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Weekly Report

Weekly FX Market Update

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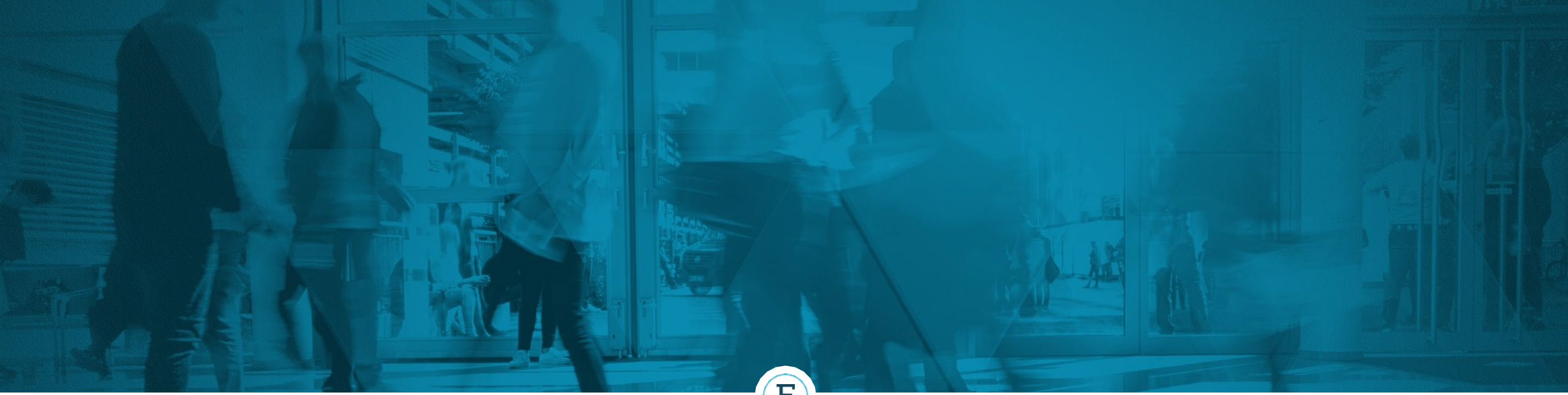


Sterling rallies after UK government’s dramatic tax U-turn

The pound stole the spotlight in yet another volatile week of FX trading.

Sterling rallied on news that Prime Minister Truss had fired Kwasi Kwarteng from his Chancellor of the Exchequer position, with UK assets reacting positively to the government U-turning on almost all of the tax cuts promised just three weeks ago. This was enough to propel the UK currency to the top of the FX performance rankings, as almost the only major currency to hold its own against the dollar. More bad news on the inflation front sent US yields soaring again and further fuelled the dollar rally.

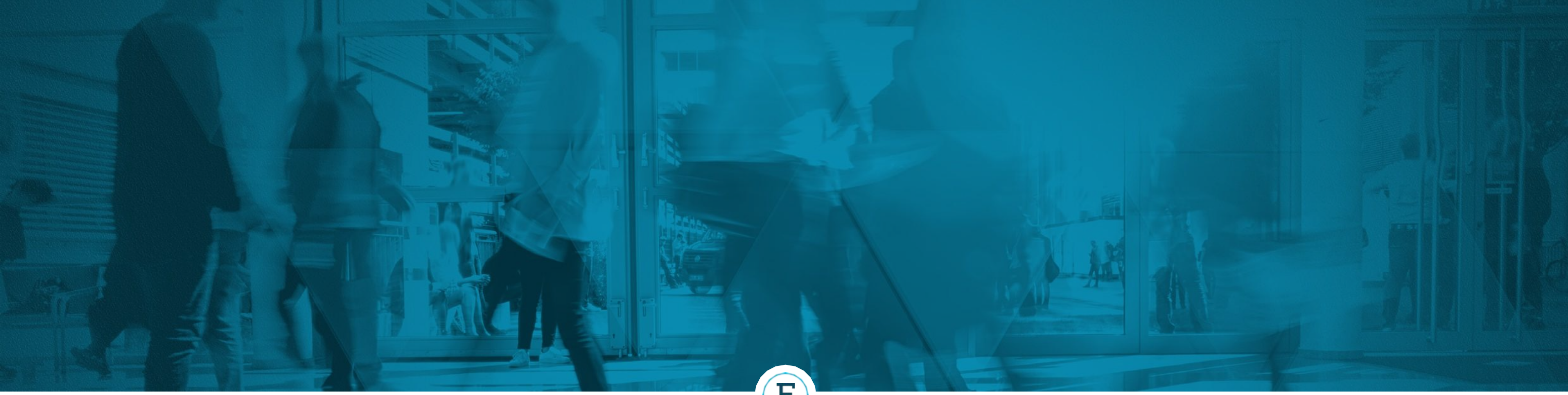
The week's best performers were the Eastern European currencies, which were buoyed by the Hungarian National Bank’s draft of extraordinary measures to combat forint depreciation, including massive rate hikes targeted at currency markets. Considering the negative inflation news, risk assets and the common currency held up remarkably well to end the week nearly unchanged.

A light economic calendar elsewhere means that the focus this week will once again be on the UK bond and currency markets, now that the Bank of England has promised to stop supporting the long-term bond market. The inflation report out of the UK on Wednesday is sure to add to the market drama. A slate of public speeches by Federal Reserve officials starting on Tuesday should also drive markets, as the expected Fed funds terminal rate inches closer to 5%.

