Weekly Report

Weekly FX Market Update

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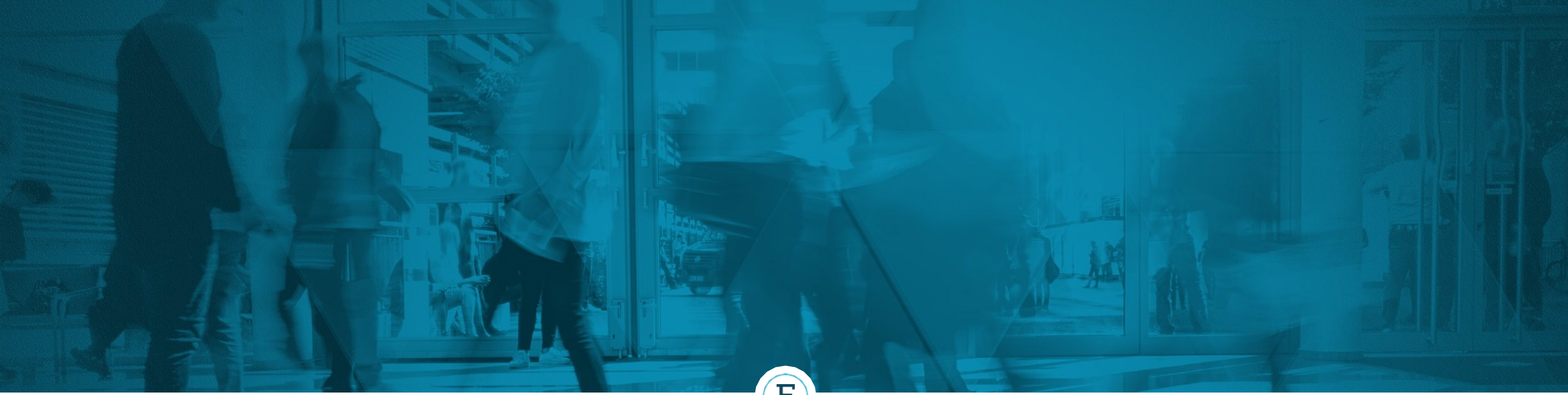


US dollar rally stalls in spite of hawkish Federal Reserve

Currency market volatility continues to rise, and signs are emerging that the dollar rally is running out of steam.

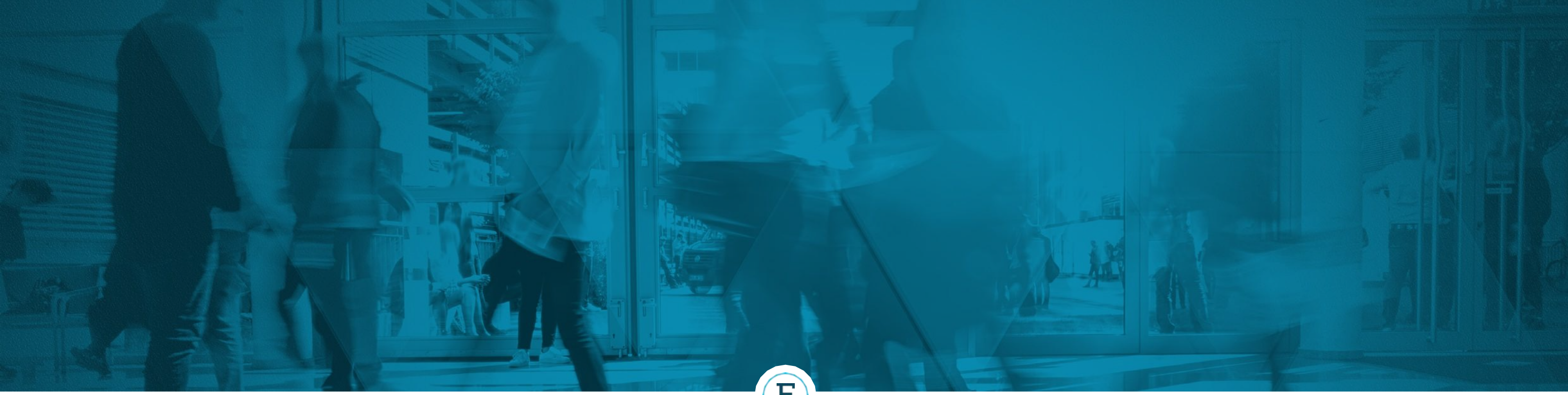
The Federal Reserve delivered a massive hike and a more hawkish than expected message, while other central banks begin to fret about the impact of higher rates on their respective economies. However, the dollar failed to rally and in fact fell against most G10 currencies, with the notable exception of sterling, which was hobbled by an uber-dovish Bank of England. The star of the week, and also the year so far, was undoubtedly the Brazilian real, a favourite of ours, which put in another scorching rally on the back of the peaceful transfer of power to what looks to be a moderate Lula administration.

All eyes turn now to the critical October CPI inflation report out of the US (Thursday). Headline prices will probably drop further as energy prices continue to moderate, but the key will be once again the more persistent core rate. Beyond economic news, it will be important to see whether signs of China easing its COVID policies are confirmed. As this is written, signs are emerging that last week's rally in Chineses assets may have been premature.

CZK

Koruna rallied to the strongest position since August against the euro today, extending last week’s gains. Part of this appreciation can be attributed to a slightly more-hawkish-than-expected tone of the CNB meeting last week. The move, however, is largely in line with the shifts of the broader market: most European, regional and emerging market currencies are showing gains.

