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Weekly Report

G10 Weekly FX Update

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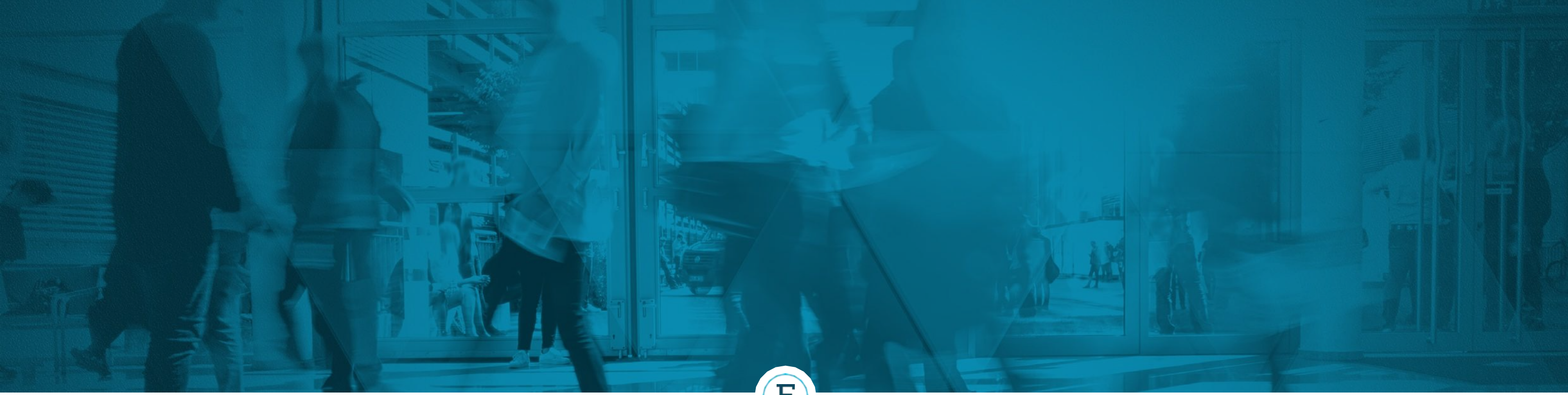
12th February 2024



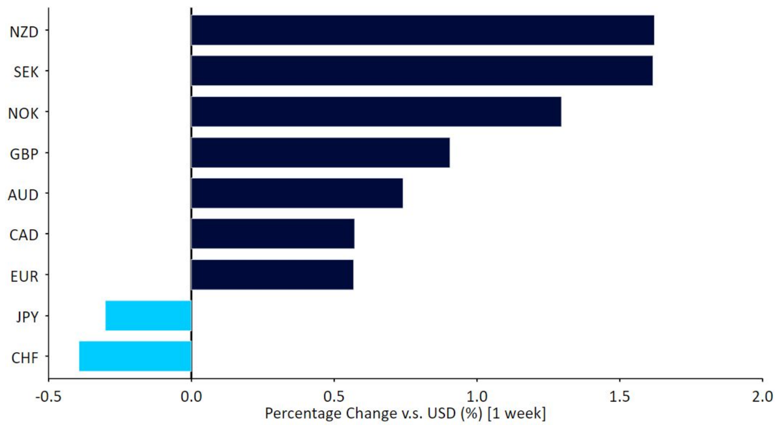
Safe haven currencies suffer as investor flock to risk assets

Markets continue to celebrate the apparent defeat of inflation by sending stock markets worldwide to fresh all-time highs.

