Ebury What borders?®

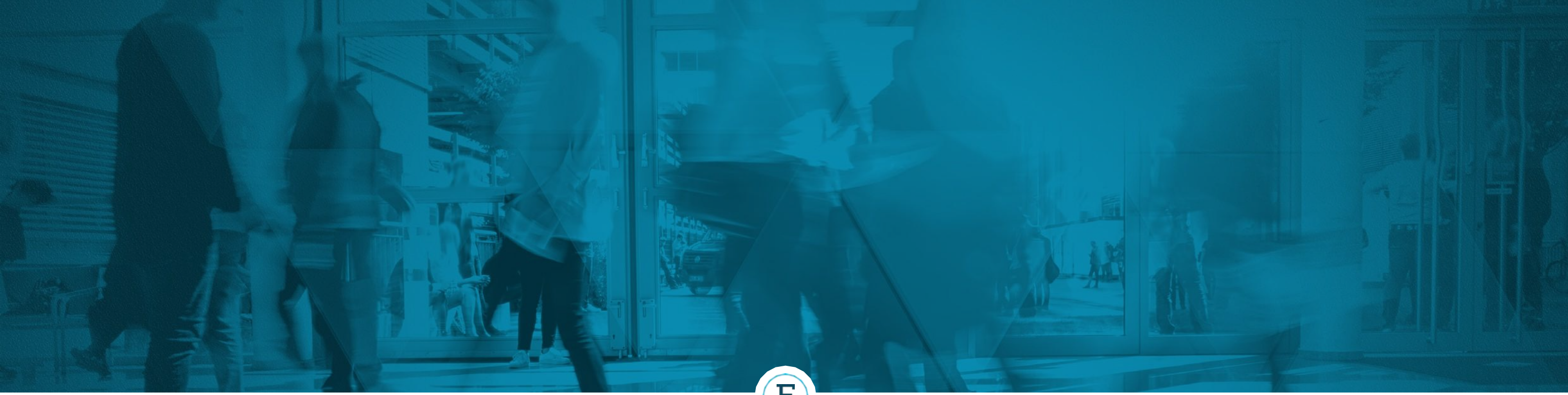
Weekly Report

Weekly FX Market Update

Written by:

Enrique Díaz-Alvarez, Matthew Ryan, Roman Ziruk & Itsaso Apezteguia

24th January 2022



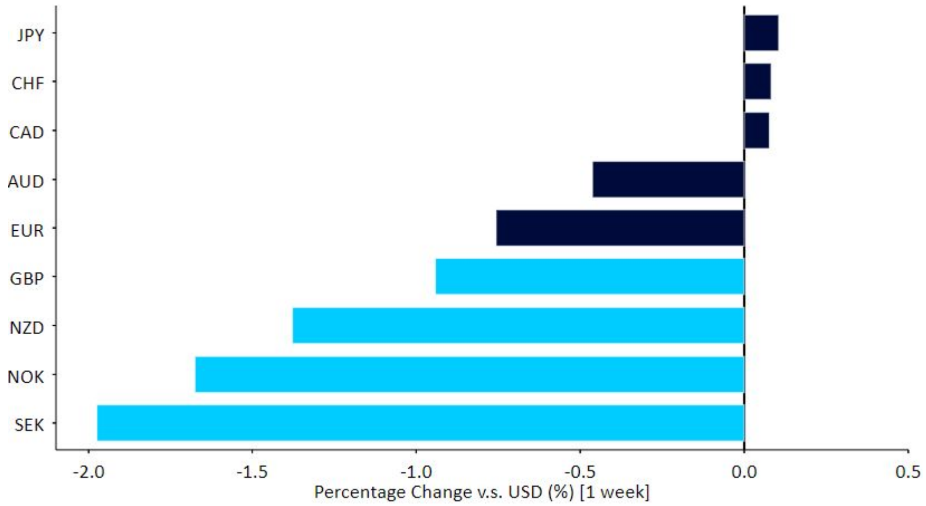
Emerging market currencies shrug off stock market woes

Last week saw the continuation of an interesting theme, in which emerging market currencies continue to hold their own even as stock markets in developed countries are shaken by bouts of risk aversion.

