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

Pound: By issuing position papers on a daily basis, the U.K. seems to build up some pressure on the E.U.
Peso: Adjusted for calendar effects, the Mexican economy grew in Q2 at the highest rate since Q1 2013
Forint: Despite solid economic growth and optimal inflation, the MNB sticks to its very loose policy

Pound: Hurry up!

Yesterday, Prime Minister Theresa May's government already issued its third position paper in two days on how it sees its future relationship with the E.U. The paper describes possible options to manage cross-border disputes between consumer, businesses, and investors.

Is she all right?



Source: Jos Collignon / Cagle Cartoons

Two more position papers will be released this week as part of efforts to move talks with the E.U. beyond simply setting the divorce between the two but also to address their future relationship. However, we all know the schedule of Michel Barnier, the E.U. chief negotiator: He wants to see first sufficient process on divorce issues before talking about the future relationship. The next round of negotiations starts next week and Barnier tweeted last Monday that he will “focus on orderly withdrawal” and that he has been “clear and transparent” on this since day

one. It is unclear to us what May with her activism is striving for as the E.U. is clearly not budging. Arguably, a close cooperation is not just in the interest of the U.K. but also in the interest of the 3.2 million E.U. citizens living in Britain. Nevertheless, Barnier is clearly in the stronger position. In addition, there remain several “red lines” on both sides and as long as they remain unsolved, the “Brexit risk premium” will continue to weigh on the Pound. One of the two further position papers released this week will be issued today, focusing on the role of the E.U. Court of Justice. Ending the jurisdiction of the ECJ has been a red line for May, but equally so, the E.U. will not give up on that claim. Consequently, May is caught in a bind because conceding on the ECJ would mark a U-turn and draw complaints from those who campaigned to leave, while failing to find a solution would prompt the E.U. to delay the start of talks on a trade deal.

Conclusion: We think the Brexit risk premium will remain in the foreseeable future. We therefore still recommend staying short the Pound.

Peso: Solid prints continue

The Mexican economy ended the second quarter of the year on a strong note as GDP kept its annualized pace of Q1, and again increased by 1.8 percent. Adjusted for calendar effects, the Mexican economy grew at 3.0 percent year-on-year, the highest rate since Q1 2013. Looking at the GDP break-down, the story seems to remain the same: a modest industrial sector driven by a reduction in oil production and relatively weak construction, but strong manufacturing activity backing the services sector in a solid domestic market. Also the labor market continues to show signs of strength (unemployment rate at 3.3 percent).

\$/Peso in the past 12 months



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We were expecting a correction of the Peso (see our 10 August edition), but it does not seem to happen. Macro data continue to be very solid.

QUICK NEWS HEADLINES (time in CET)

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

- Euro-zone: The Manufacturing PMI for August is expected at 56.3, the Services PMI at 55.4 (10:00).
- Brazil: Inflation (IPCA-15) is expected to have risen 2.7% as of mid-August y/y (14:00).
- Mexico: Retail sales are expected to have risen 2.8% in June y/y (15:00).
- U.S.: The Manufacturing PMI for August is expected at 53½, the Services PMI at 54.9 (10:00).

Forint: Remaining accommodative

The Magyar Nemzeti Bank kept its benchmark 3-month rate at 0.9 percent despite reasonable growth and optimal inflation. GDP expanded at an annual pace of 4.2 percent in Q1 and 3.2 percent in Q2 while CPI is hovering around 2 percent since the beginning of the year. The unemployment rate stands at 4.3 percent, the lowest on record. However, the MNB is concerned about the strength of the Forint. The exchange rate rose to the strongest level against the Euro since May 2015 and broke out of a 2-year long trading range against the Franc in July, when overall Franc weakness set in. Unlike most central banks which aim for 2 percent inflation, the MNB’s inflation target is 3 percent, plus/minus 1 percentage point (in place since March 2015). Governor György Matolcsy expects inflation to reach that target only in early 2019. In reality, the MNB’s monetary policy is looser than the 0.9 percent in-

terest rate suggests as it also uses FX swaps to boost Forint liquidity. In addition, the interbank rate stands at 0.15 percent vs. 0.9 percent benchmark rate. Taken together, with this very loose monetary policy we think the recent strength of the Forint is not sustainable and recommend going short the Forint vs. Euro.

Forint vs. Franc in the past 2 years



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We recommend going short the Forint against the Euro. Ask your local FX Advisor for tailor-made proposals.

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