Julius Bär

18 September 2017

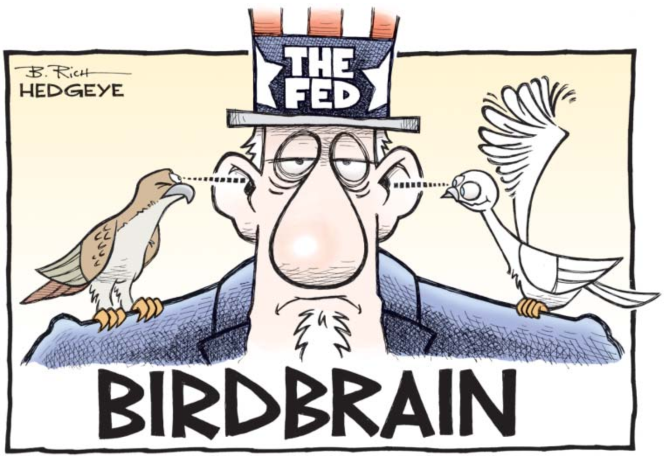
CURRENCIES & MORE
OUR INSIGHT INTO THE WORLD'S LARGEST MARKET

Dollar: Wednesday's FOMC meeting will be the highlight of this week with new economic projections
Pound: We were surprised last Friday that even BoE's uber-dove Gertjan Vlieghe turned hawkish
Ruble: Bank Rossii cut its Key Rate by ½ percent to 8½ percent but the real yield remains still high

Dollar: In the run-up to the FOMC meeting

The highlight of this week will be the FOMC meeting which concludes on Wednesday. Of course, it will not be an interest-rate hike but about how Fed Chair Janet Yellen appears in the press conference, comments on the start of the balance-sheet run-off, and the new Summary of Economic Projections.

What are the hawks and the doves seeing?



Source: B. Rich / Hedgeye

The market will be gauging at the press conference whether Yellen sounds more like Board Governor Lael Brainard - increasingly dovish – or New York Fed President William Dudley – more down the middle. Last Thursday's CPI print for August showed that weakness in core CPI this year is not all due to one-off idiosyncratic factors and that core CPI is still struggling to gather significant momentum. The plan to cease reinvesting proceeds from maturing securities in the Fed's portfolio has been so well-flagged in advance and will be so modest to begin with, that it is unlikely to have any material impact. At the June meeting, the FOMC stated that it will start by letting $ 6 billion a month in maturing Treasuries run off, which will slowly increase to $ 30 billion over the coming months. With regards to agency debt and Mortgage-Backed Securities, they laid out a similar plan where it will begin tapering $ 4 billion a month until it reaches $ 20 billion. The initial $ 10 billion per month is trivial. In comparison, the Fed was buying assets at a pace of $ 85 billion per month during QE3. As the Fed prepared markets carefully for this balance-sheet run-off, it is very unlikely that Yellen will present different numbers. More interestingly will be the SEP as the Fed will release the 2020 economic and Fed Funds projections for the first time. The market's focus will be whether the FOMC will adjust the near-term profile lower in order to leak the Fed Funds cyclical end-point into 2020 or not. There is a clear possibility that a majority of FOMC members will project no further rate hike this year. The reason is not only the mentioned subdued components of core inflation but also the deal between President Donald Trump and the Democrats to extend Federal spending for three months. This means that the December FOMC meeting could occur against a backdrop of a partial government shutdown.

Conclusion: The Dollar will likely trade around current levels until Wednesday and then it will depend on Yellen's tone in the press conference and the new SEP.

