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Weekly Report

Weekly FX Market Update

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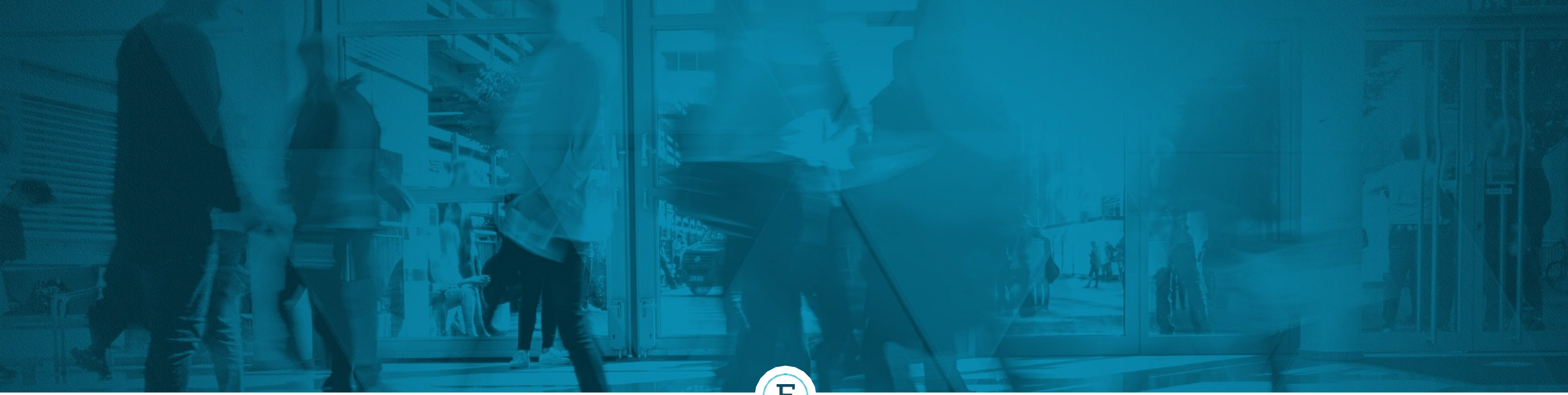


Federal Reserve hawkish turn tanks markets

Safe-havens like the Japanese yen and Swiss franc outperformed last week, as the unambiguously hawkish statements from Fed chair Powell added to the uncertainty over the impact of the omicron COVID variant and sent risk assets tumbling worldwide.

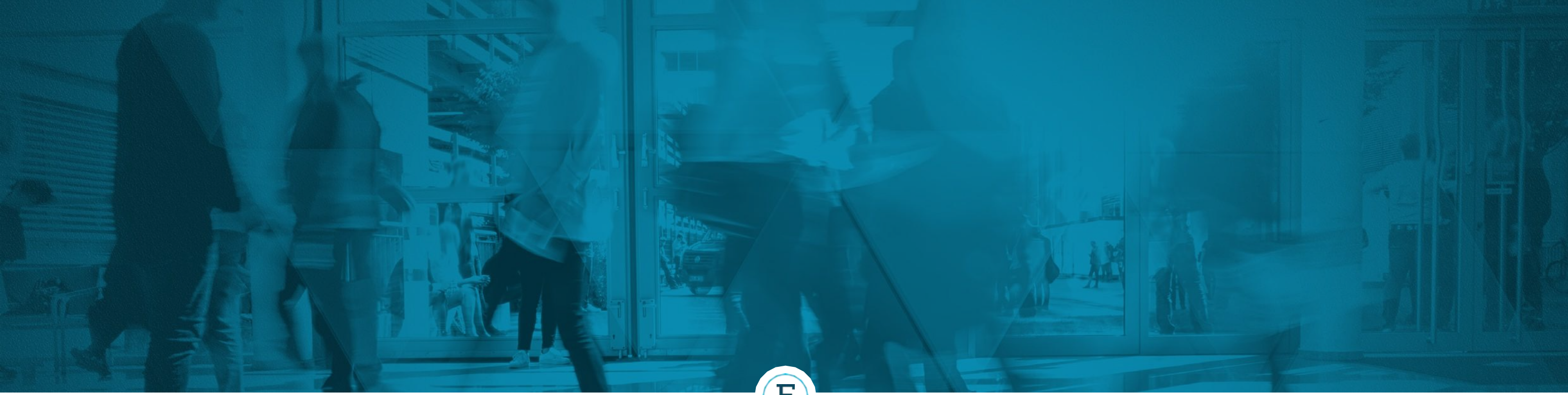
A mixed jobs report out of the US did little to steady nerves in equity and credit markets, though moves among major currencies were of modest size. The dollar put in a mixed performance, and there was no clear theme among emerging market currencies, which ranged from a 2% gain by the Mexican peso to yet another weekly collapse of around 10% by the Turkish lira, slammed by Erdogan's increasingly erratic policies.

In addition to any news regarding the virulence of the omicron variant, traders will be looking closely at the inflation report out of the US on Friday, where yet another increase in both headline and core indices to 30-year highs is expected. Aside from that, there is not a lot of first-tier economic information on tap, so markets will continue to hang onto every word coming out of central bank officials.

CZK

The Czech koruna regained a portion of its recent losses last week, edging up by approximately 1% against the euro. The currency rallied alongside regional peers and a number of other EM currencies, but some of the really seems to be related to an increase in bets regarding monetary policy tightening in Czechia after their previous decline.

The positive news is that the recent Covid wave in the country might be peaking as the 7-day moving average of new infections was relatively stable throughout the past week and actually started to decline. This should support the koruna moving forward as it removes one of the potential stumbling blocks to higher interest rates in Czechia. Nonetheless, developments on the Covid front would still need to be watched carefully, particularly considering the discovery of the omicron variant which has already stirred the market sentiment.



Last week’s manufacturing PMI reading for November surprised to the upside. This week we’ll receive a number of other economic readings, among which the most important would be Friday’s November CPI print. Year-over-year growth is expected to increase further, but considering the pattern of higher-than-expected prints over the past months and stronger price growth in November in both Eurozone and neighbouring Poland we might see an even stronger increase than is currently pencilled in.

EUR

The common currency has held up surprisingly well through two weeks of risk aversion and hawkish noises from the Federal Reserve. The massive upward surprise in Eurozone November inflation last week should make President Lagarde's extreme dovishness increasingly untenable.

The 21.9% print in October producer price inflation all but guarantees that inflation levels will not be coming down anytime soon, as those price pressures bubble up through the supply chains to the final consumer. Of particular note should be the German HICP inflation number of 6% in November. We expect some hawkish pushback against Lagarde's dovish line to emerge soon in the wake of these ugly numbers, and remain of the view that ECB interest rate hikes cannot wait until 2023.

USD

Chair Powell's hawkish turnaround last week is a remarkable development, albeit one we have long expected. He explicitly stated that the word "transitory" should be retired when discussing the current inflationary episode, and suggested he's ready for a significant increase in the pace of the tapering of bond purchases at the December meeting.

The mixed US labour report for November is unlikely to have changed this view. While the job creation headline was disappointing, the household survey's unemployment numbers all dropped sharply, suggesting that the US economy is at or very near full employment and that little relief on inflationary pressures will come from supply side expansion. The inflation report this week should be another one for the record books, going back to many decades and cementing the Federal Reserve's newfound resolve to fight inflation pressures through monetary tightening.

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