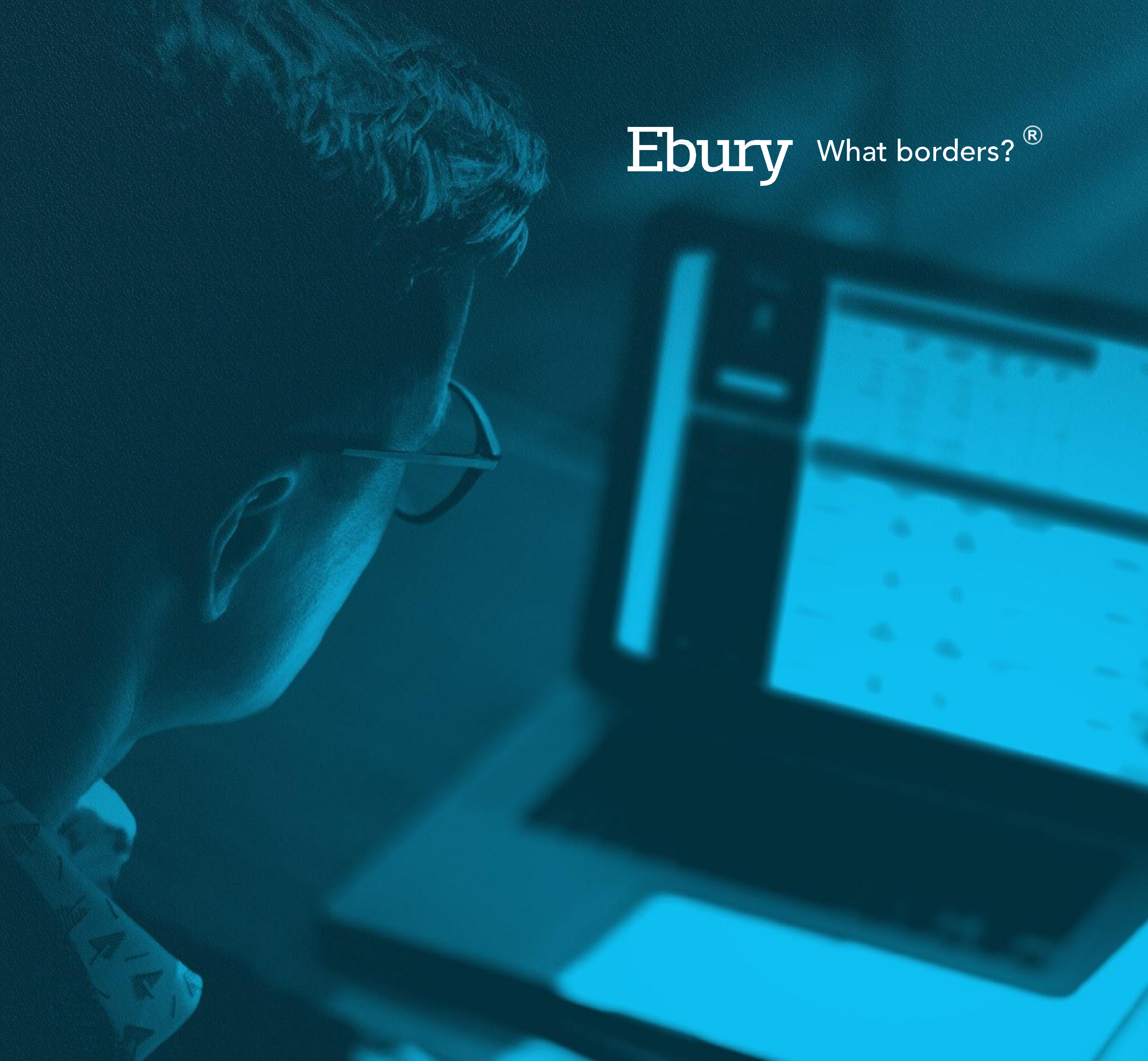

Ebury What borders?®

Weekly Report

G10 Weekly FX Update

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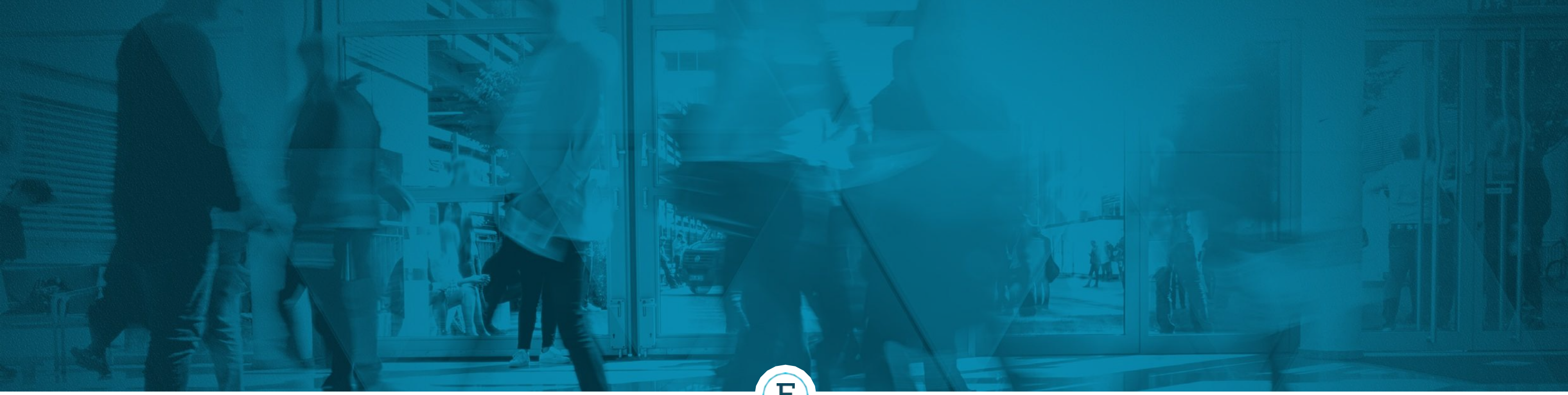
19th February 2024



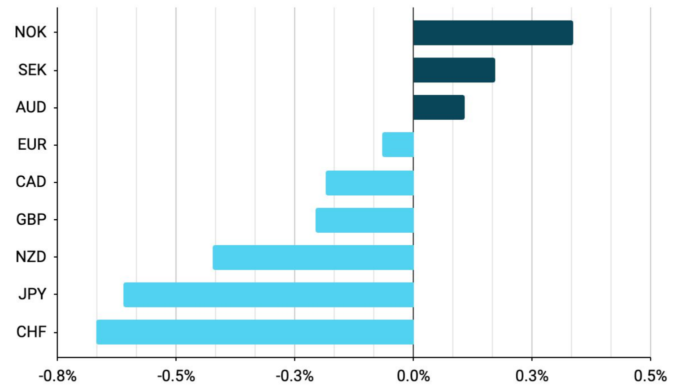
Dollar extends rally as inflation fears return

The January CPI inflation report out of the US contained everything the Federal Reserve did not want to see.

Upward surprises in both the headline and core indices, and a clear sense that the disinflation trend we saw throughout most of 2023 has hit a wall, with price increases running again comfortably north of 4%. Bonds worldwide fell sharply, as did risk assets, but the latter recovered most of their losses by week-end. The dollar was one of the best-performing currencies among the majors, but the rally was surprisingly subdued given the inflation news, as the greenback rose less than 1% vs all of its G10 peers.

