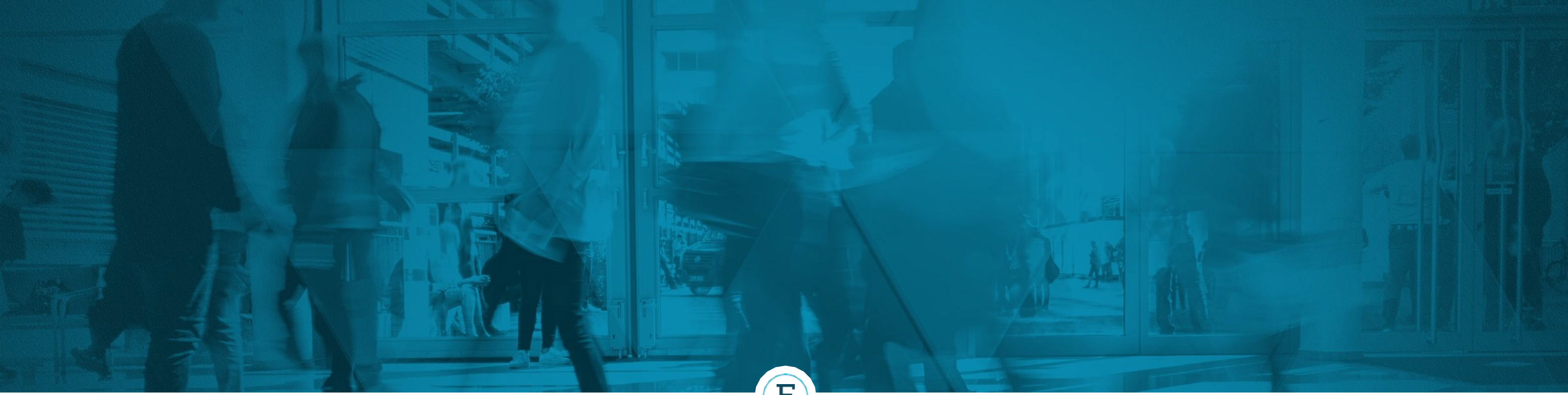
Last week did not buck the trend. While the Fed January meeting did not move currency markets much, a blowout labour market report out of the US forced interest rate traders to push back the timing of the first cut from March till May. The fact that this economic strength is not matched elsewhere in the world is fueling the dollar rally, which rose last week against most major currencies, including all of those in the G10.

This week is exceptionally light in terms of both major data releases and monetary policy events in the main economic areas. The aftermath of last week's Fed hawkishness, and evidence of an accelerating US economy, may keep most world currencies on the back foot against the US dollar, as we await the all-important inflation number from the various economic areas in mid-February. We maintain that these data points continue to be the key to medium-term currency movements.

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



Source: LSEG Datastream Date: 05/02/2024

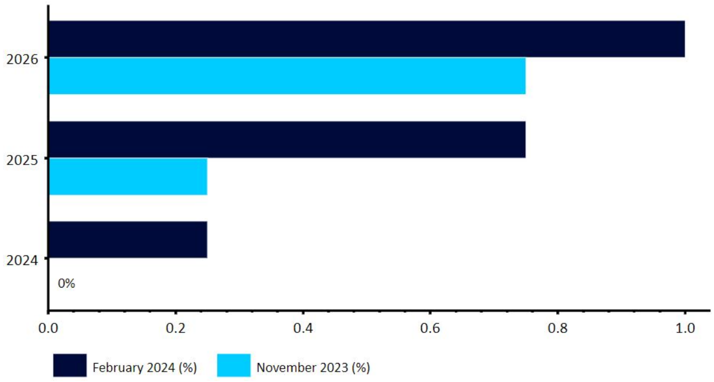


GBP

The Bank of England's Monetary Policy Committee edged slightly closer to a dovish stance last Thursday, as one member shifted from voting to a hike to a neutral stance, and another from neutrality to voting for a cut. However, the consensus position at the MPC is that while rates have reached their cycle high, there is little appetite for immediate cuts and the first cut will not come before the summer at the earliest. The growth forecasts were also revised upwards, with the bank saying that UK inflation would pick-up again after the second quarter.

