

## FX Daily: China data supports 2023 FX trends

Chinese activity data for 4Q22 released overnight was much better than expected and supports the proposition that the 2023 Chinese growth story will support pro-cyclical currencies, including the euro. Ongoing declines in natural gas prices are also helping. Today's focus will be on digesting UK labour market data, the German ZEW, and Canadian CPI



Activity data released overnight supports the view that China's zero-Covid reversal will spark resurgent Chinese demand

### 📌 USD: Quiet start to the week still favours pro-cyclical currencies

FX markets have had a quiet start to the week – perhaps awaiting edicts from Mount Davos? However, Chinese data released overnight was material and very much supports this year's hottest trend that China's zero-Covid reversal will spark resurgent Chinese demand. My colleague Iris Pang [was very impressed](#) by the December retail sales and fourth-quarter GDP data, so much so that she has revised up the 2023 China GDP forecast to 5%. The December data, in particular, supports the proposition that despite the pick-up in case numbers, the freedom of movement story is positively dominating the Chinese demand story.

The Chinese data did not, however, trigger any follow-through buying of the renminbi or Asian currencies in general. Rather than concluding that this story has already run its course in FX markets, we would prefer to see price action as merely quiet before the Chinese New Year starting next week, and the big event risk in early Asia tomorrow, which is the Bank of Japan (BoJ) meeting.

The dollar itself is steady. The US data calendar only really kicks off with what may be a soft December US retail sales release tomorrow. And there are no Fed speakers during European hours today. Some further DXY consolidation looks likely in a 102.00-102.50 range today. A downside break could emerge in Asia tomorrow, were the BoJ to again tweak its 10-year JGB yield target.

*Chris Turner*

## EUR: Revising the EUR/USD forecast higher

Yesterday we published some [substantial upside revisions](#) to our EUR/USD forecast profile. Broadening signs of slowing US price pressures, stronger signs of US recession, a better Chinese demand outlook and a better energy situation all made our sub-consensus EUR/USD forecasts untenable. We now favour EUR/USD moving higher through 2Q23 towards the 1.15 area – but the gains may stall there in 2H23 given what could be trouble with the US debt ceiling in late summer and higher energy prices next winter.

Back to the shorter term, the EUR/USD backdrop remains supportive. As discussed above, China's demand trends are supportive of pro-cyclical currencies like the euro. That better outlook for the eurozone could appear in today's German January ZEW investor survey, where the expectations component is expected to have improved from -23 to -15.

Also positive is the continuing fall in European gas prices. Two stories caught our eye today. The first is that European natural gas inventories are now 82% full versus the average levels of 63% normally seen at this stage of the heating cycle. The second is that Chinese importers are redirecting LNG shipments to Europe, given local inventories seem sufficient. That is a surprise. The continuing fall in European natural gas remains a positive development for the eurozone trade balance and is euro supportive.

EUR/USD may consolidate in a 1.0780-1.0870 range today – but the near-term macro trends remain supportive.

*Chris Turner*

## GBP: 50bp hike still in play for February

Our UK economist, James Smith, describes today's release of November jobs figures as "another month of relative resilience in the UK jobs market". Wage growth was a little higher than expected and supports the latest findings from the Bank Of England's Decision Maker Panel survey. Depending on the resilience of tomorrow's release of December UK CPI data it seems too early to dismiss the risk of another 50bp rate hike from the Bank of England on 2 February. Currently the market prices in around 42bp of tightening at that meeting.

Today's data saw EUR/GBP drop 15 pips – a move that makes sense. EUR/GBP is trading close to 0.89 because of December's hawkish ECB shift. The longer the BoE stays in hawkish mode, the more support sterling can get. Expect EUR/GBP to trade on the soft side of an 0.8850-0.8900 range today, with tomorrow's UK CPI release proving the next major input.

Chris Turner

## CAD: Inflation key for BoC January move

The Bank of Canada (BoC) looks set to face a hike/no-hike dilemma at next week's (25 January) policy meeting. Signs of slowing economic activity were taken on board in the latest BoC statement and clearly emerged in yesterday's BoC Business Outlook survey, where the future sales index dropped to the lowest since the pandemic and most interviewed firms said they expect a recession in Canada.

However, the jobs figures came in very strong in the December read, with robust full-time hiring keeping the unemployment rate around cyclical lows. The slowdown in wage growth from 5.4% to 5.2% did not seem enough of a silver lining, and markets have been reluctant to price out the 19bp currently embedded in the OIS curve.

Today's CPI read will be key. Consensus expectations are centred around a deceleration in headline inflation from 6.8% to 6.4%, and from 5.0% to 4.9% in the core (median) rate. Any signs of resilience in inflation would likely see markets fully price in a 25bp hike in January. Below-consensus reads should support CAD short-dated bonds, but it seems hard that investors will completely rule out a hike next week. The impact on CAD should be quite visible in both directions, although external forces should remain the key drivers on the loonie. Building USD weakness may favour a USD/CAD contraction to 1.31-1.33 in the coming weeks, although a surprise hold by the BoC is a clear upside risk for the pair.

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