Julius Bär

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

Aussie: MP Turnbull's government is looking increasingly uncertain due to the dual-nationality fiasco
Euro: Mario Draghi emphasized the risk of the Euro overshooting and of tightening financial conditions
Loonie: No surprise in Canadian CPI data but market reaction was strong, leading to a higher Loonie

Aussie: Australia early election risk

The dual-nationality fiasco in Australia is slowly starting to turn into a constitutional crisis. Next week, Australia's High Court will decide on the eligibility for office of Fiona Nash (Rural Health Minister) and five other MPs, including Deputy PM Barnaby Joyce. Fiona Nash is the deputy leader of the second largest party in Australia's government coalition, the National Party. Fiona Nash holds, allegedly unwittingly, a UK citizenship by descent due to her Scottish-born father. This wouldn't be all that interesting if there was not a 117 year old law in Australia, barring MPs to hold dual citizenships.

Australia dual-citizenship fiasco

Source: Kudelka Cartoons

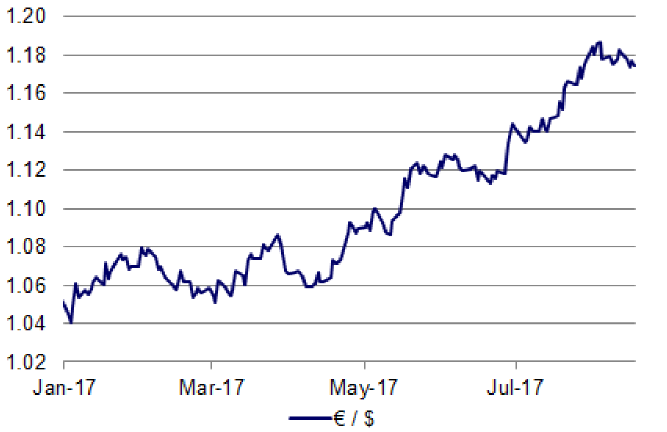
The law, Section 44, was implemented to prevent politicians from having conflicts of interests with other countries. For now, Nash said that she will remain in her position until the High Court clarifies a section of Australia's constitution. This fiasco is an embarrassment for Prime Minister Malcolm Turbull's government and could even threaten his hold on power. His government has been trailing in opinion polls as it struggles to deliver a policy agenda. Worse still, if any government MP in the lower house were ruled to be ineligible, the government could lose its one-seat majority in the lower house. The effect on A$/$ is unclear at the moment but we feel it is likely to trade heavy and lower on such news.

Conclusion: Watch A$/$ closely next week with Australia's High Court ruling on eligibility for office of six MPs.

Euro: ECB Minutes revisited

The ECB Minutes were under close scrutiny on Thursday after Draghi mentioned that he would not deliver a new policy message in Jackson Hole this week. Draghi said that generally financial conditions remained supportive of the economic expansion. The appreciation of the Euro could be seen "in part as reflecting changes in relative fundamentals in the Euro-zone vis-à-vis the rest of the world." He expressed concerns about the risk of exchange rate overshooting in the future. Favorable financing conditions should not be taken for granted or relied on monetary policy accommodation. Draghi did not mention the above in his press conference, indicating that this part made it to the Minutes only later. In fact, there were three references with regards to the Euro overshooting and the risk of tightening financial conditions which did not appear in the press conference. This put pressure on the Euro. The Euro fell from a 1.1700 level to a low of 1.1663 but recovered subsequently to 1.1750 where it is still trading this morning. We feel this will likely put a cap on €/$ around 1.18 over the next few weeks. If the ECB succeeds in stabilizing the Euro, it could well mean that they will hike faster than expected. Euro crosses should remain heavy as well. Maybe this is the long awaited correction after all.

The risk of the Euro overshooting is a concern of the ECB



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: Expect €/$ to remain capped around current levels and euro crosses to consolidate over the next few weeks.

QUICK NEWS HEADLINES (time in CET)

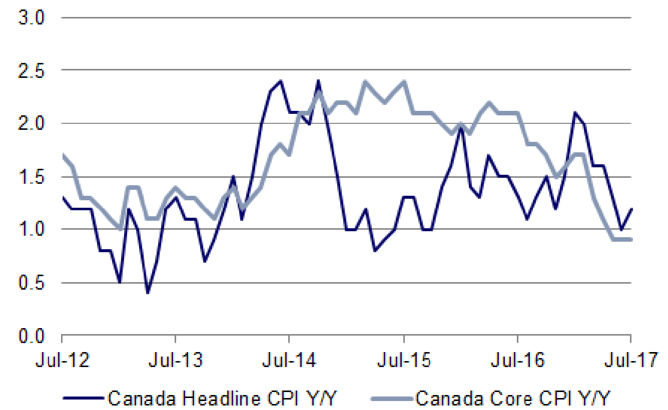
The following four headlines might have an impact on currency markets today:

- Japan: The All Industry Activity Index rose 0.4% in June, matching expectations.
- Switzerland: Total Sight Deposits at the SNB will be published at 10:00 (last: SFr 578.9 billion total and SFr 476.3 billion domestic).
- Israel: The unemployment rate is expected to have stayed at 4½% in July (12:00).
- Canada: Wholesale trades sales are expected to have declined ½ % in June m/m (14:30).

Loonie: Inflation data as key driver

On Friday, Canadian inflation data came out. The data was widely anticipated as it will have a direct impact on the near-term direction of the Loonie. The Canadian dollar has been negatively affected by the general downturn in crude oil prices this month, and will likely suffer further if the risk sentiment deteriorates. Ahead of CPI data the Canadian dollar moved higher, supported by Gold rising to a nine-month high and a rebound in oil prices as well as favorable yield spreads. Annualized CPI came in at 1.2 percent, as expected, vs 1.0 percent prior release. Core CPI remained at 0.9 percent for a third straight month (see chart below). $/C$ dropped around 60 pips due to the slightly higher headline CPI, a strong move for data that came out in line. Inflation picked up for the first time since January, with the higher fuel price the main reason behind the increase. The BoC kept arguing the recent softness was mostly temporary and therefore raised its key rate slightly last month. It looks like they were correct. This could mark a renewed bullish trend in the Loonie. The market should digest the news first before we can make a longer-term call. For now we believe that the Canadian dollar will gain in momentum over the near–term.

Headline and core CPI in the past 5 years



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: Inflation data came out in line but picked up its pace for the first time since January. We are likely to see a renewed bullish trend in the Loonie but wait for the market to digest the news first.

CONTACTS

FX Market Advisory Zurich
+41 (0) 58 888 8484

FX Market Advisory Geneva
+41 (0) 58 885 3551

FX Market PB Solutions Zurich
+41 (0) 58 888 8484

FX Market Advisory Hong Kong
+852 2979 2688

FX Market Advisory Singapore
+65 682 71 790

Author: Laura Hilber
+41 (0) 58 888 8419

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