Meanwhile, sterling continues to benefit from the highest short-term rates in the G10, as well as the modestly better economic data that we are seeing recently, at least compared to other European countries. Next week's fourth quarter GDP data will be interesting in this regard, as there remains a very reasonable chance that we could see the confirmation of a technical recession.

Figure 2: BoE GDP Projections [February 2024]



Source: LSEG Datastream Date: 05/02/2024

EUR

Data last week confirmed that the economy of the Eurozone as a whole stalled both in the last quarter of 2023 and for the entire year, though it managed to avoid a technical recession. Inflation in January continued its downward trend, albeit the core number came in slightly above market expectations.

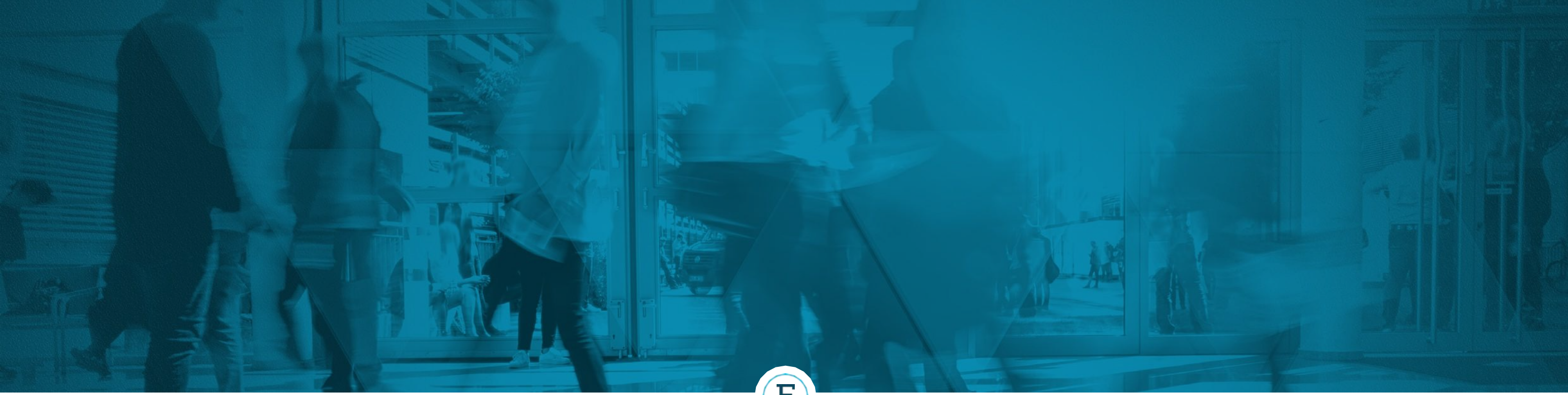
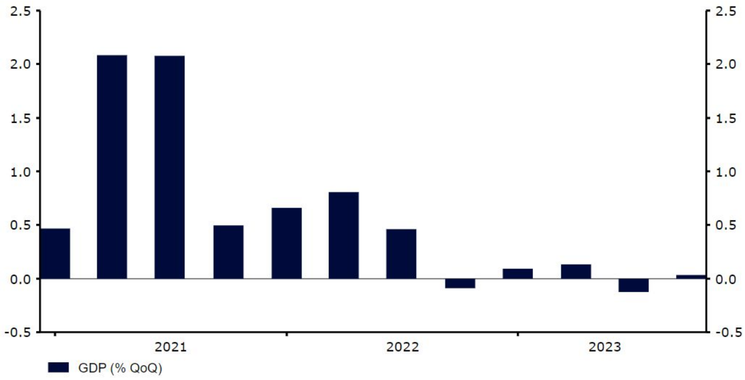


Figure 3: Euro Area GDP Growth Rate (2021 - 2023)



Source: LSEG Datastream Date: 05/02/2024

Overall, and absent an unexpected rebound in inflationary pressures, we think it is likely that the European Central Bank will cut rates ahead of the Bank of England and the Federal Reserve, though probably not till April. Swap markets are largely in agreement, with an April cut roughly two-thirds priced in. Focus this week will be on the latest PMI numbers (Monday), followed by December retail sales (Tuesday) and speeches from ECB members, including chief economist Lane, on Thursday.

