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February 2024

Market Commentary
Key Themes Driving Currency Markets

G10 Currency Moves:

USD — **Appreciated** following continued US economic outperformance supported by an upside inflation surprise and blowout NFP print

EUR — **Appreciated** following an upside core inflation print and encouraging activity data has led to upward market repricing of rate expectations

JPY — **Depreciated** due to strong push back by the Governor that BoJ was not about to embark on a tightening cycle and below consensus GDP growth figure

GBP — **Appreciated** as BoE signalled they are still waiting for affirmation in the wage and inflation data before discussing rate cuts

CHF — **Depreciated** as inflation printed far below consensus and SNB continued to operate a neutral FX intervention policy

CAD — **Depreciated** as inflation declined below consensus and labour market data continued to demonstrate resilience

AUD — **Depreciated** as inflation undershot expectations and labour market data showed weakness keeping the market wary of rate cuts this year

SEK — **Appreciated** as inflation printed above consensus, keeping markets wary of Riksbank's previous communication that inflation is unlikely to become entrenched

NZD — **Appreciated** as RBNZ committee kept rates on hold and unemployment rate released below expectations

Appreciation/depreciation is average against G10 universe

Central Banks: Balancing Slower Disinflation Risks with Growth Slowdown

Overall, G10 central banks continue to remain in a highly data dependent approach before implementing rate cuts but are unlikely to hike rates further. Recently, this has led to a low volatility environment in FX markets as rates await further guidance from central banks over the outlook for this year.

US headline inflation printed above-expected at 3.1% YoY versus 2.9% consensus, and core inflation at 3.9% YoY versus 3.7% consensus. This reflected a continued disinflationary trend in goods, as well as energy prices remaining more benign, waning of geopolitical risks and supply chain bottlenecks. However, services inflation continues to remain on the sticky side, fuelled by a strong labour market and wage pressures currently at 4.5% YoY versus 4.1% (average hourly earnings). The non-farm payroll number was far above expectations at 353K versus 180K, led by higher-than-expected gains in many growth-enhancing sectors such as professional and business services. Unemployment remained at 3.7% versus the 3.8% uptick expected, all leading an upward repricing in OIS-implied rate expectations (Figure 1).

Japan entered a technical recession following its negative Q4 GDP reading, which weighed on the Bank of Japan's longer dated rate expectations as they aim to balance the growth slowdown risks with battling above-target inflation. A key consideration for the Bank of Japan will be the current output gap, as weak domestic demand and a declining population could continue to create challenges for a durable inflation level. This prompted policymakers such as Uchida to comment that they are 'not about to embark on a tightening cycle'. Core inflation later printed 2.0% YoY which shows the first move within target range in 21 consecutive months, however with 1.8% expected there was still a slight upward repricing for 1-year and 2 year OIS rates.

