



Ebury What borders?®

Weekly Report

Weekly FX Market Update

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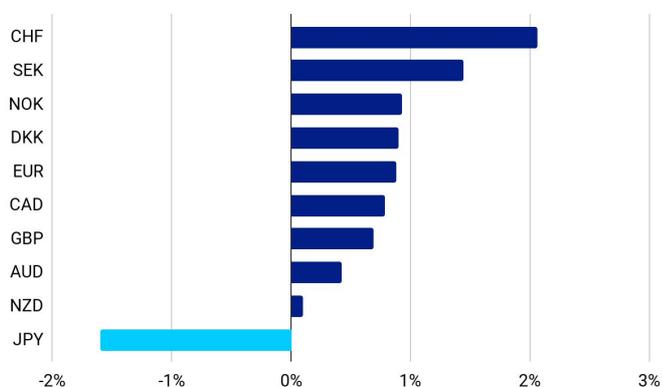
European currencies bounce back on hawkish ECB, Ukrainian advance

The ECB massive 75bp hike, followed up by hawkish comments from the usual "sources", sent the common currency soaring against most of its global peers, dragging along all other European currencies, while the Japanese yen ended up again at the bottom of the rankings, dragged down by the Bank of Japan insistence on remaining the last dovish holdout among the G10.

It wasn't just the ECB, rates went up aggressively across the world last week. US Treasury yields broke out to fresh cycle highs, but this time the move failed to support the US dollar. As this is written, European currencies are rallying further, possibly buoyed by Ukrainian military successes against Russian forces that are raising hopes of a resolution to the war there.

The key event for this week will certainly be the US inflation report for August, out on Tuesday. The headline number is almost certain to show another pullback, on the back of easing energy prices. The key however will be the more sticky core number. Regardless of the outcome, the hard hawkish pivot from the Fed means that another jumbo 75bp hike is very likely the week after this one. The Bank of England meeting scheduled for this week has been moved to the next one due to the passing of the Queen of England, so there will be little scheduled news outside inflation to move markets.

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



Source: Bloomberg Date: 12/09/2022

GBP

The passing of Her Majesty dominated the headlines last week in the UK, though understandably the impact on markets was muted. Sterling joined in the general European rally against the US dollar, though it did not quite keep pace with the euro. This week we will pay close attention to the labor market report out on Tuesday. We expect another strong showing across the board, including job creation, claimant count and wages, which should support our contention that a strong consumer buoyed by full employment and pandemic savings is likely to be the main pillar of the UK economy in the coming months.

EUR

The ECB delivered the massive 75bp hike we had penciled in. President Lagarde's press conference was muddled, as usual, but a drumbeat of "ECB sources" afterwards reaffirmed the hawkish pivot and sent both rates and the euro soaring higher. Another 75 bp rate is on the cards for October, and we still think that at around 2.5% the priced-in terminal level for ECB rates is way too low. This week's industrial production numbers are for July and hence too lagging to have much market impact, so the US CPI report on Tuesday should be the key for the euro as well.

USD

Second tier US data were consistent with our view that the economy retains momentum. The non-manufacturing ISM number surprised to the upside, confirming the story being told by the employment data. However, the increase in US rates lagged that seen elsewhere, and the dollar suffered as a consequence. All eyes are now in the inflation data out on Tuesday. The key focus will be on the core data, which strips out volatile food and energy components. The annualised change in this indicator has been on a gentle downward trend for the past few months, while remaining unacceptably high for the Federal Reserve. A reversal here would be very unwelcome news for the central bank and would necessitate further repricing of the expected terminal value for overnight rates in the US, currently hovering around 4%.

CHF

The Swiss franc was the best-performing G10 currency last week and outshined other safe havens. Near the end of it the EUR/CHF pair edged closer to the 0.96 level, albeit the franc gave up some of its gains in early trading today. Part of the currency's rally could have to do with a general improvement in sentiment towards Europe. Rates in Switzerland have also been repriced higher.

The attention slowly turns to the SNB meeting in the week after this one. Although we're leaning towards a 75 bp increase, we acknowledge that nothing can be ruled out. At the last meeting, the SNB surprised nearly everyone with a 50 basis point hike and could decide to stun the markets again in September. Speaking last week, SNB president Jordan emphasised that the move isn't settled and will be decided after the bank has the most current information.

In the meantime, the franc is likely to react to changes in sentiment and shifts in investors' expectations regarding policy tightening in Switzerland and the Euro Area.

