

20 August 2014

Breaking out

Euro/dollar found itself at new nine-month lows yesterday, finally breaking free from the stability that we have seen so far this month. From here there's a good chance that that the euro slips into a 1.25-1.30 range for much of what's left of the year.

The approach of tighter monetary conditions in the US – and UK – might be seen by many as the key to the slide in the euro, even if it is coming in slow motion. After all, ECB President Draghi said recently that the Fed and ECB had essentially put all the conditions in place for a lower euro. However, in our view, monetary policy is not the key: the balance of payments is the key.

Yesterday we saw more data from the euro zone that shows the pit-prop of balance of payments strength is starting to creak. This is important in our view. We saw in Japan how years of deflation and easy money failed to weaken the yen – until the Fukushima disaster started to eat into the country's current account surplus. And, in the euro zone, the deep recession from Q4 2011 through Q1 2013 has failed to really undermine the euro – because the region's balance of payments position has been so strong.

But now there are signs that the trends in the balance of payments are changing. If we look at the current account, for instance, 2012 saw a surplus of EUR133bn, followed by EUR228bn last year but, for the first six months of this year, the surplus is running at an annual rate of around EUR160bn. Direct investment and portfolio flows tell a similar story; EUR23.8bn of surplus in 2012, followed by EUR78.1bn last year, but a mere EUR39bn annual pace so far in 2014.

Looking ahead, it seems likely that this deterioration will continue. With respect to the current account there's the prospect that slightly firmer economic growth will stop the slump in imports. On top of this there's also the damage to exports from the sanctions imposed on Russia – although we admit that this will be modest.

Within the financial accounts of the balance of payments, inflows into periphery euro zone bond markets will be more limited now that these markets no longer offer a significant pick-up over other developed-market bond yields. While, in equities, our sense is that yet more disappointment concerning economic recovery in the larger euro zone countries, such as Germany, France and Italy, is making many overseas fund managers wonder whether equity levels are a bit rich right now.

But while we expect the euro to fall we still think it will occur at a snail's pace for a few reasons. The first is that currency volatility is still on the floor because traders are scared that regulators are still circling overhead. This is unlikely to change anytime soon. The second is that the market seems pretty short of the euro already, at least judging by the weekly CFTC data.

This being said, there may well be a broad consensus in the market that the euro will slide at a modest pace against the dollar. This could open the door for surprises if traders are wrong-footed, by either a sharper slide in the euro, or a rebound. Right now we think the odds of the former are the greatest.

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Overnight developments

Stevens pledges stable rates – again

In his semi-annual testimony to lawmakers, Reserve Bank of Australia Governor Stevens continued to suggest that rate stability was the most appropriate path for the moment. He said that while the RBA would consider lower rates if necessary, he does not regard the stance of monetary policy as the factor that's holding back the economy. He suggested that firms needed more animal spirits to take advantage of things like the development of Asia and that another rate cut from here would not necessarily help in this regard. In fact he said that there may be some benefit from unchanged rates in terms of breeding confidence through a sense of monetary policy stability and predictability. As usual he argued that the market underestimates the risk of a fall in the Australian dollar. He also expressed surprise that the US dollar is not stronger given the recovery in the US economy although, in our view, that reflects a lack of understanding of currency markets as stronger growth and stronger currencies do not always (or even very often) go hand in hand.

Stronger exports and imports than expected in Japan

Japanese trade data came through worse than the market consensus. The unadjusted deficit was JPY964bn against calls for JPY714bn of red ink. In seasonally adjusted terms the deficit was JPY1024bn, well above the JPY767bn expected and close to the JPY1067bn from last month. Exports rose 3.9% in annual terms, just above the 3.8% expected and the first annual rise in three months. Imports rose 2.3% after 8.4% last time and were above the -1.5% predicted. In all the data perhaps provides a bit of hope with exports and imports above consensus – even if the consequence is a wider trade deficit than anticipated.

