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Weekly Report

Weekly FX Market Update

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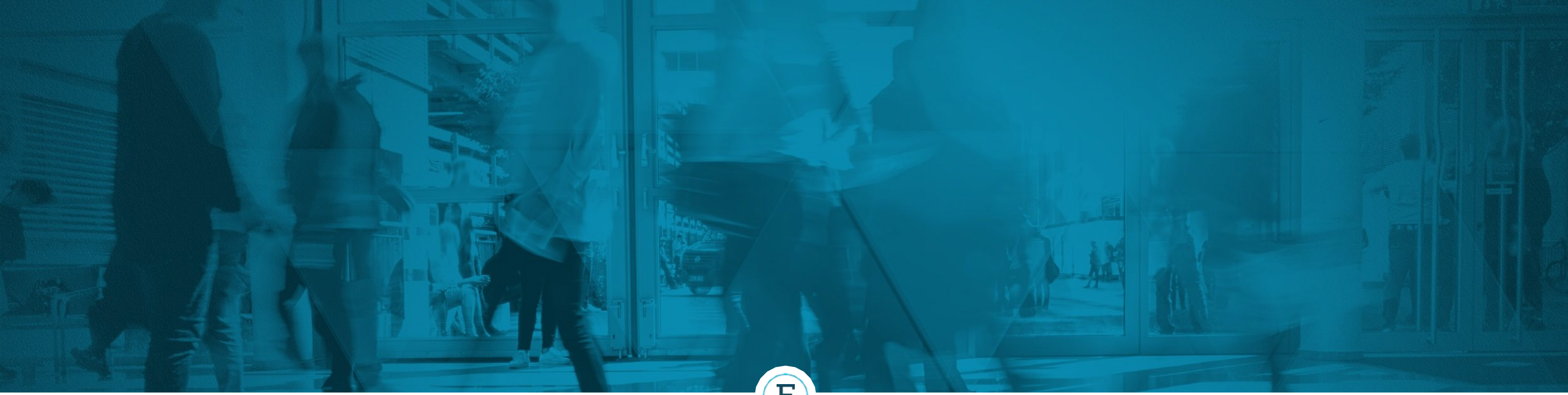


Powell dovish Jackson Hole speech fails to boost the dollar

The key event of last week was as expected the Jackson Hole conference of central bankers.

Powell's generally dovish speech sent most major currencies higher against the US dollar, as it suggested that the Fed Chair remains unconcerned by the recent spike in inflation and is in no hurry to remove accommodation, let alone raise rates. Risk assets rose in response, led as usual by equities and commodities, the dollar fell and emerging market currencies benefited.

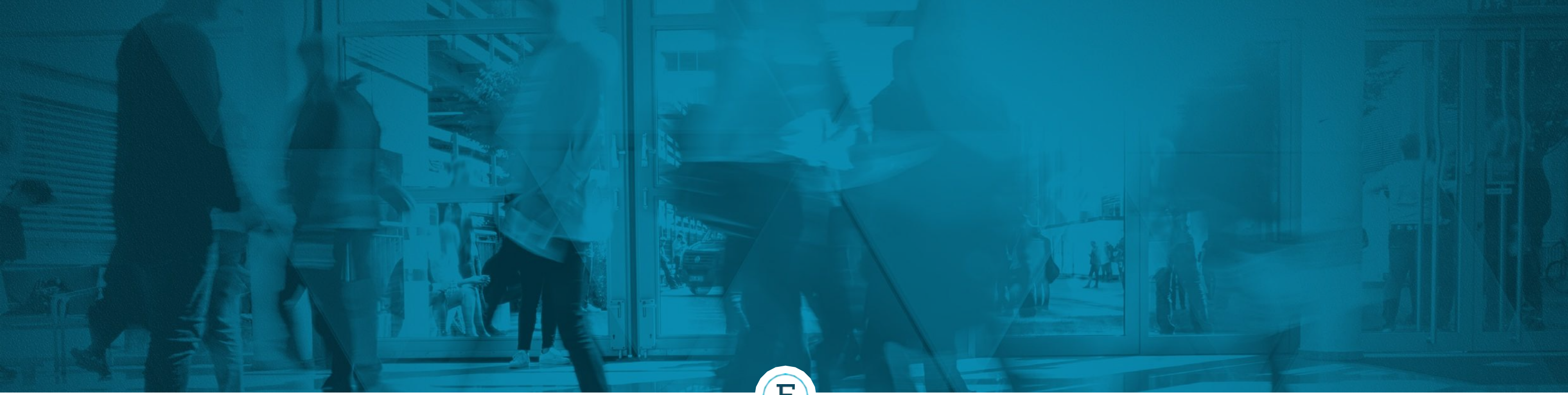
While the tone of Powell's speech was undoubtedly dovish, it did validate market expectations that the tapering of purchases of securities by the Fed will start before year-end. The timing and speed of this taper will be driven by inflation and job market data and the internal debate within the Fed, which we expect will become more heated soon. This week's US payroll report will be the key to the outcome of the September FOMC meeting.

GBP

PMI business activity numbers were disappointing, especially in the services sector. However, markets took this in stride, and the consensus seems to be that high vaccination and past COVID positives in the UK render it more resilient to the delta variant. Little economic or policy news of note is on tap for this week, so sterling will probably trade in line with the euro against the US dollar.

EUR

Strong PMI numbers out of the Eurozone confirmed our view that the economy there remains resilient and the delta variant is having so far limited impact on the booming recovery. We expect to see a lagged version of the inflationary tensions manifested in the US, driven by energy prices and supply-chain disruptions. There seem to be signs of it already, judging by the recent data out of the Eurozone countries and August inflation print for the bloc released this morning. Inflation came out stronger than expected at 3%, its highest level in a decade, although wasn't as high as we thought it might. The market reaction was muted as core inflation was only somewhat higher than expected at 1.6% and it's hard to differentiate one-off effects like the expiration of German VAT cuts, from genuine cost pressures.



