Calm before the storm? Busy week ahead...

Market Report 30/01/23 - By Sam Balla-Muir

USD

Last week, the US Dollar started the week under review on a weak footing, as upbeat data from the UK, Australia, and New Zealand ensured that the risky currencies made a headstart on the greenback. The greenback lost further ground as the week progressed, as global market sentiment continued to show improvement leading to advances on major market indices across the world. The greenback stopped the rot when the advance GDP figures released on Thursday, 26 January, showed that the American economy contracted, but not as much as expected. Durable goods orders and unemployment claims were also USD-positive, and a single percentage point rise in the Core PCE Price Index was enough to ensure the US Dollar pared some of the week's earlier losses. However, the US Dollar Index was slightly lower on the week.

We have a loaded week of action coming up. The star event is the first FOMC decision for 2023. It comes as consumer inflation maintains a downward trajectory for the 5th straight month, allowing the markets to price in a much tamer rate hike in the order of 25 basis points rate hike by the Fed when the new rates are announced on Wednesday, 1 February.

The Fed started the rate hiking cycle with a 50 bps move and followed this up with three successive 75 bps hikes. It slowed to 50bps, and with inflation numbers going the way the Fed wants, the markets are almost 100% convinced that a 25 bps rate hike is the way to go. If the Fed raised by 50 bps or opted to leave rates as they are, the markets would be stunned. These two conditions would produce intense volatility in the USD pairs.

If the Fed hikes by 25 bps as expected, more of the market's attention would shift to the press conference and unscripted responses to questions by the Fed Chair, Jerome Powell. Traders would search his speech for hints of an earlier-than-expected shift to a more accommodative policy. The dot plot released last year favours 5.00% as the end-point of the rate hiking cycle, but this is not set in stone. I think the FOMC press conference may cause a surprise.

After this event, the Non-Farm Payrolls report comes up on Friday, 3 February. Economists are predicting the slowest job growth pace since December 2020 as companies struggle with the impact of recessionary conditions. The ISM Services PMI data will round off a week that is sure to produce boatloads of trading opportunities on USD pairs.

GBP

he British Pound reclaimed the highs of 14 December 2022 as improving global economic sentiment and easing global financial conditions enabled risky currencies to continue their advance against the greenback. But the pace of advance is starting to slow and, indeed, is showing signs of running out of steam.

The major news for the week is the Bank of England's interest rate decision. Higher wages and inflation in the UK services sector have prompted expectations of a 50 bps rate hike. If the bank delivers on this, it will put it within touching distance of the rate tops that economists predict. The pace of consumer inflation in the UK has only stagnated, not reduced. This means that the impact of 2022's rate hikes is yet to be felt, even as sections of the economy sensitive to recession produced by a contractive monetary policy have started to feel the pinch.

Last December marked a shift from the unanimous 9-0-0 MPC voting pattern to the 7-0-2 pattern, meaning that two members are now in favour of keeping rates as they are. I think that any significant change in the voting pattern could be a market-defining shift for the GBP/USD pair.

EUR

The EUR/USD took out the 12 January high after last week's advance on the greenback. However, the advance GDP and Core PCE Price Index data favoured the US Dollar, leading to a pullback that allowed the pair to end the week only slightly higher than it closed the previous week.

The pace of the Euro's advance, which kicked off with a triple bottom bounce in Q4 2022, has slowed in recent weeks. This week will present another opportunity for the single currency to gain a fundamental push from the European Central Bank. Thursday, 2 February, brings the ECB's rate decision and press conference with ECB Chair Christine Lagarde. In the last press conference that followed a 50 bps rate hike, Lagarde indicated that inflation in the Eurozone was markedly above the bank's target and would continue to raise rates until this target was achieved.

In predicting another 50 basis points rate hike by the ECB, traders would seek to trade any rate policy divergence between the ECB and the Federal Reserve. In 2021, the divergence widened as the Fed shot off the block rather aggressively while the ECB remained ponderous. Will this week's rate decisions reverse the scales? This is the question whose answer will determine the direction of the EUR/USD going forward.

The Week Ahead

After two weeks of relatively light action as far as the economic calendar is concerned, we have a week of heavy action which will be concentrated on the US Dollar, Euro and Pound. So expect to see a lot of volatility from the GBP/USD and the EUR/USD.

The US Dollar's prominent feature in the week ahead kicks in on Wednesday, when the ADP Employment Change, the US ISM Manufacturing PMI data, and the Fed Funds Rate/FOMC Press Conference will take centre stage. Due to the much more anticipated FOMC decision and press conference by Fed Chair and Federal Open Market Committee Chairman Jerome Powell, it is unlikely that the market will see a significant reaction to the first two data sets.

Last Week's Changes In Exchange Rates

Exchange Rate	%- change on week
$ per £	- 0.05
$ per €	+ 0.05
€ per £	- 0.10

Key Events

Date	Market	Time (GMT)	Release/Event	Period	Previous	Analysts' Expectation
Tue. 24th	UK	09.30	Flash Manufacturing PMI	Jan.	45.3	45.4
Tue. 24th	US	07.00	Flash Services PMI	Jan.	49.9	49.6
Thu. 26th	US	13.30	Advance GDP Q/Q	Jan.	3.2%	2.7%
Fri. 27th	US	13.30	Core PCE Price Index	Jan.	0.2%	0.3%