SMBC Capital Markets, Inc.

fxPoetry

August 3, 2022

Andrew Fately
Executive Director, Senior FX Marketer
Global Markets Marketing Department
andrew_fately@smbcgroup.com
Direct: +1 212-224-4532
Representative: SMBC Capital Markets, Inc.

Nowhere Near Done

Said Daly, 'we're nowhere near done'
Said Mester, 'we've not yet begun'
To see prices easing
And so, we'll keep squeezing
Inflation til it stops its run

Said Evans, 'I think three point five'
Is how high, for rates, we should strive
But Bullard said four
And possibly more
Is needed lest 'flation still thrives

It is abundantly clear that the Fed was quite unhappy with the bond market's interpretation of Chairman Powell's comments at the last FOMC meeting. This has been made evident this week by the plethora of sudden appearances by FOMC members to fine tune the message. When Powell explained that "…***at some point, it will be appropriate to slow down***," he did not mean that was the September meeting! It is obvlious they will be slowing down their rate hikes at some point. Nobody expected them to raise rates forever! And yet, based on price action in both the bond and equity markets, you would have thought Powell had indicated they were done tightening policy. Granted, he did claim they believed the current Fed Funds rate of 2.50% was the neutral rate, but they have been quite clear they would need to go above neutral to fight the ongoing inflationary impulse.

Hence, by the end of this week we will have been treated to an onslaught of Fed speakers, with a total of thirteen speeches now on the schedule, up from just three prior to the weekend. What is more remarkable, although certainly quite purposeful, is that we have been hearing from the most dovish members (Kashkari, Daly, Evans) that the Fed's job is not nearly done on inflation. Add to that the hawks like Bullard and Mester explaining that 4.0% seems appropriate and there has not yet been any compelling evidence that inflation is slowing, and the picture we get of the Fed today is an organization that is totally focused on this part of its mission, halting inflation. Things started on Sunday with Kashkari's comments on the Sunday talk shows but it was

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yesterday's efforts that seemed to get through to investors as the combined comments of Daly, Evans, Mester and Bullard were enough to send Treasury yields (+2.9bps today, +18bps yesterday) much higher. The Fedspeak wave continues today with five more FOMC members on the tape starting early this morning with Bullard at 7:30 and running through Kashkari at 2:30 this afternoon. Get ready for more of the same theme. While I doubt we will see quite as dramatic a move in yields, I imagine they will continue to pressure higher.

The Speaker has fled from Taiwan
And though China's happy she's gone
Xi's still working hard,
His rep, to safeguard
So live fire drills will press on

I mention Speaker Pelosi's trip because people keep talking about it as having had an impact on markets. While it is entirely likely that in the run up to her arrival in Taipei, some risk was removed from portfolios, especially Asia facing risk, once her plane landed safely there, the dangers certainly ebbed. After all, a full-scale invasion was clearly not on the cards, so we got the required amount of bluster from Chinese mouthpieces, but ultimately nothing changed. Yesterday's poor equity market performance was entirely attributable to the Treasury market's move, where not only did yields rise sharply across the board, but the curve's inversion increased to its current 32 basis point level. Again, one needs to go back to 2000 to see this large an inversion in the Treasury market. However, a recession may be defined, it is quite clear investors and traders are expecting slowing growth in the future. However, what we heard yesterday, and will almost certainly hear again today, is that the Fed doesn't care. They have all acknowledged that growth will slow as they attack inflation, so slowing growth will not be sufficient to stop their current policy momentum.

So, how have markets behaved since? Well, risk is a mixed bag at this point with yesterday's US equity weakness seeing no consistent follow through. In Asia, the Nikkei (+0.5%) and Hang Seng (+0.4%) both managed to rally a bit although Shanghai (-0.9%) failed to follow along. Perhaps it was disappointment in Xi's response to the Pelosi trip, or maybe it is just the fact that China is watching its property sector slowly implode and investors are concerned about the future there. Europe has been quite dull (DAX +0.1%, CAC +0.2% FTSE 100 0.0%) as investors surveyed the Services PMI data, which was mixed, slightly better than initial data but still weak overall with the Eurozone Composite PMI at 49.9. UK data was also softer than initial readings and Retail Sales in Italy (-1.1%) and the Eurozone (-1.2%) did not make for pleasant reading. But don't worry, US futures are bid, up about 0.5% as the equity market has still not read the Fed memo. My sense is that will happen at some point in the next month or so.

Besides the Treasury market, yields are higher across the board in Europe (bunds +5.6bps, OATs +4.0bps, Gilts +4.4bps, BTPs +2.6bps) as there seems to be a little follow-on from the Treasury market. You will have noticed that the Bund-BTP spread has narrowed slightly, now 'just' 220bps, but what has been less widely reported is that the ECB has begun their TPI process as during the past two months, they have purchased €10 billion of BTPs and **sold** €15 billion of Bunds. Consider, this occurred before the official beginning of TPI. As I have written consistently, however they want to describe it, the ECB is going to need to buy more BTPs and sell more Bunds if they are going to reduce that spread. There are no other choices.

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In the commodity space, oil is rallying this morning, up 1.1%, after OPEC+ intimated that while they would be looking at a production increase, it will be the smallest in their history, just 100,000 bbl/day. NatGas (+0.9%) is following as the heat wave in the US seems to be picking up again. Gold (+0.3%) continues to rebound from the depths below $1700/oz seen two weeks ago, but if yields continue to rise, I expect it will be a tough road higher. Copper (+0.8%) is also firmer although aluminum (0.0%) has not seen a bounce at all.

Turning to the dollar, it is generally, though not universally, weaker this morning with NOK (+0.75%) leading the G10 revival on the back of oil's rebound, but the rest of the bloc seeing much less movement. JPY (-0.2%) is the laggard today after it fell sharply yesterday on the back of the US yield rally. In the EMG space, HUF (+1.0%) and PLN (+0.75%) are leading the charge higher amid expectations for higher policy rates while the APAC bloc (INR -0.6%, PHP -0.55%, THB -0.4%, KRW -0.4%) all felt pain from the repercussions of the Pelosi trip and the ongoing events in China. Interestingly, TWD barely moved.

This morning brings just Factory Orders (exp 1.2%) and ISM Services (53.5) with the latter far more highly anticipated. With the recession discussion ongoing, a weak print here will simply get more tongues wagging on the subject.

As long as the Fed continues to push the hawkish narrative, I believe the dollar will remain underpinned. This is especially so for USDJPY but is generally true as well. As I have written before, until the Fed blinks, and all of these comments show their eyes are wide open, the dollar feels likely to go higher over time.

Good luck and stay safe
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