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31 August 2017

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

Euro: Several FX market participants expect the €/$ rally to lose momentum due to ECB concerns
Dollar: ADP Employment Change suggests a solid labor report on Friday, however, inflation is the issue
Pound: The third round of Brexit talks in Brussels concludes today with a press briefing around noon

Euro: What others are saying

Currently, the market has two key assumptions on the path of €/$ over the next seven days, until the Governing Council has its meeting on 7 September. On one side, that profit taking and/or verbal intervention by the ECB will reverse the rally that is in place since March. On the other side, that large buying programs from hedge funds will continue to drive €/$ higher.

What's going on inside the ECB building?

Source: Reuters

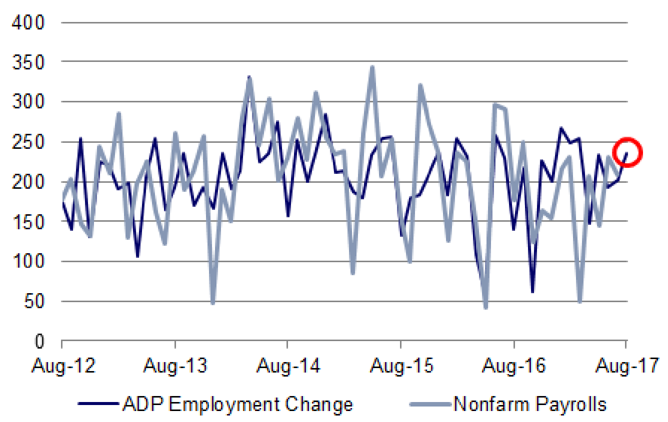
Those arguing for limited upside or even a reversal of €/$ are asking the rhetorical question about ECB Mario Draghi's Euro-pain threshold. Crédit Agricole said, "the sharp Euro appreciation in recent months may have pushed the currency very close to, if not above, that threshold," concluding that "the combination of persistent currency appreciation and oil-price deflation could pose significant downside risks to the Euro-zone inflation outlook in the next 6 to 12 months". On the first statement, we think there is no pre-defined threshold for the ECB. Most valuation models of major banks have the fair value of €/$ around the 1.25-level. Regarding the second argument: the share of imports into the Euro-zone from the U.S. accounts for 12 percent of the total, roughly the same as from the U.K. Therefore, they should be equally concerned about the weakening Pound. Also, UniCredit expects the ECB to make some reference to the exchange rate that could halt, or at least lessen, the pace of the Euro's appreciation but said "a meaningful reversal remains unlikely." Similarly, UBS points out that "the market might continue to test the ECB's patience" but rather expects speculators to "try to follow up on the current rally heading into the September meeting". Their rationale is that "Draghi needs support and coordination from all members of the GC before he can say some remarkable comments to halt the Euro's rally". A similar line is advocated by Danske Bank, saying that "the pace of the Euro appreciation should pose a rising problem for the ECB and we would not be surprised to hear Draghi mention this at the September meeting". ING reckons that due to the increase of €/$, the "ECB's preference will be for a cautious tapering, with a very gradual withdrawal of some monetary stimulus that ideally does not cause any tightening of financial conditions". Finally, Société Générale wrote that despite €/$ broke to new highs after Draghi's speech in Jackson Hole "we still believe the Euro appreciation will be slower from here on". All in all FX markets are expecting, a slowdown of upside momentum of the ongoing €/$ appreciation based on expected comments from Draghi at the upcoming MPC meeting on 7 September.

Conclusion: Currently, FX market participants are losing some courage for further upside in €/$. However, for a turnaround, the pattern of continuously higher lows has to be reversed.

Dollar: Solid labor report expected on Friday

As an indicator for Friday's NFP, the ADP Employment Change rose to 237'000 in August from 201'000 in July. With that, it almost matched the average of the past 12 months, namely 240'000. NFP will likely come in somewhat higher than the 180'000, the consensus expectation of 83 economists surveyed by Bloomberg, and confirm again a solid U.S. labor market. However, the more relevant issue is declining price pressure, with core CPI declining in the past six months from 2.3 percent to 1.7 percent as of July. Core PCE, even the Fed's favorite inflation gauge is on a downward slope for 8 consecutive months.

ADP and NFP in the past 5 years



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: The U.S. labor market remains solid.

QUICK NEWS HEADLINES (time in CEST)

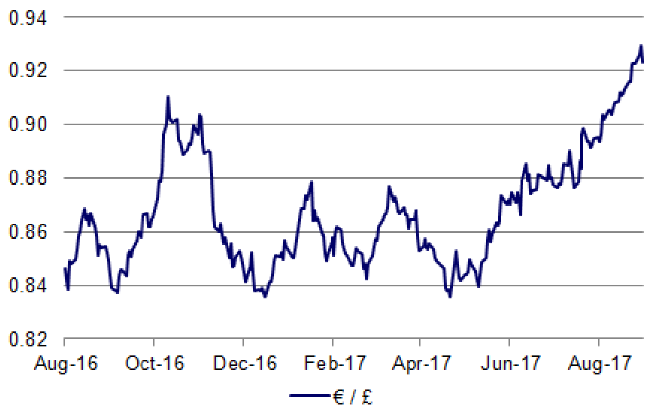
The following three headlines might have an impact on currency markets today:

- Japan: Industrial production rose 4.7% in July y/y, less than the 5.2% expected.
- Germany: The unemployment rate for August is expected at 5.7% (09:55).
- South Africa: The trade surplus for July is expected at Rand 7.1 billion (14:00).

Pound: Third round of talks finished today

Today, the third round of Brexit negotiations will be concluded, followed by a press briefing around lunchtime. As some frustration of the talks was aired in public, we think a breakthrough or even some progress until October is looking increasingly unlikely. There are only two more rounds planned before an E.U. summit that will decide if "sufficient progress" has been made on the divorce settlement for talks to move on to trade. The discussions are scheduled in 4-day long blocks each month, yet most of the British officials did not arrive in Brussels until mid-morning on Tuesday, due to the the Summer Bank Holiday on Monday. We think it is not really an option for the U.K. team to let the timeline slip because there are a lot of companies waiting to act on contingency plans. The ongoing uncertainty will delay investments, and consequently weigh on the Pound.

€/£ still near the highs



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We still recommend staying short the Pound.

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