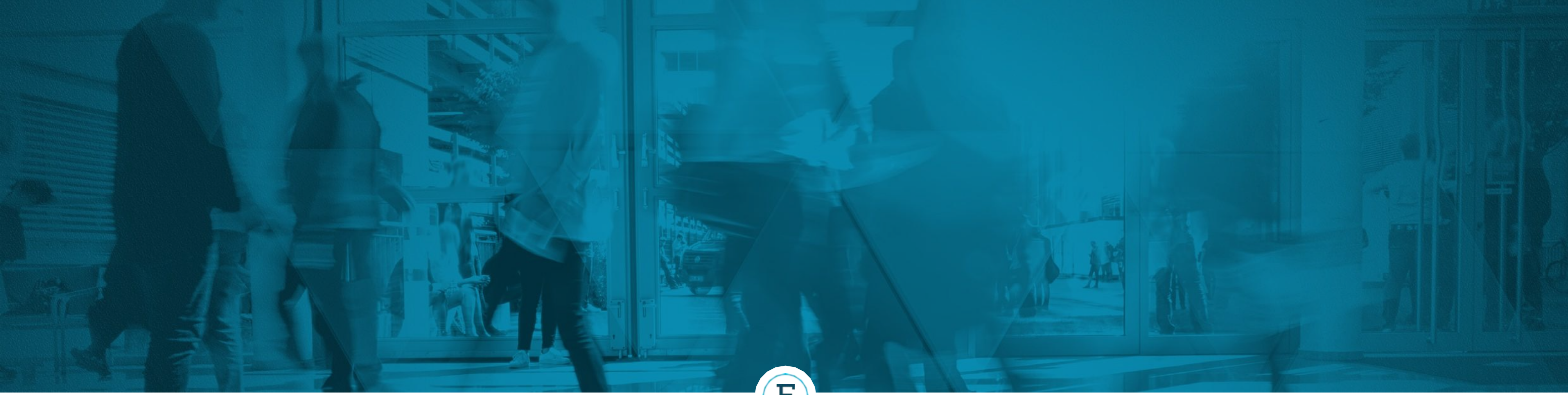
Last week, commodity and emerging market currencies joined the party, and traditional safe-havens like the Japanese yen, the Swiss franc and (this time) the dollar suffered, while the New Zealand dollar topped the table of world currencies. The celebratory mood in financial markets is all the more remarkable given that Federal Reserve cuts continue to be pushed back into the future.

This week will be all about inflation. The US inflation report is now the most important single economic release worldwide, and the January data to be released this Tuesday will be the main market focus this week, followed by the equivalent UK report the following day. In keeping with the theme that the 'last mile' in the inflation fight will be the hardest, markets are expecting a monthly print in the critical US core sub index consistent with inflation in a 3.5-4% annualised range. Expect serious fireworks in financial markets in response to any meaningful surprise.

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



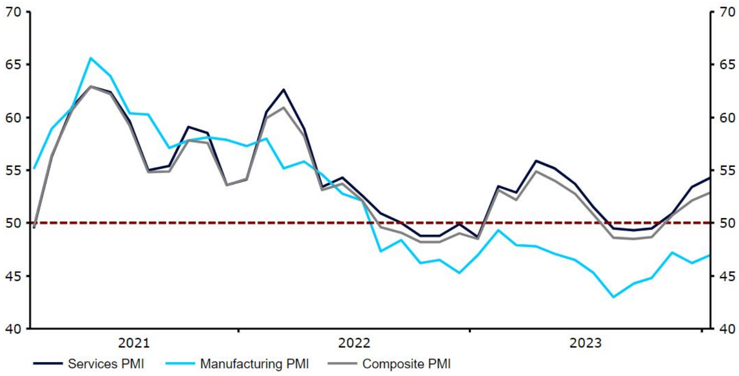
Source: LSEG Datastream Date: 12/02/2024



GBP

Sterling reacted positively to the risk-seeking mood in markets last week, and a decent upward revision to the January PMIs of business activity didn't hurt either. The better than expected tone in economics news, and the highest rates in the G10, have propelled sterling to the second position in the G10 year-to-date rankings, behind only the US dollar.

Figure 2: UK PMIs (2021 - 2024)