This week will be relatively quiet in terms of macroeconomic news. Not a lot of first-tier data will hit the tape until Thursday, when the February flash PMI indices of business activity are released in the US, UK and the Eurozone. An array of Fed speakers and a key speech on inflation by ECB board member Schnabel on inflation will round out the week. More generally, after this week's nasty surprise, traders will be more jittery around the release of any further inflation numbers or indicators worldwide.

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

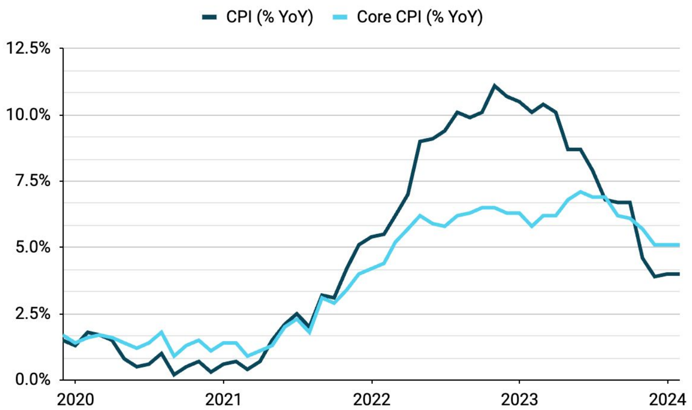


Source: Bloomberg Date: 19/02/2024

GBP

January inflation data out of the UK went the opposite direction from that in the US, with a small downward surprise. Offering further support for Bank of England doves, the GDP report for the last quarter of 2023 confirmed that the UK entered a technical recession.

