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Projected rate paths are key for NZD and SEK

Over the past three weeks, we have been discussing inflation concerns and bond market pricing in the week ahead given their instrumental roles in FX markets in the current climate. In the past week, these dynamics sat front of mind for most investors yet again as bear steepening in the US yield curve sent EURUSD to fresh 16-month lows and EM markets began to wobble. Not to be left out, the Turkish lira captured most of the headlines throughout the week as President Erdogan showed his preference for lower rates to tackle inflation, pushing the lira down 6% in the run-up to the Thursday CBRT meeting, until a 100bps cut by the central bank sent USDTRY soaring above the 11.00 handle to mark double digit losses on the week. This had ramifications across the EM space as a whole, with the rand falling close to a percentage point despite the SARB conducting their first rate hike of the cycle by increasing rates 25bps, and other high yielding currencies also feeling the pinch from deteriorating risk sentiment.

Amid the current environment, it has been difficult to look beyond the dollar on the whole. However, notable performances have been logged by GBP, NZD and CHF. In a week where the DXY index rose to test the 96 handle, the pound has notched marginal gains against the greenback as economic data confirmed a rate hike from the BoE in December is the most likely scenario. Meanwhile, an above target report on 2-year inflation expectations emboldened calls for the RBNZ to commit to a steeper hiking path, helping the Kiwi dollar trade on a more stable footing than its Australian counterpart, and deteriorating conditions in Europe finally pushed EURCHF through the 1.05 level.

> Next week, **focus will not only remain on how markets price central bank tolerances to inflation, but also global growth conditions** as Covid cases begin to rise and force major nations to impose tighter containment measures.

On top of that, Swiss sight deposit data will be scrutinised as EURCHF traded questionably stable around the 1.05 level for most of this week. Still, the data may prove less relevant given Friday's price action saw the rate dive below the previous intervention level. Bank of England speakers will also be heavily followed as markets position for December's meeting but remain cautious of previous miscommunications. Finally, the RBNZ is expected to hike rates again by 25bps, but the main focus will be on their implied tightening path amid the latest inflation expectations report. Risks of a 50bps aren't immaterial, however.

Calendar (all times GMT)

Monday – 22/11

The week's data calendar begins with **Swiss sight deposit data at 09:00** for the week of November 19th. The data will be examined for signs of SNB intervention, however, we view the latest stabilisation in EURCHF around the 1.05 level as market driven and a psychological by-product of 2020's intervention. Given Friday's breach down to the mid-1.04 level, any uptick in sight deposits may be viewed as the SNB managing the pace of exchange rate appreciation as opposed to preventing it. However, the data is unlikely to give too many clues as to the answer to the question on everyone's lips right now: what is the SNB's new line in the sand for EURCHF?

For the rest of the day, the data calendar focuses on economic activity data, with the release of the **Chicago Fed activity index for October at 13:30** and **Australian preliminary PMIs for November at 22:00.** The activity index is likely to show mixed results if this week's soft US data is anything to go by, while Australia's preliminary PMIs are likely to show activity remaining robust as the economy enjoys the recent exit of lockdown conditions.

Tuesday – 23/11

Inflation in Singapore is expected to rise from 2.5% YoY to 2.9% in October when the data is released at 05:00. This will confirm the Monetary Authority of Singapore's decision in October to move to a marginal appreciation trajectory in the S$NEER, given that most of the nation's food and energy is imported. The focus then flips from inflation to economic activity as **preliminary PMIs for November are released for France, Germany and the eurozone as a whole between 08:15 and 09:00.** The French composite reading is expected to fall from 54.7 to 53.3, driven by a decline in activity in both the services and manufacturing sector, while Germany's is expected to fall from 52 to 51. The German data will be focused on more heavily by markets given the recent rise in Covid cases, which may impact the services reading more heavily than already expected, while supply-chain disruptions continue to weigh on manufacturing output.

> “The **eurozone composite PMI** should encapsulate these dynamics on the aggregate, with the reading expected to fall just under a point from 54.2 in October to 53.3 in November.”

The emphasis on economic activity remains as markets turn their attention to the **UK's preliminary PMI data for November at 09:30.** The UK composite PMI is also expected to follow the trends set out in mainland Europe, with the composite index expected to fall from a higher base of 57.8 to 57.2. Most of the downturn is expected to be driven by the decline in services activity, which is being pressured by rising inflation and limited stock due to supply chain disruptions.

The services PMI is expected to fall from 59.1 to 58. Sticking with the UK, Bank of England MPC member Jonathan Haskel is set to speak at 11:00 on “high inflation now and then”.

While the title still leaves much to interpretation, commentary around the persistence of current inflation is likely to stoke BoE expectations. The likelihood of hawkish commentary is limited, however, as Haskel previously called for caution in the inflation debate.

Finishing up the day is **US preliminary PMI data for November at 14:45** and commentary from **BoC Deputy Governor Beaudry at 18:00 on risks to the stability of the Canadian financial system.** While the latter is unlikely to be too instrumental in the FX space unless Beaudry speaks on recent housing market developments, the former should provide more volatility for FX markets as US economic momentum is expected to buck the trend in Europe. The US composite PMI is projected to increase from 57.6, as median expectations sit at a print of 59 for both the services and manufacturing measures - an increase from 58.7 and 57.6 respectively.