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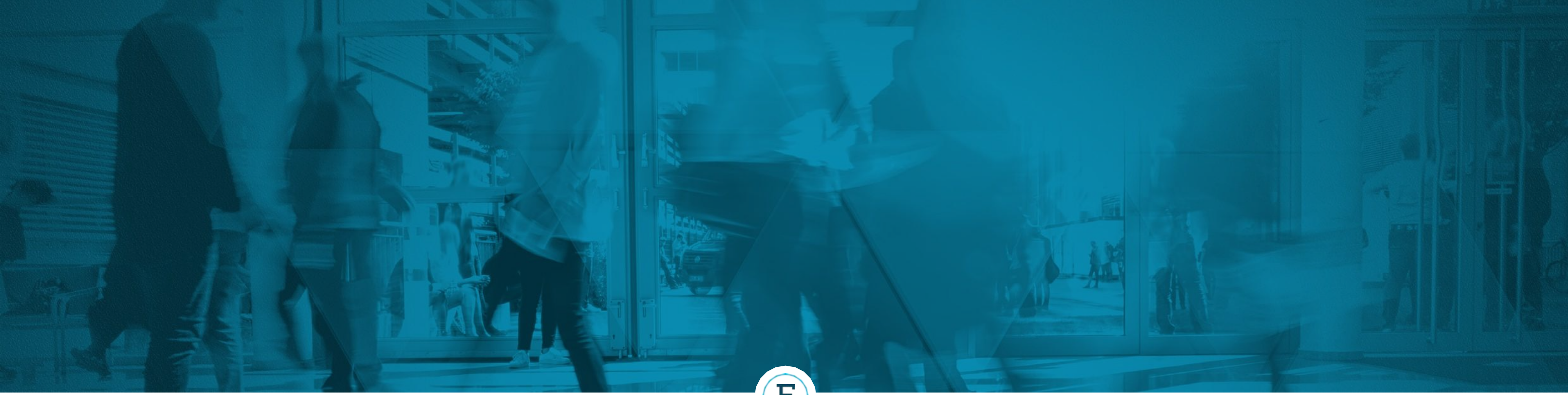
This week's employment and inflation reports will be critical for the future path of Bank of England policy. Employment data, in particular, has tended to surprise on the upside recently, which could further support the pound. Thursday’s fourth quarter GDP data will also be closely watched by market participants, given that this could show that the UK economy entered into a technical recession in the second half of 2023. Economists are eyeing another modest quarterly contraction, following the 0.1% downturn in Q3.

EUR

As the Eurozone economy stagnates in spite of a labour market at essentially full employment levels, markets are expecting the European Central Bank to be the first in cutting rates. Even here, however, the timing continues to be pushed back, as communications from Governing Council members largely strike a hawkish tone, notably chief economist Lane last week, who said that the bank would need more confidence that inflation was heading to target before lowering interest rates.

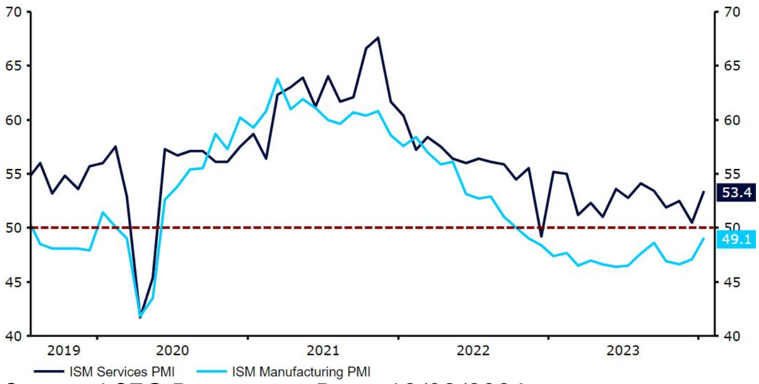


As things stand, an April rate cut is now only 50% priced in, which we think is consistent with both ECB rhetoric and economic fundamentals. This week there is little economic data out of the Eurozone, but a number of ECB council members are scheduled to speak, including president Lagarde on Thursday. Fourth quarter GDP data will be released on Wednesday, although this is a revision from the preliminary estimate.

USD

Now that markets have backed away completely from a March Fed cut, and the US economy continues to fire on all cylinders, chair Powell's relentless pushback against market pricing for early rate cuts has been completely vindicated. Last week's blowout ISM business activity reports provided further evidence that pricing pressures are not yet tamed. Macroeconomic news, in general, is surprising to the upside (Citigroup's US Economic Surprise Index has risen to its highest level since early-November), while the Atlanta Fed's GDPNow estimate is pointing to growth above 3% annualised.

Figure 3: US ISM PMIs (2019 - 2024)