Figure 2: UK CPI Inflation (2019 - 2024)



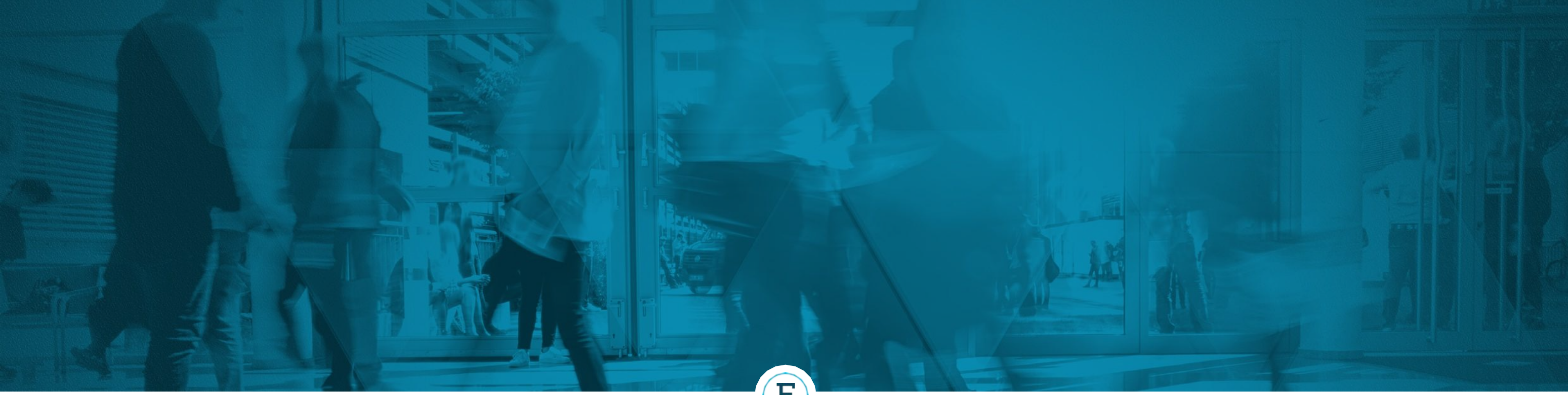
Source: Bloomberg Date: 19/02/2024

Flash PMIs this Thursday should provide more timely guidance on the current state of the British economy. Markets expect the numbers to be consistent with a significant rebound in growth in the first quarter of 2024, which is probably why dips in Sterling are proving shallow and short-lived.

EUR

December industrial production in the Eurozone delivered a rare positive surprise, growing (on a work-day adjusted basis) for the first time since March of 2023 vs a year earlier.

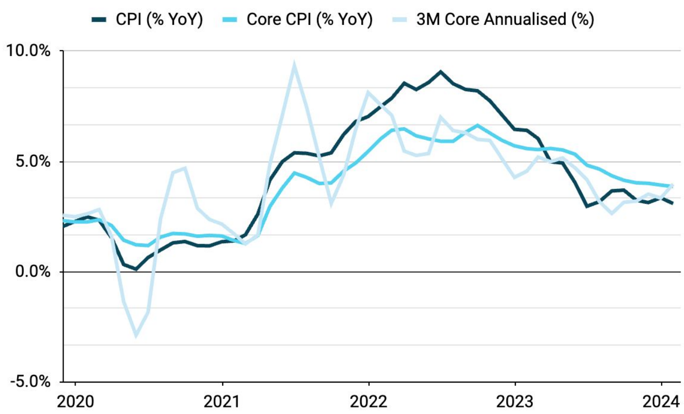
If the PMI indices out Thursday manage to surprise to the upside relative to gloomy expectations, we could see the euro forming a bottom somewhere around the 1.07 level against the US dollar. Markets are now split 50/50 between predicting a first cut at the April and June meetings of this year. We find this to be a proper balance of the possibilities at this point.



