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

Dollar: The Dollar spiked last night as the Fed stayed on course for an interest rate hike in December
Krone: With continuing solid macro prints, Norges Bank might move forward the first rate hike a bit
Pound: Market participants seem to be addicted to central bank speak and underestimate hard facts

Dollar: Thrust reversal in October

Last night, the Fed took the first tentative steps to unwind its massive economic stimulus. The FOMC announced in the Statement it will begin roll to off its $ 4½ trillion balance sheet in October. Even though it was already telegraphed several times in recent months, this was the first time the Fed provided a formal timetable for how the operation will take place.

The Fed is looking for clues

Source: B. Rich / Hedgeye

The Fed will allow $ 10 billion to roll off at first, increasing quarterly increments by $ 10 billion until the total hits $ 50 billion starting in October 2018. At the same time, the Fed did not raise the Fed Funds target range from 1 to 1¼ percent, which was widely expected. The most interesting part was the new Summary of Economic Projection, which include also the "dot plot". 12 of the 16 FOMC members expect another rate hike this year. However, their estimate of the long-run neutral rate was nudged down to 2.8 percent from 3.0 percent, meaning that rates are now projected to end 2020 slightly above this neutral level, at 2.9 percent. At the same time, Fed reduced its outlook for inflation, cutting its expectation to 1½ percent from 1.7 percent this year, and to 1.9 percent from 2 percent in 2018. In sum, that means the Fed now believes it will not reach its 2-percent inflation target until 2019. Officials still put the long-run natural unemployment rate as high as 4.6 percent and the long-run outlook for GDP growth remained at 1.8 percent. To recap: The outcome was more or less neutral but the market had likely expected a dovish tilt which led to instant Dollar buying.

Conclusion: The Fed not blinking on the December rate hike was the trigger for the Dollar to rally. However, for a sustainable recovery, the pattern of continuing lower highs has to change first.

Krone: Norges Bank most likely on hold

All 20 economists surveyed by Bloomberg expect Norges Bank to keep its Deposit Rate unchanged at ½ percent today. What is less clear is what Governor Øystein Olsen and his colleagues will signal in terms of the future rate path. On 22 June, Norges Bank removed the easing bias but said the first increase in rates will not happen until the start of 2019. In recent months, most macro prints showed that Norway's economy is well underway. GDP rose 1.1 percent in Q2 from a quarter earlier and the Manufacturing PMI around 56 indicates optimism in the sector. CPI rising at a yearly rate of 1.3 percent in August is below Norges Bank's 2½-percent inflation target but Olsen has signalled that he is fine with that as long as inflation expectations remain well anchored, which they are. Consequently, there are good reasons to move forward the first rate hike a bit closer in time. This should limit any downside for the Krone which makes it attractive for investments in Reverse Convertibles.

€/NKr in the past 12 months

Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We recommend investing Euros in Reverse Convertibles with Krone as alternative currency. Please ask your local FX Advisor for a tailor-made proposal.

QUICK NEWS HEADLINES (time in CEST)

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

- Japan: The BoJ kept its policy rate unchanged at -0.1% and the 10-year yield target at 0%.
- New Zealand: GDP rose 2½% y/y, as expected.
- U.S.: The Leading Index is expected to have risen 0.2% in August (16:00).

Pound: Are we all addicted to central bank speak?

Economists and investors have become so used to overt guidance from central banks that they underestimate macro-economic data. When the BoC lifted its Overnight Lending Rate two weeks ago – contrary to the forecasts of most economists – it received a lashing for a failure to communicate properly in advance. Any economist could have looked at public data, showing that Canada's economy grew a heady 4 ½ percent in Q2 and confirming a solid uptrend from 2.7 percent in Q4 2016 and 3.7 percent in Q1 this year. That should have been an indication at least not to write off a rate increase. Forward guidance is meant to be only part of the equation. Commentary and abundance of communication do not always make for the best guidance, especially when officials do not follow through. A prime example for this is BoE Governor Mark Carney who has been an inconsistent messenger for the central bank's intentions. Since 2014, Carney talked several times about potential rate hikes but never did it. Following his announcement after the MPC meeting a week ago that an interest-rate hike is imminent, the market has instantly fully priced in a ¼-percent increase of the Bank Rate by February 2018. Despite Carney's poor track record in communicating monetary policy, the market is currently putting more faith in the BoE than on overall subdued macro data as GDP growth continues to slow. British employers are the most pessimistic about the outlook for the economy since last year's Brexit vote, according to a Recruitment & Employment Confederation report published yesterday.

We expect the Pound to decline again

Source: Office for National Statistics

Conclusion: We believe the Pound will fall back towards the 92-level vs. Euro.

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