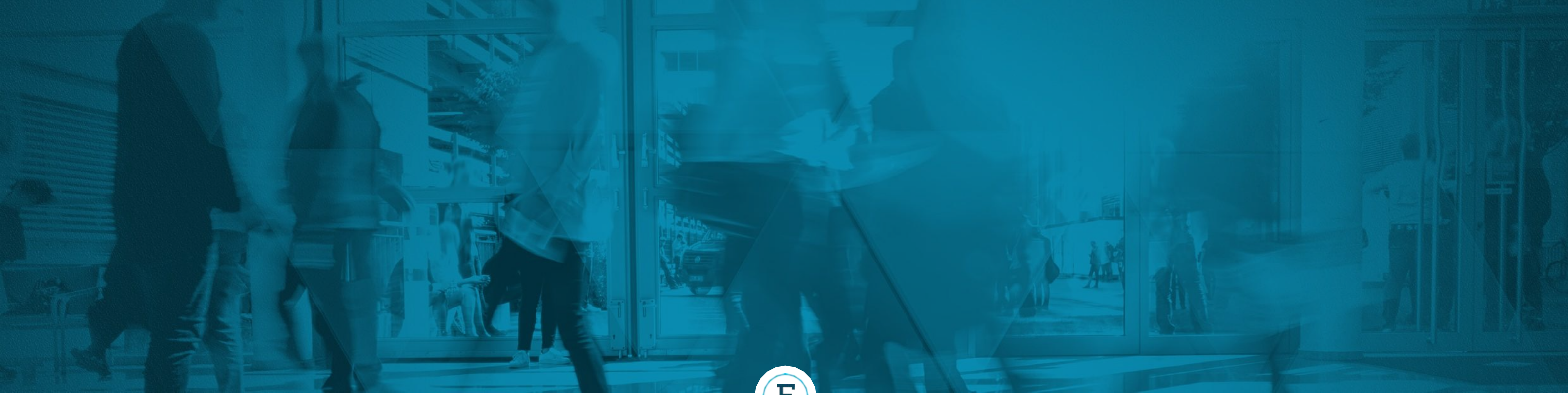
US rates took a breather in their march higher, with the 10 year yield down 2 basis points. The ostensible catalyst for the sell off in risk assets was geopolitical concerns around the Ukraine crisis, which leaves most major emerging economies relatively unaffected (Russia excepted of course), US yields flat to lower and commodity prices higher. All in all a positive combination for emerging markets. The net result was a very unusual currency scoreboard, with Latin American currencies on top together with the G10 safe-havens, the Swiss franc and the Japanese yen.

The Federal Reserve meeting on Wednesday will be the key event of the week, with the market near universally expecting the FOMC to signal a hike in March, and the possibility of an early end to asset purchases. The PMI leading indicators of business activity in the Eurozone and the UK, out Monday, will provide a read on the impact of the omicron variant on the bloc's economy. Finally, traders will also be watching the latest headlines out of Ukraine.

Figure 1: G10 FX Performance Tracker (1 week)



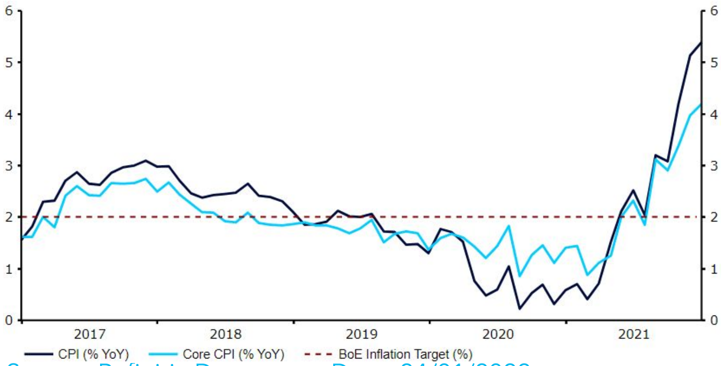
Source: Refinitiv Datastream Date: 24/01/2022



GBP

The sterling rally paused last week on soft economic news out of the UK, namely the sharp decline in December retail sales, and a generally risk averse trading environment. However, the big upwards surprise in December inflation all but guarantees a Bank of England hike at its February meeting. UK headline inflation rose to 5.4% last month (above the 5.1% consensus), and its highest level since March 1992.