USD

Looking back to a few weeks ago, it seems hard to believe markets were pricing in a Fed interest cut in March. Since then, the US economy has reaccelerated, and inflation has rebounded. Our favourite inflation indicator, the 3-month annualised average of the core CPI, is now solidly back above 4% and has been trending up for over six months now.

Figure 3: US CPI Inflation (2019 - 2024)



Source: Bloomberg Date: 19/02/2024

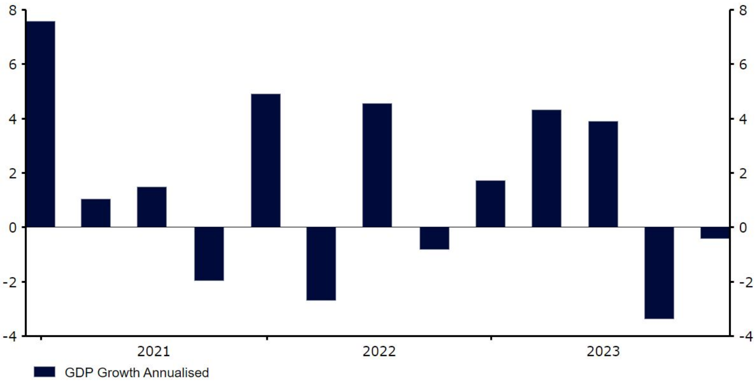
For now, markets have pushed back the pricing of a full first cut all the way to June. This, too, seems like a reasonable outlook, absent further upward surprises in the inflation data.

JPY

The Japanese economy unexpectedly slid into a technical recession in Q4, adding further misery to the already beleaguered yen, which ending last week just above the 150 level on the US dollar and not far off its weakest position since November. Japan's economy unexpectedly contracted by 0.4% annualised in the three months to December (0.1% QoQ), which was a big downside surprise after economists had pencilled in fairly solid expansion of 1.4%. This will be a worrying development for politicians and BoJ officials alike, particularly given the accommodative policy stance adopted by the latter, which is still yet to raise interest rates since the start of the global inflationary episode.

Despite the disappointing economic news, swaps markets continue to see a more than 70% implied probability of a first 10bp rate hike from the Bank of Japan in April. The fragile state of the economy, particularly consumer spending will, however, do nothing to convince markets that anything more than a gradual pace of policy normalisation will be required thereafter, which could limit the extent of any yen rally. Trade balance data will be closely watched on Tuesday in an otherwise rather quiet week in Japan.

Figure 4: Japan Annualised GDP Growth Rate (2021 - 2024)



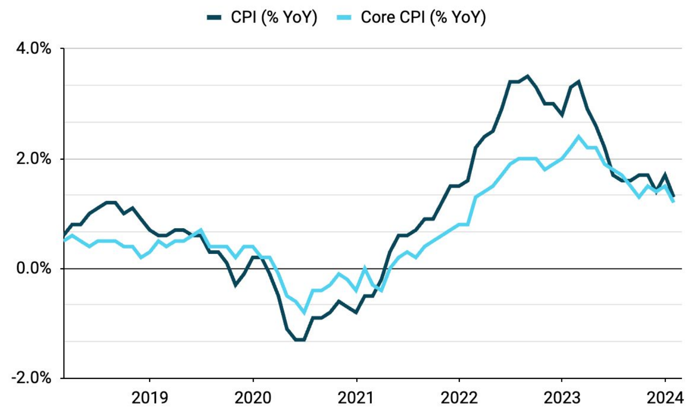
Source: LSEG Datastream Date: 19/02/2024

CHF

The widening gap between interest rate cut expectations in Switzerland and other major countries put pressure on the franc last week. The swissie ended it as the worst-performing G10 currency and fell to the lowest level since mid-December against the euro. Compared with the rest of the G10, Switzerland is a country where the disinflation process has been particularly impressive. Last week's data showed that inflation in Switzerland unexpectedly fell at the start of the year, with the headline measure falling from 1.7% to 1.3% (the lowest level in almost 2.5 years) and the core measure from 1.5% to 1.2%. Weak price momentum (0.2% MoM in Jan, 0% in Dec) and what appears to be a significant easing in underlying price pressures have encouraged markets to increase their bets on policy easing in Switzerland.

