UK inflation cools strengthening the pound

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

USD

The US Dollar had a poor week, losing further ground against its peers after the highly-anticipated US Consumer Price Index (CPI) data showed a further cooling of consumer inflation. Headline US CPI for December came in at 6.5%, with the core number registering at 5.7%. These represent the lowest readings of US consumer inflation in a year, indicating that consumer inflation may have peaked. As a result, the markets are now pricing in a 25 basis points rate hike by the Fed in its February meeting, which would represent a reduction in the scale of the monetary policy tightening by the Fed.

Consequently, demand for the US Dollar waned in the forex market, with market participants preferring the non-interest-yielding gold and riskier assets such as the British Pound and Euro. The US Dollar Index lost 1.67% in the week under review, as bets for a 25 basis points hike by the Fed in February rose from 75% to 93%. The Federal Reserve maintains it will continue to raise rates well into 2023 as it seeks to meet its inflation targets. This is the only factor that has prevented the greenback from falling off the cliff as the USD Index targets lows last seen in May 2022.

The US Dollar will experience some intense volatility in the new week. Several Fed members will be giving speeches at various events. These have a penchant for producing unpredictable moves in the US Dollar. These speeches will go hand in hand with several economic news data listed below. These will ensure that the

EUR/USD and GBP/USD will see plenty of market action that could produce opportunities for discerning traders.

GBP

The British Pound continued its late resurgence of the previous week to extend gains against the US Dollar, on the back of the latter being offered after US CPI data dropped to 1-year lows. It has now been several months since the Bank of England predicted the worst recession in 60 years for the UK economy as it struggled under the cost of living crisis. The Pound will face volatility from three critical data in the week ahead. Economists expect annualised inflation to have cooled slightly by two percentage points, but at above 10%, this remains high and above any increases offered by employers to the various striking unions. The Chinese GDP data may generate some interest around risk sentiment, which puts risky currencies such as the British Pound in the hot seat on Monday.

The Pound remains on course to continue its recovery from Q4 2022 after it plunged to record lows from the crisis that engulfed the 45-day government of Liz Truss. If the economic data for the week produce more demand, the Pound will have the recent December highs in its sights.

EUR

The Euro's recovery against the US Dollar has been more profound than that of the Pound. This is because the European Central Bank has not pulled any punches in stating that it is determined to pursue a hawkish pathway in its monetary policy until it hits its inflation target. Eurozone inflation remains close to historic highs. The ECB also says that these targets remain far off, pointing to a prolonged rate-hiking cycle. Goldman Sachs Asset Management Market Pulse indicates that terminal rates for the ECB could be at 3%. The Eurozone remains at risk from the economic fallouts of the Russia-Ukraine conflict, which remains a significant headwind for the single currency. An improvement in the growth-inflation mix should be supportive as the year progresses.

The Euro ended the week higher against the US Dollar, surpassing the May 2022 highs. With a sparse economic data schedule for the week, the EUR/USD will be impacted by events from across the Atlantic.

The Week Ahead

The week ahead is probably the busiest this January, with key market-moving data expected from the US, United Kingdom, and China. China's quarterly GDP data will hit the newswires early Monday. Economists are expecting a 60% contraction in China's economy. This data piece is relevant to traders worldwide as it will sway the sentiment around risk, which will determine how the risk-associated and safe-haven currencies will start the week. On Monday, the Bank of England's Governor Andrew Bailey will provide testimony about the December UK Financial Stability Report before the Treasury Select Committee in London. This testimony could create volatility on the Pound very early in the week before the Claimant Count Change data comes up on Tuesday. The last high-impact news from the UK is expected on Wednesday when the Consumer Price Index (CPI) data hit the market.

The US Dollar will have a much busier time. The Chinese GDP data could set off risk aversion, with attendant demand for the greenback if China's economic contraction is worse than economists have predicted. A further test of strength in the US Dollar comes up on Tuesday when the Empire State Manufacturing Index is released. Wednesday's Retail Sales and Producer Price Index (PPI) data round off the scheduled economic news data out of the United States. However, there could be some added volatility from Fedspeak, as FOMC members Patrick Harker (Philadelphia Fed Chief), Fed Governor and notable hawk Lael Brainard, and Fed Governor Christopher Waller will be speaking at various events throughout the week. Economic data from the Eurozone is relatively sparse this week. The only item of note is a panel discussion at the World Economic Forum (WEF) in Davos, Switzerland, featuring ECB President Christine Lagarde. Other listed economic news are of little market impact. This week's events out of the United States will be the driving force for price activity on the EUR/USD.

Last Week's Changes In Exchange Rates

Exchange Rate	%- change on week
\$ per £	+ 1.04
\$ per €	+ 0.40
€ per £	+ 0.85

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%