SMBC Capital Markets, Inc.

fxPoetry

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Andrew Fately
Executive Director, Senior FX Marketer
Global Markets Marketing Department
andrew_fately@smbcgroup.com
Direct: +1 212-224-4532
Representative: SMBC Capital Markets, Inc.

Great Peals of Thunder

The news overnight from Down Under
Resounded like great peals of thunder
They hiked 50 beeps
And said to their peeps
A hundred more won't be a blunder

Therefore, it can be no surprise
That Aussie, quite quickly, did rise
But Governor Lowe
Has quite far to go
To 'out hawk' Jay and his allies

The first of this week's central bank meetings was far more surprising than expected as the RBA increased their overnight rate by 0.50%, to 0.85%, against market expectations of just a 0.25% rise. According to Governor Philip Lowe, *"The board expects to take further steps in the process of normalizing monetary conditions in Australia over the months ahead. It is committed to* ***doing what is necessary*** *to ensure that inflation in Australia returns to target over time*." [emphasis added.] I guess this is Lowe's version of 'whatever it takes' which has been so effective for central bankers since those words were first uttered by then ECB President (and current Italian PM) Mario Draghi in 2012 amid the European debt crisis. Not surprisingly, the initial market reaction was for Aussie to rally sharply, jumping nearly 1% in the first minutes after the announcement, although since then, it has given back all those gains and is actually -0.1% on the session. As to other Australian markets, the ASX 200 fell -1.5% and Australian 10-year yields jumped 7.2bps by the close.

Has this changed the narrative at all? Not in the least. In fact, the RBA is the fiftieth central bank to have raised interest rates by at least 50bps in a single move this year! This may be a more telling statistic. The era of ultra-easy money is clearly behind us as central banks worldwide race to catch up to inflation readings that are running away. This is not to say that these same central bankers won't make the same mistakes again in the future, in fact they are almost certain to do so, but for now, the outcry over inflation globally has them on their heels.

But, in the interconnected world in which we live, everything is relative. So, while the RBA may be today's hawk of the day, the broad-based narrative remains that the Federal Reserve is going to be the most hawkish of all (after all, inflation here is higher than elsewhere) and so the dollar remains king of the hill.

The key concern for these central banks is that global growth may be slowing more rapidly than previously thought and the impact on economies of rising interest rates and slowing growth can be quite negative. At this stage, there is evidence on both sides of the growth argument as Friday's NFP report was clearly stronger than expected, but that came on the heels of weaker than expected regional manufacturing surveys, abysmal productivity and ULC numbers and softening factory orders in the US. Speaking of Factory Orders, this morning Germany revealed they fell -2.7% in April, well below expectations and the third consecutive monthly decline. International orders are what are missing, quite a negative harbinger for the German economy.

The point is that the future of economic activity is entirely unclear at this time and so central banks are addressing the very clear inflation problem while simply hoping that their respective economies can withstand tighter monetary conditions. Personally, I have my doubts they will be able to achieve their mooted 'soft landings' but the jury is still out. We will learn a great deal as the summer progresses and monetary policy tightens further around the world.

Speaking of which, Thursday brings the ECB meeting, where expectations are for an official end to the APP (QE) and a virtual promise to raise rates 25bps at the July meeting. While some of the more hawkish members of the governing council have been calling for 50bps, until Madame Lagarde seems to be moving into that camp, I suspect that 25bps is the most likely outcome. But remember, that will still leave the overnight deposit rate in the Eurozone at -0.25% while inflation is running at 8.1%. It appears Madame Lagarde and her amies have a long way to go.

While AUD may not be higher, the RBA did manage to set the tone for markets today and that tone is distinctly risk-off. Though Asian markets, aside from Australia's, were little changed (Nikkei +0.1%, Hang Seng -0.55%, Shanghai -0.1%), Europe is under a bit more pressure (DAX -0.9%, CAC -0.8%). The outlier here is the UK (FTSE 100 0.0%) which seems to be absorbing the info that PM Johnson won his no-confidence vote, but with a greatly reduced majority and all the talk is now about when he will ultimately stand down and who will take over. But the relief is palpable as I guess, had he lost, the problems would have seemed much larger. Meanwhile, after a choppy session yesterday in the US, that ended with all 3 major indices slightly higher, futures this morning are all red in the -0.6% range.

In the bond market, yesterday saw 10-year Treasury yields rise convincingly above 3.0% again and while they are 2bps lower this morning, they remain at 3.02%. Technicians are looking toward 3.20%, the intraday high a month ago, as the key resistance level with a break there indicating to many that the next leg higher will begin. And if that is the case, it is anybody's guess as to how high it will go. European bond markets are mostly behaving in a risk-off manner with yields edging lower in both Germany (-1.7bps) and France (-1.7bps), although Gilts are essentially unchanged on the day as well as the FTSE. It seems that political uncertainty has resulted in a bit of paralysis this morning.

In commodity markets, oil (-0.4%) continues to consolidate its recent gains but remains well above the breakout level of $115/bbl and appears to be preparing for another leg higher soon. NatGas

(+0.8%) is following yesterday's blockbuster rally with a modest gain, while European gas (-2%) has been sliding lately. These two prices seem destined to move much closer together going forward, and I believe a great deal of that will be from higher prices in the US. Even with recent moves, European gas is still around $25/MMBtu compared to the US price of $9.40. Gold (+0.5%) is holding up very well despite the dollar's strength although both copper (-1.4%) and aluminum (-0.8%) continue to suffer on fears of an economic slowdown.

Turning to the dollar, other than ZAR (+0.4%) which rallied on a better-than-expected GDP print this morning of 3.0%Y/Y, the rest of the EMG bloc is under pressure led by KRW (-1.2%) and TRY (-1.0%). While Turkey's story is well-known and shows no signs of ending (if you have Turkish assets or revenues, hedging makes a great deal of sense) the won suffered over general risk-off concerns as well as higher US Treasury yields and was not helped by the fact that North Korea launched 8 missiles over the weekend and is threatening another Nuclear test.

In the G10, NOK (-1.1%) is the laggard today followed by NZD (-0.7%) and JPY (-0.7%). Oil's recent price action has not been helping the krone while the commodity price weakness is clearly impacting kiwi. However, the most interesting case remains the yen, where despite a modest round of verbal intervention (government officials are closely watching currency markets) traders and investors remain convinced that as long as the two monetary policies remain divergent, so will the currencies' fate. Yesterday we touched above 133, a new high for the move and there is nothing to prevent this from reaching140 or 150 unless the BOJ reverses course.

On the data front, we see the Trade Balance (exp -$89.5B) and then this afternoon Consumer Credit ($35.0B). Prior to the past two readings, the highest in the history of the series, dating back to 1904, was $28.6B in 2016. The amount of credit card borrowing that is ongoing is extraordinary and just another indication that people are struggling to make ends meet around the inflation situation. This is not a positive.

With no speakers, today's clues will come from equities and bonds. Right now, risk is clearly off and I see no reason for that to change. I like the dollar to continue to grind higher until something breaks and that doesn't seem likely for a while yet.

Good luck and stay safe
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The author is a salesperson in SMBC Capital Markets, Inc.
The views expressed are his own and may differ from Research.