Opinion polls continue to suggest a Swedish government loss

In Sweden the latest opinion poll gives the opposition centre-left grouping higher support going into the September 14th election. An Ipsos poll puts the opposition on 50.4%, which is 0.6% higher than its last poll in June. The centre-right government bloc is stable – and a long way behind – on 35.6%. It seems a done deal that the government will lose and, as we have highlighted before, it could turn out to be an important election as the opposition has promised to look closely at the Riksbank's inflation-only mandate with a possible view to widen it to incorporate employment as well. Such a possibility could weigh on the krona as we lead up to the election.

Low German PPI figure

German producer prices came through a bit below consensus – which has been a pretty consistent theme for some time. Prices fell 0.1% in the month, against calls for a flat figure. It leaves prices 0.8% below year-ago levels after -0.7% the prior month and is clearly one factor helping to keep consumer prices in check as well.

Today's G10 outlook.

G10 calendar

| Time | | Event | | Survey | Actual | Prior | *Risk |
|-------|----|--|-----|----------|--------|---------|-------|
| 00:30 | AU | RBA Governor Stevens Semi-Annual Testimony | | | | | |
| 00:50 | JN | Trade Balance Adjusted | Jul | -¥761.3B | -1024B | -¥1067B | - |
| 00:50 | JN | Exports YoY | Jul | 3.8% | 3.90% | -1.9% | - |
| 00:50 | JN | Imports YoY | Jul | -1.5% | 2.30% | 8.4% | + |
| 07:00 | GE | PPI MoM | Jul | 0.00% | -0.10% | 0.00% | - |
| 09:30 | UK | Bank of England Minutes | | | | | |
| 10:00 | EC | Construction Output MoM | Jun | -- | | -1.50% | |
| 11:00 | UK | CBI Trends Total Orders | Aug | 4 | | 2 | |
| 14:00 | NO | Norges Bank's Olsen speaks | | | | | |
| 19:00 | US | Fed Minutes from July 29-30 FOMC Meeting | | | | | |

Source: Standard Bank Research, Bloomberg, *Risk reflects our view on whether data is likely to be above expectations (+), below (-), or in line (=).

BoE vote is likely to have been 9-0

The Bank of England minutes will be watched by the market for signs that some members are getting twitchy about rates. Quite clearly this could come in terms of a non-unanimous vote, although our view is that it will be 9-0 in favour of unchanged policy. Needless to say, if it is anything other than 9-0, the pound will rise sharply and the fixed income market (and probably stocks) will sell off. But even if there's nobody voting for higher rates the minutes will still be scoured for signs that members are getting closer to pulling the trigger. One difficulty for the market is that the complexion of the MPC has changed quite a bit in recent months. For instance, Nemat Shafik participated in her first meeting in August, while Andrew Haldane had only been to two before, with Kristen Forbes only starting in July. These new members, especially Shafik and Forbes, are a bit of an unknown quantity for the market and, as such, could be a cause of some volatility in the future, even if the market currently suspects that, if anybody voted for higher rates earlier this month, it was a relative veteran of the MPC – Martin Weale.

What's more important, the Fed minutes or Yellen's upcoming speech?

The Bank of England is not the only central bank to release the deliberations of its last policy meeting: the Fed does the same later in the day. Whether the minutes can usurp Yellen's speech on Friday as the key event of the week is debatable. The market clearly thinks that if the Fed wants to make any significant changes to the way that it conducts its policy guidance it will do so in a speech such as Friday's; it will not be buried in the minutes of the most recent meeting. While this seems reasonable we (and the market), are sceptical that Yellen will be announcing any sort of seismic change on Friday. But, of course, you never know and the apprehension over this speech could make the market reticent to read too much into the minutes tonight. Don't forget that UK short-sterling futures traders have been trampled all over by apparent policy flip-flops from Carney. US treasury traders won't want to be led up the garden path in the same way and hence might be a bit reticent to respond to the minutes.