USD

The dollar rallied only modestly after Wednesday's Fed meeting, in spite of Chair Powell's strong pushback against market timing for interest rate cuts. While the statement removed the line that further hikes may be needed, it also stressed that additional evidence would be needed on inflation. During his press conference, Powell also said that a March rate cut was unlikely, signifying an unusually explicit piece of forward guidance.

However, the blowout January labour market report, with strong rebounds in job creation and wages and a fresh drop in the unemployment rate, finally forced traders to pare back to near zero the chances of a March cut and send the dollar higher. This week we could see some fireworks when the scheduled revisions to past CPI data to be released Friday.

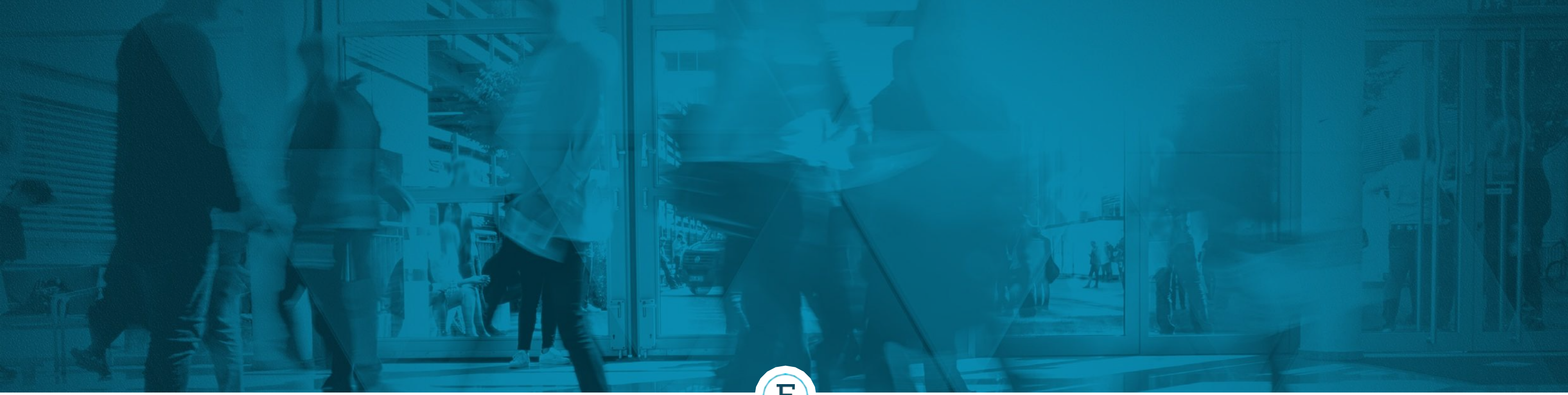
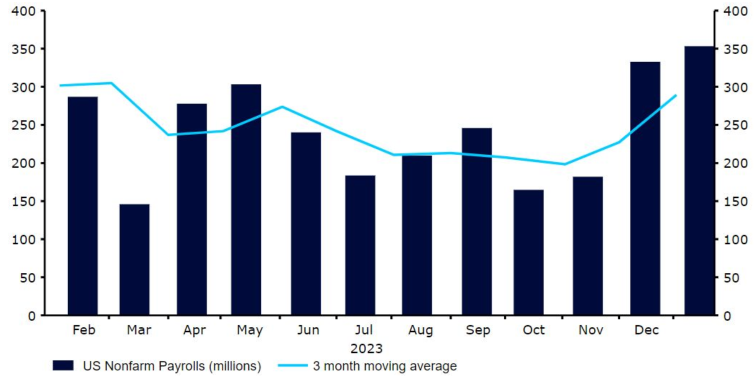


Figure 4: US Nonfarm Payrolls (2023 - 2024)



