Monthly Report

November 2024

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Introduction – An FX narrative reset

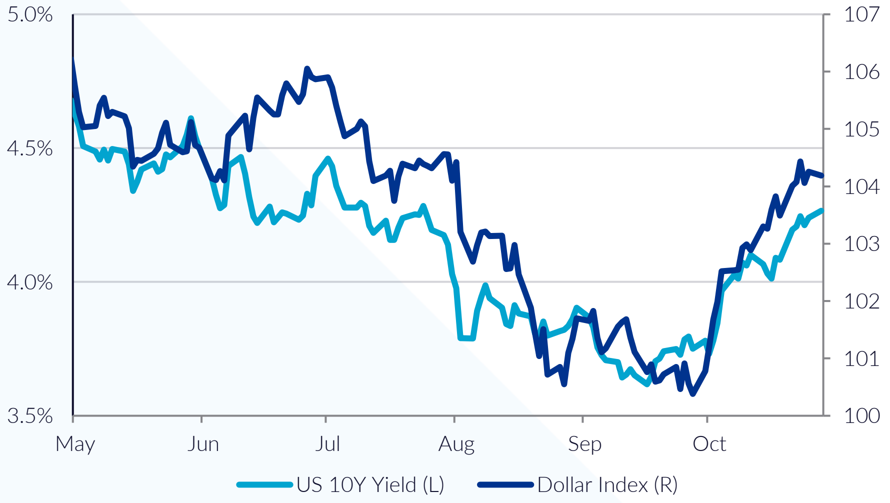
Summer data fooled the Fed (and the market)

Over the summer, softening labour market and growth data shaved nearly 100bps off the 10-year Treasury yield and sank the dollar as markets repositioned for an aggressive Federal Reserve easing cycle. That outlook was validated by the Fed themselves to some extent, as policymakers kicked off with a 50bp move in September. In October, however, that narrative was turned on its head by a flood of stronger macro data and revisions.

Now, it looks like US economic exceptionalism never left, in great contrast with what is happening in Europe. At the peak, nearly 80bps in rate cuts were initially priced into the final two fed meetings this year, suggesting one half-point and one-quarter point move. That is now 35bps – markets are leaning towards a December pause. The story goes that the Fed no longer needs to go so hard to ensure a 'soft' economic landing – in fact, there may never be a 'landing' for the US economy at all. Uncertainty remains, however, particularly when looking at the softer leading indicators in the labour market.

And while the Fed is slowing down, many others are speeding up. The ECB has switched to back-to-back rate cuts, the Bank of Canada has delivered its first 50bp move, the RBNZ may even go for a 75bps, and the Bank of England Governor reckons he might be able to get more 'aggressive', although a tumultuous budget announcement might get in the way of that. And it was the yen that fell to the bottom of the pack, falling dramatically thanks to fading hope for rate hikes and its high sensitivity to yields at the longer end.

The dollar and yields pivoted upward as macro narratives were reset



Trump trades kick into high gear

Yet that was not the dollar's only tailwind. Rising bets on a Trump election win in November had a hand in lifting Treasury yields higher, particularly at the longer end, and positioning for hedges against his policies hurt high-beta G10 in particular (NOK, SEK, AUD, NZD) while appearing to help the Swiss franc.

The market relevance of this election centres around Trump's trio of main policy objectives that the consensus sees as inflationary and bad for risk appetite: big tax cuts, reduced immigration, and heavy trade tariffs. The race is still too close to call, but if Trump is successful then the biggest winners will be the dollar and the other safe havens (CHF, JPY), while the biggest losers are likely to be the Chinese yuan, emerging markets, and the risk-sensitive G10, all of which have already suffered in pre-election trades.

