

G10 Weekly FX Update

Dollar on the back foot as Trump trade takes a breather

Written by:

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Dollar on the back foot as Trump trade takes a breather.

The so-called Trump trade suffered a meaningful reversal last week, with possible profit taking and month-end rebalancing flows also contributing to a broad dollar retracement.



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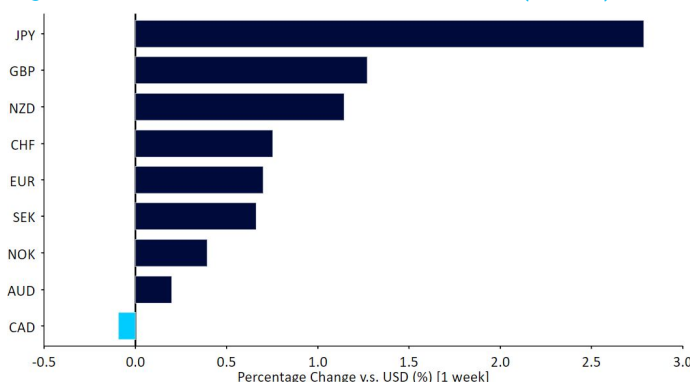
Highlights:

- USD gives back gains as Trump trade unwinds.
- Euro Area inflation picks up, but ECB to stay dovish.
- JPY outperforms on BoJ rate hike bets.
- AUD lags behind after soft inflation report.
- RBNZ delivers 50bp cut, but strikes hawkish note.
- Canada tariff threat triggers CAD sell-off.

Treasury yields retreated, possibly on relief that US inflation came out largely as expected. The dollar gave up some of its gains, ending the week down against every G10 currency, except the Canadian dollar. The euro was helped along by hawkish noises from ECB officials who seemed to push back against expectations for a 50bp cut this month. The week's clear winner was the Japanese yen, up sharply on stronger than expected inflation and general repricing for Bank of Japan hikes in 2025. On the downside, the Brazilian real was the worst performer, as Lula's government budget disappointed investors.

As we go into year-end, markets should refocus away from Trump's cabinet picks (the most important have already been made) and back towards central bank meetings. None of the critical ones will take place this week, but uncertainty over upcoming decisions means that the remaining data points are critical. Friday's payrolls report stands out, but Euro Area retail sales provides one of the few hard data references for the ECB before its momentous decision on 12th December.

Figure 1: G10 FX Performance Tracker [vs. USD] (1 week)



Source: LSEG Datastream Date: 02/12/2024

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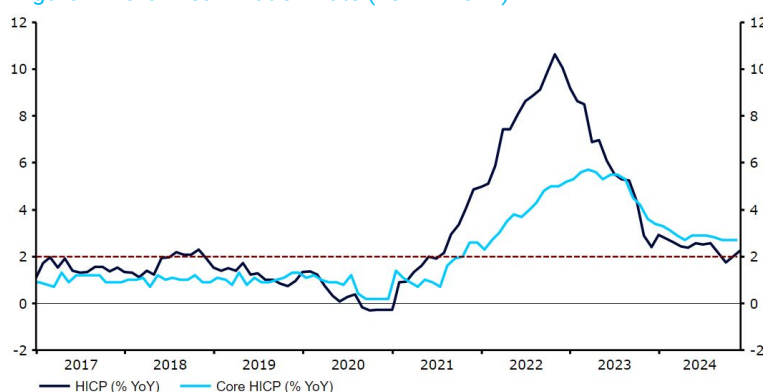
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The Thanksgiving holiday in the US traditionally means a shortened week of light trading, and last week was no exception. Data on inflation, incomes, durable goods and jobless claims remained consistent with healthy growth amidst a thriving labour market.

This week's payroll report is doubly important, both because it is the last one before the December Federal Reserve meeting, and also because the previous one was muddled by the Boeing strike and the hurricanes that hit Florida and the South. We think the Fed's decision to either cut rates or leave them unchanged later in the month will be crucially dependent on the outcome of this report and the inflation one the following week. As things stands, markets see around a 60% chance of a 25bp cut this month, so there is plenty of scope for a repricing in either direction.

November flash inflation data in the Eurozone confirmed that price pressures remain steady. They are somewhat above ECB targets, but have yet to show any worrisome signs of reacceleration, while monthly prices are actually falling, in spite of solid growth in wages. Consumer confidence data, however, is displaying a similar malaise to its business counterpart, and confirms the remarkable gloom that has settled over the European economy.