How to trade the markets

The information flow comes mainly in the form of BoE and Fed minutes rather than economic data. Yesterday's CPI data from the UK and US reinforces the idea that price pressures remain muted and that if central banks do hike within the next year, or so, they are likely to be doing so against the backdrop of modest price pressure, rather than chasing their tails, which both have had to do in the past. If this scenario plays out the amount of disruption caused by monetary tightening should be limited.

One other important thing to bear in mind about the tightening scenario from the US and UK is that it does look as it will be played out against the backdrop of continued weakness in the euro zone economy, and the persistence of very low inflation, if not deflation. We think that this too is of importance. For while there is plenty of room, in our view, for treasury yields and gilt yields to rise relative to core euro zone bonds, like German bunds, we feel that the softness in the euro zone does put something of a limit on the upside for US and UK yields. For instance, it's much easier for the treasury market and gilt market to trust in the secular stagnation theme, and hence relatively low rates over the long haul, if secular stagnation seems to be playing out before our very eyes in the euro zone.

For currencies, spread widening between gilts/treasuries and euro zone bonds may help the pound and dollar rally against the euro but, as we mention on the front page, this won't be enough if the euro zone balance of payments remains strong. Fortunately, perhaps, this strength is ebbing and with it should come more weakness for the euro against the dollar and pound.

Forecasts

G10 FX forecasts

| | Current | 1 month forecast | forward | 3 months forecast | forward | 6 months forecast | forward | 1 year forecast | forward | 2 years forecast | forward |
|---------------------|---------|---------------------|---------|----------------------|---------|----------------------|---------|--------------------|---------|---------------------|---------|
| Dollar rates | | | | | | | | | | | |
| EUR/USD | 1.33 | 1.32 | 1.33 | 1.29 | 1.33 | 1.27 | 1.33 | 1.25 | 1.33 | 1.20 | 1.34 |
| USD/JPY | 103 | 101 | 103 | 102 | 103 | 105 | 103 | 112 | 102 | 120 | 101 |
| GBP/USD | 1.66 | 1.67 | 1.66 | 1.65 | 1.66 | 1.65 | 1.66 | 1.67 | 1.65 | 1.71 | 1.64 |
| USD/CHF | 0.91 | 0.92 | 0.91 | 0.95 | 0.91 | 0.98 | 0.91 | 1.04 | 0.90 | 1.08 | 0.89 |
| USD/CAD | 1.09 | 1.09 | 1.09 | 1.10 | 1.10 | 1.15 | 1.10 | 1.20 | 1.10 | 1.30 | 1.11 |
| AUD/USD | 0.93 | 0.91 | 0.93 | 0.90 | 0.92 | 0.85 | 0.92 | 0.80 | 0.91 | 0.74 | 0.89 |
| NZD/USD | 0.84 | 0.85 | 0.84 | 0.84 | 0.84 | 0.81 | 0.83 | 0.75 | 0.81 | 0.7 | 0.79 |
| USD/SEK | 6.87 | 7.05 | 6.87 | 7.25 | 6.87 | 7.48 | 6.87 | 7.40 | 6.88 | 7.50 | 6.85 |
| USD/NOK | 6.16 | 6.25 | 6.17 | 6.36 | 6.18 | 6.38 | 6.20 | 6.40 | 6.24 | 6.25 | 6.27 |
| USD/CNY | 6.14 | 6.16 | 6.16 | 6.15 | 6.19 | 6.12 | 6.22 | 6.10 | 6.25 | 6.00 | 6.29 |
| Euro rates | | | | | | | | | | | |
| EUR/JPY | 137 | 133 | 137 | 132 | 137 | 133 | 137 | 140 | 137 | 144 | 135 |
| EUR/GBP | 0.80 | 0.79 | 0.80 | 0.78 | 0.80 | 0.77 | 0.80 | 0.75 | 0.81 | 0.70 | 0.81 |
| EUR/CHF | 1.21 | 1.22 | 1.21 | 1.23 | 1.21 | 1.25 | 1.21 | 1.30 | 1.21 | 1.30 | 1.20 |
| EUR/CAD | 1.46 | 1.44 | 1.46 | 1.42 | 1.46 | 1.46 | 1.46 | 1.50 | 1.47 | 1.56 | 1.48 |
| EUR/AUD | 1.43 | 1.45 | 1.43 | 1.43 | 1.44 | 1.49 | 1.45 | 1.56 | 1.47 | 1.62 | 1.50 |
| EUR/NZD | 1.58 | 1.55 | 1.58 | 1.54 | 1.59 | 1.57 | 1.61 | 1.67 | 1.64 | 1.71 | 1.70 |
| EUR/SEK | 9.15 | 9.30 | 9.15 | 9.35 | 9.16 | 9.50 | 9.16 | 9.25 | 9.18 | 9.00 | 9.16 |
| EUR/NOK | 8.20 | 8.25 | 8.22 | 8.20 | 8.24 | 8.10 | 8.27 | 8.00 | 8.33 | 7.50 | 8.39 |

