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The US dollar (DXY) remained strong for most of the week on inflation surprises though the strength faded towards the end of the week. The catalyst was heightened speculation that a 50bps cut is still on the table for this week's FOMC meeting. The trigger was apparently a media article titled ([The FED's rate cut Dilemma: Start Big or Small](#)) in The Wall street Journal suggesting that the decision is close call. A few former FED officials also seemed to endorse 50bps cut. The US2Y & US10Y both closed the week 8bps lower. There has been significant change in big figure of major currencies, while the positive spread between US10Y & US2Y have risen to c.8bps. Yen has shown highest sensitivity to US dollar against other crosses reached to new high for the year. While ECB delivered its second rate cut for the year and adopted data depended stance for future rate cuts. Our baseline scenario seems to be 25bps rate cut yet FOMC decision remains on a close watch.

The key FX themes from last week are outlined below. Coming week all attention will shift towards central banks from G10 economies where FED, BoE and BoJ is set to announce its monetary policy. (Pls refer: [Uni-Fx: Markets in Mayhem mode amid US recession fears & unwinding of carry trades](#))

- ♣ The FED's rate cut dilemma: start big or small?
- ♣ ECB remains cautious along its rate cut path
- ♣ BoE likely to remain status quo in its monetary policy; all eyes on voting pattern
- ♣ BoJ monetary policy meet in focus while JPY continue to appreciate
- ♣ Rupee recovers, gush in FPI inflows & Dollar weakness supports

The FED's rate cut dilemma: start big or small?

The FOMC is widely expected to kick off the long-awaited easing cycle this week, yet market participants are divided on the quantum of rate cut. The FED's updated projections (FED's dot plot) will be key data to watch. Last week, saw a swing in the odds of 50bps rate cut in September FOMC. On 9th September the odd of 50bps rate cut according to CME FedWatch tool stood at 29% which fell to 19% on Wednesday post CPI data. However, as we move towards the end of the week the probability spiked to 49% after article in wall street journal indicated high possibility of jumbo rate cut from FED as stated above. Ex NY-FED member William Dudley said he saw a strong case for a 50bps reduction. As this is black out period there we no comments from current FOMC members. The probability of 50bps rate cut currently stands at 59% while markets are still pricing c.110bps rate cut by end of 2024. Last week we saw Michigan's consumer index which came in at 69.0 up from 67.9 a month earlier and 67.8 in September 2023. Meanwhile year-ahead inflation expectations fell for the fourth straight month, coming in at 2.7%. The current reading is the lowest since December 2020.

UST yields across the curve continue to fall along with US dollar

The US dollar (DXY) is trading close to year low, while the yield on US2Y is trading below 3.60%-mark lowest level since April 2023. The yield on US10Y just managed to hold above 3.60% level. The drop-in yield across the curve are currently indicating significant easing in financial conditions. However, in our view UST yields might be overreacting specially the front end of curve i.e.US2Y, while indicating probability of recession. On other hand the credit spreads of fixed income market signalling probability of soft landing as spreads continue to remain narrow. Going forward at the September FOMC meet the forward guidance of J Powell will be closely watched.

Headline CPI for August declined to lowest level since February 2020

- The monthly headline CPI stayed flat at 0.2% in August on a seasonally adjusted basis in line with market EST of 0.2%, while most importantly on YoY basis it declined to 2.5% in August vis-à-vis 2.9% in July slightly below the market EST of 2.6%.

Market still divide on quantum of September rate cut by FED we feel the FED might cut by 25bps

Yield on UST continues to showcase significant easing in financial conditions

Headline inflation falls lowest level since Feb 2020

Shelter prices continues to remain drag on CPI data

ECB cut the deposit rate by 25bps, and main refinancing rate by 60bps in order to reduce the spread between the two rates

ECB continues to follow data dependency policy

- Another month of tepid food inflation and falling energy prices kept headline inflation in check. Food prices fell slightly by 0.1% in August vis-à-vis 0.2% in July. Inflation for food consumed away from home clocked 0.3% MoM and 4% YoY and outpaced prices at the grocery store which remained unchanged MoM and was up 0.9% on YoY basis.
- The prices of energy, specifically gasoline, has been another source for fall in CPI. A relatively small 0.8% decline in energy prices, led by 0.6% dip in gasoline prices and a 1.9% drop in utility gas services. Going forward while seeing the recent trends in the oil prices we expect oil prices to stay on lower side which might get reflected in next month CPI release.