USD

While Powell's communication tone remains dovish, other FOMC members seem to be taking a less relaxed view of the unbalance between supply and demand and resulting inflationary pressures. The announcement of a taper of Treasuries is now a matter of time, and hence every inflation and job market data point takes added importance. Consequently, the key event for currency markets this week will be the August payroll report, where another strong month of job creation and a drop in the unemployment rate is expected.

CHF

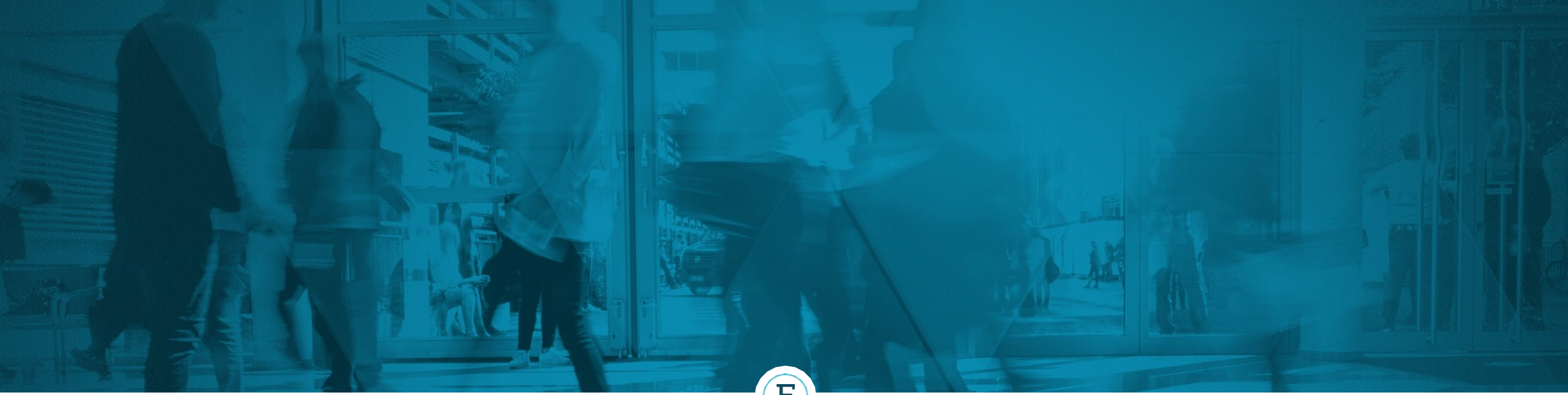
Improved market sentiment after Powell's Friday address at Jackson Hole meant the franc was one of the worst-performing G10 currencies last week. Last week's CFTC data showed another decline in CHF net longs to the lowest level in more than two months. It seems that despite the dire situation in Asia and large caseload in the US there seems to be a sense of optimism making its way through the worrying news headlines.

The franc is likely to continue being driven by market sentiment and shifts in the US yields, but in the next few days, it's worth looking at the economic readings from Switzerland, as the calendar is filled with important prints. Thursday will be particularly busy as we'll get August inflation reading and second-quarter GDP data.

AUD

The Australian dollar was one of the best-performing G10 currencies last week, rallying by more than 2% against the US dollar. As a high-beta currency, the AUD was supported by improved market sentiment and further boosted by the reassuring speech by the Fed president on Friday, indicating a slow approach to monetary policy tightening in the US.

That being said, news from Australia is not particularly encouraging. New coronavirus cases are on the rise, with the most populous states of New South Wales and Victoria posting sharp increases. In the last two days, the country registered record numbers of new cases, at more than 1,300 per day. The worsening of the situation has forced premier Daniel Andrews to extend lockdown measures beyond September 2 which isn't particularly surprising but seems to be weighing on the currency.



Looking at the next few days, we'll continue to focus on the shifts in market sentiment and internal COVID-19 developments, but will also pay attention to economic data as this week's calendar is particularly busy. Wednesday's second-quarter GDP print is the most comprehensive but dated. August PMI prints, on the other hand, will provide a more forward-looking assessment of the situation when released on Wednesday and Friday.

CAD

The Canadian dollar has recently recovered some of its earlier losses which saw the USD/CAD pair reaching its highest level since December. In addition to the USD weakness, the currency was boosted by a rebound in oil prices, with WTI prices rising to above $70 per barrel.

The market is also increasingly betting that the Bank of Canada will start its hiking cycle around the middle of 2022, before the Federal Reserve, which further supports the currency. We think the divergence in those bets is likely to widen further, which should support the CAD in the near term.

CNY

The Chinese yuan ended the week higher against the weaker US dollar but underperformed most key EM and Asian currencies. The currency's behaviour also contradicted that of its G10 proxies, as AUD and NZD were among the best performers.

With tough measures in place, the coronavirus situation in China seems to be under control, with only a few dozen cases reported in recent days, nearly all imported. This week the attention turns to economic data. Today's official PMI prints disappointed, showing declines to the lowest level since February 2020, when the economy experienced a strong hit from the pandemic. Non-manufacturing PMI declined to 47.5, while manufacturing PMI dropped to 50.1, coming in just slightly above the level separating expansion and contraction of the sector. Wednesday and Friday will see a release of Caixin PMIs, which are focused on medium-sized and small private companies as opposed to large state-owned enterprises, giving a fuller picture of the state and prospects of China's economy. The upcoming data could guide further actions by the PBOC which seems to be nearing a targeted RRR cut aimed to support rural banks, but could mull a broader set of measures if data continues to disappoint.

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