| | Current | 1 month forecast | survey* | 3 months forecast | survey* | 6 months forecast | survey* | 1 year forecast | survey* | 2 years forecast | survey* |
|---------------------|---------|---------------------|---------|----------------------|---------|----------------------|---------|--------------------|---------|---------------------|---------|
| Dollar rates | | | | | | | | | | | |
| EUR/USD | 1.33 | 1.32 | 1.34 | 1.29 | 1.33 | 1.27 | 1.30 | 1.25 | 1.28 | 1.20 | N/A |
| USD/JPY | 103 | 101 | 103 | 102 | 103 | 105 | 105 | 112 | 108 | 120 | N/A |
| GBP/USD | 1.66 | 1.67 | 1.69 | 1.65 | 1.70 | 1.65 | 1.69 | 1.67 | 1.68 | 1.71 | N/A |
| USD/CHF | 0.91 | 0.92 | 0.91 | 0.95 | 0.92 | 0.98 | 0.94 | 1.04 | 0.97 | 1.08 | N/A |
| USD/CAD | 1.09 | 1.09 | 1.09 | 1.10 | 1.09 | 1.15 | 1.10 | 1.20 | 1.12 | 1.30 | N/A |
| AUD/USD | 0.93 | 0.91 | 0.93 | 0.90 | 0.92 | 0.85 | 0.91 | 0.80 | 0.89 | 0.74 | N/A |
| Euro rates | | | | | | | | | | | |
| EUR/JPY | 137 | 133 | 138 | 132 | 137 | 133 | 137 | 140 | 138 | 144 | N/A |
| EUR/GBP | 0.80 | 0.79 | 0.79 | 0.78 | 0.78 | 0.77 | 0.77 | 0.75 | 0.76 | 0.70 | N/A |
| EUR/CHF | 1.21 | 1.22 | 1.22 | 1.23 | 1.22 | 1.25 | 1.22 | 1.30 | 1.24 | 1.30 | N/A |

Source: Standard Bank Research, Reuters. *Survey refers to Reuters monthly survey of around 60 analysts