Pound: Vlieghe turns into a hawk

A hawkish tilt from one of the BoE's most outspoken doves has given Sterling another jolt higher. Speaking to the Society of Business Economists in London on Friday, MPC member Gertjan Vlieghe said that the BoE "might need to raise interest rates in the coming months". His comments came after the BoE said on Thursday that a majority of its nine policy makers believe that a rate hike in the coming months was likely. Vlieghe has warned until recently against a premature hike as it would be a bigger mistake than one that turns out to be slightly late. The market seems to have taken his comment as a sign that the BoE was moving as a whole towards its first interest-rate hike since July 2007. The Pound has now risen 2.4 percent against the Euro since last Thursday's shift in rhetoric and even 5.4 percent since the low at 0.93 at the end of August. Admittedly, we underestimated this huge reaction as all the other Brexit related issues remain unchanged. Most likely the Pound rally was so massive due to huge short Pound positioning and many market participants were caught on the wrong foot.

€/£ in the past 12 months

Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We would not chase the Pound rally and believe it will fade relatively soon.

QUICK NEWS HEADLINES (time in CEST)

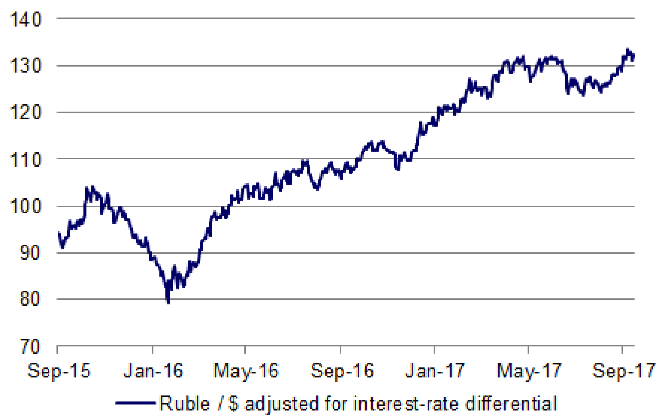
The following headline might have an impact on currency markets today:

- Czech Republic: Producer prices are expected to have risen 1.3% in August y/y (09:00).

Ruble: Real interest rate further supportive

As widely expected, Bank Rossii cut its Key Rate by ½ percent to 8½ percent after inflation hit record lows last month. Inflation has risen only 3.3 percent in August from a year earlier, the lowest on record. Since Governor Elvira Nabiullina took office in June 2013, Bank Rossii appeared characteristically hawkish. Now, there was a noticeable shift in tone: In the accompanying Statement, Bank Rossii only mentioned medium-term risks to inflation while previously, it also expressed concerns over short-term risks. This suggests that another rate cut might be in the pipeline this year. Nevertheless, the real interest rate is substantial (nominal – inflation still more than 5 percent), which will continue to support the Ruble. Since oil bottomed at the beginning of 2016, the Ruble rose more than 60 percent against the Dollar adjusted for the interest rate differential of the two currencies (see chart below).

Carry adjusted Ruble vs Dollar in the past 2 years



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We remain long the Ruble for our trading book.

Would you like to trade right now? Use our Market Link App

CONTACTS

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

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

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

FX Market Advisory Hong Kong
+852 2979 2688

FX Market Advisory Singapore
+65 682 71 790

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

IMPORTANT LEGAL INFORMATION

This publication constitutes marketing material and is not the result of independent financial research. Therefore the legal requirements regarding the independence of financial research do not apply. The information and opinions expressed in this publication were produced by Bank Julius Baer & Co. Ltd., Zurich, as of the date of writing and are subject to change without notice. This publication is intended for information purposes only and does not constitute an offer or an invitation by, or on behalf of, Julius Baer to make any investments. Opinions and comments of the authors reflect their current views, but not necessarily of other Julius Baer entities or any other third party. Services and/or products mentioned in this publication may not be suitable for all recipients and may not be available in all countries. Clients of Julius Baer are kindly requested to get in touch with the local Julius Baer entity in order to be informed about the services and/or products available in such country.