As expected the CNB meeting did not yield a change in interest rates. The new CNB forecasts, however, showed much higher rates (PRIBOR 3M) than the previous one, raising hopes that the central bank may not rush with rate cuts – or pursue only slow adjustments in 2023. The Board also mentioned its willingness to intervene in the FX market and governor Michl suggested that the Board’s decision in December will be between a hike and rate stability – although we think any upward adjustments are unlikely.

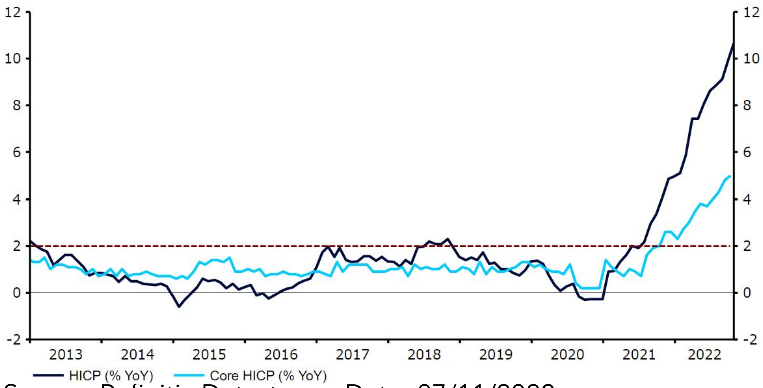


Aside from the CNB, it's worth mentioning last week's third-quarter GDP release. It was somewhat disappointing: the economy contracted on a quarterly basis (-0.4%) and annual expansion slowed substantially, to 1.6% from 3.7%. This week the attention will be on inflation print for October, out on Thursday.

EUR

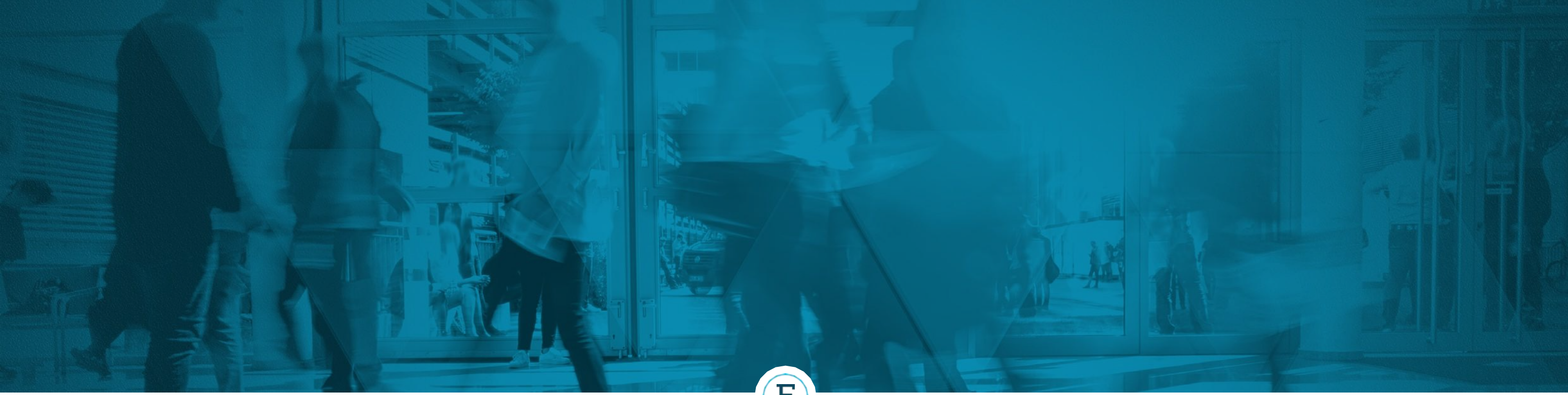
Another month, another blow out inflation report out of the Eurozone. This one came just a few days after the muddled attempt at a dovish pivot from the ECB at its meeting the previous week, thereby contributing to the developing credibility gap at the institution. In addition to double digit headline inflation, sticky core inflation continues to march higher.

Figure 1: Euro Area Inflation Rate (2013 - 2022)



Source: Refinitiv Datastream Date: 07/11/2022

On the plus side, the worst fears about a winter energy crisis continue to fade. On the negative side, early Monday morning reports from Asia suggest that hopes for an easing of Chinese lockdowns may have been premature, and hence the recovery of European exports to China may be further delayed. This week's main event in the Eurozone will be a number of ECB official speeches, including President Lagarde.



USD

Second tier data in the US from the housing market, consumer confidence and durable good orders all suggested that Fed hikes are finally beginning to have an effect. Weak tech company earnings also contributed to the sense that we may be reaching a pivot point, at least in the short-term, and that the Fed may be able to start easing off the brakes soon. The key, however, remains the labour market, where no signs of easing are evident yet.

Figure 2: US Nonfarm Payrolls (2021 - 2022)

Source: Refinitiv Datastream Date: 07/11/2022

The inflation report this week is expected to show another easing of headline annual price pressures on the back of lower energy costs. However, the key will be the core index that strips out the volatile food and energy components. The Fed needs to see a downward trend in these numbers before it can think of pausing hikes in interest rates, and is unlikely to see that in this report.

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