



Julius Bär

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

Global FX: North Korea's latest nuclear test provoked the usual knee-jerk buying of Gold and Yen
Franc: Modest GDP growth, no inflation pressure and the SNB on the sidelines suggest limited upside
Pound: With the House of Commons reconvening today, the market's focus will be back to politics

Global FX: How to hedge?

Following the latest provocation from the North Korean dictatorship, we received several questions on how to hedge against potential escalation. While one can arguably debate which instruments are appropriate, each time North Korea launches a ballistic missile or conducts nuclear testing, price and market reaction indicate which currencies actually increase or decrease.

day's nuclear test, which North Korea said was an advanced hydrogen bomb, Gold and the Yen advanced around 1 percent against the Dollar. However, unless there is really U.S. military action – which we doubt – then the flight to safety peters out quickly, and Gold and Yen will tend to give back some of their gains relatively soon.

Conclusion: We think Gold and the Yen are the only real hedges against a possible escalation in North Korea.

Meanwhile in Asia



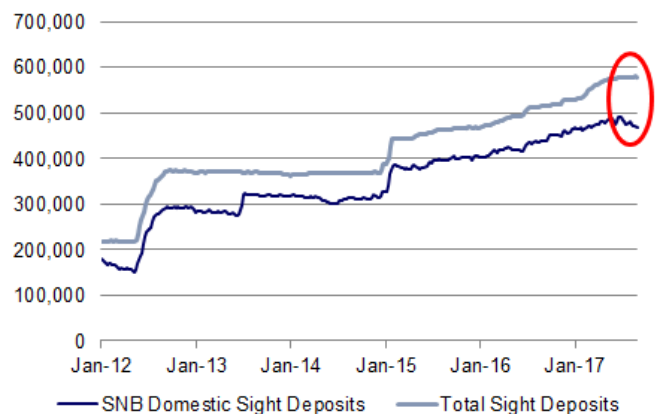
Source: Nath Paresh / Cagle Cartoon

In the past, Gold and the Yen have reacted positively each time such news emerged. While Gold is the classic safe haven, opinions on the Yen are split. The Yen clearly has a haven nature, but due to the proximity to the Korean peninsula, some also argue against it. We put more emphasis on the Yen's safe-haven status. Japan is the world's largest creditor nation, and the majority of traders tend to assume Japanese investors would repatriate foreign assets at times of crisis, thus pushing up the Yen. Following Sun-

Franc: GDP, CPI and Sight Deposits

This morning at 07:45, the State Secretariat for Economic Affairs (SECO) published the GDP for Q2. The Swiss economy increased its output by 0.3 percent from Q1 and also from a year earlier. With that, GDP came below the lower end of the 1 to 2 percent range year-on-year that has been prevailing in the past five years.

Sight Deposits at the SNB



Source: Bloomberg Finance L.P., Julius Bär

At 09:00, the Federal Statistics Office will publish CPI for August. Consensus expectations are that CPI remained unchanged from July and increased ½ percent from a year earlier. This would confirm the picture that the deflationary phase of consumer prices of the years 2015 and 2016 has been conquered, but also, there is still no price pressure in Switzerland this year. Interestingly, domestic Sight Deposits at the SNB declined again, as yesterday's print showed. Domestic SDs are down to SFr 468.5 billion from the peak of SFr 491.7 billion on 23 June, an astonishing SFr 23.2 billion. This raises the question whether SNB is silently reducing its reserves in FX markets? Probably not, as total SDs have remained around SFr 579 billion in the past 12 weeks (see chart above). Our interpretation is that domestic banks reduced their excess reserves at the SNB, as they increased their loan books. President Thomas Jordan said last week that the SNB has "no intention or need to reduce its balance sheet in the current situation". To summarize: The Swiss economy is doing semi-okay but far from great, there is no consumer price pressure building up and the still overvalued Franc has weakened in the past two months without FX interventions.

Conclusion: The Franc will likely remain on a soft footing in the days ahead.

QUICK NEWS HEADLINES (time in CEST)

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

- Australia: The RBA left its Cash Rate unchanged at 1½%, as expected. The Statement also gave little away in terms of new guidance, still saying downside risks persist from a strong Aussie and lack of wage growth.
- Russia: The Services PMI for August is expected at 53.9 (08:00).
- Turkey: CPI is expected to have increased 10.3% in August y/y (09:00).
- U.K.: The Services PMI for August is expected at 53½ (10:30).
- South Africa: GDP is expected to have increased 2.3% in Q2 (11:30).
- U.S.: Factory orders are expected to have declined 3.3% in July (16:00).

Pound: Changing their mind?

FX markets will keep an eye on politics with the U.K. House of Commons reconvening today after its summer recess. The third round of talks with the E.U. ended last week with another impasse over money and citizens' rights (see our 1 September edition). Recent news suggest that most of Prime Minister Theresa May's senior Ministers agree on a transitional arrangement with the E.U. and that

the U.K. is going to have to pay something to the E.U. as it leaves. Furthermore, Brexit Secretary David Davis' team has set out what it sees as the options on a range of charged issues, including paving the way for a legal compromise whereby the E.U. judges may continue to have a say on U.K. affairs. Interestingly, this has not led to outrage from Brexit hardliners.

€/£ off the highs, but the trend is still intact



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We remain skeptical on the Pound, but there might be a turnaround coming in the weeks ahead.

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CONTACTS

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

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

FX Market Advisory Singapore
+65 682 71 790

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

FX Market Advisory Hong Kong
+852 2979 2688

Author: Jürg Mettler
+41 (0) 58 888 8454

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