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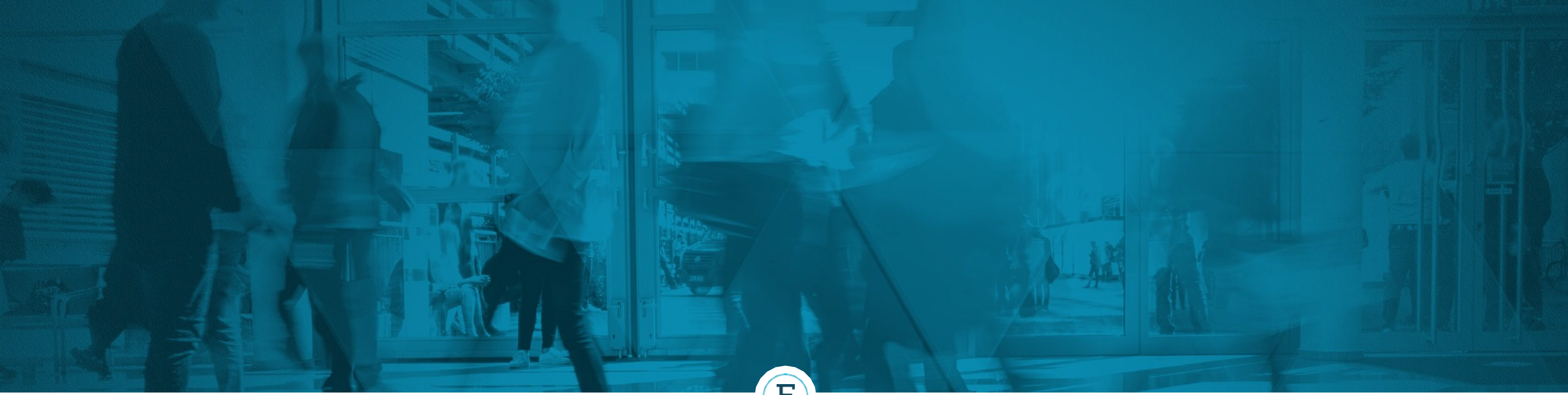
This week's CPI report may be less positive for the greenback, with markets bracing for a drop in the headline number to 3%, which would match its lowest level since March 2021. Any upward surprise here will cement our view that we will not see any cuts until June.



JPY

A combination of US economic strength and some dovish comments from Bank of Japan officials sent the USD/JPY pair back towards the 150 level last week, around its highest level since November. Speaking last week, BoJ deputy governor Shinichi Uchida said that the bank would not raise interest rates at an aggressive pace once it has begun its tightening cycle, while governor Ueda stressed that 'chance are high' that policy conditions would remain accommodative, even after the negative rate policy was abandoned. Markets continue to eye the April BoJ meeting for hikes to commence, though the prospect of a gradual tightening cycle is keeping the yen under a bit of selling pressure.

Data out last week was not supportive of the yen, as while wage growth is trending upwards, the December print came in below expectations. Focus this week will be squarely on Wednesday's fourth quarter GDP report. Markets are anticipating a rebound in activity, with 1.4% annualised expansion expected.

CHF

The franc was the worst-performing G10 currency last week, as evaporating rate cut bets in the US pressured down low-yielding currencies. The above, coupled with the SNB's turn away from supporting the currency, boosts the case for a weaker franc. CPI data from the US and Switzerland released this week will provide markets with additional information to gauge the likelihood of changes in monetary policy in both countries, and we could see some more volatility around these releases.

The Swiss data, out on Tuesday, is expected to show very limited changes in both headline and core measures, with both continuing to print within the inflation target. Thursday's January producer and import inflation data will provide additional context about price developments. Aside from that, attention will likely be focused on news elsewhere.

AUD

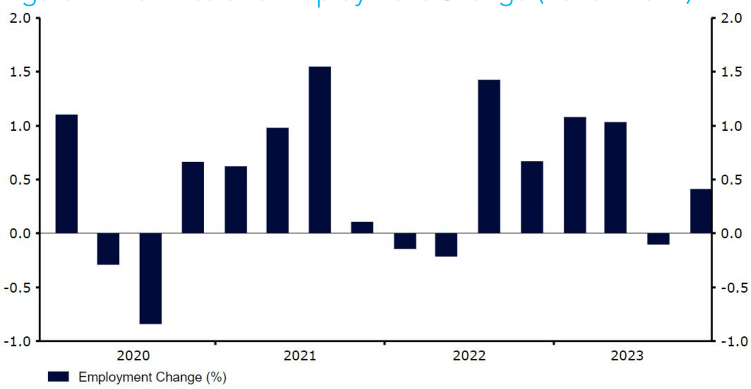
The Reserve Bank of Australia keep rates unchanged last week, while striking a less hawkish note in its communications. Both the latest inflation and growth forecasts were revised lower, with the RBA noting that inflation was easing, all clear signals that additional hikes are highly unlikely. That said, governor Bullock said that rates would need to remain restrictive, and that bringing down inflation was the bank's priority. This rhetoric is in line with our view that we'll have to wait until probably quite deep into the second half of the year for the start to the easing cycle.

