January 2024

Market Commentary
Key Themes Driving Currency Markets

G10 Currency Moves:

USD — **Appreciated** as rate expectations were revised upwards following surprisingly strong December numbers and Fed pushback against market expectations

EUR — **Appreciated** with no signal as to rate cut timings and inflation remaining above consensus

JPY — **Depreciated** as hawkish comments from Ueda normalisation were negated by a moderation in core inflation

GBP — **Appreciated** with strong inflation and growth data signalling potential BoE pushback against rate cut

CHF — **Appreciated** following signals the SNB is no longer targeting CHF strength through FX reserve sales

CAD — **Depreciated** on the back of falling oil prices and indications of rate cuts in 2023

AUD — **Depreciated** due to below consensus inflation print and signs of stagnating growth

SEK — **Depreciated** following lower inflation, weaker growth and high unemployment data

NZD — **Depreciated** as inflation fell again and PMIs remained contractionary

Appreciation/depreciation is average against G10 universe

Rate cuts and Conflict in the Middle East

Data-Dependency of Central Banks:

The **US Federal Reserve** kept interest rates on hold, while signalling confidence that inflation and employment are moving into balance. Chairman Powell pushed back against the market's expectation of rate cuts as early as March, requiring further evidence that inflation is moving sustainably towards the target. A combination of above consensus December non-farm payrolls, demonstrating resilience in the labour market, and sticky CPI inflation, tempered disinflation momentum (Figure 1).

The **Bank of Japan** again kept interest rates on hold in negative territory and left its 10-year yield target unchanged. Governor Ueda was assessed as being hawkish, indicating that the likelihood of achieving the price goal has 'continued to gradually rise'. Additionally, he commented that real wages need not return to positive territory before the BoJ can hike rates, which led markets to pull forward slightly the expected timing of Japan's first rate hike. Core inflation moderated further towards the central bank's target.

UK inflation printed higher than expected at 4.0% YoY (3.8% expected), driven by core services which continued to print higher than the Bank of England would like. Meanwhile, growth is also showing signs of resilience with November GDP showing a 0.3% MoM increase, and PMIs surprising to the upside for January. Markets maintained the view that the BoE would wait longer to cut than the Fed and ECB.

The **ECB** kept interest rates on hold at 4.5% with the Bank continuing to signal a data-dependent approach to policymaking while uncertainties remain. President Lagarde reiterated that policymakers need further data prints to reassure them of sustainable disinflation before rate cuts are discussed, with an emphasis on wage data and