Core CPI (ex food & energy) picks up due to rising prices of shelter and travel

- The core CPI picked up in August as the index on MoM basis rose by 0.3% after rising 0.2% in preceding month and above the market EST of 0.2%. While on YoY basis it stayed flat at 3.2% in August while was in line with market estimate.
- The main contributor towards the headline inflation was shelter which has one-third weightage in index has risen by 0.5% in August vis-à-vis 0.4% in July accounting for 70% of core price increase. The shelter index was up 5.2% on YoY basis but is increasing at a slower pace, core CPI-ex shelter decline to only 1.72% on YoY basis. Despite the notably lower pace of rental inflation the rent of primary residence rose 0.5% in August vis-à-vis 0.4% in July.
- Along with shelter, core services ex shelters also received a boost in August from higher travel prices where airfare rose by 3.9% after declining in each of the previous 5 months, lodging away from home was up 1.8%. Core goods fell 0.2% which was led by autos (-1.0%), the index for used cars and trucks fell 0.1% in August, following 2.3% decrease in July.

ECB remains cautious along its rate cut path

On expected lines, the ECB governing council lowered the deposit rate from 3.75% to 3.5% and cut the main refinancing rate by 60bps in order to reduce the spread between the two rates. The ECB, reiterated that the monetary policy will remain restrictive for as long as necessary to achieve the inflation target of 2%. The ECB followed the data-dependent and meeting by meeting approach. The ECB stated:

- Domestic inflation and wages are elevated, but the cost pressures are moderating, profits are partially buffering the impact of higher wage on inflation.
- The outlook for core inflation was revised slightly higher, as service inflation remains a worry.
- Financial conditions remain restrictive, and economic activity is still subdued, reflecting weak private consumption and investment.

The ECB lowered its GDP growth forecast for each year, which now see Eurozone growth at 0.8% in 2024, 1.3% in 2025 and 1.5% in 2026. ECB projected its core CPI at 2.9% for 2024 and 2.3% for 2025 a bit higher than June's staff projection.

ECB the way forward

ECB in its meeting remained non-committal regarding the future outlook for the policy rates, by stating that it will continue to follow a data dependent and meeting by meeting approach to determining the appropriate level and duration of restriction on its monetary policy stance. The ECB also said that it is non-pre-committing to a particular rate path. Looking at the comments from ECB's Lagarde where she stated that there is very little time until Oct'24 policy meet, ***we feel the ECB approach towards rate cut will remain different from that of FED, where FED is likely to cut rate consistently in its each policy meet whereas ECB may follow a more data dependent approach. The ECB might deliver a pause on rates in October meeting followed by 25 bps rate cut in December.***

Expectation of UK policy rate to remain higher than other major economies remains supportive for GBP

JPY outperform on lower UST yield

Downside risk to USD/JPY remain on policy divergence between FED and BOJ

FX reserves continues to rise to clock to fresh record high

BoE may maintain status quo in its monetary policy, all eyes on voting pattern

The BoE will announce its policy decision this week on 19th September after it delivered its first rate cut by 25bps in August meeting. The July CPI inflation figure stayed at 2.2% level on YoY basis after remaining flat 2% in May and June month which is BoE inflation target. Attention will shift towards UK inflation data on Wednesday which is expected to show flat reading of 2.2% which is before BoE meeting. While the GDP data remains, strong which clocked 0.9% growth in Q2'24 vis-a-vi 0.3% in Q1'24. More encouraging signs from other economic indicator such as manufacturing and service PMI which continued its upward sing. ***Going forward we expect the BoE might just deliver one more rate cut by 25bps this year.*** If we continue to see further easing in price pressure while other economic indicator shows the growth is cooling which might prompt BoE to cut back to back by 25bps next year.