Source: LSEG Datastream Date: 05/02/2024

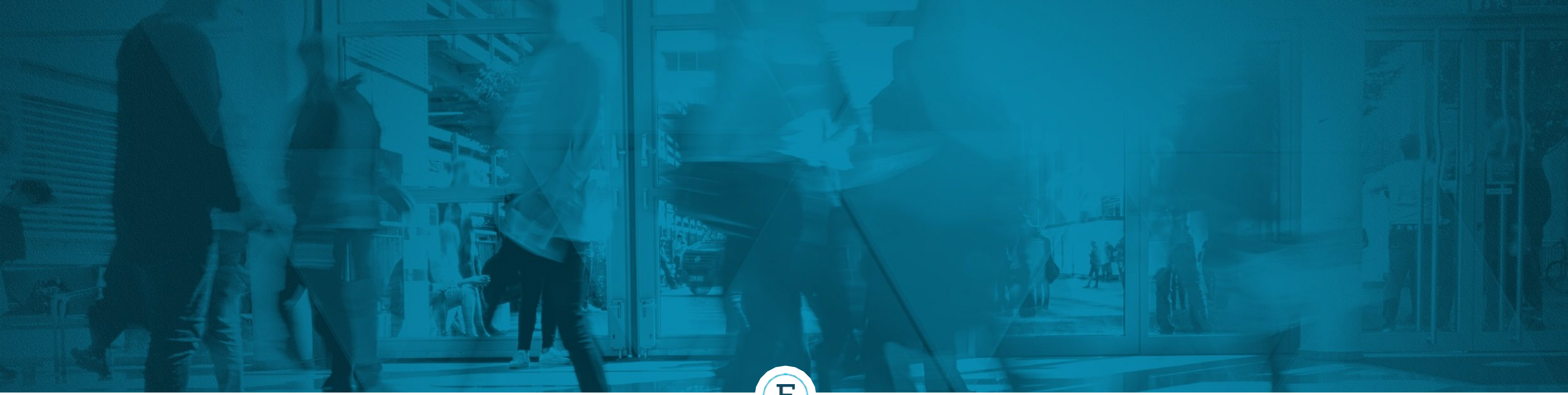
JPY

The yen received some support last week following the release of the latest Bank of Japan meeting minutes, as policymakers continued to lay the groundwork for the start to rate hikes later in the year. One member noted that conditions for an end to the negative rate policy was already being met, while there were suggestions that the impact from the New Year's Day earthquake would be limited. The minutes also noted that discussions were being had on the process for ending the current accommodative stance.

All signs suggest that us that a first rate hike as soon as the BoJ's April meeting remains a very real possibility, with this now roughly 70% priced in by markets. But, the bank will need to be confident of an acceleration in wages before then. The annual 'Shunto' wage negotiations have commenced, and members may receive news on these salary negotiations in the next couple of weeks.

CHF

The franc extended its gains against the euro and outperformed most of its G10 peers last week. Domestic economic data released recently has come in mixed. The jump in the KOF index to 101.5 in January, its highest level since April 2022, contrasted with the rather disappointing January PMI and December retail sales data. The latter confirmed a decline in the real volume of retail sales in 2023.

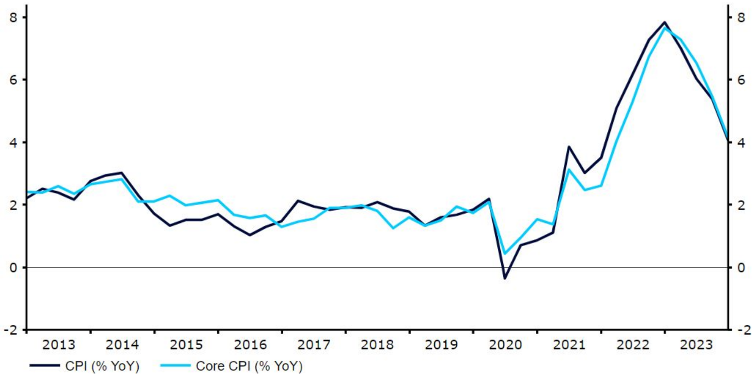


In essence, consumption still appears weak and activity in manufacturing and services highly divergent, albeit the jump in the KOF index suggests that investors should have some optimism about the future. With little news on the domestic economic front this week, investors are likely to focus on external news.