G10 rate forecasts

| | Current | 2014 Q3 | Q4 | 2015 Q1 | Q2 | Q3 | Q4 |
|-----------------|---------|------------|--------|------------|--------|----------|----------|
| US | | | | | | | |
| Policy rates | 0-0.25 | 0-0.25 | 0-0.25 | 0-0.25 | 0-0.25 | 0.25-0.5 | 0.5-0.75 |
| 3mth cash | 0.39 | 0.35 | 0.40 | 0.45 | 0.50 | 0.65 | 0.70 |
| 2yr yield | 0.42 | 0.50 | 0.75 | 0.90 | 1.20 | 1.40 | 1.50 |
| 10yr yield | 2.40 | 2.50 | 2.75 | 2.90 | 3.15 | 3.25 | 3.50 |
| Eurozone | | | | | | | |
| Policy rates | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 |
| 3mth cash | 0.20 | 0.20 | 0.22 | 0.25 | 0.28 | 0.30 | 0.28 |
| 2yr yield | -0.02 | -0.05 | -0.10 | 0.00 | 0.20 | 0.30 | 0.30 |
| 10yr yield | 1.00 | 0.90 | 0.75 | 0.85 | 1.00 | 1.40 | 1.60 |
| Japan | | | | | | | |
| Policy rates | 0-0.1 | 0-0.1 | 0-0.1 | 0-0.1 | 0-0.1 | 0-0.1 | 0-0.1 |
| 3mth cash | 0.13 | 0.15 | 0.20 | 0.20 | 0.25 | 0.25 | 0.25 |
| 2yr yield | 0.08 | 0.05 | 0.10 | 0.20 | 0.30 | 0.35 | 0.40 |
| 10yr yield | 0.50 | 0.45 | 0.50 | 0.70 | 0.90 | 1.00 | 1.10 |
| UK | | | | | | | |
| Policy rates | 0.50 | 0.50 | 0.50 | 0.75 | 1.00 | 1.25 | 1.50 |
| 3mth cash | 0.75 | 0.75 | 0.80 | 0.85 | 1.10 | 1.60 | 1.75 |
| 2yr yield | 0.71 | 0.75 | 1.00 | 1.20 | 1.40 | 1.80 | 1.90 |
| 10yr yield | 2.40 | 2.55 | 2.70 | 2.85 | 3.05 | 3.40 | 3.50 |

Source: Standard Bank Research, Reuters

G10 calendar

G10 calendar

Monday 18

| Time | | Event | | Survey | Actual | Prior | *Risk |
|-------|----|-------------------------------|-----|--------|--------|--------|-------|
| 00:01 | UK | Rightmove House Prices MoM | Aug | -- | -2.90% | -0.80% | |
| 10:00 | EC | Trade Balance SA | Jun | -- | 13.8B | 15.3B | |
| 15:00 | US | NAHB Housing Market Index | Aug | 53 | 55 | 53 | + |
| 23:45 | NZ | PPI Output QoQ | 2Q | -- | -0.5% | 0.90% | |
| 23:45 | NZ | PPI Input QoQ | 2Q | -- | -1.0% | 1.00% | |
| | CH | Foreign Direct Investment YoY | Jul | 0.80% | -17.0% | 0.20% | = |

Tuesday 19

| Time | | Event | | Survey | Actual | Prior | *Risk |
|-------|----|----------------------------|-----|--------|--------|--------|-------|
| 06:30 | JN | Nationwide Dept Sales YoY | Jul | -- | -2.50% | -4.60% | |
| 09:00 | EC | ECB Current Account SA | Jun | -- | 13.1B | 19.5B | |
| 09:30 | UK | CPI MoM | Jul | -0.20% | -0.30% | 0.20% | - |
| 09:30 | UK | CPI YoY | Jul | 1.80% | 1.60% | 1.90% | - |
| 09:30 | UK | PPI Input NSA MoM | Jul | -1.00% | -1.60% | -0.80% | = |
| 09:30 | UK | PPI Output NSA MoM | Jul | 0.10% | -0.10% | -0.20% | = |
| 09:30 | UK | PPI Output Core NSA MoM | Jul | 0.00% | 0.00% | 0.00% | = |
| 13:30 | US | CPI MoM | Jul | 0.10% | 0.10% | 0.30% | = |
| 13:30 | US | CPI Ex Food and Energy MoM | Jul | 0.20% | 0.10% | 0.10% | - |
| 13:30 | US | Housing Starts | Jul | 966K | 1093K | 945K | + |
| 13:30 | US | Building Permits | Jul | 1000K | 1052K | 973K | + |