BoJ monetary policy meet in focus while JPY continue to appreciate

The yen continues to outperform as USD/JPY has fallen to new low since December 2023. The catalyst for the move lower has come from the weakness in US Dollar on expectation that the FED may deliver a jumbo 50bps rate cut in its September policy meet despite higher CPI and PPI print last week. After Ueda in his testimony stated that there is no change to BoJ's stance to adjust the degree of monetary easing if it became convinced that economic and price developments were moving as per forecast since then other BoJ members have followed his hawkish stance which led the Yen to strengthen against the US dollar.

This week on 20th September BoJ will deliver its monetary policy decision, while consensus estimate expects the central bank to keep its policy rate on hold at 0.25%. The headline inflation remains elevate in Japan at 2.8% in July, also core CPI accelerated higher in July at 2.7% while next week we will get August inflation figures. The other economic growth indicators remain encouraging. ***We expect that the BoJ will remain cautious on further rate hike and will prefer not to repeat the black Monday seen on 5th August where major risk assets plummeted drastically. The BoJ might defer the rate hike cycle to 2025. In medium term the USD/JPY pair might continue its weakness and the range might get shifted lower at 132.00-142.00. levels.***

Rupee recovers, gush in FPI inflows & Dollar weakness supports

Last week, US10Y softened to 3.60% levels and Dollar (DXY) weakened gradually to lows of 100.66 levels, prompting the currencies to appreciate. Unlike Asian peers, Rupee weaken and hovered close to its all-time lows again (On 12th Sep'24 @ 83.99). The downside (Psychological barrier of 84.00) was mainly capped by continuous Dollar sales by FPIs in the domestic equity & debt market. However, it is key to note that the volatility in Rupee was the weakest compared to other Asian peers.

India being a major oil importing country will be sensitive to any change in global crude oil prices as it will impact directly in the country's broad trade data. Despite middle east tensions and Libya output cut, rising concerns over weak demand growth in China has led oil prices to plunge lows since Dec'23 (Highs of \$77.63/bbl. to Lows of \$68.68/bbl., Current level: \$71.94/bbl.), domestic oil companies rushed to purchase crude at lower levels had put pressure on the rupee. Also, fixing pressure due to NDF maturities made the USD/INR pair bullish.

Liquidity operations by the central bank to absorb surplus liquidity amid FAR related inflows is carried on with VRRR, also RBI - Weekly Statistical Supplement - Extract showed the OMO sales continued for 9th consecutive week with a total sale of Rs 695crs in the week ended 06th Sep'24 & cumulative of Rs. 18,940crs. Our analysis shows the record high forex reserves kitty have continued to inch further up by \$5.25bln to \$689.24bln (\$2.87bln rise was adjusted after valuation effects), signalling that the Central Bank has continued to beef up its accumulation strategy to buffer its reserves to avoid any unforeseen future volatility in the domestic currency. The domestic currency was majorly supported by the outpour in FPI inflows in the equity segment (notable amount in IPOs) \$2010.42mln was seen vis-a-vis inflows of \$1308.84mln a week ago, even the debt has seen gush of inflows (majorly in the FAR segment) of \$2000.61mln vis-à-vis \$909.24mln a week ago. However, the appreciation in the local currency was capped amid Dollar bids from oil buying and Dollar squeeze, as the inflows induced by

hence dollar supply has taken a hit now.