Markets are now assigning a roughly 50/50 chance of a first rate cut in March. We continue to hold the opinion that a cut in June is the most realistic, without entirely ruling out March, and last week's release makes us more confident in our call. We would not be surprised if the economic consensus, which had previously bet on September, warmed up to the idea of a cut in June. The domestic economic calendar is quite light this week. Investors will likely focus on outside news, although Tuesday's trade data would also be worth watching.

Figure 5: Switzerland CPI Inflation (2021 - 2024)



Source: Bloomberg Date: 19/02/2024

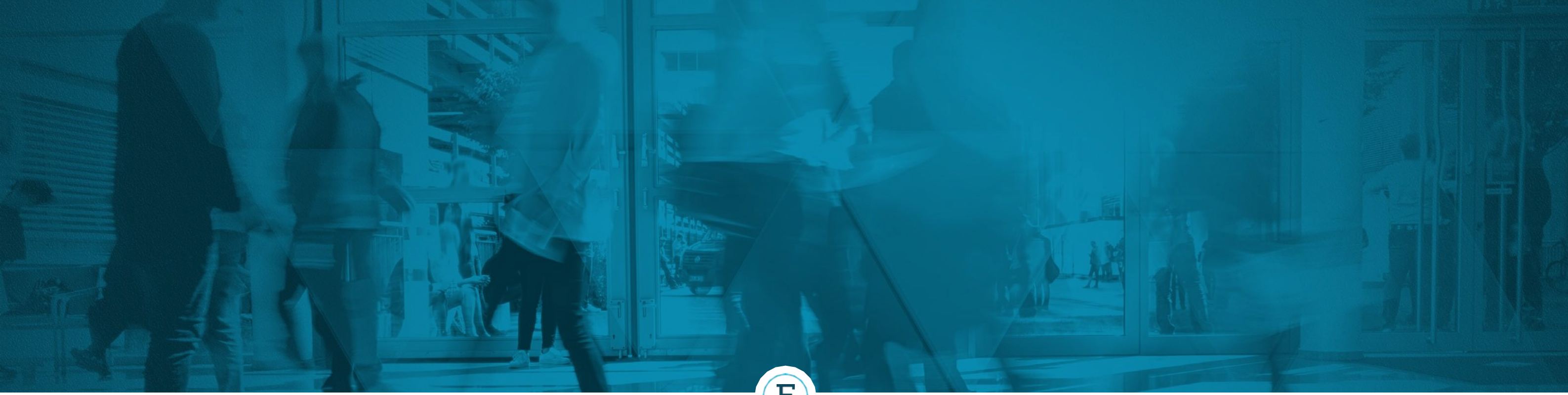
AUD

Last week's labour report for January was a big disappointment. Net job creation came in essentially flat (+0.5k vs. 30k consensus), while the unemployment rate also ticked up by 0.2 p.p to 4.1%. Speaking on Thursday, Reserve Bank of Australia governor Bullock also struck a relatively dovish note, saying that the central bank was in a good position to get inflation down in a 'reasonable amount of time', another fairly firm signal to suggest that the next move in rates will be lower, rather than higher.

The Australian dollar, however, managed to post reasonable gains in the second half of the week, and ended trading on Friday roughly where it started it against the USD. Focus this week will be on Tuesday's RBA meeting minutes, and Wednesday February PMIs. The composite index remained stuck below the key level of 50 in January, so investors will be looking for signs of improvement and a move into expansion.

NZD

The New Zealand dollar sold off against most G10 currencies last week, which we attribute to its recent outperformance more so than anything else. Economic news last week was reasonably encouraging, with the business activity manufacturing PMI rebounded to its highest level since June (47.3 vs. 43.1 in December). RBNZ governor Orr also struck a relatively hawkish note during his remarks on Thursday, stressing that the bank had 'more work to do' in bringing inflation expectations back towards 2%.



Ahead of the next RBNZ meeting at the end of the month (28/02), markets will have the latest trade balance and retail sales data to digest on Wednesday and Thursday respectively. The latter has been very weak indeed for the best part of two full years, so it will be interesting to see whether we're due a modest rebound.

