



Julius Bär

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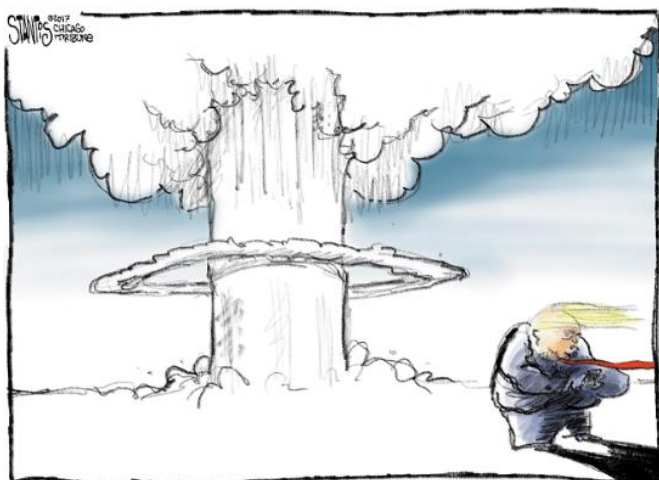
CURRENCIES & MORE OUR INSIGHT INTO THE WORLD'S LARGEST MARKET

Asian FX: We outline our opposing view of Yen vs. other Asian FX in case the Kim-Trump spat escalates
Dollar: Inflation remained lackluster as hotel room rates, vehicle and wireless service prices declined
Aussie: Speaking to Parliament, Governor Philip Lowe indicated the RBA will remain on hold for longer

Asian FX: Why the Yen, why the Aussie?

We received some feedback regarding our rationale that the Yen – next to the Franc – is a safe-haven currency in case the Kim-Trump saber-rattling would seriously escalate. The arguments opposing our view are based on the involvement of Japan into this potential escalation, as Defense Minister Itsunori Onodera said last Thursday that his country's military will shoot down North Korean missiles targeted at the U.S. territory of Guam.

The day after tomorrow



TWEET 'HAVOC' AND LET SLIP THE DOGS OF WAR...

Source: Scott Santis / Tribune Content Agency

Arguably, there is some truth in this thinking. However, in case of real stress – Japan's well-known knee-jerk reaction of repatriating foreign assets – should outweigh concerns of geopolitical involvement. The proof for our assessment is that since the U.S. President issued his "fire and fury"

comment last Tuesday, the Yen advanced 1.8 percent against the Dollar (the Franc 1.2 percent), while other Asian currencies like the Aussie, the Kiwi, and – of course – the Won declined. Therefore, the FX market's reaction as a broad gauge confirms our view. We still believe that the probability of a full-blown crisis is very low, but the escalating war of words between Trump and Kim Jong-un will continue to impact FX this week. In that context, we received some questions why the Aussie should suffer, as the continent is much further away from the Korean peninsula than Japan. The answer is that Australia is one of the U.S.'s closest allies. Indeed, Australians have fought alongside Americans in every major conflict since the First World War, and is currently aiding the mission to destroy Islamic State in the Middle East. A U.S.-Australian alliance was formalized in 1951 with the Anzus Treaty, which originally included New Zealand.

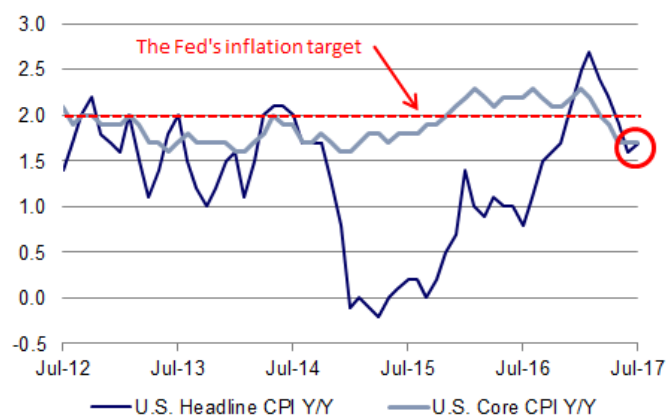
Conclusion: Some further verbal escalation should be expected in the coming days, keeping the Yen supported and weighing on Aussie, Kiwi, and the Won.

Dollar: Lackluster inflation

As a welcome break to the nasty U.S.-North Korea tensions, we got the inflation print for July last Friday. Both, headline and core CPI increased by another lackluster 0.1 percent in July, which left the annual core inflation rate unchanged from June at an underwhelming 1.7 percent. The big drags last month came from lodging away from home (hotel room rates), which plunged by 4.2 percent, new and used vehicle prices, which both fell ½ percent, and (again) wireless telephone services, which declined 0.3 percent. Interestingly, used vehicle prices are being depressed by the flood of off-lease vehicles coming back onto markets and now supply surge is beginning to hit new

vehicle prices too. The slump in wireless telephone services is due to the price war that broke out among providers earlier this year.

U.S. CPI in the past 5 years



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: The ongoing trend in inflation does not (yet) point towards a reversal.

QUICK NEWS HEADLINES (time in CEST)

The following two headlines might have an impact on currency markets today:

- Japan: GDP rose 4.0% in Q2 y/y vs. 2½% expected.
- China: Retail sales rose 10.4% in July vs. 10.8% expected.

Aussie: Finding the balance

For both Antipodean currencies, we have not seen a real trend for quite some time already, but rather a broad range wherein we recommend going long near the lower end and going short at the upper end. The Aussie and the Kiwi have in common that both countries exhibit solid economic growth (2 to 3 percent over the past couple of years) on one side but on the other side Governors who repeatedly intervene successfully if the exchange rate appreciates too much (see also our 11 August edition on the Kiwi). Last Friday, Governor Philip Lowe delivered his semi-annual testimony to Parliament. He remained slightly upbeat on economic growth prospects, but indicated that the Board is patiently waiting for a stronger economic recovery. He concluded that rate hikes are “some time away.” He also noted that further short-term monetary stimulus benefits have to be weighed against medium-term balance-sheet risks facing the economy, hence, the RBA needed to strike a balance and has preferred a prudent approach to promote both macro-economic and

financial stability. Overall, while acknowledging several positives in the economic backdrop, we believe that the advocacy for “patience” within the Board makes the testimony tilted to the dovish side. With the RBA’s Cash Rate at 1½ percent for a year now, we think a first interest rate hike will likely take place only around Q2 2018. Too optimistic rate-hike expectations are fading now, which should bring the Aussie lower.

Sell and buy zone for A\$/SFr



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: The Aussie turned south recently, based on the SoMP a week ago and last Friday’s testimony. We expect this trend to continue for a while.

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