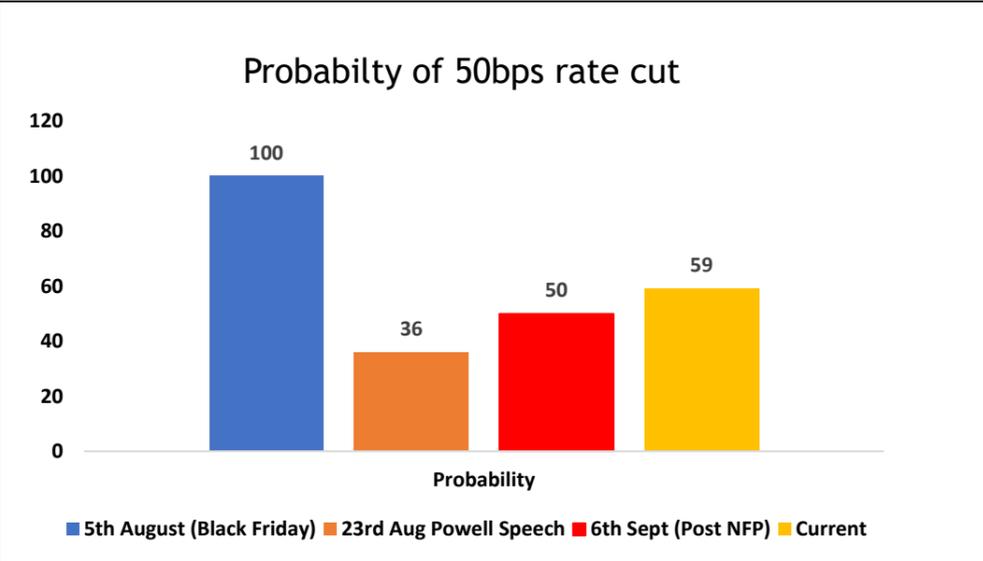
Last week, INR traded in a narrow range with an appreciating bias to 83.85 levels from 83.99 (All time low). In this week, the major driver will be the quantum of rate cut by the Fed in its September FOMC meeting, also further guidance by Powell to its rate cutting cycle and will determine the flows in the high yielding EM assets. We expect the domestic currency hovering at current levels with a positive bias, supported by FPI dollar inflows and broad Dollar weakness. We maintain our technical stance that INR should take support of 83.56 and will find a strong resistance around 83.99 levels, breach of which will test 84.16 levels (NDF highs). **With respect to rupee, the RBI governor asserted that the currency's resiliency is reflecting the nation's strong economic fundamentals.**

In the coming months, the interest rate differential between US & India is likely to rise as FED is likely to start cutting rates from this September FOMC. While RBI will continue to stay on its "Withdrawal of accommodation" policy stance due to higher food inflation. This in turn is likely to open doors for more FPI flows leading support to the domestic currency.

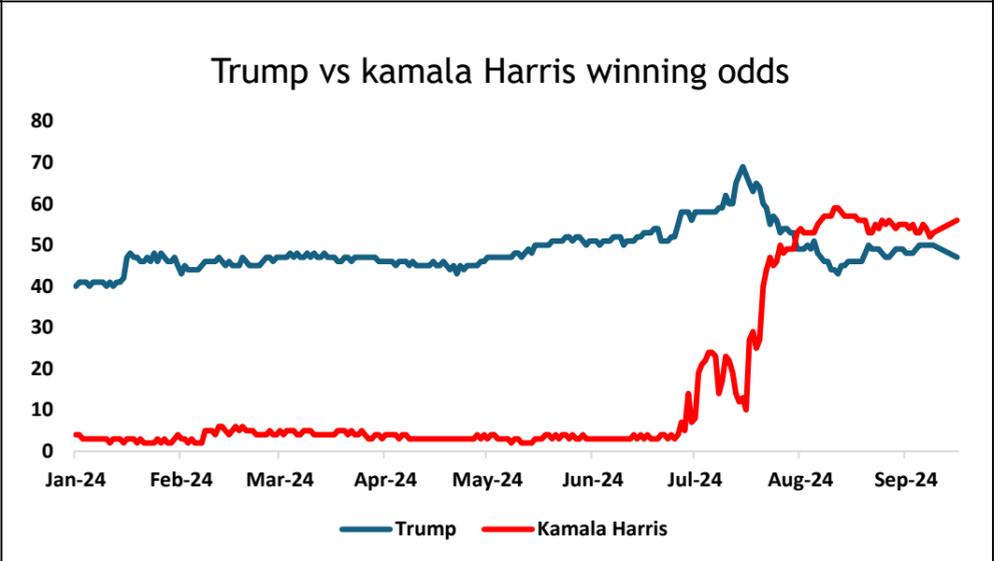
Events this week:

Date	Time (IST)	Country	Data	Month	Forecast	Previous
17.Sep.24	18:00	US	Core Retail Sales m/m	Aug	0.2%	0.4%
17.Sep.24	18:00	US	Retail Sales m/m	Aug	-0.2%	1.0%
18.Sep.24	11:30	UK	CPI YoY	Aug	2.2	2.20%
18.Sep.24	11:30	US	FED Fund Rate	Sept	5.25%	5.5%
19.Sep.24	16:30	UK	Bank Rate	Sept	5.0%	5.0%
19.Sep.24	18:00	US	Unemployment Claims	Sept	232k	230k
20.Sep.24	08:30	JP	Policy Rate	Sept	<0.25%	<0.25%
20.Sep.24	11:30	UK	Retail Sales m/m	Aug	0.4%	0.50%