AUD

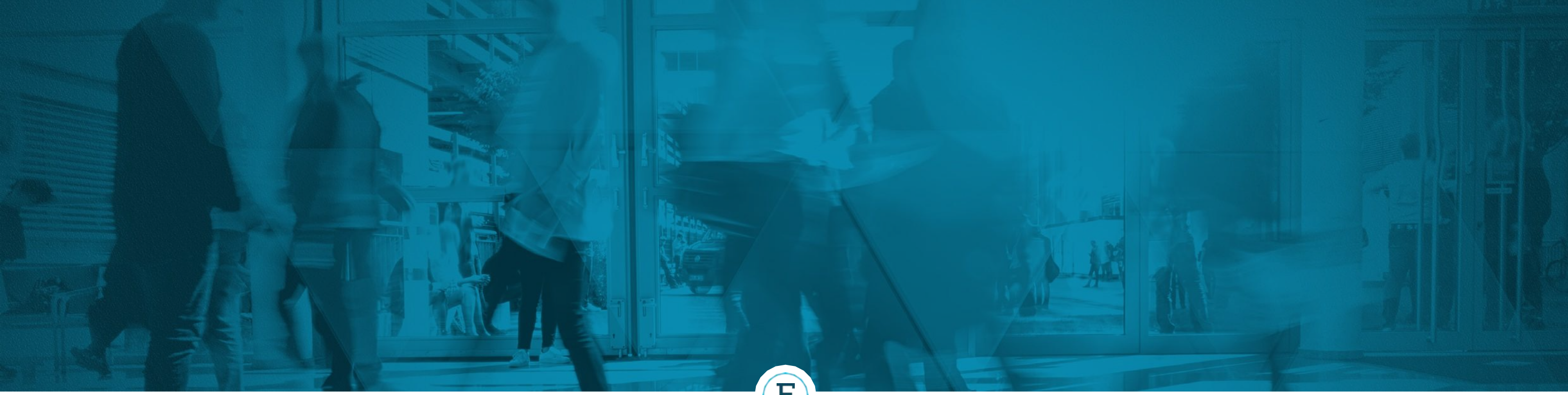
The Reserve Bank of Australia will be announcing its latest policy decision on Tuesday. There will be no change in rates, with attention firmly on the bank's communications. Last week's Q4 inflation data came in below the market's expectations (4.1% vs. 4.3% consensus), and it will be interesting to see whether RBA members comment on this surprise, and note whether it raises the likelihood of a return to the 2% target by year-end. Recent activity data has also been on the soft side, while the December employment change number was nothing short of disastrous.

Figure 5: Australia Inflation Rate (2013 - 2023)



Source: LSEG Datastream Date: 05/02/2024

Should governor Bullock express confidence on inflation, and deviate from her recent hawkish stance, then we could see a bit of weakness in AUD this week. As things stand, markets are not pricing in the first RBA rate cut until August. But this is almost entirely speculation, as the bank has given no real indication as to whether and when it will begin easing policy.