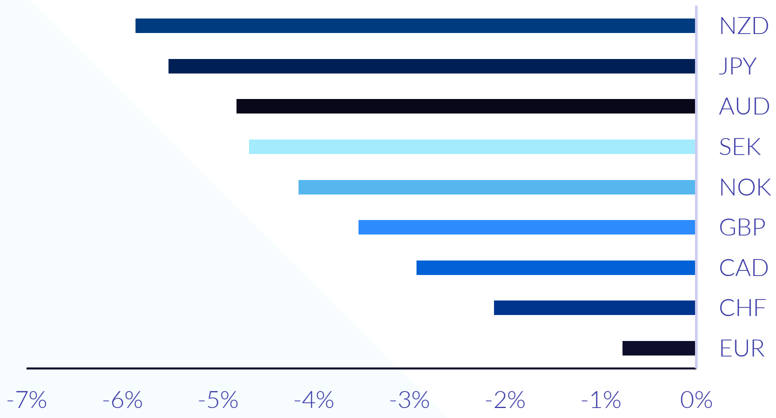
An incredibly important month

The scope for FX volatility in November is probably the largest of the year. Now that EUR/USD one-week options cover the days after the election, implied volatilities have surged to their highest since the Us regional banking crisis in March 2023. The first full week of November is a minefield for traders – as the election results trickle in, there are central bank decisions for Australia, the US, the UK, Sweden, and Norway.

The election is a fork in the road for FX. If Harris wins, pre-election hedges can settle down and the dollar can cool off. If Trump wins, we could be looking at a surge in US inflation, significantly fewer Fed cuts, global trade wars, and dampened growth – at least according to the economist forecasts.

Geopolitics is also a risk that continues to bubble in the background. A regional war in the Middle East remains a genuine possibility, and Iran and Israel appear to be locked into tit-for-tat airstrikes that could eventually end up hitting oil facilities and driving up consumer prices globally.

G10 October Performance vs USD



FX Reviews

USD

US exceptionalism returns

The dollar made strong and steady gains in October, rising in 19 of 24 sessions and notching its best week in two years. There are two main reasons: a) fresh macroeconomic data divergence vs its peers, and b) positioning for a Republican election win.

The data story has swung back and forth several times in the past year. Each time the US economy finally looks to be materially softening and the Federal Reserve appears ready to put its foot down cutting rates, the macro narrative flips back to one of continued outperformance. This time, a labour market rebound and some notable revisions to consumption data upended what the market thought it knew over the summer. At the time of the 50bp cut in September it looked like there were genuine risks that a softening in the labour market could accelerate – now, it looks to be stabilising. A blowout 254K September payrolls report came with a drop in the unemployment rate and 72K of upward revisions to previous months. It is reasonable to guess that September's 50bp rate cut may not have come had policymakers seen those changes in advance.

On the activity side, an upward revision to incomes suggested that there is a significant amount more juice left in the consumer than previously thought. Consumption growth remains solid, and that helped to post a strong 2.8% annualised growth rate in Q3. Inflation has become stickier than expected, too, with core CPI inching up from 3.2% to 3.3% and core PCE printing at 0.3% month-on-month.

The conclusion from this batch of data was that the Fed no longer needed to rush its easing cycle to save the US economy. This wiped out bets on further 50bp moves and even reintroduced the notion of a pause at the December meeting. Alongside a dovish ECB, markets had all the excuse needed to lift the USD:EUR two-year-yield differential from 157bps to 189bps.

The US economy is not in the clear yet, however. The hard data looks good for now, but there are still some unavoidable indicators which suggest that a further rise in the unemployment is on the way. Job openings continue to fall, the quits rate is down to 1.9%, and the Conference Board's jobs 'hard to get' versus 'plentiful' survey measure – historically a very good predictor of unemployment – has risen sharply this year. If the uptick in payrolls turns out to be an aberration, US yields could fall just as quickly as they rose. What's to say the narrative doesn't flip again?

The US election is the clear headline for the final two months of the year, and markets have already begun to favour positioning for a Trump victory. While difficult to disentangle from the simultaneous impact of the hawkish Fed repricing, Trump's inflationary trio of tariffs, tax cuts, and immigrant deportations has translated into higher inflation breakevens, higher yields, and higher demand for safe havens. In other words, the perfect environment for a stronger dollar. If Harris wins, we will quickly discover just how much the 'Trump trade' is influencing asset prices, and the dollar should shed gains. The realisation of a Trump win, meanwhile, opens the floodgates for US yields to be levered higher.

After disappointing all summer, the US economy is surprising to the upside once again

GBP

Budget jolt

Like the rest of the G10, sterling suffered heavily against a rising dollar. And while GBP/EUR at one point hit a more than two-year high, it finished sharply lower overall as a last-minute gilt selloff injected a risk premium into the pound.

