BALLINGER GROUP

Monthly Report

April 2024

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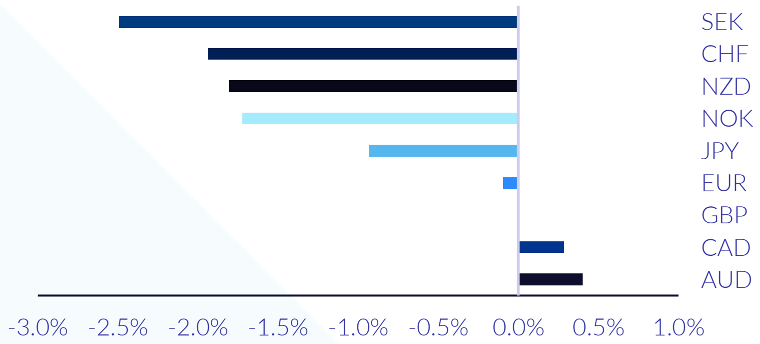
Introduction – The ball is rolling on rate cuts

March's FX moves were marked by key turning points in monetary policy. A rate hike in Japan heralded a new era for an economy that has struggled for decades with weak demand and deflation, while a rate cut in Switzerland got the ball rolling on the long-awaited developed markets easing cycle.

While the Swiss National Bank is now the first to the mark, most major central banks took another step towards joining them, with markets converging on June as the month in which the Federal Reserve, the ECB, the Bank of England, and the Bank of Canada are most likely to pull the trigger. The dollar gained against all but three of its peers, as it continued its recovery from the euphoric rate cut rally of the fourth quarter.

As we approach widespread policy easing, it is the least dovish who wins in FX. The Swiss National Bank out-doves all, of course, and fell accordingly, after a string of soft data prompted policymakers to slash their inflation projections and cut its rate from 1.75% to 1.50%. It joins the risk-sensitive Swedish krona and New Zealand dollar as the worst three performers in the G10, who each struggled to defend against a rising tide of US rates.

G10 March Performance vs USD



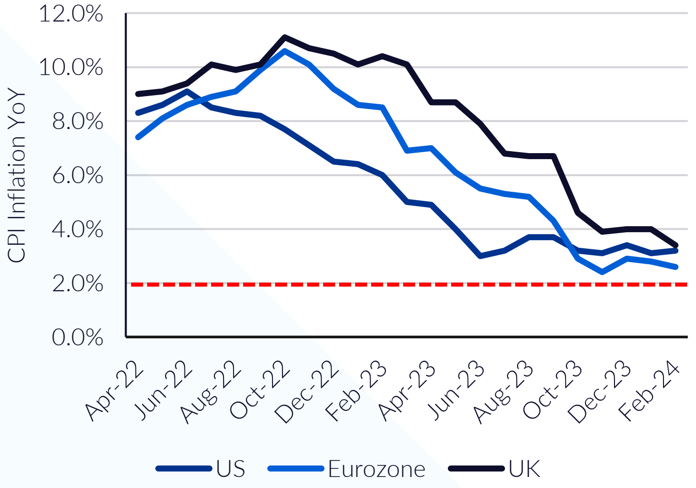
Sterling and the euro both held relatively steady despite inflation moving in the right direction, as Fed Chair Powell's dovish testimony cancelled out the impact of another piece of evidence for a sideways trend in US price growth.

> *In fact, policymakers across the G10 became more optimistic about inflation. ECB President Lagarde wanted a touch more movement along the disinflation pathway but pinned her hopes on June, while BoE Governor Bailey commented that rate cuts were now 'in play' at future meetings. But it was Fed Chair Powell who displayed the strongest bias towards easing, shifting to a more dovish stance in the absence of a corresponding move in the data.*

The yen is the outlier of them all, meanwhile, having ironically fallen further to a 34-year low after the Bank of Japan finally exited its negative interest rate policy for the first time in eight years. Tokyo had clearly hoped that this would spur a recovery, but the BoJ disappointed markets with its forward guidance and only piled the pressure on the yen.