CZK

The koruna sold off steadily throughout last week and the EUR/CZK pair returned to the 24.6 mark. The currency underperformed its peers, particularly the Hungarian forint, which received a major boost from series of central bank actions, including a 950 bps increase in the overnight collateralised lending rate, meaning the upper-end of its rate corridor is 25%.

Last week’s inflation data from Czechia surprised significantly to the upside. Price growth jumped to 18% in September and was the strongest since 1993. Core inflation, has, however stabilised, printing at 14.7% for the third month in a row, helped by the base effect. September print does not necessarily change the monetary landscape in Czechia. CNB’s deputy governor, Eva Zamrazilova commenting on the data did not find it surprising and stated that higher energy prices limit household spending in other areas.



CNB's governor, Ales Michl also touched on the inflation subject last week, assessing that government's plan for higher budget deficit this and the next year compared to its initial plan would make it more difficult to fight inflation.

This week's economic calendar for Czechia looks largely empty, we'll therefore focus primarily on outside new.

EUR

In a week with little news of note, the common currency performed remarkably well, managing to close unchanged against the dollar in spite of the bad inflation report in the US and the subsequent rise in Treasury yields. A sharp drop in EU natural gas prices since their peak in late-August has partly helped the euro, and indeed European currencies in general, which almost all sat near the top of the FX performances rankings last week.

New support packages for consumers and businesses to ease the impact of energy prices also continue to be announced, while markets appear to be quietly confident that energy shortages over the winter will be avoided. We think that the impact of all these demand-supporting measures is underappreciated and lowers the risk of a deep, prolonged recession in the common bloc. The significant drop in commodity prices from the summer highs has also eased the impact on European terms of trade, another improvement that we believe is not yet reflected in euro trading levels.

USD

The September US inflation report delivered the second consecutive unpleasant surprise. Once again the headline number dropped on easing energy prices, but the more meaningful core index broke through to yet another record, at 6.6%. Markets are now fully pricing in a 75bp interest rate hike from the Fed at its next monetary policy meeting in November, and now see a strong possibility that we could get another in December, with a terminal Fed funds rate of nearly 5%.

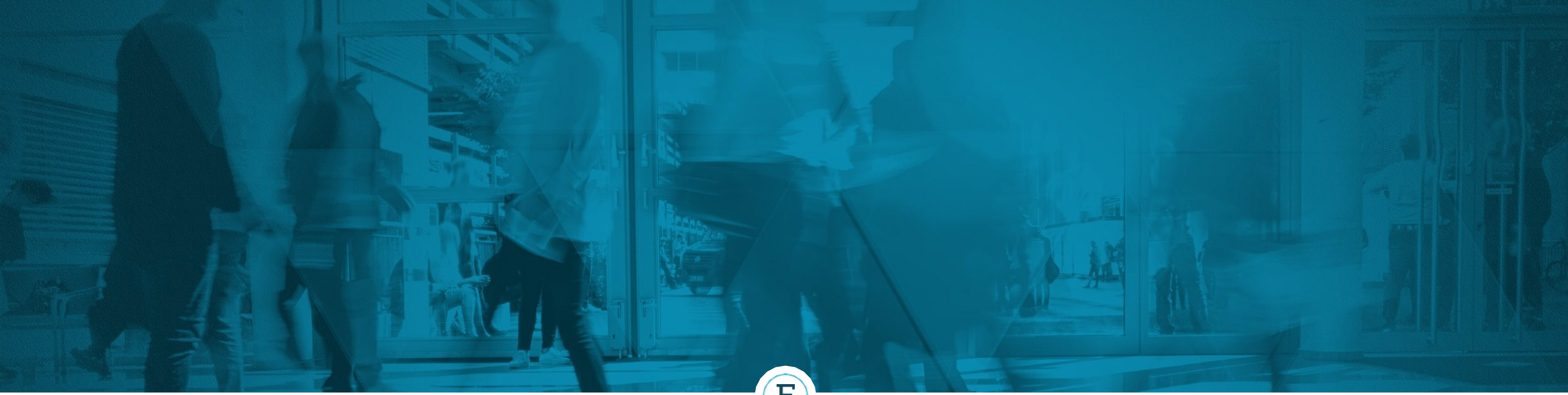
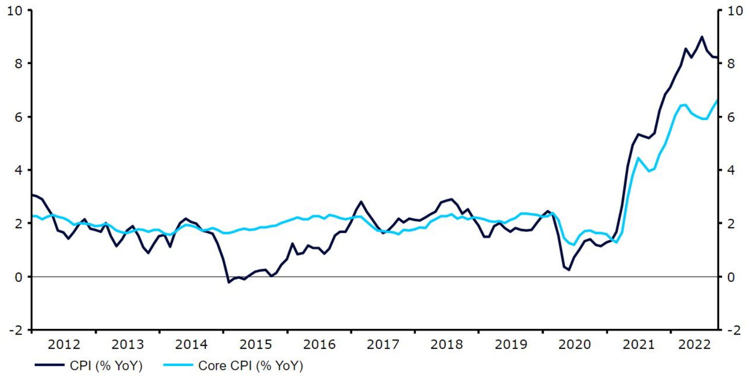


Figure 1: US Inflation Rate (2012 - 2022)



Source: Refinitiv Datastream Date: 17/10/2022

Without much in the way of first-tier economic news this week, the main news out of the US will come from the bond market. If longer-term yields have some sort of stability around current levels, there may be room for the dollar to give up some of its recent gains. A handful of Fed member speeches will also be closely watched, as markets try to gauge the likelihood of another bumper rate hike at the December FOMC meeting.

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