Focus among market participants this week will be firmly on Thursday's labour report for January. The December report was an unmitigated disaster, with more than 100k full-time jobs lost in the final month of last year. A rebound in employment is expected this time around, albeit only around half of the total jobs shed last month are expected to be recovered.

NZD

The New Zealand dollar once again outperformed its Australian counterpart last week, briefly touching its strongest position versus AUD since May last year. While last week's dovish shift in RBA communications clearly dragged the AUD/NZD pair lower, the fourth quarter labour report out of New Zealand was also pleasing on the eye. Not only did the unemployment rate rise less-than-expected, but employment also increased by 0.4% (above the +0.3% consensus).

Figure 4: New Zealand Employment Change (2020 - 2024)



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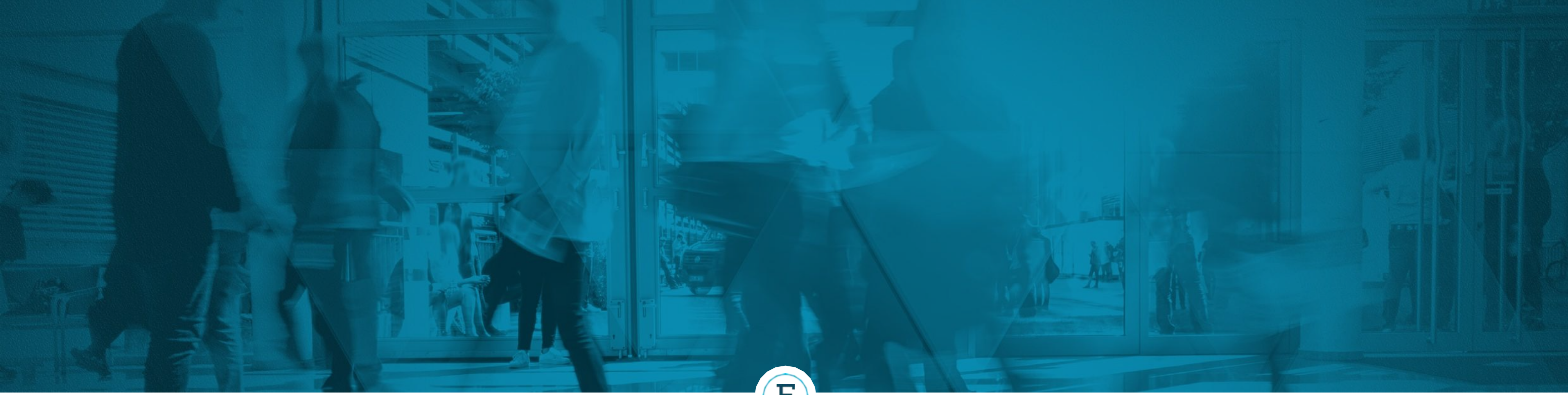
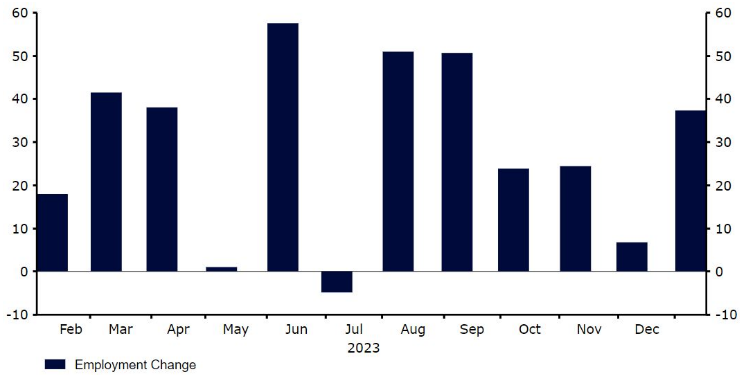


The above report should take further pressure off the Reserve Bank of New Zealand from cutting interest rates any time soon. Indeed, markets are now pricing in more than a 50% chance of another hike at the bank's April meeting, after the bank left the door open to further tightening at its last meeting, while data in the interim has largely surprised to the upside. The rising possibility of further RBNZ rate hikes should keep the kiwi well bid, with the New Zealand currency looking well placed to continue outperforming its Australian peer in the near-term.