AUD

Last week, the Australian dollar appreciated against the USD, benefiting from the Reserve Bank of Australia's hawkish stance and from the greenback's general weakness.

As widely expected, the RBA hiked rates by 50 basis points to 2.35% the fifth consecutive increase since May. According to the RBA governor, Philip Lowe, the rise in rates 'will help bring inflation back into the target range (of 2-3%) and create a more sustainable balance between demand and supply in the Australian economy'. Lowe's statement also confirmed that the decision makers expect to raise interest rates further in the coming months.

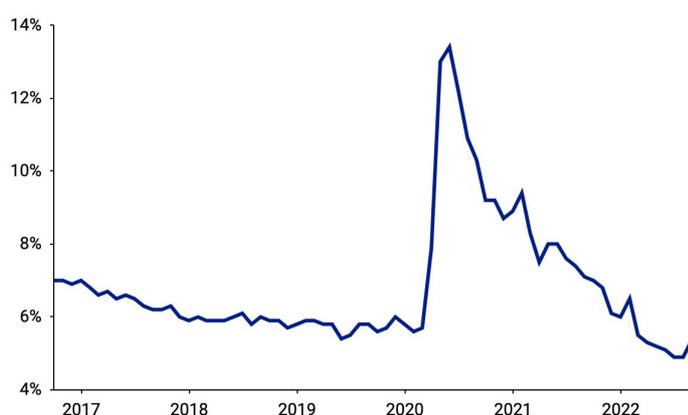
This week we'll focus on August labour market report, which could influence expectations for monetary policy tightening in Australia, and therefore, impact the Australian dollar.

CAD

The Canadian dollar appreciated against the USD last week, as did the majority of G10 currencies.

As expected, the Canadian central bank hiked rates by 75 basis points last week. At 3.25% the key rate is above the 'neutral rate' which the bank puts at between 2% and 3%. Moreover, the bank suggested that rates will have to increase further. As for last week's data, they were far from encouraging. The unemployment rate rose to 5.4% in August from the record-low of 4.9% observed in the previous two months, the first increase in the jobless rate in seven months.

Figure 2: Canada Unemployment Rate (2016 – 2022)



Source: Bloomberg Date: 12/09/2022

With no major domestic data on tap, we think that changes in oil prices and market sentiment will be the main drivers of the Canadian dollar this week.

CNY

The Chinese yuan has remained under pressure last week, albeit it managed to partly recover in its second half. Some of this recovery can be linked to the broad weakness of the US dollar. A report in Securities Daily and rumors regarding easing restrictions on house purchases, which could support demand, seem to have also helped the sentiment towards Chinese assets near the end of the week.

It's worth noting that People's Bank of China is taking increasingly bold steps to stem the currency's depreciation. Last week, the bank announced a cut in FX reserve requirement ratio to 6% from 8% and has recently set stronger-than-expected yuan fixings.

Even though inflation surprised to the downside, falling to 2.5% in August, expectations of near-term monetary policy easing have declined with the recent weakness of the yuan. 1-year MLF rate is set to remain unchanged this week. Other than that we're going to look out for economic data including industrial production and retail sales for August out on Friday. Coronavirus situation, which still remains rather difficult, will also be in focus during this holiday-shortened week.

Economic Calendar (12/09/2022 - 16/09/2022)

Economic Calendar	Country	Day	Date	Time (BST)
Industrial Production (Jul.)	UK	Monday	12/09	07:00
ILO Unemployment Rate 3M (Jul.)	UK	Tuesday	13/09	07:00
CPI Inflation (Aug.)	US	Tuesday	13/09	13:30
CPI Inflation (Aug.)	UK	Wednesday	14/09	07:00
Industrial Production (Jul.)	EZ	Wednesday	14/09	10:00
Unemployment Rate (Aug.)	AUS	Thursday	15/09	02:30
BoE Meeting	UK	Thursday	15/09	12:00
Retail Sales (Aug.)	US	Thursday	15/09	13:30
Industrial Production (Aug.)	US	Thursday	15/09	14:15
Industrial Production (Aug.)	CHN	Friday	16/09	03:00
Retail Sales (Aug.)	CHN	Friday	16/09	03:00
Retail Sales (Aug.)	UK	Friday	16/09	07:00
CPI Inflation (Aug.)	EZ	Friday	16/09	10:00

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