Wednesday – 24/11

The **Reserve Bank of New Zealand will kick start proceedings at 01:00,** where they are expected to raise interest rates by a further 25bps such that the Cash Rate ends the year at 0.75% (more on this on page 4). Then at **09:00, results of the German Ifo survey for November** are expected to deteriorate amid high energy costs and rising Covid cases. The expectation index is expected to fall further from 95.4 to 94.4, extending its decline from June's peak of 104, to sit below its long-term average. Meanwhile, the current assessment index is also expected to fall below to 100 mark to 99, before likely deteriorating further in December amid tighter containment measures. **US continuing claims, durable goods data for October, and the second reading of Q3 GDP are all released at 13:30**, with the durable goods data proving the most important for financial markets. Headline durable good volumes are expected to rise by 0.2% MoM in October, highlighting an improvement in consumer sentiment following September's Covid induced dip. Then, **October PCE data is released at 15:00.** The data will have a limited impact as much of the inflation signal was relayed to markets in the CPI release, but with the PCE index the Fed's preferred measure, it will still garner some attention. Similar to the CPI index, headline PCE is expected to rise above 5% for the first time in decades.

> The release of the **Department of Energy's crude inventory data for November 19th at 15:30** may also be in scope as this week's release prompted concerns about a stealthy release of Strategic Petroleum Reserves by Federal officials in order to contain gas prices.

With no official statement as to federal inventory releases, crude oil markets remain on tenterhooks. Wrapping up the day is the release of **November's Fed meeting minutes at 19:00.** Given the concerns over the inflation backdrop and the Fed's reluctance to speed up its normalisation cycle so early on, levels of dissent to the Fed's core views will be gauged from the minutes in an attempt to second guess what December's meeting has in store.

Thursday – 25/11

The final reading of German Q3 GDP is released at 07:00 along with the GfK consumer confidence data for December. Given expectations for no change in the GDP data, the focus will rest on the GfK consumer confidence measure. Following up from previous survey data from Germany in the week, the measure should add colour to the overall picture of economic sentiment in Germany amid the fury of the fourth wave.

At **08:30, the Riksbank will publish their latest policy decision** where rates are widely expected to remain on hold. Most policy makers suggest that the current bout of inflation is transitory and will moderate next year, however, the recent uptick in eurozone inflation suggests the repo rate projection could see rates rising in 2024 ever so slightly. One of six policy setters, Henry Ohlsson, has warned that there are signs of persistence in inflation dynamics.

The data calendar is then empty until the afternoon, when **Bank of England Governor Andrew Bailey is set to speak at 17:00** with the renowned economist Mohamed El Erian at a Cambridge Union event. Bailey has been lambasted for miscommunicating the Bank's policy decisions following his comments in October and U-turn in November. Questioning by El Erian may focus on the impact that had on the Bank's credibility going forward. Wrapping up the day is **New Zealand's ANZ consumer confidence measure for November at 21:00.**

Friday – 26/11

After a busy data week, Friday's session is set to be quieter. **Australian retail sales for October are released at 00:30** and are likely to show strong growth given the beginning of summer and strong consumer confidence measures. Then, **Q3 GDP data from Switzerland is released at 08:00,** with growth expected to match Q2's pace of 1.8% QoQ. Finishing up the week, **the CBI reported sales measure for November is released at 11:00.** It should show the best flash indicator of how UK retailing is holding up after this week's official October data showed consumers purchasing Christmas gifts early as concerns around supplies remain rife.

RBNZ preview

RBNZ to continue leading the G10 normalisation race

In October's meeting, the RBNZ raised the Official Cash Rate (OCR) by 25bps to 0.5% and the accompanying rate statement maintained a hawkish bias, noting that "further removal of monetary policy stimulus is expected over time, with future moves contingent on the medium-term outlook for inflation and employment".

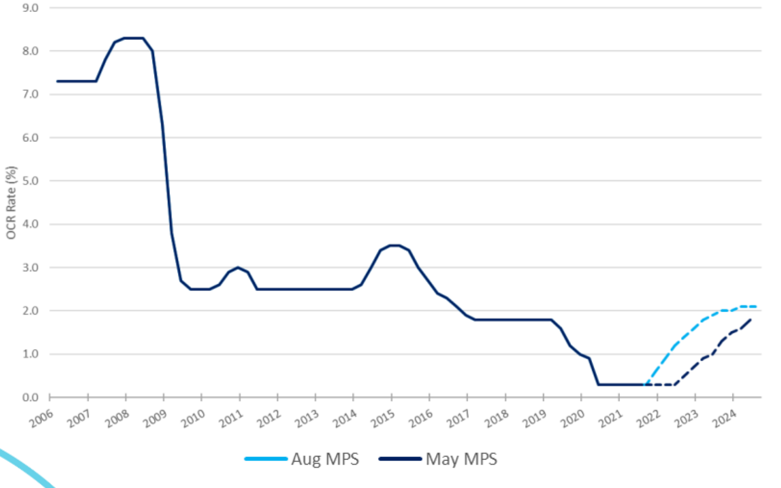
Since the October meeting, third quarter inflation and labour market data has been released, with both printing on the stronger side. Headline CPI in Q3 rose from 3.3% to 4.9%, above the Bank's 1-3% target band, while the unemployment rate fell to a record low of 3.4% as the inflow of migrant workers remains restricted by containment measures.