CAD

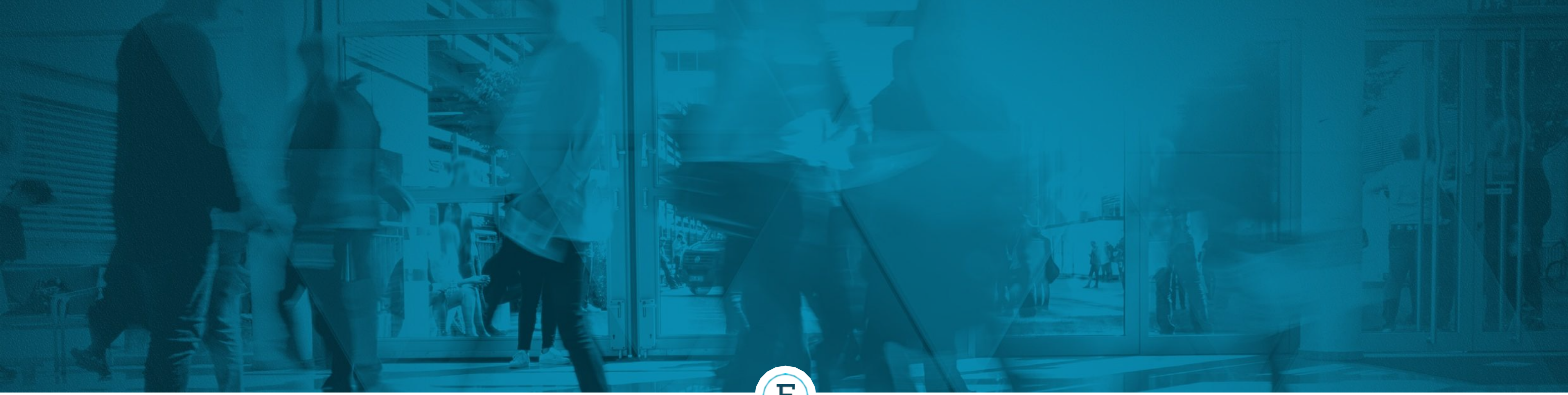
Once again, the Canadian dollar largely tracked its US counterpart last week, ending Friday trading roughly unchanged against the greenback. There was no major economic news out of Canada last week, and even oil prices only rose very modestly, with Brent Crude trading around the $83 a barrel mark. We did see somewhat of an easing in bets in favour of Bank of Canada interest rate cuts last week, although this largely followed the re-pricing evident globally, and the impact on FX was minimal.

This Tuesday's inflation report for January will dominate the narrative in Canada in the coming days. Economists are eyeing a further moderation in the headline number to 3.3% (from 3.4%). Any downside surprise here could force markets to push back their expected timing for the first BoC rate cut into the second half of the year.

SEK

The Swedish krona found itself just behind its Norwegian counterpart last week, benefiting from improved sentiment towards the region. Market attention did, however, shift largely towards today's January inflation reading. Although both its main measure, the CPI (5.4%), and the main measure with a fixed interest rate, the CPIF (3.3%), placed significantly above both consensus and the previous month's level, the SEK kept its gains. Attention should be drawn to the less volatile core CPIF measure, which fell by 0.5% on a monthly basis in January, as expected, and reached its lowest level since March 2022 (4.4%). Monetary policy easing, in view of the sluggish performance of the Swedish economy and, as highlighted by the core CPIF measure, the downward trajectory of inflation, seems to be approaching. Investors do not rule out the possibility of a cut before the end of Q1, albeit a move before the Q2 is not the market's base scenario.

With no macroeconomic data releases of great importance in the remainder of the week, we expect the currency's exchange rate to be driven mainly by outside news and, possibly, by comments from Riksbank policymakers since a number of them are speaking on Tuesday.