50bps rate cut probability currently stand at 59% (Fig 1)

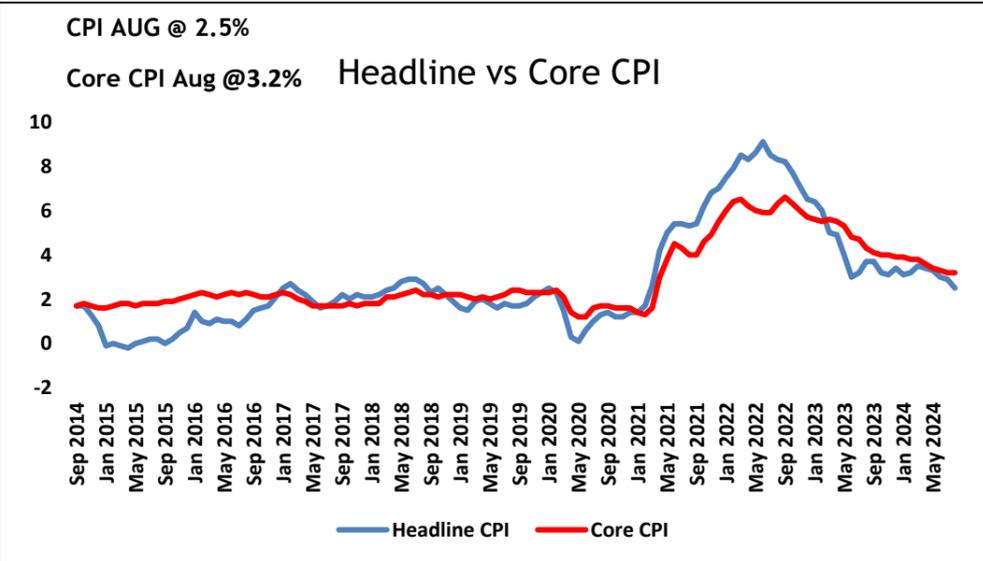


Current winning odds of Kamala Harris stands at 56% (Fig 2)

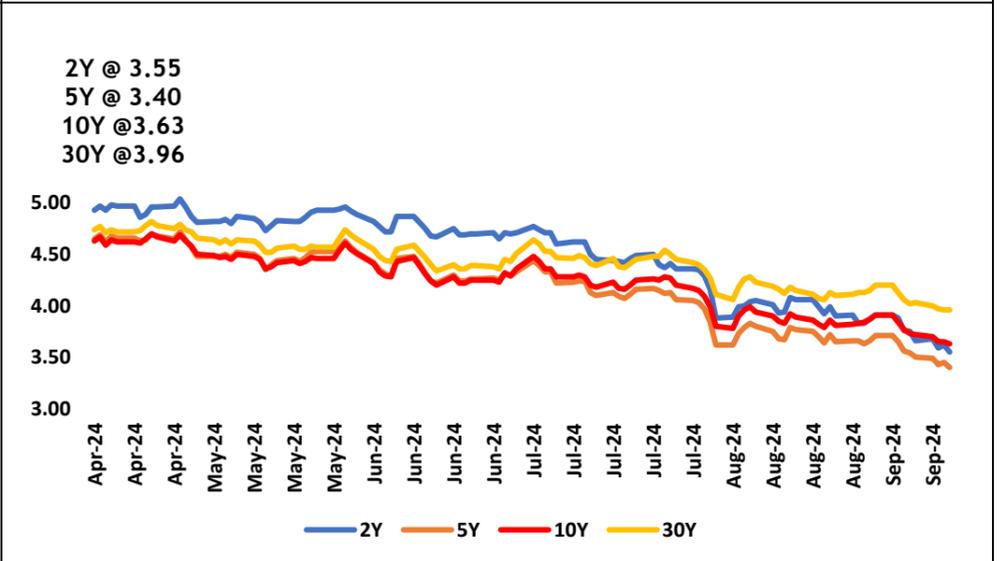


Source: Bloomberg, CME Fedwatch Tool, UBI Research, Predict-IT

Headline CPI lowest since FEB 2020, continues disinflation path (Fig3)