Additionally, this week's Q4 inflation expectations data released by the RBNZ saw 2-year inflation expectations rise from 2.27% to 2.96%, further emboldening calls for a faster and more aggressive tightening timeline.

"With a 25bps hike to 0.75% already baked in, **swap markets are pricing in the possibility of a larger rate hike from the New Zealand central bank**, with the current implied rate currently sitting at 0.865%."

In this regard, the central bank could surprise in a hawkish manner in one of two ways. Firstly, via a 50bps rate hike, which given current data isn't a distant possibility but would still surprise relative to consensus. Secondly, the central bank could steepen its OCR projection further relative to August's estimate, while also increasing its projected medium-term rate above the 2% inflation target. By projecting rates above the 2% target over the medium-term, the Bank would signal a level of caution with regards to economic overheating. Such a move would raise front-end NZGB yields, especially as the 2024 bond is yielding just 2.1% at present while the 2025 inflation protected bond continues to yield a negative rate – a sign that markets expect real rates to remain negative over the medium-term.

RBNZ could prove hawkish not just by hiking 50bps, but by increasing the steepness of their OCR projection and their 2024 terminal rate

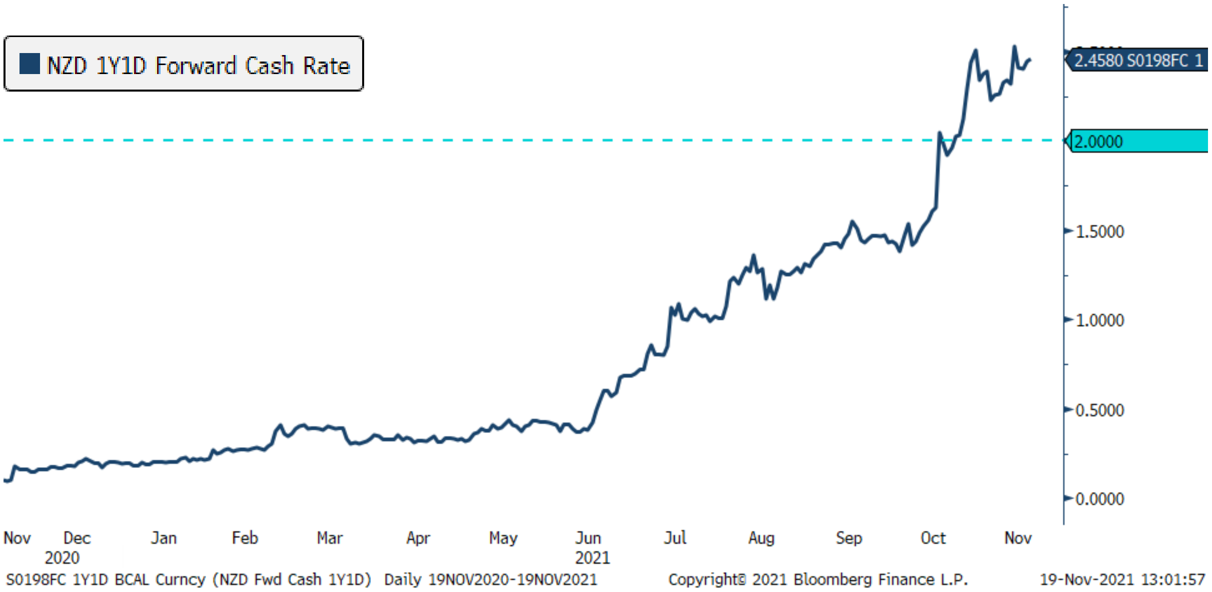


"While there remains a risk that the RBNZ will look to front-load their hiking cycle given the recent overshoot in inflation and the aggressive move in 2-year inflation expectations, **we think the central bank will continue along a path of 25bps hikes**."

This would be in line with recent commentary from Assistant Governor Hawkesby, whose preference is for slow and small steps, and would also make sense from a risk management perspective given New Zealand's highly leveraged housing market and the still tentative Covid backdrop. Successive 25bps rate hikes would be in line with rates reaching 2% by roughly August 2022, if the RBNZ's monetary policy calendar aligns with 2021's timeline beyond the scheduled July 13th 2022 meeting.

If such a policy path were to be signalled by the RBNZ's OCR projection in November, it would see rates rise to the 2% level a full year before August's projections. The question then for markets would be whether the RBNZ continues to see inflation threatening its target in the second half of 2022, a time in which most central banks expect inflation pressures to begin moderating.

Will the RBNZ live up to money market speculation and raise rates aggressively above the 2% inflation target over the coming year?



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