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Weekly Report

Weekly FX Market Update

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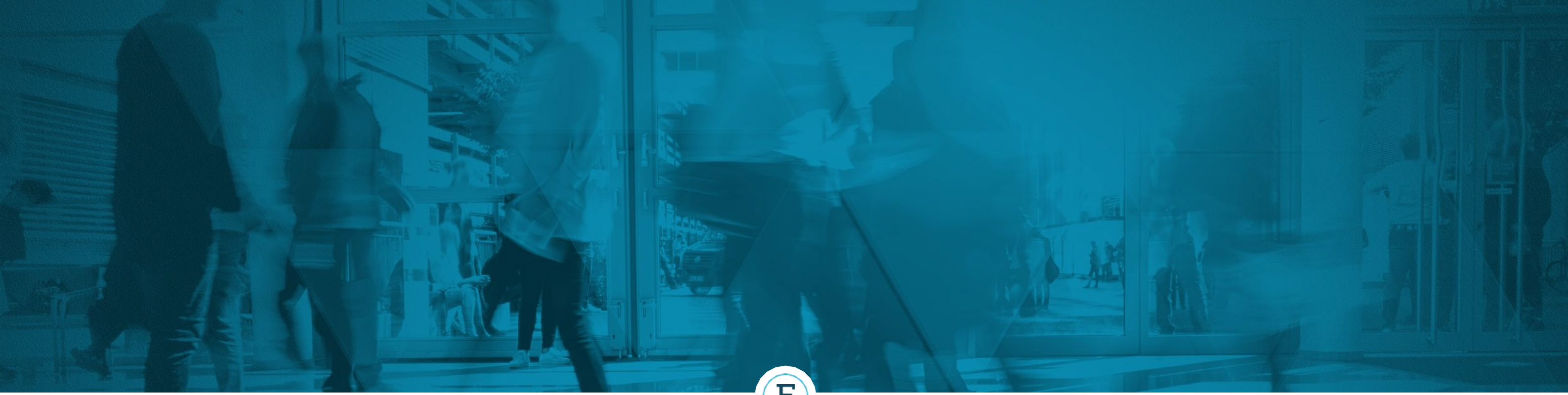


Dollar sinks on softer US inflation report

The news that markets had been desperately hoping for finally arrived last week.

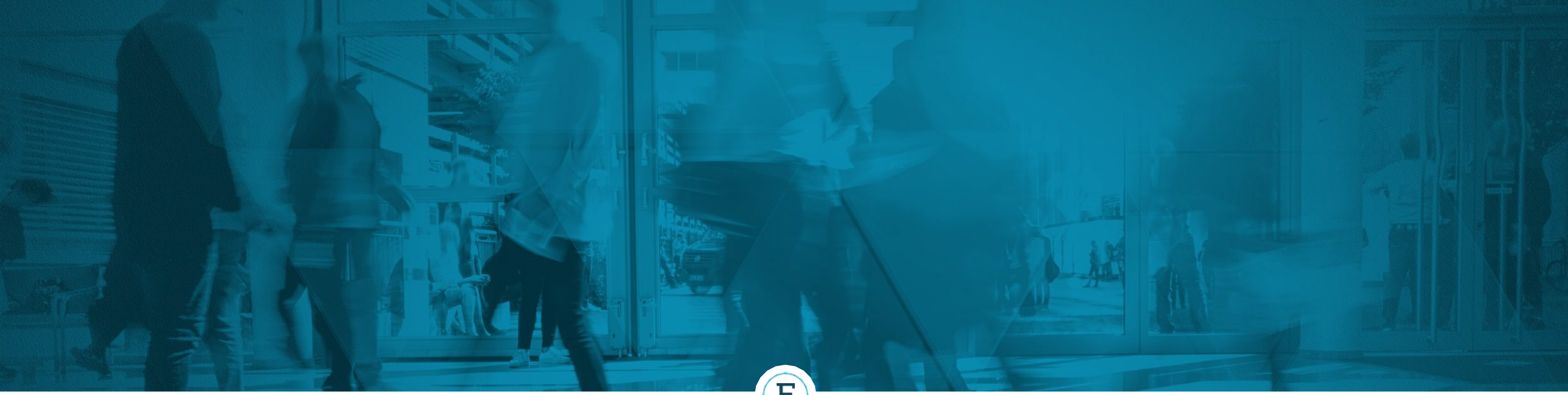
Inflation in the US came out lower than expected, US rates dropped the most since the pandemic era and risk assets worldwide soared in jubilation. The dollar experienced one of the sharpests two-day falls in history, falling anywhere from nearly 6% (against the Japanese yen) to just under two percent (against the Canadian dollar, the week's second-worst performer). Emerging market currencies also rose. The notable exception was the Brazilian real, where markets had a brutal reaction to a Lula speech suggesting that he favours Truss-style unfunded spending.