In April, policy decisions in the eurozone, Canada, and New Zealand should give some clearer cues on the pace and timing of rate cuts, while traders will be watching a meeting in Japan for central bankers' plans for policy normalisation. The next round of inflation data will be some of the last before the big meetings of the early summer, and the resulting price action should begin to intensify as they reignite divergence in expectations for policy trajectories.

The Disinflation Pathway



FX Reviews

USD

The least dovish wins

Fed Chair Powell's testimony to lawmakers initially plumbed the dollar to a near two-month low, when he claimed he was 'not far' from gaining sufficient confidence to start cutting rates, despite strong inflation data only weeks before that had cast doubt over policymakers' willingness to begin easing policy.

But the greenback's trough was short-lived, and the trimming of rate cut bets soon returned. Markets brushed aside a surprise uptick in CPI inflation to 3.2% in February as the details painted a less hawkish picture, but could not ignore the PPI data beat that corroborated the sideways inflationary trend a few days later.

Attention then turned to the Federal Reserve's policy decision, where a set of fresh macroeconomic projections pencilled in higher growth, higher inflation, and lower unemployment, but simultaneously made no change to the three cuts expected this year. While the longer-term rate did inch up slightly, the Fed took a further dovish turn in the press conference, when Powell pinned the blame for the recent high inflation prints on seasonal quirks and reasoned that they did not change the overall story.

In fact, he displayed a distinct bias towards cutting rates and crafting a perfect soft landing, hinting towards an asymmetry in the bank's reaction function that sets the bar high for a delay to summer policy easing, even claiming that strong employment data would not be sufficient.

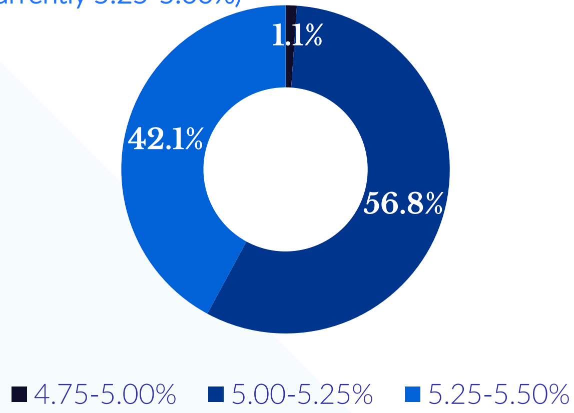
Yet despite an initial 1% crash, the dollar ended the week sharply higher against its peers.

> *The Fed was dovish, but ultimately it turned out to be the least dovish of the major central banks that month – at least in the eyes of the market – and this meant that the unchanged rate projections and a bias for normalisation failed to pin the dollar down.*

The dollar then moved a leg higher as some hawkish pushback followed and a familiar mantra re-emerged. In the words of Governor Waller: '*There's still no rush*.' The overall growth outlook in the US continues to outshine the rest of the developed markets economies, and so the argument for the likes of Waller and Bostic is that policymakers can afford to wait until inflation is dead and buried. After all, if policymakers are still not confident and growth is unlikely to suffer – why risk a cut?

All of this sets up the March inflation data – and the policymaker reaction – to be the primary determinant for the dollar's direction this month, ahead of the May and June meetings. Some progress will certainly be needed to help bridge the remaining gap in confidence to maintain the June cut as a real possibility.

Market-Implied Probabilities for the Federal Funds Rate at the June Decision, 1st April (Currently 5.25-5.00%)



GBP

No longer the laggard

The pound had a phenomenal start to the month, as its low profile allowed it to surge as others weakened – we were even quoted in the Financial Times talking of a seven-month high, an improving growth outlook, and a Bank of England that was set to lag its peers. But it ended March a good 2% off this peak, after a soft inflation reading and a dovish turn at the British central bank meant that the estimated timing of the first rate cut reconverged with the Fed and the ECB in June.

Sterling is still the best performing currency against the dollar in the G10 this year, but last month's data flipped the overall performance from a net gain to a net loss. First up was the softest wage growth print since October 2022 at 5.6%, followed by the lowest CPI reading since 2021 at 3.4%, although a higher-than-expected services inflation neutralised the overall impact of the latter.