Figure 2: UK Inflation Rate (2012 - 2022)



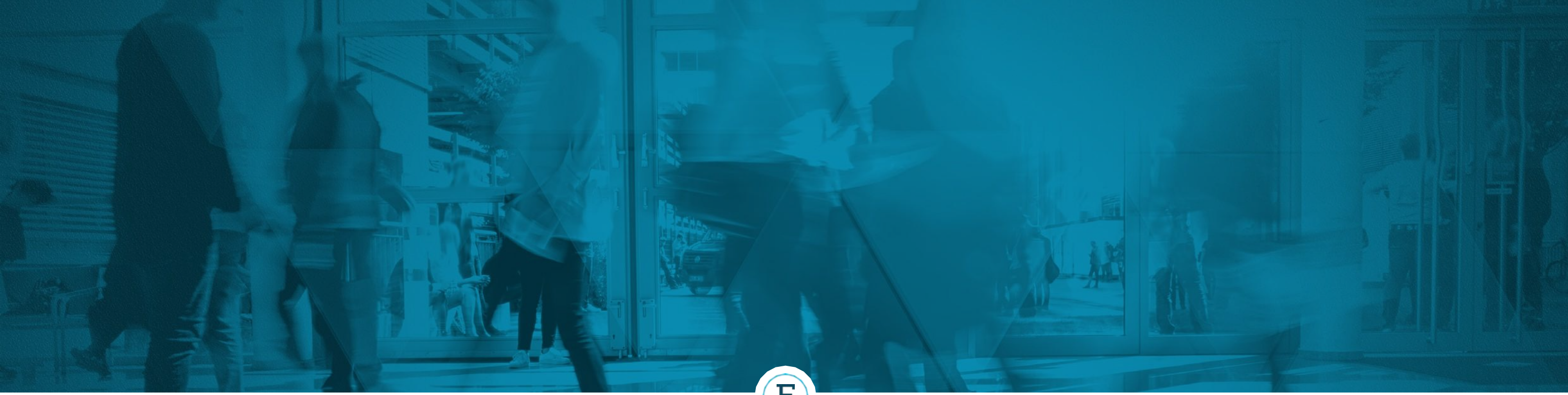
Source: Refinitiv Datastream Date: 24/01/2022

We look to the January PMIs on Monday to confirm that the impact of omicron in the UK economy is noticeable but manageable, as all three subidinces stay in expansionary territory. We think that the relief in lockdown measures announced earlier-than-expected last week may provide enough impetus for a positive surprise here and start the pound on a solid footing for the week.

EUR

We are witnessing the development of a significant split in the outlook of the ECB governing council. By all accounts, it is growing less comfortable with its optimistic assumptions regarding a prompt return to 2% inflation, and there are disagreements over the wind up of the QE programme, as evident in the latest set of accounts from the bank's December meeting.

On the other hand, President Lagarde seems to still cling to a dovish view of inflation and its prospects. We think that the European Central Bank's inflation forecasts are implausibly optimistic at this stage. We expect the split in the Council to grow wider and eventually lead to an ECB interest rate hike before year end, which we think should provide a tailwind for the euro.



USD

The march upward of market expectations of Fed hikes continued last week, even amid risk aversion and lower yields in the US Treasury curve. Aside from the volatility in markets, there was little news of note out of the US last week.

The Federal Reserve's January meeting on Wednesday is a critical event for currency markets. In addition to a clear signal that a March hike is coming, we think there is a good chance that an announcement will be made to wind up QE even sooner than scheduled currently. The actual impact of such an early end would be small, but the psychological effect of such a hawkish signal would be unpredictable. Therefore, we think that it's more likely than not that the programme will be allowed to expire as scheduled, though we expect to see very hawkish communications from the Fed at the meeting.

CHF

The Swiss franc was the second-best performing G10 currency last week after the Japanese yen, with the EUR/CHF pair falling to another recent low this morning, edging closer to the 1.03 level. Fresh worries about global growth and heightened risk of an escalation in Russian-Ukraine tensions added to omicron concerns, exacerbating euro weakness and boosting the safe-havens.

