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

Pound: The BoE voted 7–2 to keep the Bank Rate unchanged but did everything to talk up the Pound
Franc: Contrary to the BoE, the SNB did everything yesterday to prevent the Franc from rising again
Dollar: Rising shelter and energy prices reversed some of the losses in summer in the headline CPI rate

Pound: The BoE talks to the Pound
As in the two previous meetings, two MPC members Ian McCafferty and Michael Saunders maintained their push for a ¼ percent increase, which would reverse the rate cut put in place in August 2016 after the Brexit vote. The vote to keep the Bank Rate on hold was, therefore, 7–2.

Mark Carney explaining the decision

Source: Reuters

The MPC was back at its full complement of nine members, having been down to just seven in June. The new member David Ramsden participated for the first time, siding with the majority. The key message was that a majority of its nine policy makers judged that, “some withdrawal of monetary stimulus was likely to be appropriate over the coming months in order to return inflation sustainably to target”, if the economy develops as they anticipate, according to the Minutes. The BoE’s Asset Purchase Program has been increased by £ 100 billion to £ 435 billion last year. The Minutes reiterated that, “if the economy were to follow a path broadly consistent with the August central bank projection, then monetary policy could need to be tightened by a somewhat greater extent over the forecast period”. FX markets appear to have taken heed of this warning, with the implied probability of a rate hike over the next six months rising considerably, (from 40 to 65 percent by February 2018, according to Sonia futures). Following yesterday’s policy announcement, there is no denying the support of the MPC for withdrawing some of the accommodation in place, by reducing the APP and hiking interest-rates in the months ahead. Nevertheless, the Minutes refer to, “relatively limited news”. The Committee’s positive and negative arguments are the same as they were in August. There is a reference to the accumulating evidence of slower supply growth – this may be related to news that net migration has slowed sharply since the Referendum – leaving the economy potentially more exposed to inflation. As an interpretation: The message yesterday was more about the MPC reaction function. It seems the BoE intends to take back the ¼-percent emergency rate cut implemented after the Brexit vote, but this is unlikely a start of a tightening cycle. At the beginning of this month, the Pound once again reached the level at which Governor Mark Carney issued warnings last year (see our 4 September edition). With this relatively hawkish MPC outcome, the BoE seems to try propping up the Pound in order to stabilize inflation (from rising import prices).

Conclusion: We do not think that yesterday’s policy decision is the start of a tightening cycle.

Franc: No change on currency concerns
The SNB left its interest rate on Sight Deposits unchanged at -¾ percent and maintained the corridor for 3-month Libor between -1¼ percent and -¼ percent. Once again, the SNB reiterated its ability and readiness to intervene in FX markets, given the still overvalued Franc (it has not

been active since June). The acknowledgement that the recent Franc weakness, “is helping to reduce the significant overvaluation of the currency”, should not be interpreted as a change in monetary policy. Therefore, we expect the SNB policy to remain expansionary for quite some time, and lagging behind the ECB. The market’s perception is obvious with €/SFr rising, following the unsurprising announcement (see chart below).

€/SFr leaving the triangle on the upside

Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We remain long €/SFr for our trading book.

QUICK NEWS HEADLINES (time in CEST)

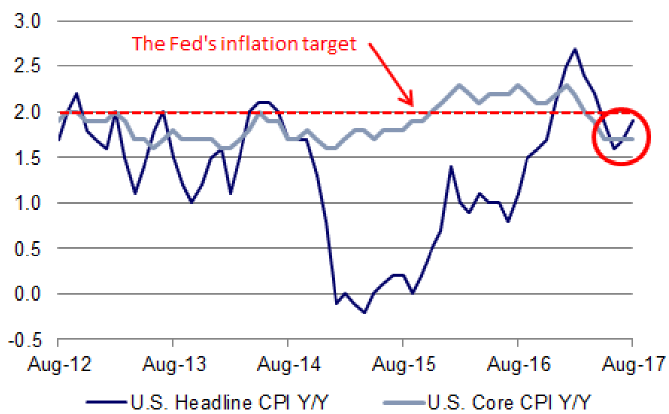
The following four headlines might have an impact on currency markets today:

- Turkey: The current account deficit for July is expected at $ 5.45 billion (09:00).
- U.S.: Retail sales are expected to have increased 0.1% in August m/m (14:30) industrial production is expected to have risen 0.1% in August m/m (15:15), the University of Michigan Sentiment Index for September is expected at 95.0 (16:00).

Dollar: August CPI buoyed by shelter and energy

Headline CPI rose to 1.9 percent from 1.7 percent in July, 0.1 percent higher than expected while core CPI remained at 1.7 percent. The upswing in the headline rate came from energy prices, as they increased strongly (2.8 percent month-on-month) and from shelter CPI, which rose ½ percent from July, the largest increase since October 2005. Lodging away from home was up 4.4 percent in August, reversing some of the strong declines in July (-4.2 percent). This was the largest monthly rise in the two-decade history of the series. However, this is also a very volatile component, and the latest jump comes after two sharp declines in recent months, so we are inclined to view the August move as a payback after a weak summer performance. With the headline inflation rate rebounding only modestly to 1.9 percent and the core inflation rate unchanged at a muted 1.7 percent, the Fed is still missing its price stability target. With the Bloomberg Dollar Index basically unchanged after the print, FX markets seem unimpressed.

Headline and core CPI stabilized after the decline



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: The August CPI print was not really much of a help. We think the Dollar will stay at current levels.

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