Review of recent FX developments & outlook

ECB FX Contact Group - Frankfurt, 23/03/2023

Hinrich W. Paul – Global Head of Financial Markets
Inflation: Market-based l/t inflation expectations moderate, with high uncertainty looking ahead

US: swap-based inflation expectations
(Percent annualized)

Eurozone: swap-based inflation expectations
(Percent annualized)

Sources: Bloomberg, Commerzbank Research, as of 17th March
Inflation: The boomers have left the labour market & disinflation from globalization is easing, e.g. in the US

**US: labor force participation rate**
(Percent, nsa.)

**US: PCE deflators per broad categories**
(Indices, end-2019 = 100)
Germany: Inflation stubbornly high

CPI (change on year in percent)

Indeed wage tracker (change on year in percent)

Sources: destatis, Indeed, Commerzbank Research
Germany: Relief from energy price shock and improving Ifo index

Expenditure on imports of natural gas, crude oil and hard coal to Germany (percentage of gross domestic product, from 2023 Commerzbank forecast)

Ifo business climate (seasonal adjusted monthly figures, grey areas mark recession periods)

Sources: IFO, BdEW, Bloomberg, BP, Federal ministry of economics, destatis, IHS, Commerzbank Research
ECB: Among G10, ECB has been medium aggressive so far

Change in core inflation and in key policy rates vs. early corona period
(Percentage points)

Horizontal axis: Change in core inflation since end-2019;
vertical axis: change in key policy rate since end-2020

Eurozone and G10 core inflation
(Percent year-on-year)

ECB: Continuation of the rate-hiking cycle?

ECB deposit rate, ESTRON and OIS-based market expectations
(Percent)

Sources: ECB, Bloomberg, Commerzbank Research
USD: Banking system stress has led to downward revision of Fed expectations (ahead of Fed’s meeting)

Effective Fed funds rate, target (lower bound) and OIS-based market expectations (Percent)

Source: Federal Reserve, Bloomberg, Commerzbank Research
USD: USD profited from energy price shock vs currencies of energy importers

US terms of trade
(Indices, end-2019 = 100)

G3 terms of trade
(Indices, end-2019 = 100)

Source: BLS, Eurostat, ESRI, Commerzbank Research

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USD: Lack of long-term RIP in EUR-USD since 2014

T-notes and Bunds: real 5Y×5Y yields
(Percent, spread in percentage points)

Sources: Bloomberg, Commerzbank Research
Liquidity: Spreads stabilised at the end of 2022, beginning 2023
Liquidity: Lower liquidity 2022 compared to 2021

Source: Commerzbank
Japan: Inflation continues to accelerate

CPI
(Percent year-on-year)

Source: Ministry of Communication and Internal Affairs, Bloomberg

10Y JGBs: yield and BoJ target range

(Percent)

Source: Ministry of Communication and Internal Affairs, Bloomberg

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Japan: Is Japan’s debt “sustainable”?

Japan: primary budget balance
(Percent of GDP)

Japan: government debt
(Percent of GDP)

Sources: IMF, Bloomberg, Commerzbank Research

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Summary and open questions

• Core inflation expected to be sticky, we therefore expect more rate hikes than currently priced in.
• Main downside risks for Europe is conflict in Ukraine, related energy price risk and potential fall-out of SVB & Credit Suisse crisis.
• German economic data indicate feeble recovery. Inflation and wage pressure stubbornly high. We expect rate hikes to burden growth.
• Spreads did significantly widen in the course of 2022, compared to 2021.
• Inflation pressure mounting on BoJ, high level of uncertainty with regard to potential change of monetary stance.

Topics for group discussion
• USD, FOMC & US banking system
• EUR, CHF/CSFB & European situation
• JPY, Japan, China & Asia
• FX spreads
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