As they influence shifts in market sentiment, we'll continue to focus on the topics mentioned above this week. That being said, the Swiss KOF leading indicator for January out on Friday will also be worth watching as it's one of the best proxies for assessing the country's economic prospects.

AUD

The Australian dollar sold-off against the broadly stronger US dollar last week, as traders braced for an aggressive tightening cycle from the Federal Reserve. AUD did, however, outperform most of its peers as domestic macroeconomic data came out rather strong. Australia's seasonally adjusted unemployment rate fell to 4.2% in December, its lowest level since August 2008, from 4.6% a month earlier and below market estimates. The stronger than expected employment report has raised expectations for an early interest rate hike. Markets are now pricing in a 70% chance of a hike by May and expect the Australian central bank to end its quantitative easing program at its 1st February policy meeting. This remains much more aggressive than the RBA has indicated, which may present some upside for the Australian dollar.

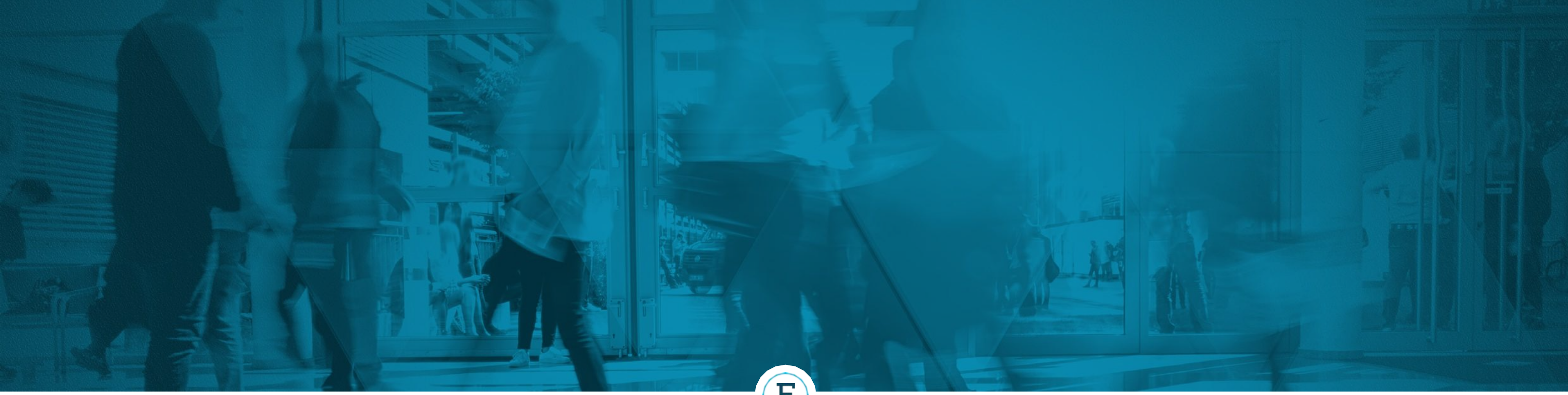


Figure 3: Australia Unemployment Rate (2010 - 2022)