A hawkish repricing of Bank of England rate expectations continued, despite Andrew Bailey's best efforts. In a dovish interview that took most by surprise, he told the Guardian that the BoE could become 'a bit more aggressive' in policy easing, so long as the data (read services inflation) continues to come down. Pill and Greene were more cautious, and that went some way to undo the resulting drop in sterling.

But Bailey broadly got what he wanted in the data. Headline inflation fell to 1.7% and, more importantly, services inflation fell from 5.6% to 4.9%. The market rightly declined to read too far into the size of the fall, because volatile components played a big part and several more distilled measures of services price pressures saw less progress. But it was progress nonetheless, and at the time suggested that the BoE could switch to rate cuts at consecutive meetings.

Yet ultimately, a quarterly pace of rate cuts is now more embedded in the SONIA curve than ever. The two-year gilt yield has risen 80bps since the day after the BoE started cutting in August, of which nearly 30bps came in the final day and a half of October. There are two main factors to point to here. The first is a more general hawkish repricing of expectations across the G10 central banks (with some exceptions) - a sterling positive, although outpaced by the US. The second was a surge in yields as an extra £30bn in annual extra gilt issuance for the next five years prompted bond investors to dump gilts at a rapid pace.

This market reaction was nowhere near as severe as the fated Truss mini-budget, but the 30bp surge in two- and ten-year yields was a hefty move, and the 'bad' rise in yields saw the pound sink below 1.29 for the first time in two months.

> *"It was broadly the tax-and-spend, bigger state agenda that everyone was expecting, but annual borrowing is set to be double in five years' time, and the inflationary impulse from the short-term fiscal loosening has vastly reduced the BoE's assumed scope for rate cuts."*

The OBR raised its forecasts for Bank Rate by 25bps across its horizon, on the assumption that the extra stimulus next year will feed into an economy already running at capacity, injecting some extra inflationary pressure. And the market now agrees – markets are no longer fully convinced by a November rate cut, and the consensus is for a pause come December. Policymakers are unlikely to address the impact of the budget too directly, but if the new fiscal plans filter through to higher inflation projections, the gilt market could find some validation.

EUR

ECB gathers speed

EUR/USD suffered on both sides of the equation. In the eurozone, poor macro data nudged policymakers to shift to back-to-back rate cuts, and in the US, the story was broadly the opposite. However, the euro did claw back some losses and became the second-best performer in the G10 as Q3 GDP figures soothed growth fears.

The weak growth picture revolved around the activity surveys – the eurozone posted its second consecutive contractionary PMI print in October, dragged once again by Germany and France. That points to deteriorating demand conditions that could accelerate the disinflationary process. And, although underlying inflation has fluctuated in the 2.5-3.0% range for many months now, headline CPI is running at 2%. Weak growth also risks pushing the labour market to a tipping point and exposing latent weakness there, with some at the ECB worried that companies could begin shedding the labour that they have been hoarding over the last few years.

Despite the lack of hard data corroborating these concerns, policymakers felt the urgency to act quickly. Even the most hawkish policymakers were swayed into delivering a quarter point rate cut, and it was openly signalled ahead of the actual meeting. The ECB announced that the disinflationary process was 'well on track', that risks were now tilted more to the downside than the upside on growth and inflation, and that target inflation would now likely be achieved earlier on than the second half of 2025, as per previous indications.

With the June meeting still fresh in memory, when policymakers had tied their hands with previous commentary and had to cut despite some hawkish data, Lagarde stuck to the zero-guidance approach regarding future meetings. But in the following week, several dovish themes emerged within rates-setter and market commentary. The first was a concern that a growth slump could cause inflation to persistently undershoot the 2% target. That fuelled debate about the possibility of a 50bp move in December and a quicker return to neutral rates, which even Nagel and Holzmann – two notorious hawks – initially left on the table. And if they are easing aggressively to rescue the eurozone economy, could rates even need to be cut back to stimulative territory?

The answer to that question swerved towards a likely no by the time the final data releases arrived. Fears were alleviated significantly after Germany skirted a recession and eurozone growth printed twice as high as expected in Q3. October inflation also beat expectations at 2.0%, and unemployment surprisingly fell further to 6.3%. The hawkish adjustment to policymaker rhetoric was instant, with Schnabel quick to remind us that the inflation fight is not yet won and that there was no need to cut too aggressively.

