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

G-10 FX: Inflation will likely be the most watched topic at Jackson Hole Symposium
Yen: The recent strength of the Yen suggests risk-off, 108.00 is the level to watch
Aussie: Rising iron ore prices prop up the Aussie, but this is unlikely to be sustainable

G-10 FX: Jackson Hole casts its shadow

The long-awaited Jackson Hole Symposium, starting this Thursday, is already casting its shadow on FX markets. This year's topic "fostering a dynamic global economy" suggests some optimism after years of muddling through. Within G-10, there is clearly solid growth and falling unemployment but inflation has been slow to pick up.

Searching for inflation in Jackson Hole

Source: Ingram Pinn

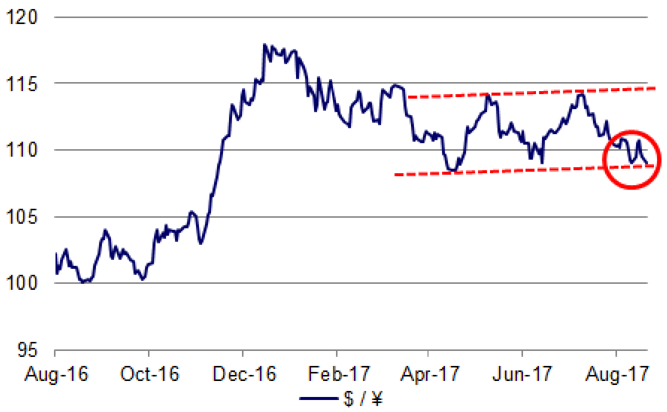
From this point of view, we think the market's focus will mainly be on comments regarding the assessment of inflation going forward. U.S. inflation stands at 1.4 percent as of June, based on the Fed's preferred gauge (core PCE), and CPI in the Euro-zone – currently at 1.3 percent – has wavered since the start of the year. Japan's inflation around zero and Switzerland's at 0.3 percent are even much more subdued. Superficially judged, U.K. CPI around 2½ percent looks good but this is mainly due to the declining Pound following the Brexit vote last year. The only central bank within G-10 being "on track" is the Riksbank, with Swedish CPI at 2.2 percent. With the glacial price gains in most G-10 economies, it will be potentially market-moving from what we hear of the main participants. Clearly, Fed Chair Janet Yellen and ECB President Mario Draghi will be in the spotlight, but also other central bank Governors might be good for a surprise. Yellen will start talking on Friday at 16:00 CEST and Draghi will take the podium after midnight our time. In total, representatives from central banks of more than 40 countries will attend the gathering. SNB President Thomas Jordan will be among the participants. While the Fed has basically telegraphed to get moving on unwinding its $ 4½ trillion balance sheet in September, any signals of uncertainty of Yellen over her inflation outlook could cast doubt on the Fed's interest-rate hiking path. Tomorrow, Draghi will speak in Lindau, Germany, before traveling to Wyoming, and might provide first hints of his current views. We think Draghi will choose to strike a balanced tone by expressing optimism over the economy but steering clear of singling his precise thoughts until 7 September, when the Governing Council meets in Frankfurt.

Conclusion: We think Jackson Hole almost guarantees market-important information and we bet it has to do with the inflation topic.

Yen: Risk off, Yen up?

From a rates perspective, the recent Yen strength does not rally make sense. With the BoJ's yield-curve control and the 10-year JGB yield basically around zero percent this year and the Treasury equivalent around 2.2 percent, one could argue that $/¥ should move higher. Even more so as Governor Haruhiko Kuroda pushed back the BoJ's forecast to reach its 2-percent inflation target for the sixth time last month (see our 21 July edition). The answer to the Yen strength must be clearly coming from the corner of elevated concerns of further escalation around the Korean peninsula. From a technical point of view, $/¥ is sitting just above the months-long support line (see chart below) and if it breaks, a deeper move would be in the cards. Textbook analysis suggests a move corresponding to the height of the formation, roughly 6 Yen.

$/¥ is sitting at the support line



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: A break of the major support around 108.00 would open a move towards 102.

QUICK NEWS HEADLINES (time in CET)

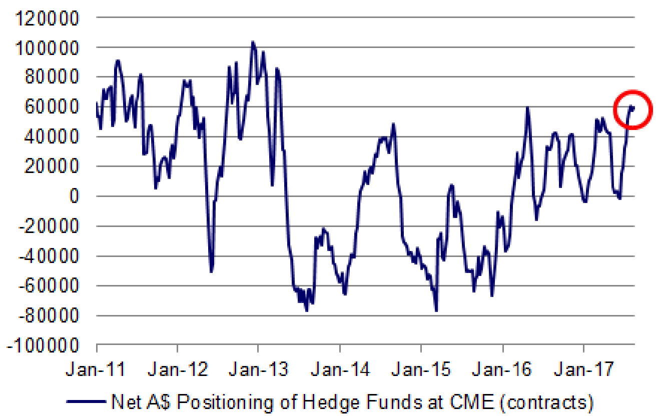
The following two headlines might have an impact on currency markets today:

- Germany: The ZEW Survey Current Situation for this month is expected at 85.3 (11:00).
- Hungary: The MNB is expected to leave its policy rate unchanged at 0.9% (14:00).

Aussie: Too much bullishness

Despite a relatively dovish RBA recently, the Aussie is still holding up pretty well. On 11 August, when Governor Philip Lowe delivered his semi-annual testimony to Parliament, he said that rate hikes “are some time away” (see our 14 August edition). No increase of the Cash Rate is expected until August next year, based on OIS futures. According to pundits, especially Asian-based funds keep buying Aussie due to the ongoing rally in iron ore futures. Arguably, iron ore is Australia’s largest export earner, accounting for A$ 47.8 billion last year or about 15 percent of the total. The price of iron has risen from $ 60 per metric ton to $ 90 currently. However, this is only back to the average price of the past couple of years. Our commodity research expects steel consumption and production to retreat from current levels as construction is at the seasonal peak. They also note that there are no shortages in steel and the iron ore market is amply supplied as Chinese port inventories are close to record levels. Our colleagues conclude that “sentiment seems excessively bullish.” Similarly, net positioning of Aussie futures at the Chicago Mercantile Exchange is also very bullish. The latest reading shows that hedge funds are long almost 60’000 contracts, equivalent to A$ 6 billion, the highest in more than four years (see chart below).

Aussie positioning at the CME at extreme levels



Source: Kudelka Cartoons

Conclusion: We still do not see any upside for the Aussie in the foreseeable future.

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