Wednesday 20

| Time | | Event | | Survey | Actual | Prior | *Risk |
|-------|----|--|-----|----------|--------|-----------|-------|
| 00:30 | AU | RBA Governor Stevens Semi-Annual Testimony | | | | | |
| 00:50 | JN | Trade Balance Adjusted | Jul | -¥761.3B | | -¥1080.8B | - |
| 00:50 | JN | Exports YoY | Jul | 3.8 | | -2 | - |
| 00:50 | JN | Imports YoY | Jul | -1.5 | | 8.4 | + |
| 07:00 | GE | PPI MoM | Jul | 0.00% | | 0.00% | - |
| 09:30 | UK | Bank of England Minutes | | | | | |
| 10:00 | EC | Construction Output MoM | Jun | -- | | -1.50% | |
| 11:00 | UK | CBI Trends Total Orders | Aug | 4 | | 2 | |
| 14:00 | NO | Norges Bank's Olsen speaks | | | | | |
| 19:00 | US | Fed Minutes from July 29-30 FOMC Meeting | | | | | |

Thursday 21

| Time | | Event | | Survey | Actual | Prior | *Risk |
|-------|----|--------------------------------------|--------|--------|--------|-------|-------|
| 02:45 | CH | HSBC China Manufacturing PMI | Aug P | 51.6 | | 51.7 | - |
| 08:30 | SW | Unemployment Rate SA | Jul | -- | | 8.00% | |
| 08:30 | GE | Markit/BME Germany Manufacturing PMI | Aug P | 51.5 | | 52.4 | - |
| 08:30 | GE | Markit Germany Services PMI | Aug P | 55.5 | | 56.7 | + |
| 09:00 | NO | GDP QoQ | 2Q | 0.40% | | 0.30% | - |
| 09:00 | NO | GDP Mainland QoQ | 2Q | 0.70% | | 0.50% | - |
| 09:00 | EC | Markit Eurozone Manufacturing PMI | Aug P | 51.3 | | 51.8 | - |
| 09:00 | EC | Markit Eurozone Services PMI | Aug P | 53.7 | | 54.2 | = |
| 09:30 | UK | Retail Sales Incl. Auto MoM | Jul | 0.40% | | 0.10% | - |
| 09:30 | UK | PSNB ex Interventions | Jul | 0.5B | | 11.4B | = |
| 13:30 | US | Initial Jobless Claims | Aug-16 | 302K | | 311K | |
| 14:45 | US | Markit US Manufacturing PMI | Aug P | 55.7 | | 55.8 | + |
| 15:00 | US | Philadelphia Fed Business Outlook | Aug | 19.4 | | 23.9 | + |
| 15:00 | US | Existing Home Sales | Jul | 5.02M | | 5.04M | + |
| 15:00 | EC | Consumer Confidence | Aug A | -9.1 | | -8.4 | + |
| 15:00 | US | Leading Index | Jul | 0.60% | | 0.30% | = |
| 21-23 | US | Kansas Fed's Jackson Hole symposium | | | | | |

Friday 22

| Time | | Event | | Survey | Actual | Prior | *Risk |
|-------|----|--|-----|--------|--------|--------|-------|
| 13:30 | CA | Retail Sales MoM | Jun | 0.40% | | 0.70% | - |
| 13:30 | CA | Retail Sales Ex Auto MoM | Jun | 0.60% | | 0.10% | - |
| 13:30 | CA | CPI NSA MoM | Jul | -0.10% | | 0.10% | = |
| 13:30 | CA | CPI Core MoM | Jul | 0.10% | | -0.10% | = |
| 15:00 | US | Fed's Yellen speaks on the labour market | | | | | |

Source: Standard Bank Research, Bloomberg, *Risk reflects our view on whether data is likely to be above expectations (+), below (-), or in line (=).

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