This publication has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Before entering into any transaction, investors should consider the suitability of the transaction to individual circumstances and objectives. Nothing in this publication constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate for individual circumstances, or otherwise constitutes a personal recommendation for any specific investor. Julius Baer recommends that investors independently assess, with a professional advisor, the specific financial risks as well as legal, regulatory, credit, tax and accounting consequences. Past performance is not a reliable indicator of future results. Performance forecasts are not a reliable indicator of future performance. The investor may not get back the amount invested.

Although the information and data herein are obtained from sources believed to be reliable, no representation is made that the information is accurate or complete. Bank Julius Baer & Co. Ltd., Zurich, its subsidiaries and affiliated companies do not accept liability for any loss arising from the use of this publication.

This publication may only be distributed in countries where its distribution is legally permitted. This information is not directed to any person in any jurisdiction where (by reason of that person's nationality, residence or otherwise) such publications are prohibited. **Dubai International Financial Centre:** this information has been distributed by Julius Baer (Middle East) Ltd. It may not be relied upon by or distributed to retail clients. Please note that Julius Baer (Middle East) Ltd. offers financial products or services only to professional clients who have sufficient financial experience and understanding of financial markets, products or transactions and any associated risks. The products or services mentioned will be available only to professional clients in line with the definition of the Dubai Financial Services Authority (DFSA) Conduct of Business Module. Julius Baer (Middle East) Ltd. is duly licensed and regulated by the DFSA. **Germany:** Bank Julius Bär Europe AG, authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), disseminates this publication to its clients. This publication has been produced by Bank Julius Baer & Co. Ltd., Zurich, which is supervised by the Swiss Financial Market Supervisory Authority FINMA. Neither the legal requirements regarding the independence of investment research nor the prohibition of trading previous to the announcement of financial analyses do apply. **Hong Kong:** this publication has been distributed in Hong Kong by and on behalf of, and is attributable to, Bank Julius Baer & Co. Ltd., Hong Kong branch, which holds a full banking license issued by the Hong Kong Monetary Authority under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong SAR). The Bank is also a registered institution under the Securities and Futures Ordinance (SFO) (Chapter 571 of the Laws of Hong Kong SAR) to carry on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities with Central Entity number AUR302. This publication must not be issued, circulated or distributed in Hong Kong other than to 'professional investors' as defined in the SFO. The contents of this publication have not been reviewed by any regulatory authority. If you have any queries concerning this publication, please contact your Hong Kong relationship manager. Bank Julius Baer & Co. Ltd. is incorporated in Switzerland. **Monaco:** Bank Julius Baer (Monaco) S.A.M., an institution approved by the Minister of State for Monaco and the Bank of France, is sending to its clients this publication issued by Bank Julius Baer & Co. Ltd., Zurich, an institution in Switzerland under the supervision of the Swiss Financial Market Supervisory Authority FINMA. **Singapore:** this publication has been distributed by the Singapore branch of Bank Julius Baer & Co. Ltd., Zurich, and is available for accredited investors only. As the Singapore branch of Bank Julius Baer & Co. Ltd., Zurich, has a "unit" exemption under section 100(2) of the Financial Advisers Act, it is exempted from many of the requirements of the Financial Advisers Act, amongst others, the requirement to disclose any interest in, or any interest in the acquisition or disposal of, any securities or financial instruments that may be referred to in this publication. Further details of these exemptions are available on request. Please contact a representative of the Singapore branch of Bank Julius Baer & Co. Ltd., Zurich, with respect to any inquiries concerning this publication. **Switzerland:** in Switzerland this publication has been distributed by Bank Julius Baer & Co. Ltd., Zurich, authorised and regulated by the Swiss Financial Market Supervisory Authority FINMA. **United Arab Emirates:** this information has been distributed by a representative office of Bank Julius Baer & Co. Ltd., Zurich, authorised and regulated by the Central Bank of the United Arab Emirates.

United States: NEITHER THIS REPORT NOR ANY COPY THEREOF MAY BE SENT, TAKEN INTO OR DISTRIBUTED IN THE UNITED STATES OR TO ANY US PERSON.