This data opened the door to some particularly dovish developments at the March monetary policy decision, when the final hawks threw in the towel and dropped their votes for further tightening, leaving the vote split at 8-1 in favour of a hold versus a cut. This was followed only a day later by a remarkably optimistic outlook on the British economy by Governor Bailey in the FT, who stated that rate cuts were 'in play' at future meetings and that risks of a sticky inflationary persistence were abating more quickly than expected.

> *"In one foul swoop, Bailey undermined the whole thesis underpinning sterling's strength: the persistent inflation, slower cuts, and high yield fundamentals that had propelled it to a seven-month high only weeks before. No longer the laggard, the Bank of England is now assumed to be most likely to cut at its next meeting."*

The August first cut quickly became June, with even a modest probability that the policy easing cycle begins as soon as the next meeting in May. And with speculators' positioning in stretched long territory, this leaves sterling vulnerable to large short coverings if cuts do indeed come that quickly.

The pound has historically performed very well in April, but for this seasonal trend to continue, we will need some signs that Bailey's newfound optimism is overstretched – whether through some upside inflation surprises, or hawkish pushback from other members of the MPC. And as we head into a new financial year, traders will keep a keen eye on the conflicting impacts of the much-discussed inflationary impulse National Living Wage increases versus a 12% fall in the energy price cap.

EUR

A bit more in April, a lot more in June

The euro edged slightly lower in a rather uneventful month for the bloc. The primary theme was a bolstering of bets for a first rate cut in June, which policymakers themselves have increasingly zeroed in on as a likely entry point to kickstart the easing cycle.

While the month began with a modest upside surprise on the 2.6% February inflation print, the eurozone economy ultimately took another step towards the 2% target, inducing some sharp downward revisions to the inflation projections at the following week's monetary policy decision. The average growth and inflation figures for 2024 moved down to 0.6% and 2.3%, respectively. The markets attempted to trade the euro downwards as a result, but the move was drowned out by the risk asset rally triggered by Powell's concurrent dovish testimony across the Atlantic.

At the press conference, President Lagarde acknowledged the solid progress made so far, but again stressed that she was not yet sufficiently confident that wage and profit price pressures had cooled enough to sustainable achieve target inflation. And on how this confidence may be obtained, she quipped that they would know 'a bit more in April', but 'a lot more in June'. Policymakers will arrive at the April meeting with a fresh CPI print to hand, which could be enough given a significant surprise, but ultimately it will be the wage data later in the month that stands a much better chance of doing the job.

While the focus on wages and services inflation as a stubborn last hurdle has prevented a decisive move lower for the euro, a capitulation in these measures will be a sure signal that cuts are imminent. To some it is already too late, and delaying the first move any further risks a deeper and sharper easing cycle that could cause havoc for the euro. Some doves within the ECB itself appear to mirror these views, with Cipollone, for example, emphasising that policy would still be highly restrictive even after cutting rates.

Meanwhile, the growth outlook remains bleak but is transitioning into a weaker headwind. Economic activity edged closer to expansionary territory, credit spreads are at a two-year low, and ZEW investor confidence has surged to a one-year high. The subdued economic environment adds a sense of urgency to cut rates, but has not become severe enough to force the ECB's hand.

2.6%

Eurozone March CPI Inflation

CHF

First to the mark

The Swiss franc continued its march lower last month, having now fallen 7% against the dollar and 5% against the euro since the turn of the year.

The franc's artificial strength was bound to unwind once the Swiss National Bank pulled its support from the open market, and the central bank accelerated the process in March when it kickstarted its easing cycle with an unexpected 25bps cut. The policy decision came with sharp downward revisions to the forecasted inflation trajectory, even with assumptions for the lower 1.50% rate. While the soft inflation prints of late – including a fall to 1.2% in February – had a minority betting on a cut, most had expected June, leading to a 2% crash across the month as Swiss yields slumped.

The low inflation forecasts hint towards further cuts throughout the year, too, with markets looking for just under two more from the next three meetings. Along with the yen, the low yielding currencies have been the worst performers in the G10 this year, something which looks to remain the dominant direction of momentum until the commencement of the Fed and ECB easing cycles begins to chip away at the yawning rate gaps.