The worst fears were soothed, and we are back to consecutive 25bp rate cut bets, but it is too early to get excited about a recovery. The Q3 reports captured only one contractionary month and were lifted by one-offs, including a volatile Irish figure. Further weakness over the coming months or a Trump election win could add to the euro's bearish case.

CHF

Negative rates on the cards

Despite short-term Swiss yields moving in the opposite direction to a broad rise across most of the G10, the franc performed relatively well compared to its peers, falling only against the euro and the dollar.

The SNB has not been able to revise its inflation projections down quickly enough this year, and inflation once again printed weaker than expected, this time at 0.6%. It was also the third month in four that there has been deflation on a month-on-month basis, and the risks are rising that it eventually filters through to negative price growth on a yearly basis. Schlegel seems to agree, and he has repeatedly put negative interest rates on the table, if not outright FX intervention to quash the strong franc's disinflationary impact. The USD:CHF 2-year yield spread widened from 320bps to 380bps – the last time the gap was this wide, USD/CHF was over 4% higher.

So what explains the outperformance? It makes sense to point to volatility and risk aversion associated with the US election – with the yen on a steady decline and US politics highly uncertain, the franc has arguably become the most attractive safe haven. Particularly so for European investors who, looking around at the economic stagnation in the eurozone, political gridlock in France, and gilt market turmoil in the UK, are quite reasonable in favouring storing their money in Switzerland.

JPY

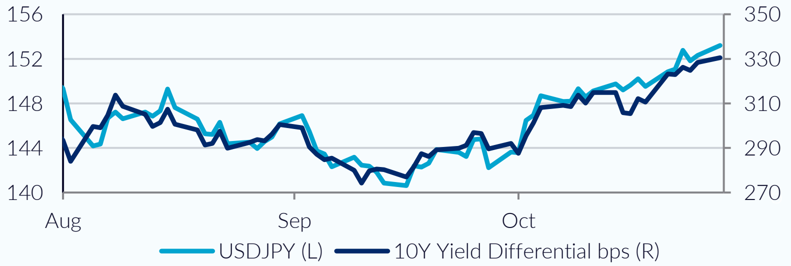
Honeymoon's over

The yen's summer rally switched rapidly into reverse in October as the market lost hope that the Bank of Japan would keep hiking and that the Federal Reserve would ease aggressively. A long-term recovery remains far off.

It is difficult to overstate just how volatile USD/JPY has been in the last four months. Between the year-to-date peak in early July and the low in September it fell 13%, and since then it has rebounded nearly 9%. And it remains glued to the pair's fundamental driver – the 10-year yield differential – as it has done since the carry trade unwind in early August.

After shifting strongly in the yen's favour in the summer, that differential has now reverted to the levels of early July. In October, Japanese policymakers started to become more cautious about the downside inflation risks from further hikes and, at the same time, bets on aggressive Federal Reserve easing were pared back dramatically. Political turmoil has also contributed to the former, with the instability following the LDP losing its majority interpreted as an obstacle to further monetary policy normalisation.

The yen is glued to its 10-year yield differential



SEK

Cyclical picture weakens

Increasingly dovish Riksbank expectations, rising yields elsewhere, election uncertainty in the US, and a big dollar rally were naturally a poor mix for the risk-sensitive, low-liquidity Swedish krona.

There were few surprises in the inflation data, but an on-target 2.0% core CPIF print was a reminder of the urgency for the Riksbank to keep chipping away at its policy rate before too much damage is taken to the Swedish economy. That is the stance of Deputy Governor Jansson, who argued that they can now proceed 'more decisively' with cutting rates. Policymakers had already flagged a 50bp rate cut in either November or December – the market is ascribing an 80% chance to it coming at the first of those opportunities.

The cyclical outlook remains subdued. While policymakers appear hopeful that falling rates and rising real wages should drive a consumption recovery, that is not materialising quite yet. The Q3 GDP indicator showed a 0.1% contraction, and in the Riksbank's business survey, manufacturers now find it 'hard to see near-term improvement'. For now, the signs point to further downside risks rather than any increase in growth momentum.