CAD

Some strong domestic macroeconomic data allowed the Canadian dollar to outperform its US counterpart last week. The January PMI figures beat consensus, with the business activity index from Ivey rising to 56.5 last month, above the 55.0 consensus and its highest level since April. Canada's labour market is also performing rather well. A net 37.3k jobs were added in January (above the 15k expected), while the jobless rate also unexpectedly fell to 5.7%, after investors were bracing for a modest increase in unemployment.

Figure 5: Canada Employment Change (2023 - 2024)



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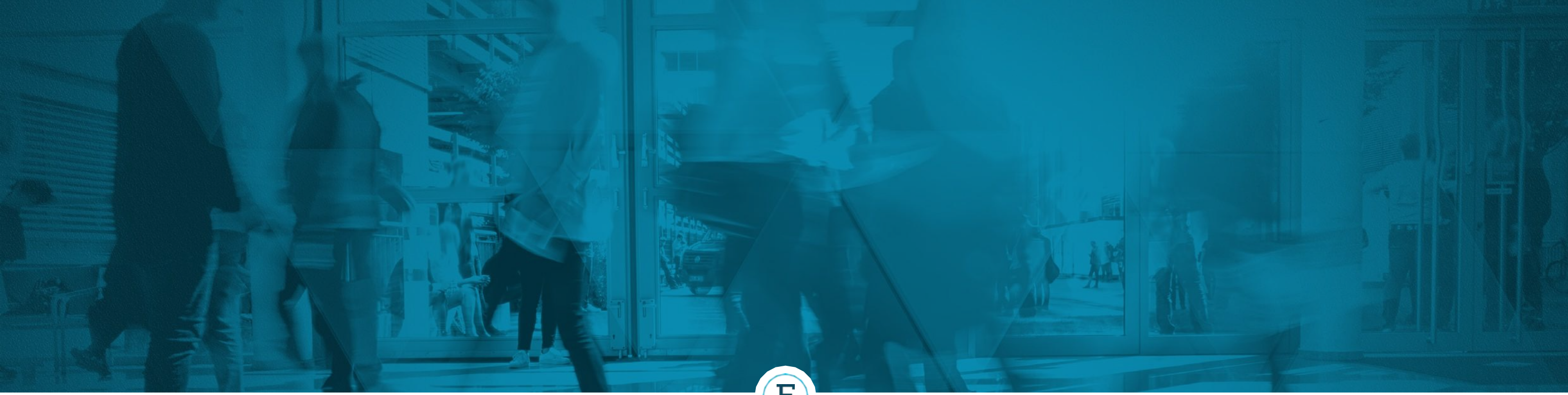
All in all, recent data supports the view that the Bank of Canada will likely need to keep interest rates higher for longer, and that cuts will have to wait for a little while yet. Swap markets are currently eyeing a first cut in June, although we see risks of a later start to easing should data continue to surprise to the upside in the interim. There will be no major economic data out of Canada this week, so CAD will likely be largely driven by developments in the US, most notably Tuesday's inflation report.



SEK

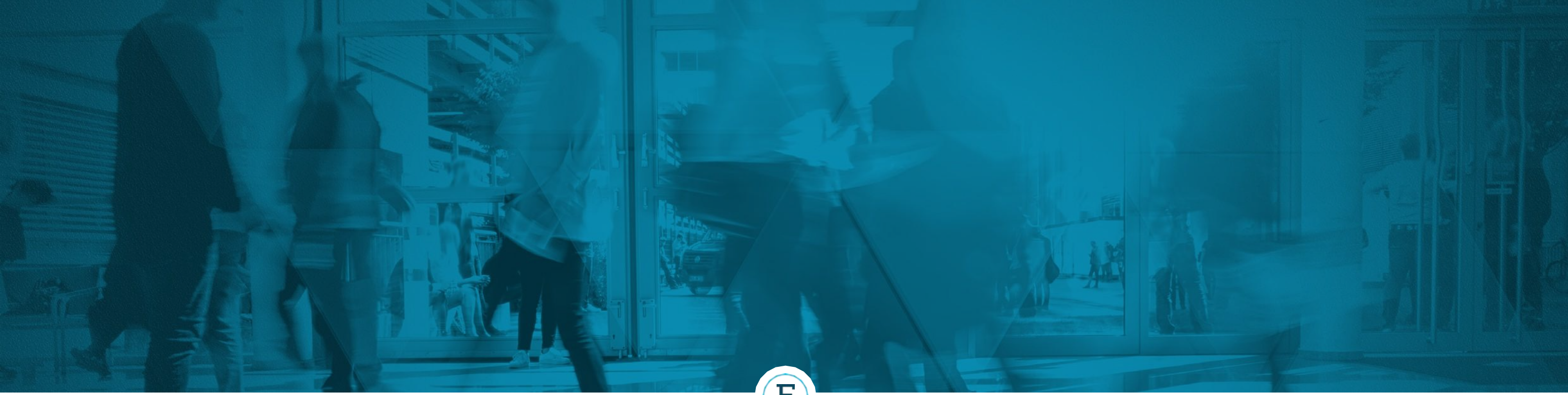
In line with other risk assets, the Swedish krona appreciated against the euro last week. Improved risk sentiment towards the end of the week supported the krona, as economic news out of Sweden was rather mixed. The services PMI increased to a six month high of 51.8 in January, the second consecutive month of expansion. However, the manufacturing sector remained in contractionary territory for the 16th consecutive month (47.1).

