SMBC Capital Markets, Inc.

fxPoetry

September 23, 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.

Slaying That Dragon

One thing is abundantly clear
The market is riddled with fear
As Powell keeps hiking
The dollar keeps spiking
And all central banks must adhere

So, growth is no longer the key
As long as inflation roams free
But slaying that dragon
Will cause so much agon-
Y, how long 'til more, money, free?

Perhaps this week will be remembered as central bank week, the period when virtually every major player changed their interest rates to keep pace with the undisputed king, the Federal Reserve. I think it is worth a quick review of the policy changes this week:

China	0.00% (current 3.65%)
Sweden	+1.00% (current 1.75%)
US	+0.75% (current 3.25%)
Brazil	0.00% (current 13.75%)
Japan	0.00% (current -0.10%)
Philippines	0.50% (current 4.25%)
Switzerland	0.75% (current 0.50%)
Norway	0.50% (current 2.25%)
Taiwan	0.125% (current 1.625%)
Indonesia	0.50% (current 4..25%)
UK	0.50% (current 2.25%)
Turkey	-1.00% (current 12.0%)
South Africa	0.75% (current 6.25%)

Source: Bloomberg

I certainly cannot remember a week with so many policy adjustments if only because the schedule of central bank meetings rarely coalesces in this manner. I have highlighted the two truly noteworthy outliers in the current zeitgeist with Japan, as discussed yesterday, remains steadfast in its belief that inflation remains temporary and the NIRP and YCC remain the best policy. In addition, I expect Stephanie Kelton and her MMT crowd must be quite jealous of the Erdogan school of economic thought as Turkey, despite inflation raging at 80.2% Y/Y, cut interest rates further under the premise that it is high interest rates that drive high inflation.

But in the end, Chairman Powell continues to steer the global monetary ship as the Fed's unambiguous hawkishness has everyone convinced that he will not stop until inflation is well and truly dead. We can all only hope that he is more Ferdinand Magellan than Edward Smith*. It can be no surprise that financial markets are responding to this unprecedented coordination in tighter monetary policy by fleeing from risk assets. The biggest problem for investors is finding a safe place to hide. Equities are falling worldwide, but so, too, are government bonds. Gold is falling, along with most commodity prices and in truth, the only thing that has maintained its value, (actually increased in value) is the dollar. Right now, it seems that USD money market funds are the best place to invest. As such, we continue to see the dollar climb against virtually every other currency despite the rout in both stocks and bonds here.

Is there any hope on the horizon? Not based on the continuing data streams. For example, this morning we saw Flash PMI data from Europe and most of it was pretty dour.

Country	Manufacturing	Services	Composite
France	47.8	53.0	51.2
Germany	48.3	45.4	45.9
Eurozone	48.5	48.9	48.2
UK	48.5	49.2	48.4

Source: Bloomberg

While the French appear to feel a bit better than the rest of the continent, and certainly the UK, this is not a table that inspires confidence that economic growth is rebounding. In truth, it is no surprise that both the euro (-0.75%) and the pound (-1.75%) are falling so rapidly. Of course, the pound has a second problem, the newly released plans of the Truss government to address the current state of affairs in the UK. The plan is massive fiscal stimulus via tax cuts in virtually all parts of the economy while simultaneously capping energy prices for households and businesses. It is a bold plan, opposite what virtually all orthodox economists would propose and anathema to the supranational organizations like the IMF and World Bank. The market has not only sold the pound aggressively, but also Gilts (+23.8bps and back to their highest yields since 2011) as well as stocks (FTSE 100 -2.0%). Good luck to them but the market's early verdict is quite negative.

However, the reality is that the world is in an extremely difficult spot. It seems that a decade of kicking the can down the road with respect to addressing real issues is coming home to roost. This is evident in the energy crisis that is spreading around the world, the food crisis that is spreading around the world and the inflation that is spreading around the world. When the history of this time is written, it will be clear that the combination of papering over each measured growth hiccup via printing more money and the self-inflicted wounds of ESG led disinvestment in reliable energy production will be fingered as the key culprits in the current economic ~~demise~~ malaise.

With those joyous thoughts to bolster us into the weekend, let's quickly recap today's markets…lower!

Literally, everything other than the dollar on the FX markets is down today. Equities (Nikkei closed, Hang Seng -1.2%, Shanghai -0.7%, DAX -2.1%, CAC -1.9%, US futures -1.4%) are lower worldwide. Bonds (Treasuries +7.9bps, Bunds +12.5bps, OATs +12.3bps, BTPs +17.6bps) are also getting sold across the board with investors aggressively pricing in fears over both more supply and higher inflation.

Commodities? Red virtually everywhere here as well with oil (-3.2%), gold (-1.55%), copper (-4.0%) and aluminum (-1.5%) all getting tossed. Only NatGas (+1.1%) has managed to buck the trend, although it suffered greatly yesterday, so this seems like a little trading bounce rather than a fundamental change.

Which takes us to the FX markets, where the dollar remains undisputed champion. The pound is the worst G10 performer but SEK (-1.3%), NZD (-1.2%) and AUD (-1.2%) are no slouches in this regard either, as the commodity bloc seems to be suffering more acutely than other currencies. But even the Swiss franc (-0.45%) is under pressure despite its traditional haven status. The yen (-0.5%) seems to be holding up better than others as fears of further intervention abound. These fears will fade, and the yen seems likely to continue to decline over time, or at least until the BOJ changes their tune.

Emerging market currencies are also suffering with ZAR (-1.5%) the worst of the bunch followed by HUF (-1.1%), PLN (-1.0%) and CZK (-0.75%). The rand is suffering along with its major commodity exports while the CE4 are merely demonstrating their high beta to the euro. But MXN (-0.75%) is under pressure as is CNY (-0.6%), with the former feeling the commodity heat while the Chinese are finding that there is limited interest in holding renminbi when higher yields are available elsewhere. Add that to the fact that the Chinese economy continues to suffer under the zero covid policy and you have the makings of a currency decline.

On the data front, we only see the flash PMIs here as well (exp 51.0 Mfg, 45.5 Services, 46.1 Composite), but we do get to hear from Chairman Powell again. I expect he must be quite pleased that the market seems to be taking him more seriously now as financial conditions tighten, but there is certainly no reason to expect him to change his tune.

And if he is not going to change his tune, neither am I. The dollar remains king and will not be dethroned until the Fed pivots. Don't hold your breath waiting.

Good luck, good weekend and stay safe
Adf

*Captain of the *Titanic*