Figure 2: Euro Area Inflation Rate (2017 - 2024)



Source: LSEG Datastream Date: 02/12/2024

Another front may have opened up for the ECB in the French budget negotiations, as French risk premia spike on fears of a government collapse. However, ECB pushback has forced markets to nearly price out the chance of a jumbo 50bp cut later this month, which is providing some support for the common currency around current levels.



United Kingdom

GBP

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Japan

JPY

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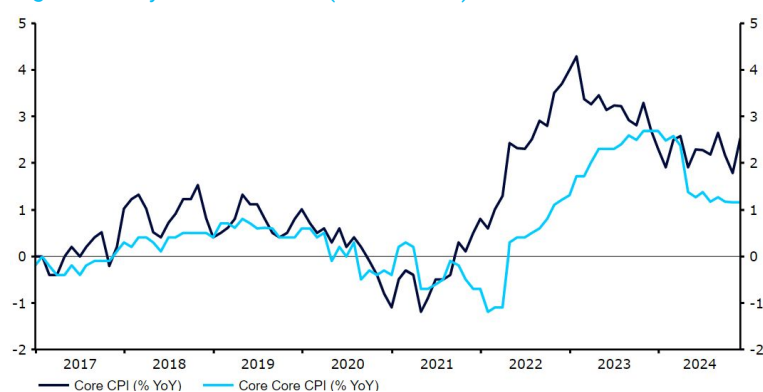
Sterling rebounded along with its European peer currencies in a week where almost no domestic data of note was released. Indeed, aside from the Japanese yen, the pound was the best performer in the G10 last week, which can perhaps be at least partly attributed to expectations that the Bank of England will be one of the more cautious major central banks in 2025. The rebound restored the pound to the top of the 2024 FX performance rankings, reclaiming the title from the dollar, although just barely.

Markets have priced out almost completely any chance of a Bank of England cut at its next meeting this month. High rates and relatively low exposure to the risk of Trump's tariffs mean that the pound's path of least resistance is probably up from here, even if the recent budget announcement makes it difficult to see a meaningful boost to UK growth.

A sharp upward repricing in Japan rate expectations provided a clear lift for the yen last week, which briefly rallied back below the 150 level on the US dollar for the first time in a couple of weeks. Recent inflation news has surprised to the upside. The November Tokyo CPI numbers out last week showed an acceleration in underlying price pressures, with the core number unexpectedly rising to 2.2%, from 1.8% - above the Bank of Japan's 2% target. Communications from BoJ governor Ueda have also been hawkish - he explicitly said last week that interest rate hikes are 'nearing'.

The above does not necessarily cement the case for a December rate hike, but it does at least make one increasingly likely. At any rate, investors now expect the BoJ to be more active in 2025 than had been previously anticipated, which can only be positive for the Japanese currency. At the time of writing, swap markets are pricing in 15 basis points of hikes at the 19th December meeting, with a total of 50bps seen through to the end of next year.

Figure 3: Tokyo Inflation Rate (2017 - 2024)



Source: LSEG Datastream Date: 02/12/2024

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The franc lagged behind most other major currencies last week, although ended little changed against the euro. Domestic macroeconomic news was rather mixed. The lagging third quarter GDP estimate came in better than expected, with the economy expanding by 2% year-on-year, above the 1.8% consensus. More timely indicators were on the soft side, however. In a sign of still rather fragile domestic demand, October retail sales contracted for the second straight month, while the November manufacturing PMI sank to a four month low 48.5.

Undoubtedly the main focus of trading in Switzerland this week will be the November inflation report on Tuesday. Markets are overwhelmingly expecting the Swiss National Bank to deliver another rate cut next week, but Tuesday's CPI data could settle whether this will be a 25 or 50 basis point cut.

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The Aussie dollar lagged behind its major peers last week as markets reacted to a surprise miss in the October inflation data (2.1% vs. 2.3% estimate). While we contest that one print probably won't change things too much for the Reserve Bank of Australia, investors have at least raised bets for easing in 2025, with around 40 basis points of cuts now seen by July, up from around 15 basis points in mid-November.

This week will be a rather busy one in Australia. We will be keeping close tabs on the latest PMI numbers for November (Tuesday) and the Q3 GDP report (Wednesday). Economists are bracing for a modest bounce in the latter, which would continue to ease concerns over the state of the domestic economy.

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The Reserve Bank of New Zealand matched expectations last week, cutting rates by 50 basis points to 4.25%. The bank's communications were more hawkish than the market had anticipated, with officials appearing comfortable with the recent weak performance of the domestic economy and the recovery. There was also no mention of a 75 basis point cut, which had been partly priced in prior to the announcement. Another 50bp move in February remains on the table, but the upward revision to the RBNZ's expected neutral rate suggests that they could take a more gradual approach to cuts in 2025. This provided decent support for the kiwi last week, which rallied by around 1% on its Australian counterpart.