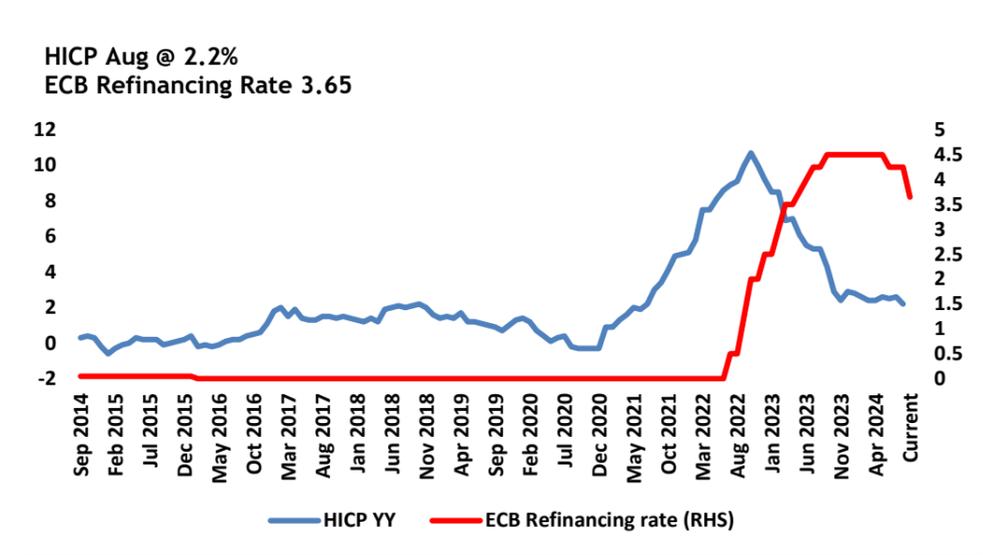


US Treasury yield falls across the tenors (Fig4)



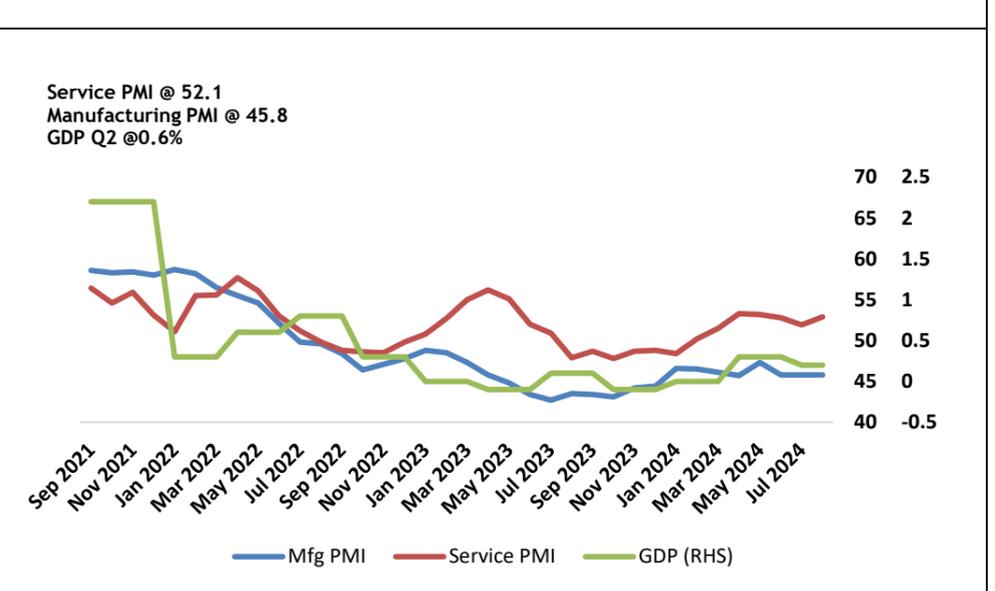
Source: Bloomberg, UBI Research, Reuter

ECB cuts its policy rates, while ECB highlights risk to inflation remains on upside (Fig 5)