The minutes of the Riksbank's latest meeting confirmed the central bank's dovish shift, which opened the door to a first rate cut in the first half of the year. However, according to the minutes, currency stability is a prerequisite for this. In this respect, the unemployment rate to be published this Friday and, above all, the inflation data to be released early next week, will be key. Overall, 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

Like all other risk and commodity-related currencies, the Norwegian krone ended last week higher against the euro. Due to its high beta status, NOK benefited from the improvement in risk sentiment at the end of last week. In addition, higher oil prices also supported the currency, due to Norway's heavy reliance on oil production.

Despite the slowdown in inflation, the latest data, released last Friday, support Norges Bank's recent hawkish pivot. Headline inflation declined to a three month low of 4.7% in January from 4.8% in the previous month. Meanwhile, CPI excluding energy products and adjusted for tax changes declined less than expected to 5.3% in January from 5.5% in the prior month. Both indexes still remain at levels inconsistent with the central bank's targets so we continue to expect Norges Bank to keep interest rates high for a prolonged period, which should be bullish for the currency.



CNY

Firm PBoC fixings, and improved market sentiment, helped the yuan last week, allowing the currency to stabilise against the US dollar. A holiday-shortened week brought some sweet and sour news from China. Equities bounced back after signs that authorities are taking concerns about the stock market more seriously. A Bloomberg report on Xi Jinping's planned meeting with financial regulators on Tuesday was cheered by investors.

Then, on Wednesday, Yi Huiman was removed from his position as chairman of the China Securities Regulatory Commission (CSRC). He was replaced by Wu Qing, a veteran securities regulator who headed the Shanghai Stock Exchange. The fact that it was announced shortly before the start of the Lunar New Year holidays suggests that authorities felt a sense of urgency and wanted to lift investor confidence ahead of the period of closed markets in mainland China, which will last through the end of this week. As for the negatives, deflation concerns were reinvigorated last week by a worse-than-expected CPI reading, which showed a 0.8% decline in consumer prices. However, credit data beat expectations, with new bank loans hitting a record high at the start of the year. Given the holiday period, no economic news will be out this week. The MLF announcement on Sunday is not expected to yield any change, so attention should be on the rollover.

Economic Calendar (12/02/2024 - 16/02/2024)

Economic Calendar	Country	Day	Date	Time (GMT)
Employment Report (Dec.)	UK	Tuesday	13/02	07:00
Inflation (Jan.)	SWI	Tuesday	13/02	07:30
Inflation (Jan.)	US	Tuesday	13/02	13:30
GDP (Q4)	NOR	Wednesday	14/02	07:00
Inflation (Jan.)	UK	Wednesday	14/02	07:00
GDP (Q4)	EZ	Wednesday	14/02	10:00
GDP (Q4)	JPN	Wednesday	14/02	23:50
Employment Report (Jan.)	AUS	Thursday	15/02	00:30
GDP (Q4)	UK	Thursday	15/02	07:00
Retail Sales (Jan.)	US	Thursday	15/02	13:30
Retail Sales (Jan.)	UK	Friday	16/02	07:00
Unemployment Rate (Jan.)	SWE	Friday	16/02	07:00

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