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

Pound: Rocky road ahead for Brexit negotiations which seem to be putting pressure on the pound
Rupee: We stick to our long-term bullish forecast but short-term weakness shouldn't be neglected
Dollar: The FOMC has different views of inflation, but generally agrees that the softness is transitory

Pound: Brexit unraveled

Articles are making the rounds that the next state of negotiations could be delayed until December and that there is still a chance that Brexit may not happen after all. The EU is still hoping for sufficient progress in the first phase of Brexit negotiations, which includes the exit bill that Britain should pay as well as expatriate rights and issues surrounding Northern Ireland. However, these talks are taking longer than anticipated, pushing back second stage negotiations.

Which way to the future?

Source: Getty Images

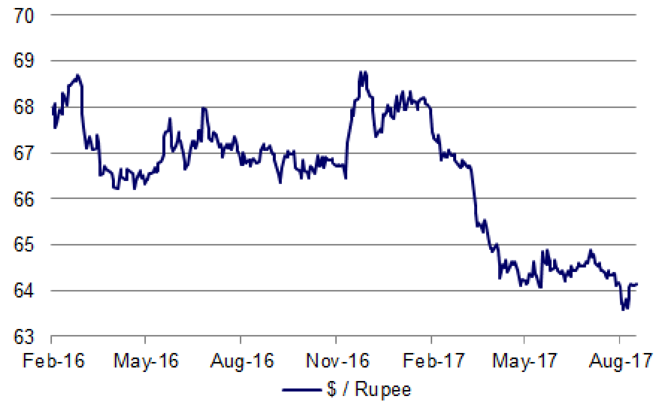
In other news, Liberal Democrat leader Sir Vince Cable told an audience at the Edinburgh International Book Festival that his view is still that the U.K. may not leave the EU after all. He backs his view by the "sheer practical difficulties" and the "unraveling politics" to leave the bloc. He states further that the process seems to be extremely complicated and that the U.K. Government is currently hiring hundreds to thousands of civil servants to cope with it, indicating how unprepared they were. Interestingly, the sterling hardly moved with better than expected data out this week, which could be a sign of weakness to come, especially once negotiations start to get tricky.

Conclusion: Brexit negotiations have a bumpy road ahead, and we feel that the pound will suffer as a result.

Rupee: Inflation the key driver

Recently, the rupee has been supported by inflows into India in the form of FDI, equity and bond flows. Yesterday, Indian sovereign bonds dropped, which drove the benchmark 10-year yield to a six week high after CPI rose to 2.36% versus 2.05% expected. Government initiatives also continue to enhance productivity and supply. The current account deficit has remained at low levels as oil prices came down and gold imports were reduced. These points, in addition to attractive interest-rate carry, make a good case for a stronger rupee. The CPI print supports the view of the Reserve Bank of India (RBI) that the inflation weakness is transitory, meaning, inflation has likely bottomed. If inflation were to rise from here, it is highly likely that the RBI could push back a further rate cut. Equity and bond inflows would slow down, putting pressure on the rupee. While we are long-term bullish on the rupee, we shouldn't neglect a short-term rupee weakness and watch out for further data out of India.

Rupee could show possible short-term weakness



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We remain bullish on the rupee but a short-term weakness could be in the cards.

QUICK NEWS HEADLINES (time in CET)

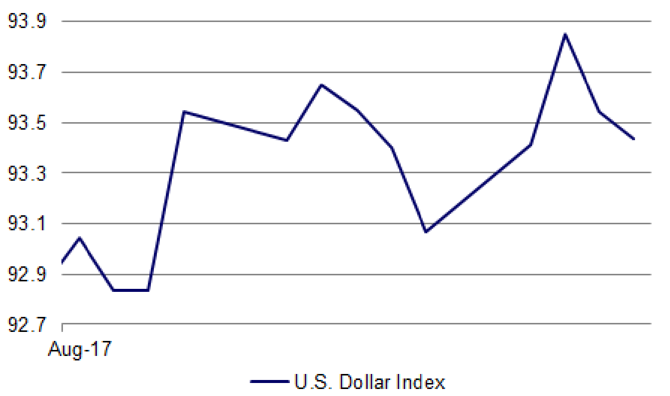
The following two headlines might have an impact on currency markets today:

- DE PPI Y/Y (08:00)
- CA CPI Y/Y (14:30)
- US U. of Michigan Sentiment (16:00)

Dollar: FOMC minutes revisited

In the FOMC meeting minutes of the July 25-26 meeting most Fed officials backed a “balance sheet move at an upcoming meeting”, implying that they cannot fully commit to the September meeting. Other headlines focused on inflation and not all were hawkish. It was noted, that the recent inflation decline is likely due to idiosyncratic factors. Some expressed concern of increased uncertainty about the inflation outlook and that risks could be tilted to the downside. This suggests a delay in a rate hike. The Greenback was trading weaker across the board overnight after the minutes. $/¥ dropped the most but has recovered all of its losses yesterday. $/¥ could even go higher in sync with US yields. Other officials argued that the strong labor market and high stock prices could produce a push in inflation above the Fed’s 2% target that would be difficult to control if rates aren’t raised soon. We believe that the Fed will announce a balance sheet normalization in September as the August minutes mentioned that several participants were prepared to do so already at the July meeting. This would give the Fed three months’ time to assess the market reaction before a possible rate hike in December.

Dollar Index decline after the FOMC meeting minutes



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: The committee is split about the timing of the next rate hike but is generally of the view that the softness in inflation is transitory.

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