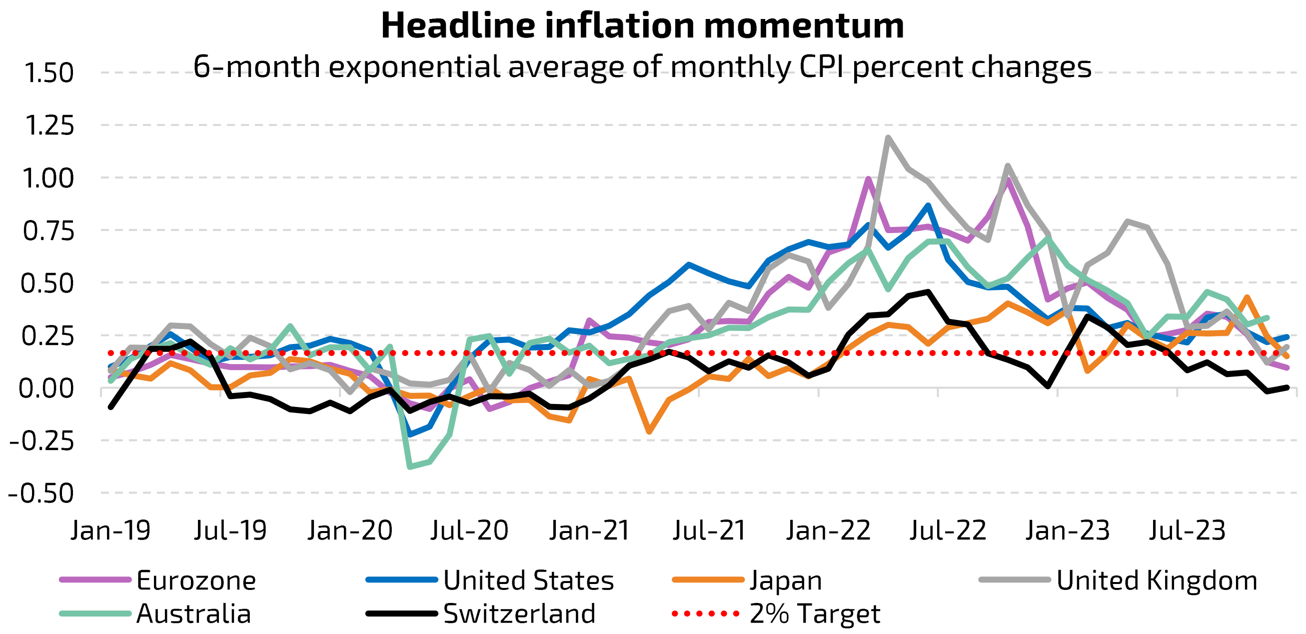

Figure 1: Record, Macrobond. Data as of 30 January 2024.

the implications for service prices. However, Eurozone PMI numbers stood out as an underperformer compared with the US and UK, highlighting the current growth risks within the region.

Switzerland's inflation came in higher than expected at 1.7% YoY versus 1.5% consensus, in line with broader European pressures. Despite this, the SNB made no adjustments to its previous signalling that it is no longer targeting nominal CHF strength with inflation moving back below target.

Australia's inflation printed less than expected at 4.1% YoY versus 4.3% consensus, keeping the RBA cautiously optimistic about the speed of the disinflationary process. However, the RBA is still expected to be one of the less dovish central banks this year with the first cut not priced until August on the back of much stickier services inflation.

The **Bank of Canada** kept interest rates on hold at 5.0% and turned their attention towards how long to maintain restrictive rates. The Bank acknowledged the lack of sustained core disinflation following an above-consensus print which will keep policymakers wary of pre-emptive rate cuts. However, the BoC will remain cautious of the cooling labor market and contracting retail sales when deliberating cutting timing.

Sweden's inflation came in closer to target at 4.4% YoY, Q4 growth figures were below consensus and unemployment increased to 7.7%, all putting pressure on the Riksbank to start considering rate cuts. The Riksbank FX hedging programme (which has bolstered SEK strength) is also likely reaching its end near early February given the programme sizes of 8bn USD and 2bn EUR are close to being reached.

Overall, G10 central banks have shifted their focus towards the discussion of how long to keep rates at their current restrictive levels. A data dependent approach seems pervasive, with policymakers closely watching incoming inflation, labor market and growth data to determine the timing of their first rate cuts this year.

Conflict in the Middle East and the Oil Market:

The outbreak of the Israel-Hamas conflict has emboldened Iranian-backed Houthi militants to attack ships in the Red Sea. In response, the US and UK conducted military strikes in Yemen to protect vessels, prompting the Houthi leader to threaten more significant attacks than those already carried out. The world's leading oil tank operators have largely been driven away from the Red Sea trade route, leading the oil price to jump above the $80/barrel mark briefly towards the end of January. Energy traders have warned that higher prices could sustain given the war risks contagion of the conflict to the wider region. Many tanker operators have confirmed they will avoid the region, running the risk of adding significant time and costs to shipments.

If a permanent change in the price of oil leads traders to reassess the 'fair' terms of trade level, we need to consider whether the FX market will adjust in favour of petrocurrencies and at the expense of oil importing nations. Monitoring the impact of geopolitical tensions on commodity prices will prove more important for keeping second order effects of inflation at bay and will be an increasingly relevant theme for FX.

Additional Information

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