NZD

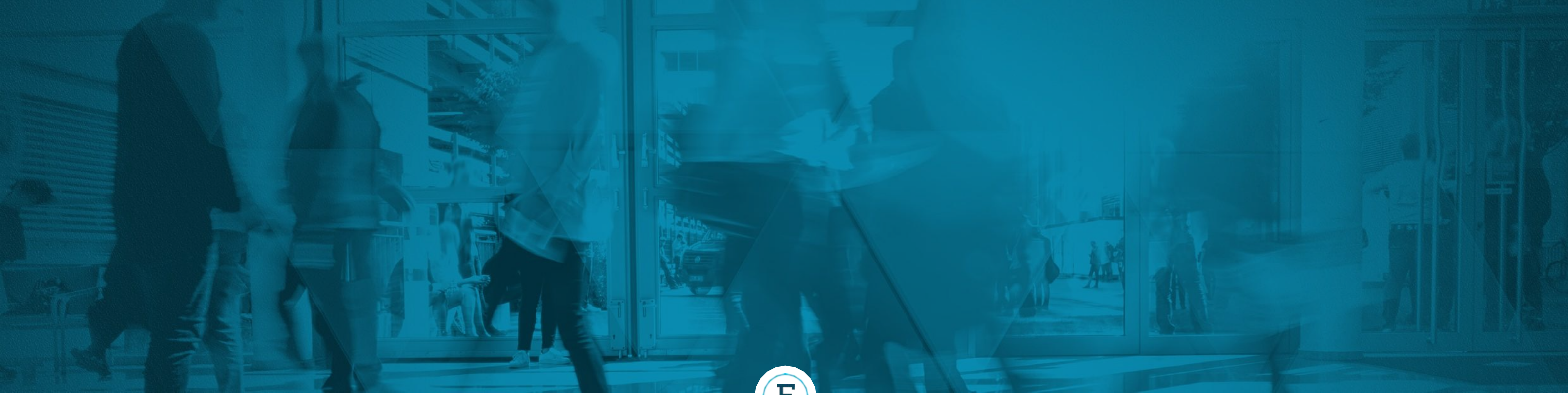
The New Zealand dollar slightly outperformed its Australian peer last week, albeit it still lagged behind most G10 currencies as investors re-evaluated their stance on a March rate cut from the Fed. Unlike last week's Australian inflation data, the Q4 CPI data out of New Zealand printed in line with expectations. Economic data out of New Zealand, in general, has been reasonably solid of late, which may encourage policymakers at the RBNZ to stick by their hawkish bias for a little while yet.

This Tuesday will see the release of the latest employment report for Q4. Economists are expecting a relatively sharp jump in the jobless rate to 4.3% (from 3.9%), although employment is seen rebounding following the contraction in Q3.

CAD

As tends to be the case, the Canadian dollar closely tracked its US counterpart last week, ending trading on Friday up on almost all of its major peers. Macroeconomic news out of Canada was largely encouraging last week, which likely helped CAD on its way upwards. While running on a lag, the November GDP report beat consensus, with the economy expanding by 0.2% on the month, which was double the consensus. The manufacturing PMI also picked up from the month previous, albeit remained in contraction at 48.3.

This week could be an important one, with PMI data to be followed by a speech from Bank of Canada governor Macklem on Tuesday. Friday's labour report for January will also be closely watched. Following the near flat month of job creation in December, markets are eyeing a solid rebound in employment, and a modest increase in the unemployment rate. The latest wage number will also likely be key, given its implications for domestic inflation.



SEK

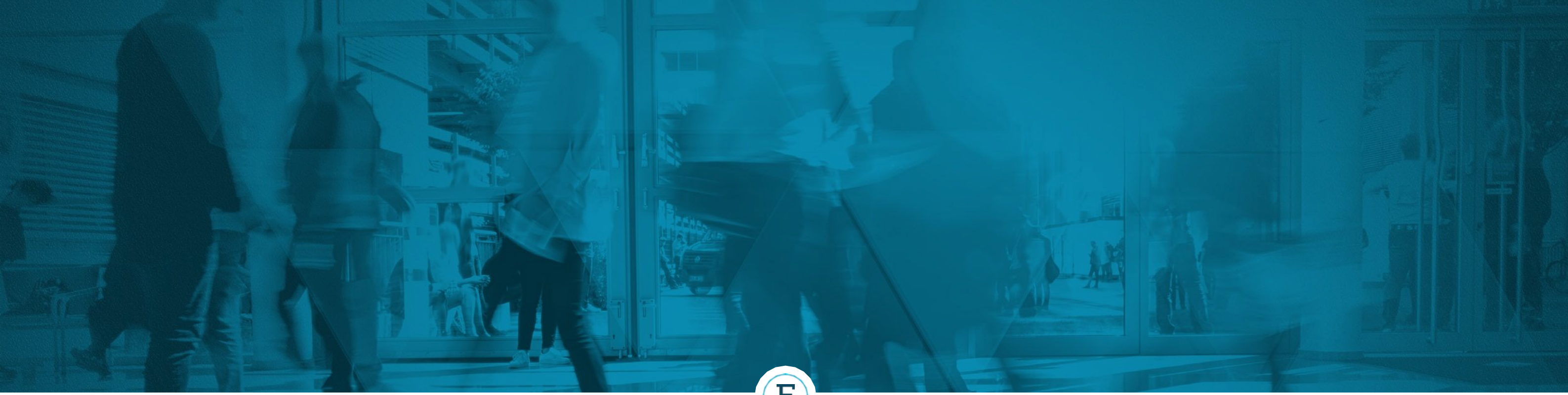
Despite some volatility during the week, the Swedish krona ended the week virtually unchanged against the euro. The key event of the week was undoubtedly last Thursday's Riksbank meeting. Although the Riksbank made a moderate U-turn, opening the door to a first rate cut before the summer, the krona did not suffer much.