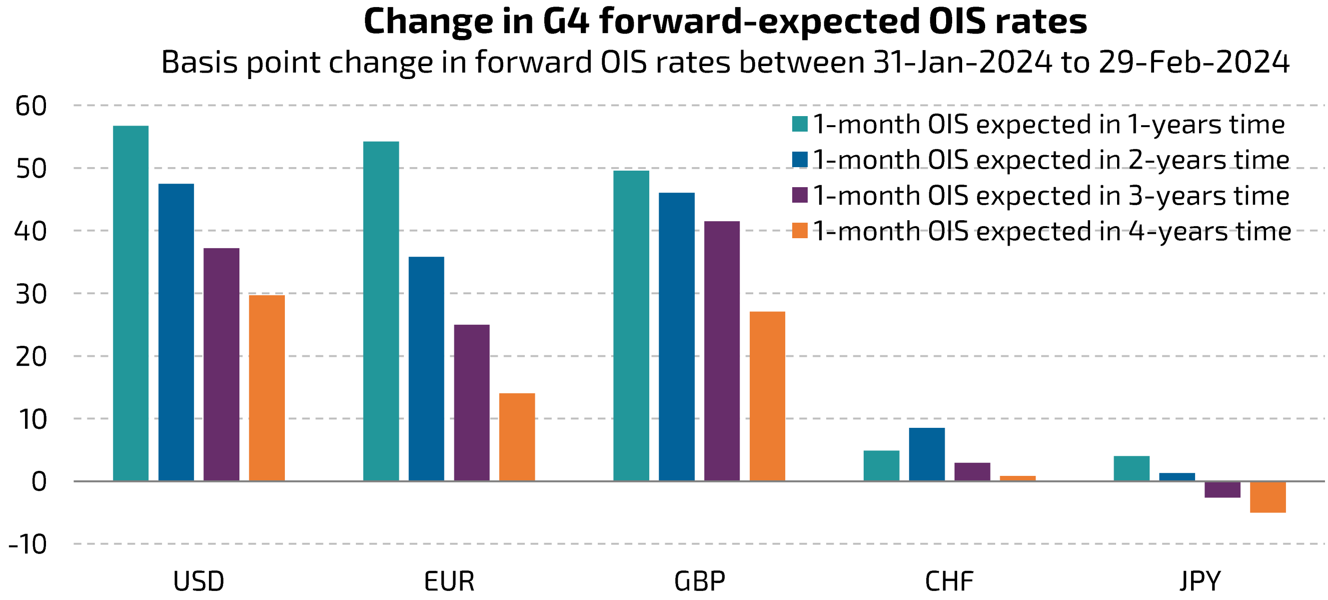

Figure 1: Record, Bloomberg. Data as of 29 February 2024.

The **Bank of England** left interest rates on hold at 5.25%, signalling a continuation of their data-led approach to rate setting given inflation risks are now more balanced. The breadth of opinions was notable as two policymakers preferred an additional 25bps hike while one favoured a cut. The committee signalled that they are cautious of sticky wage growth keeping services inflation elevated and require more confidence of a sustainable return towards target. However, in an encouraging sign, headline inflation later receded to 4.0% YoY versus 4.2% and core inflation at 5.1% YoY versus 5.2% consensus. Furthermore, the Bank will remain wary about the growth risk as the Q4 GDP growth printed -0.3% QoQ, confirming the UK entered a technical recession at the end of 2023.

As expected, **Eurozone** headline inflation printed 2.8% YoY while core inflation printed 3.3% YoY versus 3.2% consensus in a continued moderation of price pressures. However, given core services remained above-consensus it is difficult to conclude whether price pressures have abated enough to warrant an ECB guidance pivot at their next policy meeting. While there have been signs of growth resilience such as outperforming PMI readings, the longer-term growth risks seem tilted to the downside which may begin to spark rate cut timing discussions, especially since other indicators such as economic sentiment index are underperforming.

Switzerland inflation printed below consensus at 1.3% YoY versus 1.7% expected, driven largely by continued imported goods disinflation, which has begun to decline sharply given the SNB's strong franc policy for most of last year. This will keep the SNB wary of current rate levels and potentially begin to discuss or implement rate cuts at their March policy meeting, especially since unemployment ticked higher to 2.5% and Q4 2023 GDP. However, growth is still remaining relatively more resilient than their Eurozone counterparts, printing 0.3% QoQ for Q4 2023 versus 0.1% expected.

The **Reserve Bank Australia** kept their policy rate on hold at 4.35% as expected. Policymakers signalled that prices continued to ease in an encouraging sign, but inflation remained high as prices of services were not falling quickly enough. However, inflation remained flat at 3.4% YoY versus 3.6% expected with relatively broad-based spread across sectors. In addition, unemployment ticked higher to 4.1% while employment only advanced 0.5K versus 30K expected in a further sign of stagnating labour market conditions.

Canada inflation rate receded to 2.9% YoY versus 3.3% consensus, led by declines in transportation and food in a sign that inflation is moving more consistently towards target. However, the markets have scaled back their rate cut expectations as unemployment ticked lower to 5.7% versus the expected uptick to 5.9%, and the overall employment also increased by 37.5K versus 15K consensus.

In **Sweden**, the Riksbank kept interest rates on hold at 4.0% as expected as they reiterated previous rate hikes have alleviated high inflation concerns. Inflation reaccelerated to 5.4% YoY versus 5.1% consensus driven largely by housing components, however, the Executive board believes there's less risk of inflation becoming entrenched suggesting a possible earlier rate cut. The unemployment rate continues to tick higher now at 8.5%, and Q4 2023 GDP growth declined -0.1% QoQ as expected.

Additional Information

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