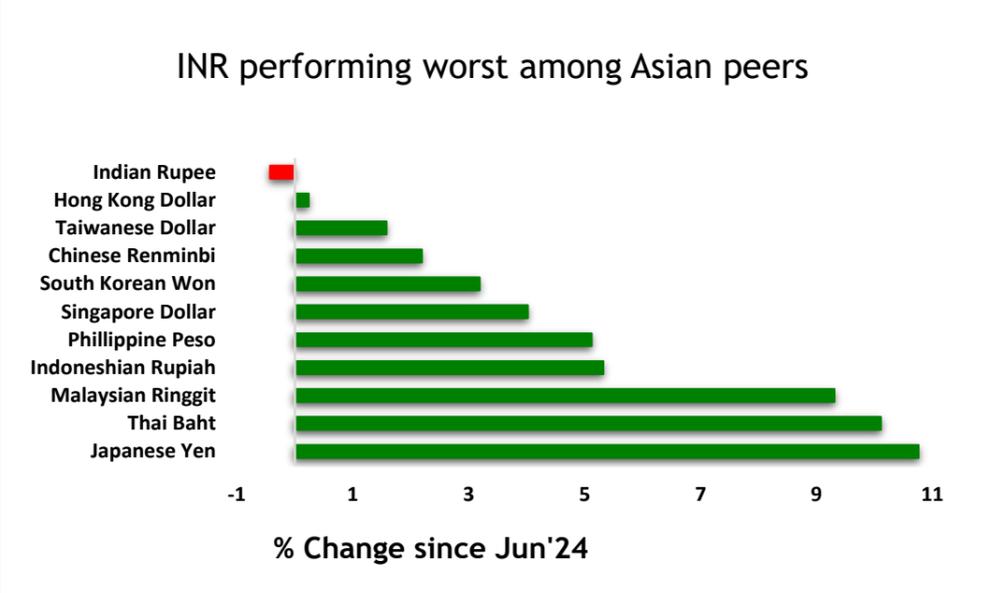


Source: Bloomberg, Reuters,

Service PMI remains in expansion zone due to Paris Olympics (Fig 6)

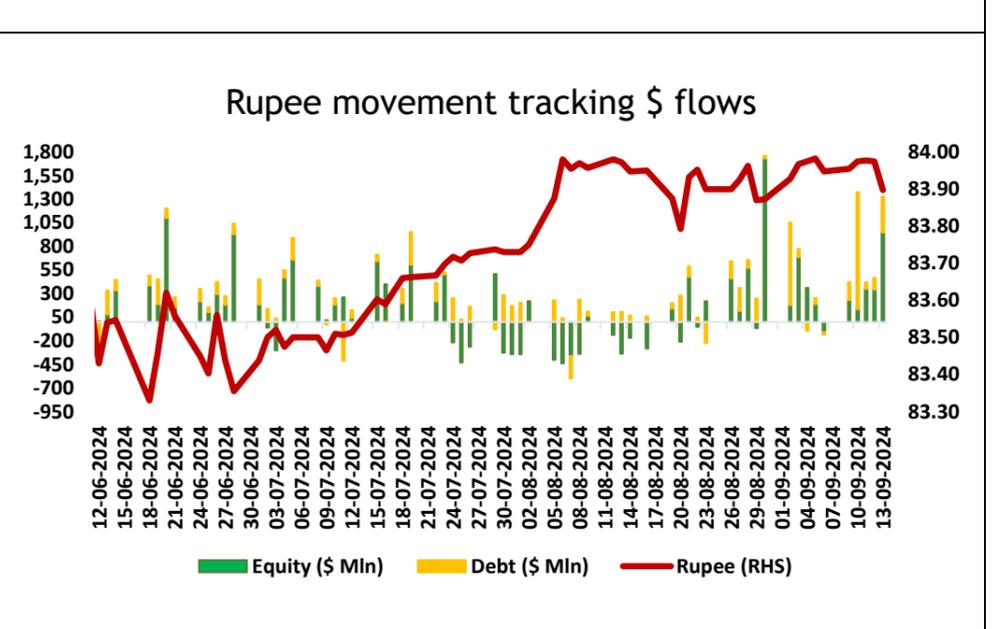


Despite US Dollar weakness Rupee remained worst performing currency (Fig 7)