This week the focus will be on a raft of inflation reports for the month of October in several G10 countries including Sweden, Canada, the UK, and Japan. These will be scrutinised for signs that inflation is peaking, though we think that the positive surprise out of the US last week cannot be extrapolated to other economic areas. We will also be paying attention to two scheduled speeches from ECB President Lagarde. For now, the relentless dollar rally appears to have peaked, and the path of least resistance for the greenback may be down in the short-term.

CZK

Although during the first half of the week koruna seems to have succumbed to profit-taking, improvement in sentiment since Thursday enabled the currency to eke out gains for the week. Falling US yields, decreasing chance of aggressive policy tightening from the Fed, and significant pressure on the US dollar was all good news for the koruna, as for other EM currencies. Some optimism with regard to easing restrictions in China seems to have helped as well.

Most readings from Czechia were quite positive last week, but the attention was squarely on the inflation print. Inflation fell to 15.1% in October from 18% in the previous month and was far lower than anyone expected. The decline of 1.4% on a month-over-month basis was the biggest on record. However, instead of easing price pressures, it reflected the government’s measures addressing energy prices. Half of the categories measured by the statistical office showed price increases in annual terms and food inflation – as in other CEE countries – was particularly rampant (25.1% YoY). Inflation report is unlikely to be a game-changer for the CNB but supports our view that the hiking cycle has already ended. In the next few days, we’ll focus mostly on outside news.



EUR

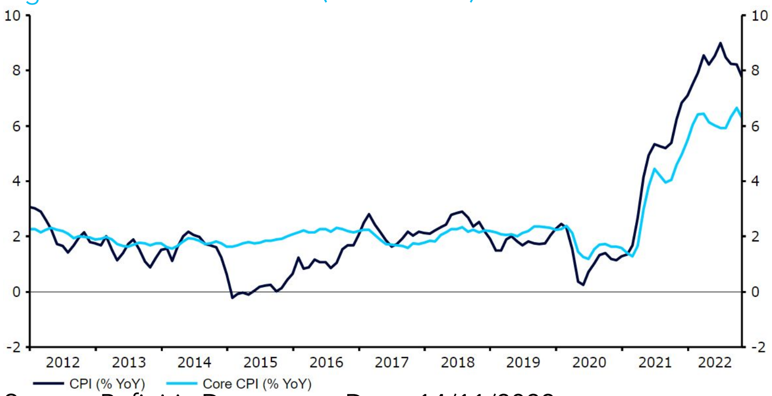
No news of any importance out of the Eurozone last week left the euro to trade mostly off events taking place elsewhere, notably the US inflation report. That said, we did get a handful of ECB member speeches, which mostly struck a hawkish tone, suggesting that there will be no let up in rate hikes just yet.

Easing of some COVID restrictions in China, a positive in the context of appetite for European exports there, also buoyed the common currency to a near 4% rise against the dollar. We still see market pricing for European terminal rates way too low and out of touch with economic reality and the relentless rise in inflation. Lagarde has two opportunities to jawbone these rates higher, one of Wednesday and another Friday. There will be little else to move markets in the Eurozone this week.

USD

One swallow does not a summer make, but the October inflation report was good news and was justly celebrated by markets as such. Goods prices came in lower than expected and drove both the core and headline numbers down from the previous month. The headline number has now been falling for some months, and while the more important core index is not yet falling, neither is it rising.

Figure 1: US Inflation Rate (2012 - 2022)



Source: Refinitiv Datastream Date: 14/11/2022

This week will be light in terms of data out of the US, but we will be getting a surfeit of Fed speeches, no fewer than seven in all. Markets will eagerly read them for hints on the impact of last week's inflation report on Fed expectations for the December hike and the terminal Fed Funds rate.

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