JPY

A new era, but not for the yen

A strong round of wage negotiations - including a 33-year high 5.3% pay bump secured by the Rengo union – propelled policymakers' confidence in sustained domestic inflation and activated the Bank of Japan's long-awaited exit from negative interest rates.

But for the yen, it was business as usual. Once the event risk had evaporated, the yen-selling recommenced. In fact, Governor Ueda's pledge to keep policy accommodative hinted towards a glacial pace of normalisation that pushed USD/JPY back to its highest levels in 34 years. Ultimately, a 10bps dent in a 500+bps US yield advantage does very little to shake the fundamentals driving yen weakness – without a robust series of hikes, it is the Fed's rate cuts that must do the legwork in generating a yen recovery.

And where there is yen weakness, there are intervention threats from Tokyo. Familiar verbal cautions have kept it penned in below the 152 mark for now, as authorities warn that they do not see the moves as reflecting fundamentals. Despite a likely will to trade the yen lower, fresh memories of the 2022 intervention continue to keep traders hesitant to do so.

April's BoJ decision is likely to be much calmer, although further clues on potential rate hikes could take the edge off the yen's losses. But it is the US data that yen investors will be focused on and, for the Japanese authorities, the sooner the Fed cuts, the better.

AUD

Best in the G10

Although still down over 4% this year, the Aussie dollar finally staged a recovery in March following a bleak two months in January and February.

The Reserve Bank of Australia meeting was a non-event for the FX markets, where the baby steps towards a more dovish stance were widely anticipated. The bank finally relented and dropped its tightening bias, saying only that they are not ruling out any moves either way.

Instead, it was the upbeat labour market indicators that propelled the Aussie dollar. The Australian economy added a stellar 116.5K jobs in February - almost three times as many as expected - while unemployment dropped sharply from 4.1% to 3.7%. And despite a slight downside miss in the headline figure, the sticky inflationary trend remained clear in the closely watched trimmed mean CPI measure.

Markets are currently placing around a two-in-three probability that the RBA kicks off its easing cycle in August. We will get some further clues from the monetary policy meeting minutes, but employment and CPI data will likely take centre stage again in April.

CAD

Resisting the tilt

To the surprise of most, the Bank of Canada took a step back in its transition to policy easing, as it went all in on pushing back against dovish expectations in a distinctly cautious statement. Repeated reference to ‘gradual and uneven’ progress on inflation and the contention that inflation would remain around the 3% mark until the second half of the year blindsided those placing their bets on a cut in April and sent the loonie soaring.

But a surprisingly weak CPI inflation reading contrasted strongly with what the BoC had said only two weeks earlier. The headline figure slipped to 2.8%, defying consensus estimates for an uptick to 3.1%, alongside weaker prints across the various measures monitored by the BoC. We had gotten used to conflicting and muddied data out of Canada, but there was little ambiguity around the strength of the disinflationary impulse in February, briefly pushing the loonie to a three-month low and spurring ramped up bets for a cut in June.

The final big piece of data was the 0.6% month-on-month GDP print for February, which delivered a much-improved outlook for a Canadian economy sapped by weak demand, easing the pressure on policymakers to cut rates. This turned the loonie’s fortunes around close out with a modest gain.

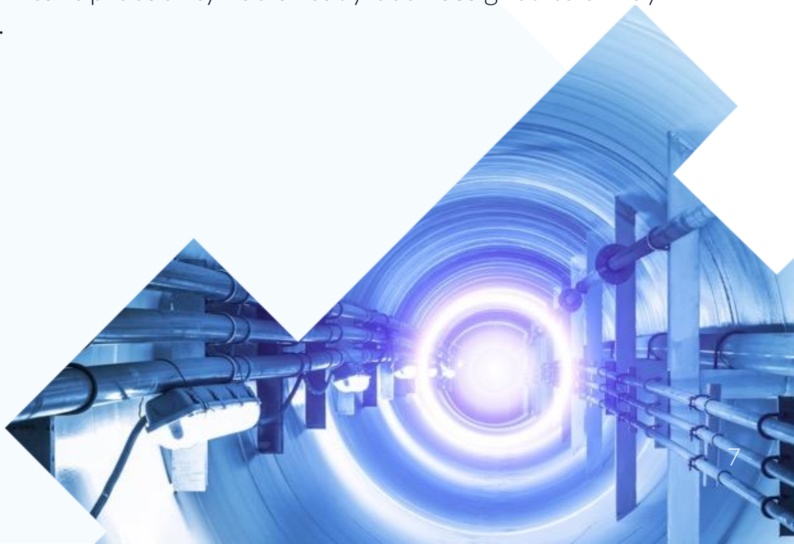
The next meeting comes on the 10th, where a hold is the likely scenario, but investors will be eager to see whether policymakers give up the hawkish stance or dismiss the positive print as a blip rather than an underlying trend.