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The Canadian dollar sold off sharply last week following Trump's 25% tariff threat, hitting its lowest level since the pandemic. However, the loonie managed to regain some ground as market participants took a moment to digest it all. Later in the week, Trump's comments helped ease investors' nerves, as he described his dinner with Canada's PM as a "very productive meeting". It is yet to be confirmed whether or not the tariffs will see the light of day, but it certainly raises the stakes for the USMCA renegotiation provision that Trump vowed to invoke upon taking office.

At any rate, the renegotiation of the agreement is likely to create challenges for Canadian exporters, and any retaliatory tariffs could push costs up for local producers. Inflation would rise, causing growth to stall as the Bank of Canada is forced into leaving rates higher. This issue could remain on the sidelines for a while, so the spotlight will likely shift back to monetary policy. The BoC is expected to cut rates on the 11th, and Friday's (6th) jobs report should provide some insight into that decision, although we don't believe it will be enough to force a large cut, and a 25 basis point reduction remains our base case scenario.

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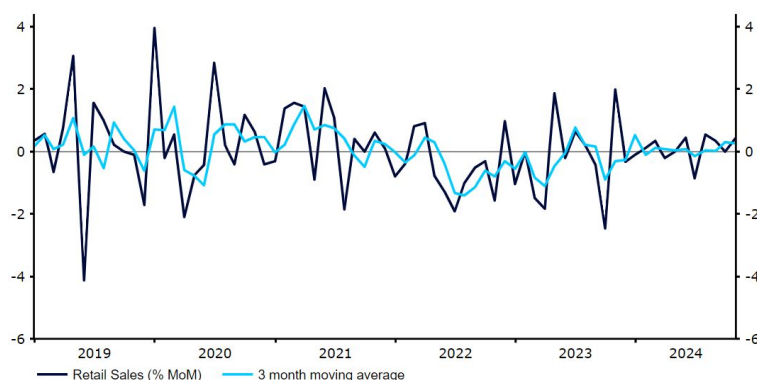
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Although still historically very low, household borrowing growth appears to be increasing. It is apparent that the Riksbank's cycle of interest rate cuts, initiated in May, is beginning to have an effect (recall that the transmission between rates and the performance of the economy is one of the fastest worldwide in Sweden). Growth data itself was also promising in the past week. GDP turned out to be significantly higher than initial estimates, rising to 0.3% QoQ and 0.7% YoY, which could be considered rather impressive for this point in the cycle. This is largely due to the strong performance of Swedish exports - the current account surplus is 3-4 times higher than in the years preceding the COVID-19 pandemic and the highest on record. Confidence indicators also hit new highs, with the domestic demand proxy, retail sales, remaining at positive levels.

Ahead of us (on Thursday) is the November inflation reading, which has remained around the Riksbank's inflation target since September and shows little sign of falling out of it any time soon. The argument on whether the bank will opt for a standard 25 bp cut or yet another jumbo one will likely be present right up until the 19th December meeting. For now, we tend to lean towards the first option, although a more aggressive pace of cuts is not out of the question.

Figure 4: Sweden Retail Sales (2019 - 2024)



Source: LSEG Datastream Date: 02/12/2024



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The OPEC+ meeting has been postponed to 5 December (Thursday), suggesting that the planned oil output hike may also be delayed somewhat and not occur at the very beginning of January, as previously speculated. The market reaction to this announcement was marginal, however, and oil prices remained almost unchanged. The Norwegian krone itself continues to be highly volatile, on the other hand. After a very successful week, it posted rather large losses against the euro, despite the unwinding in the Trump trade. Domestic data was rather sparse and confirmed that the labour market is unlikely to be of concern at the moment.

Wednesday will bring the current account reading for the third quarter and the November house price index. While the former should confirm the prevailing optimism and remain at a high level, the latter may renew concerns over inflation should we see a continuation of the recent trend. More important for the krona, however, will likely be external factors and, possibly, Thursday's OPEC+ decision.



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The yuan traded largely sideways against the US dollar during the relatively quiet Thanksgiving week. Macroeconomic news out of China was light last week, until the release of the latest PMI figures from Caixin and NBS over the weekend. These were relatively mixed. Non-manufacturing activity ground to a half last month according to NBS (50 vs. 50.2 estimate). Growth in the manufacturing sector remains positive, however, with both of the indices from NBS (50.3) and Caixin (51.5) advancing on the previous month.

Attention this week will again be on the latest business activity PMI figures, with the services index from Caixin due on Wednesday.



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