Market Report 28/03/22

US dollar struggles to climb further, despite hawkish Fed - By Sam Balla-Muir

USD

It was a mixed week for the US dollar. With few notable economic data releases – besides a rather underwhelming set of figures on durable goods orders in February – the US dollar's fortunes appear to have mainly been influenced by increases in commodity prices, including a roughly 12% rise in the price of oil. This was driven by additional worries about disruption to Russia's commodity exports, and helps to explain why the US dollar lost ground last week relative to many of the currencies of net commodity exporters, including the Canadian dollar and Australian dollar. Higher commodity prices should boost these economies. Meanwhile, the currencies of net commodity importers, such as the euro and Japanese yen, fell by around 0.7% and 2.4% against the US dollar last week, respectively. The British pound was in the middle of the pack, ending last week essentially flat against the greenback. (See the GBP Section below.)

In retrospect, it is somewhat surprising that the US dollar did not make further gains last week. After all, not only did the US Federal Reserve outline much more aggressive plans to raise interest rates at its policy meeting on 16th March, Fed Chairman Jerome Powell indicated in a speech on Monday that the Federal Reserve may raise interest rates even more rapidly than those earlier plans had suggested. Expectations for US interest rates rose sharply last week in response, and by more than in most other economies. Such a move would typically push up the US dollar, given it makes it more attractive for investors to hold USD-denominated assets.

I suspect that the US dollar's failure to rise much further last week might reflect the fact that many investors in currency markets had already been betting on tighter US monetary policy pushing the US currency higher from here, leaving relatively few marginal buyers on the sidelines ready to buy US dollars following Powell's comments. As I suggested in last Monday's note, with a lot of interest rate hikes by the Fed now already anticipated by investors, I judge that there is limited room for the US dollar to be pushed up a great deal further in the near term by investors doubling-down on their expectations for rate hikes. Even so, taking the longer view, I think that the US dollar could resume its rise within the next couple of months, as it becomes clear that persistently high inflation in the US is here to stay unless the Federal Reserve hikes rates even more aggressively than many currently expect.

GBP

The British pound fared reasonably well last week, rising very slightly – by just under 0.1% – against the US dollar, and by a little over 0.7% against the euro. Sterling's gains against the euro probably partly reflects some poor data and events on the continent (see the EUR section below), rather than good news about Britain's economy per se. However, the pound's resilience against the US dollar is more notable, given that the currencies of many other net commodity importers fell back against the US currency last week. (see the USD Section above).

While Chancellor Rishi Sunak's budget may have disappointed with its limited support for households and businesses amid surging costs, sterling may have been supported by the S&P Global/CIPS PMI for March, a business survey showing that there has so far been little negative impact on the UK economy from the war in Ukraine. Otherwise, data released on Wednesday revealed that UK inflation rose to a higher-than-expected 6.2% in February. That higher inflation will add to the pressure on the Bank of England to raise interest rates further which, all else equal, should mean a stronger pound.

In my view, the pound looks more susceptible to weakness against the US dollar in the coming months. Although very high inflation in the UK calls for interest rate hikes, the Bank of England appears concerned about the damage that rising energy costs and supply-chain disruptions across many industries are doing to the economy. That may lead the Bank to raise interest rates less quickly than many investors anticipate, which would undermine the pound. That said, sterling's prospects against the euro are probably less dim for the time being, given the headwinds that the eurozone economy faces.

EUR

The euro performed poorly last week, falling by roughly 0.7% against both the British pound and US dollar. Among the G10 currencies of the major rich-world economies, only the Japanese yen did worse. The euro's struggles partly reflect a poor recent run of economic data, with both the German IFO and eurozone PMI business activity surveys for March suggesting that supply-disruptions linked to the war in Ukraine are casting a long shadow over the continent's manufacturing sector. March consumer confidence data for the eurozone, released on Wednesday, also showed a very sharp fall on the back of worries linked to the war, suggesting that household spending – another key engine of economic growth – is now slowing too.

Meanwhile, the roughly 12% rise in global oil prices last week was further bad news for the eurozone economy, given that the currency block imports many times more oil than it exports. On top of this Russia's new demand that it be paid for its gas in roubles, rather than hard currencies such as the US dollar or euro, has raised the risks of a rapid fall In Russian gas exports to Europe, given that this might require gas export contracts to be renegotiated. The eurozone economy still relies heavily on Russian gas for its energy needs.

As I have indicated in my FX notes in recent weeks, these issues of an already weak economy and greater exposure from potential spill over from the war in Ukraine highlight why I find it hard to be upbeat about the euro over the coming months. I suspect that the eurozone economy's poor growth prospects will mean that the European Central Bank is even slower to raise interest rates than investors currently anticipate, despite high and rising inflation in the currency block. If so, that would probably prompt further weakness in the euro.

The Week Ahead

Not long after London currency traders left their desks on Friday afternoon, Russia announced – somewhat cryptically – that the first phase of its invasion of Ukraine is now over. It is not yet entirely clear what this means, though the news may provoke a reaction in FX markets on Monday morning, and could also highlight how the influence of the war on currencies has not faded yet.

Otherwise, there are some key data releases due that are relevant for the euro next week, including the ESI business activity survey for March on Wednesday – which will provide further clues on how the eurozone economy is holding up post-Russia's invasion of Ukraine – plus March inflation data for Germany – also on Wednesday – and for the eurozone overall – due on Friday. The key release in the US will be Friday's non-farm payrolls reports, where another month of big job gains would strengthen the case for a stronger US dollar.
Finally, there is limited economic data of note due in the UK next week, though a speech due by key Bank of England Monetary Policy Committee member Ben Broadbent on Wednesday could influence the British pound, if it reveals more about the Bank's latest thinking on interest rates.

Currency Moves

Exchange Rate	%- change on week
€ per £	+0.73
$ per £	+0.06
$ per €	-0.67

Key Events

Date	Market	Time (GMT)	Release/Event	Period	Previous	Analysts' Expectation
Wed. 30th	EZ	10.00	ESI Business Survery	Mar.	114.0	109.7
Wed. 30th	EZ	13.00	German HICP Inflation (% Y/Y)	Mar.	5.5%	6.1%
Fri. 1st	US	13.30	Non-Farm Payrolls	Mar.	+678,000	+450,000