NOK

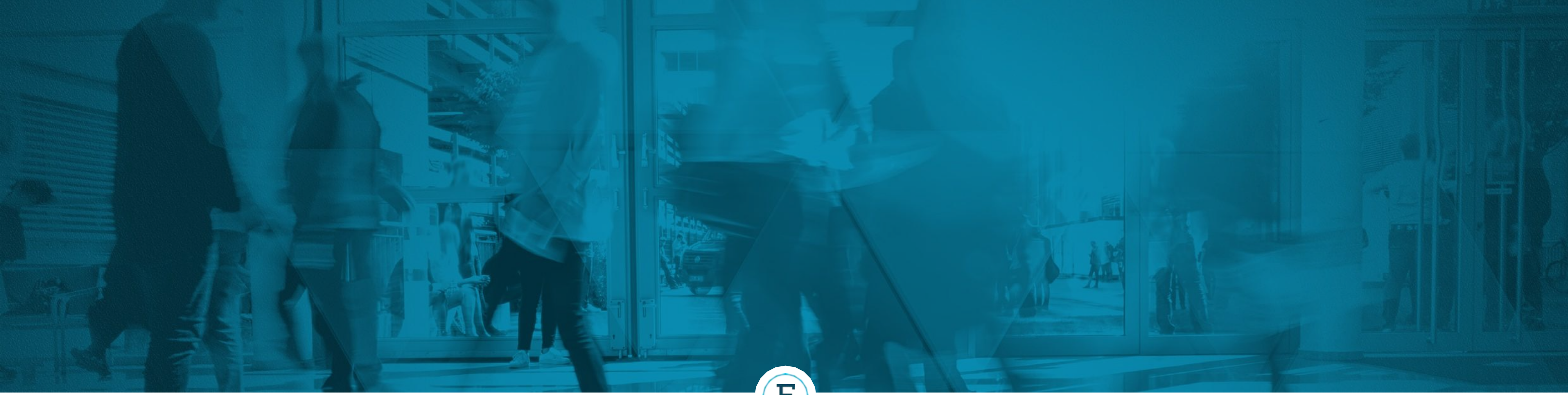
Despite the strengthening of the dollar, the Norwegian krone outperformed all of its G10 peers and most emerging market currencies last week. The currency appears to have been aided by the continued rise in oil prices, although their increases eased last week. In terms of macroeconomic data, we focused on Q4 GDP. Our preferred measure - mainland GDP - rose by 0.2% QoQ, slightly higher than consensus (0.1%), driven largely by consumer spending and net exports. Rates are expected to remain at an unchanged level for a prolonged period of time, with swap markets betting on a less than 50% chance of the first cut happening in the next six months.

The next few days will not bring key macroeconomic readings. Hence, global sentiment and commodity prices are likely to be key for the NOK.

CNY

The Lunar New Year Holiday was a bit of a respite for China watchers thanks to a break in mainland trading and data releases. The offshore yuan declined to a 3-month low against the US dollar last Tuesday following the release of US inflation data, but stocks in Hong Kong, where trading returned on Wednesday, performed well. The week is off to a positive start for China, with data covering the holiday period pointing to a welcome increase in travel and consumption indicators.

Attention now turns to monetary policy. Sunday's MLF announcement did not bring any surprises. Looking ahead, investors will focus on Tuesday's setting of the 1- and 5-year Loan Prime Rates, where adjustments may take place. Financial News, a PBOC-backed newspaper, reported yesterday that market watchers see a higher probability of a move in the 5-year rate. Accordingly, the consensus now sees a 10bps decline in the rate (a reference for mortgages), with economists more split on the 1-year rate (a reference for most new and outstanding loans). Greater support for the economy from easier financing conditions might be a positive signal for the yuan in the near term. However, in the broader context, the growing policy gap between China and major countries suggests that authorities may need to continue their efforts to counter pressure on the Chinese currency.



Economic Calendar (19/02/2024 - 23/02/2024)

Economic Calendar	Country	Day	Date	Time (GMT)
Inflation (Jan.)	SWE	Monday	19/02	07:00
RBA Meeting Minutes	AUD	Tuesday	20/02	00:30
1Y and 5Y LPRs Announcement	CHN	Tuesday	20/02	01:15
Exports and Imports (Jan.)	SWI	Tuesday	20/02	07:00
Inflation (Jan.)	CAN	Tuesday	20/02	13:30
Trade Balance (Jan.)	JPN	Tuesday	20/02	23:50
FOMC Meeting Minutes	US	Wednesday	21/02	19:00
Exports and Imports (Jan.)	NZ	Wednesday	21/02	21:45
PMIs (Feb.)	AUS	Wednesday	21/02	22:00
PMIs (Feb.)	EZ	Thursday	22/02	09:00
PMIs (Feb.)	UK	Thursday	22/02	09:30
PMIs (Feb.)	US	Thursday	22/02	14:45
Retail Sales (Q4)	NZ	Thursday	22/02	21:45

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