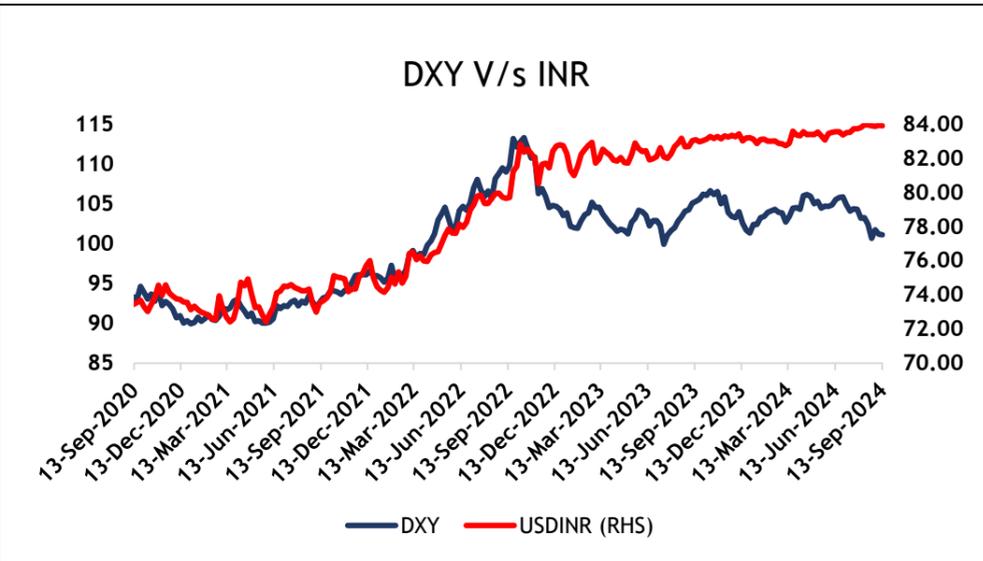


Source: Bloomberg, NDSL, UBI Research, Reuter

Outpour in FPI flows supported Rupee (Fig 8)

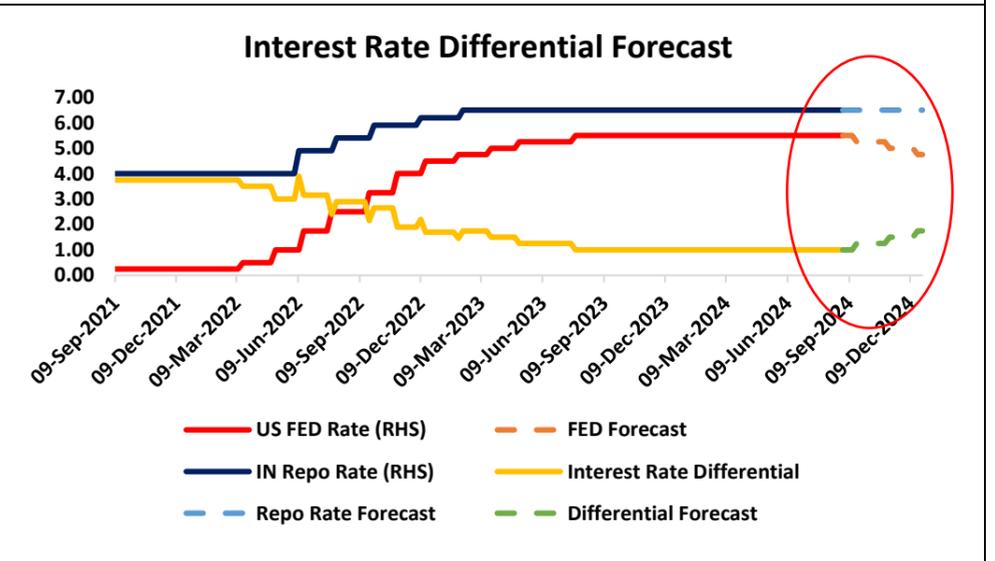


INR supported by weak US Dollar (Fig 9)



Source: Bloomberg, UBI Research, Reuter

Fed to cut this month interest rate differential to increases (Fig 10)



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