SEK

Weakness returns

Now without the support from the Riksbank’s hedging program, an acceleration in disinflation catalysed a 2.5% move lower in the Swedish krona in March. The Riksbank-preferred CPIF reading slumped from 3.3% to 2.5% in February, driven by falling electricity prices and housing costs.

As a result, the Riksbank followed up with a markedly dovish policy statement at the end of the month. Although policymakers stressed the risks that further krona weakness or supply shocks could reignite price pressures, they announced explicitly that *‘the policy rate can be cut in May or June if inflation prospects remain favourable.’* The krona largely warded off any extra depreciation, however, given that a significant probability had already been assigned to a May cut.



Economic Calendar – April 2024

Policy decisions in New Zealand, Canada, the eurozone, and Japan are the headlines for April.

Date	Time (CET)	Currency	**Event**	Previous
Tue 2nd	4:00pm	USD	JOLTS Job openings	8.86M
Wed 3rd	11:00am	EUR	CPI Flash y/y Core CPI Flash y/y	2.6% 3.1%
Thu 4th	8:30am	CHF	CPI y/y	1.2%
Fri 5th	2:30pm	USD	Non-Farm Payrolls	275K
Fri 5th	2:30pm	CAD	Employment Change	40.7K
Wed 10th	**4:00am**	**NZD**	**RBNZ Rate Statement**	**5.50%**
Wed 10th	2:30pm	USD	CPI y/y Core CPI y/y	3.2% 3.8%
Wed 10th	**3:45pm**	**CAD**	**BoC Monetary Policy Report**	**5.00%**
Thu 11th	**2:15pm**	**EUR**	**ECB Monetary Policy Statement**	**4.00%**
Thu 11th	2:30pm	USD	PPI m/m	0.6%
Fri 12th	8:00am	SEK	CPI y/y	4.5%
Fri 12th	8:00am	GBP	GDP m/m	0.2%
Mon 15th	2:30pm	USD	Retail Sales m/m	0.6%
Tues 16th	8:00am	GBP	Claimant Count Change m/m Wage Growth 3m/y	16.8K 5.6%
Tues 16th	2:30pm	CAD	CPI y/y	2.8%
Wed 17th	8:00am	GBP	CPI y/y	3.4%
Thu 18th	3:30am	AUD	Employment Change	116.5K
Tues 23rd	10:00am	EUR	Flash Manufacturing PMI Flash Services PMI	45.7 51.1
Tues 23rd	10:30am	GBP	Flash Manufacturing PMI Flash Services PMI	49.9 53.4
Tues 23rd	3:45pm	USD	Flash Manufacturing PMI Flash Services PMI	52.5 51.7
Wed 24th	3:30am	AUD	CPI y/y	3.4%
Thu 25th	2:30pm	USD	Advance GDP q/q	3.4%
Fri 26th	**4:00am**	**JPY**	**BoJ Monetary Policy Statement**	**0.0%**
Fri 26th	2:30pm	USD	Core PCE m/m	0.3%
Tue 30th	2:30pm	CAD	GDP m/m	0.6%
Tue 30th	2:30pm	USD	Employment Cost Index q/q	0.9%

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BALLINGER GROUP
BALLINGER & CO.

Group Headquarters:
65 Curzon Street, Mayfair, London, W1J 8PE

T: +44 (0) 20 3869 1800

BALLINGER EUROPE
BALLINGER MARKETS

Malta
Fino Buildings, Level 3, Trip l-Imdina, Zone 4,
Central Business District, Birkirkara, CBD 4010, Malta

T: +356 2033 0130

E: info@ballinger.group

T: ballinger.group