Combine the bleak interest rate and growth picture domestically with risk aversion and rising yields abroad, and the result is a near 5% drop in the krona. Whether it can recover its losses or plumbs to new depths will depend on a) who become US president, and b) how aggressively the Riksbank goes on the 7th.

CAD

Job done

A widening in the USD:CAD 2-year yield spread to the highest since 1997 was behind a 3% drop in the Canadian dollar in October. It was hawkish Federal Reserve expectations that fuelled the move, however, and with Canadian yields also rising, the loonie was a relative outperformer on the crosses.

That is largely because the intensely dovish Bank of Canada outlook is already well priced into the currency. The shift at the October meeting, although significant, came as no surprise to BoC watchers, who are now well-accustomed to declining per capita GDP and an economy devoid of inflationary pressure outside the housing market. Rapid immigration continues to mask some increasingly weak demand conditions - annualised Q2 growth was 2.1%, but annual population growth was 3%.

After a 1.6% headline inflation print, the BoC met the market's expectations with a 50bp rate cut, and the press conference was something of a victory speech. The fight against the inflation spike is over, with the BoC now 'equally concerned about inflation coming in higher or lower than expected'. Macklem said that 'it's been a long fight against inflation, but it has worked' and now they just need to cut rates appropriately to 'stick the landing'.

The market is split on another 50bp cut in December. More easing is on the way, but it is difficult to guess how much more, given that another big cut takes the rate to 3.25%, which is towards the top end of estimates for neutral rates.

AUD

External dynamics dominate

The Aussie dollar sharply reversed from its one-year high, dropping nearly 5% as election uncertainty, fading China excitement, and a stronger dollar took hold of the FX market.

This was purely a move driven by external dynamics, however. The Australian data was broadly quite hawkish and short-term yields rose by more than 35bps. Retail sales were strong, the unemployment rate held steady, jobs growth shot up to 64.1K, and 3.5% core inflation in Q3 kept the markets looking for a first rate cut only in April next year.

The RBA's hawkish reaction function remains a strong support for the Aussie. Bearing in mind that they target a 2-3% band rather than 2% precisely, Australian core inflation is arguably closer to target than the UK (3.2%) and the US (3.3%), both of which have already gotten started.

Economic Calendar – November 2024

The US election is the crucial event for FX this month, alongside central bank decisions in the US, UK, Sweden, Norway, and Australia.

Date	Time (CET)	Currency	**Event**	Previous
Fri 1st	2:30pm	USD	Non-Farm Payrolls m/m	254K
Mon 4th	8:30am	CHF	CPI y/y	0.8%
Tue 5th	4:30am	AUD	Reserve Bank of Australia Policy Decision	4.35%
Tue 5th	All day	USD	US Presidential Election	Biden (D)
Thu 7th	9:30am	SEK	Riksbank Policy Decision	3.25%
Thu 7th	10:00am	NOK	Norges Bank Policy Decision	4.50%
Thu 7th	1:00pm	GBP	Bank of England Policy Decision	5.00%
Thu 7th	8:00pm	USD	Federal Reserve Policy Decision	4.75-5.00%
Fri 8th	2:30pm	CAD	Employment Change m/m	46.7K
Tue 12th	8:00am	GBP	Average Earnings Index 3m/y	3.8%
Wed 13th	2:30pm	USD	CPI y/y	2.4%
Thu 14th	8:00am	GBP	GDP q/q	0.6%
Fri 6th	2:30pm	USD	PPI m/m	0.0%
Fri 15th	8:00am	GBP	Retail Sales m/m	0.3%
Fri 15th	2:30pm	USD	Retail Sales m/m	0.4%
Tue 19th	2:30pm	CAD	CPI y/y	1.6%
Wed 20th	8:00am	GBP	CPI y/y	1.7%
Fri 22nd	10:00am	EUR	Flash Manufacturing PMI Flash Services PMI	45.9 51.2
Fri 22nd	10:30am	GBP	Flash Manufacturing PMI Flash Services PMI	50.3 51.8
Fri 22nd	3:45pm	USD	Flash Manufacturing PMI Flash Services PMI	47.8 55.3
Wed 27th	1:30am	AUD	CPI y/y	2.1%
Wed 27th	2:30pm	USD	Core PCE Price Index m/m	0.3%
Fri 29th	2:30pm	CAD	GDP m/m	0.0%

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