As expected, the Riksbank kept rates unchanged at 4% at its first meeting of the year. It did, however, raise the possibility of a cut in the near future, stating that this is an option that "cannot be ruled out for the first half of the year as the inflation outlook remains favourable". In its statement, the Riksbank made it clear that inflation "remains too high and there are serious risks of a rebound" and that "contractionary monetary measures are still necessary to stabilise inflation around the target level". This signifies that the hiking cycle has come to an end, and that the next move in rates will be downwards. The Riksbank's more moderate stance could weigh on SEK, particularly relative to its Norwegian counterpart, as Norges Bank has recently affirmed its hawkish stance.

NOK

The Norwegian krone depreciated sharply last week and is trading near its lowest level since mid-December. Oil prices fell from three-month highs last week and Brent crude closed the week down 7%, due to concerns on both the demand and supply fronts. As the Norwegian economy is closely linked to oil production this weighed on the Norwegian currency.

This week could see some volatility in the EUR/NOK pair as Friday sees the release of the Norwegian inflation data for January, a key data to determine the Norges Bank's next steps. The consensus expects both the headline and core indices to decline, although they will still remain at levels inconsistent with the central bank's targets. At its latest meeting, the Norges Bank affirmed its hawkish pivot, saying that rates need to stay high for some time. Unless we see a very significant drop in inflation, we expect Norges Bank to keep interest rates high for a prolonged period, which should be clearly positive for the currency at a time when most other major central banks will ease monetary policy at a rapid pace.



CNY

Despite pressure from the stronger US dollar and a sell-off in Chinese assets, the yuan ended the week only marginally weaker against the greenback. To some extent, this can probably be attributed to dollar selling by major state-owned banks, which were active in the market to support the currency on Wednesday, according to Reuters sources. The retreat from a weaker yuan is also evident in stronger PBOC fixings.

China's Evergrande saga moved closer to the end last week with the Hong Kong court ruling on the liquidation of the company, which has become a symbol of the country's real estate crisis. Markets are still waiting for any headlines that might offer hope of an upturn in the sector, but for now, it remains in a dire place. Recent developments on economic activity suggest that things have not changed much this year, with both the official and Caixin PMI indices remaining close to December levels. In summary, the manufacturing sector is still in or on the verge of contraction, while services activity, although in expansion, is not particularly impressive. Looking ahead, it will be worth keeping an eye on January's inflation figures, which will be published on Thursday, expected to show a fourth month of falling consumer prices.

Economic Calendar (05/02/2024 - 09/02/2024)

Economic Calendar	Country	Day	Date	Time (GMT)
Caixin Services PMI (Jan.)	CHN	Monday	05/02	01:45
ISM Services PMI (Jan.)	US	Monday	05/02	15:00
RBA Monetary Policy Meeting	AUS	Tuesday	06/02	03:30
Retail Sales (Dec.)	EZ	Tuesday	06/02	10:00
Unemployment Rate (Jan.)	SWI	Wednesday	07/02	06:45
Inflation (Jan.)	CHN	Thursday	08/02	01:30
Inflation (Jan.)	NOR	Friday	09/02	07:00
Employment Report (Jan.)	CAN	Friday	09/02	13:30

Ebury

100 Victoria Street, London SW1E 5JL

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

The information contained herein is for informational purposes only. They do not constitute financial advice or any other advice, are general in nature and are not intended for a specific addressee. Before using the information for any purpose you should seek independent advice. Ebury is not responsible for the consequences of actions taken based on the information contained in the report.