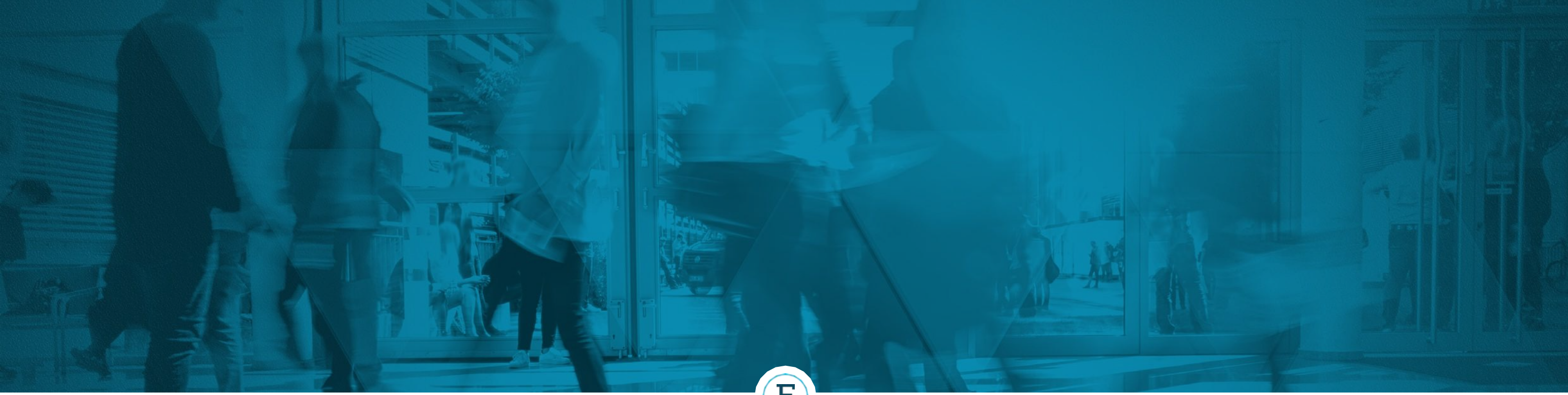
Source: Refinitiv Datastream Date: 24/01/2022

Fourth quarter inflation data, which will be published on Tuesday, will be the main economic release for the Australian currency this week.

CAD

The Canadian dollar traded at its highest level in over two months last week as higher oil prices, and consumer price data that showed inflation rose to a 30-year high in December, heightened expectations that the Bank of Canada could raise interest rates at its meeting on Wednesday. The BoC's decision looks like being a close call. While most analysts are expecting no change, we are pencilling in a surprise hike, which could provide some strong support for CAD in the second half of the week. At the very least, we think that the BoC will firmly indicate that one is on the way by March at the latest, so the sell-off in the event of no hike would be relatively contained.

CAD has actually lost ground leading up to the meeting, ending last week lower against the USD after data showed that retail sales in Canada rose less than expected in November. Sales increased 0.7% over a month earlier, easing from a downwardly revised 1.5% in October and missing preliminary estimates of a 1.2% increase. Meanwhile, Canada's inflation rate increased to 4.8% in December from 4.7% in November and October. That was the highest inflation rate since September 1991, amid ongoing supply disruptions and low base year effects.



CNY

The Chinese yuan began this week by reaching another high against the US dollar, following a small uptick last week. The currency's performance is impressive considering a largely unfavourable string of news from China: continued delta and omicron outbreaks testing the country's zero-Covid strategy, disappointing December macroeconomic data, and monetary policy easing.

After unexpectedly cutting a 1-year Medium-Term Lending Facility rate by 10 basis points to 2.85% the PBOC adjusted its loan prime rates, lowering the 1-year LPR by 10 basis points to 3.70% and 5-year LPR by 5 basis points to 4.60%. The latter was cut for the first time since April 2020. This reinforces the argument that authorities are serious about safeguarding the economy from any deeper slowdown. Worries in that regard increased after the release of December economic data, particularly a disappointing retail sales reading.

Going forward we'll focus on the January PMI data out Sunday. In addition, coronavirus developments will be closely watched, particularly ahead of the Winter Olympics in Beijing at the start of February.

Economic Calendar (24/01/2022 - 28/01/2022)

Economic Calendar	Country	Day	Date	Time (GMT)
Manufacturing, Services & Composite PMIs (Jan)	EZ	Monday	24/01	09:00
Manufacturing & Services PMIs (Jan)	UK	Monday	24/01	09:30
Manufacturing, Services & Composite PMIs (Jan)	US	Monday	24/01	14:45
Consumer Price Index (Q4)	AUS	Tuesday	25/01	00:30
Consumer Confidence (Jan)	US	Tuesday	25/01	15:00
Bank of Canada Monetary Policy Meeting	CAN	Wednesday	26/01	15:00
Fed Monetary Policy Meeting	US	Wednesday	26/01	19:00
Consumer Price Index (Q4)	NZL	Wednesday	26/01	21:45
Gross Domestic Product Annualized (Q4)	US	Thursday	27/01	13:30
Consumer Confidence (Jan)	EZ	Friday	28/01	10:00

Ebury

100 Victoria Street, London SW1E 5JL

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